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Focus on Tax Controversy

NEWSLETTER

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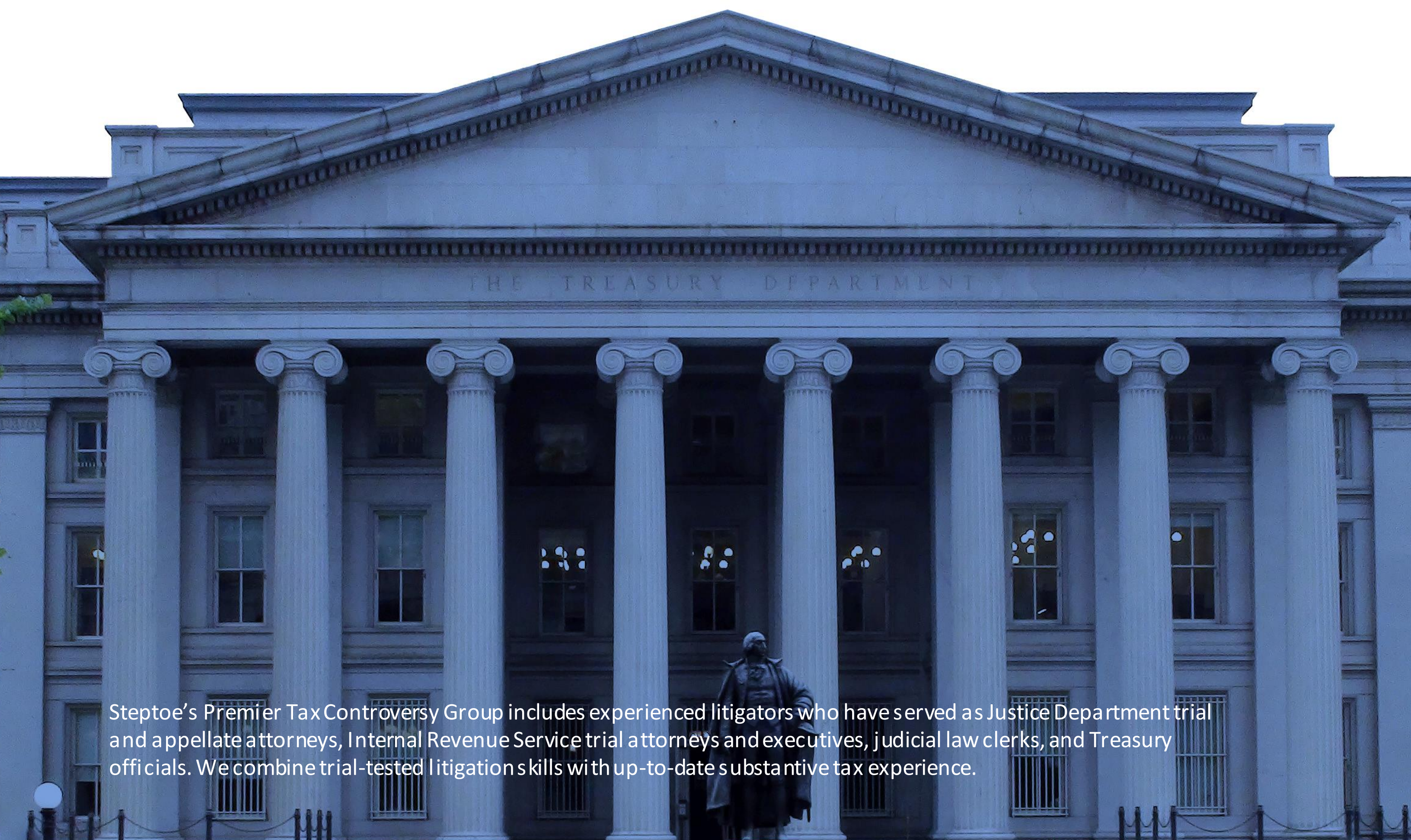

Steptoe's Premier Tax Controversy Group includes experienced litigators who have served as Justice Department trial and appellate attorneys, Internal Revenue Service trial attorneys and executives, judicial law clerks, and Treasury officials. We combine trial-tested litigation skills with up-to-date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

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CONTROVERSIAL NEW IRS REQUIREMENTS FOR RESEARCH CREDIT CLAIMS

On October 15, 2021, the IRS released Chief Counsel Memorandum 20214101F which prescribes sweeping new requirements for section 41 research credit claims, for them to be considered valid by the IRS.

Existing Treasury Regulations merely provide that a refund claim is valid, if it sets forth sufficient facts to apprise the IRS of the basis of the claim. The Chief Counsel Memorandum (CCM) provides new controversial specificity rules that must be followed for eligible taxpayers to be entitled to claim the credit. Failure to comply with the new requirements may result in the refund claim being rejected and could leave taxpayers with no recourse, other than to file a refund suit.

ONEROUS SPECIFICITY RULES

The CCM provides that valid section 41 research credit claims for refund must (at a minimum) provide the following factual information:

- All of the business components to which the section 41 research credit claim relates for that year.
- For each business component, identify all of the research activities performed and the names of the individuals who performed each research activity, as well as the information each individual sought to discover.
- The total qualified employee wage expenses, total qualified supply expenses, and total qualified contract research expenses for the claim year. This may be done using Form 6765, Credit for Increasing Research Activities PDF. The CCM, in fact, appears designed to discourage such claims for refund.

> The CCM's specificity requirements are far more demanding than the regulatory requirements and will likely increase the number of IRS controversies as opposed to decreasing them as the IRS suggests.

The process of a corporation with, for example, tens of thousands of employees gathering the information requested is unduly burdensome and time-consuming. The corporation would be required to provide a statement for each employee involved in the research activities to describe the specific research performed by the employee and the information each employee sought to discover. The taxpayer claiming the research credit must also identify the total qualified research expenses for the claim year separately itemized for employee wages, supplies and contract expenses. The CCM states that the IRS will no longer consider information provided by the taxpayer in a previous examination, and the IRS will not consider information in its own files. This information has to be provided in the refund claim.

The taxpayer is also required to identify the grounds and the specific factual information noted above in support of the taxpayer's research credit claim. Taxpayers are not required to provide supporting documentation with the claim, but are required to provide a signed declaration under penalty of perjury attesting to the accuracy of the facts contained claim. If, however, a taxpayer voluntarily provides documents with the claim, the taxpayer must specifically reference where in the documents the supporting facts can be found. The IRS will not sort through the taxpayer's records to locate this information.

If the taxpayer has prepared a credit study, the taxpayer does not need to attach it to the taxpayer's refund claim. The taxpayer may provide the requested facts in a written statement of any kind, signed under penalties of perjury. However, if the taxpayer attaches a credit study to the claim, it must identify the specific facts in the study that it contends meet the five minimum informational requirements.

SUSPECT IRS STRATEGY FOR REJECTING CLAIMS

The CCM is particularly troubling in a couple of respects. It recommends that revenue agents and service centers should reject claims before conducting any investigation of the merits of the claim to eliminate the likelihood that a court will find that the Service waived the specificity requirements. It also suggests that the IRS should delay processing refund claims until after the statute of limitations period ends under section 6511, in an effort to preclude taxpayers from perfecting an imperfect claim. This presents a significant risk to taxpayers because meeting the specificity requirement of Treas. Reg. § 301.6402-2(b)(1) is a jurisdictional prerequisite to filing a suit for refund in court[1], the failure of which may result in a court dismissing a refund suit for lack of jurisdiction.[2]

A taxpayer has the right to file a refund suit in federal district court or the Court of Federal Claims after six months have passed from the filing of the refund claim, if the IRS has taken no action on the claim.

> The IRS's controversial new policy of delaying review and denial of research credit refund claims will compel taxpayers to choose between waiting for the IRS to act in the hope that it will not summarily reject the claim, or having to file a refund suit to vindicate the claim.

GRACE PERIOD FOR IMPLEMENTATION

The IRS has provided a grace period, until January 10, 2022, before requiring the inclusion of this information with timely filed section 41 research credit claims for refund. Upon the expiration of the grace period, there will be a one-year transition period during which taxpayers will have 30 days to perfect a research credit claim for refund prior to the IRS' final determination on the claim.

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[1] *Stoller v. United States,* 444 F.2d 1391 (5th Cir. 1971)

[2] *Nick's Cigarette City, Inc. v. United States,* 531 F.3d 516 (7th Cir. 2008) (finding that taxpayer's administrative claim for refund was not sufficiently detailed to satisfy the requirements of Treas. Reg. § 301.6402-2(b)(1), thereby depriving the court of subject matter jurisdiction over the claim); *Quarty v. United States*, 170 F.3d 961, 972 (9th Cir. 1999) (holding that compliance with the specificity requirement is a prerequisite to subject matter jurisdiction over a claim for refund).

ANTICIPATED CHALLENGES TO DICTATE

Taxpayers are likely to challenge the rules prescribed in the CCM, because: (1) they impose specificity requirements that are not contemplated by the Regs; (2) they are unduly burdensome and flout statutory intent, because they are designed to discourage the filing of legitimate refund claims; and, because it is unfitting for the IRS to game the system by advising its agents to ignore processing claims for refund, in the ordinary course, for tactical gain.

With proper legal counseling and crafting of the refund claim, the specificity requirements of the Regs can be satisfied while falling short of satisfying the overreaching specificity requirements of the CCM.

Lawrence M. Hill and Richard A. Nessler

HOUSE PASSES INFRASTRUCTURE BILL WITH NEW CRYPTOCURRENCY REPORTING RULES

On November 5, 2021, the US House of Representatives passed the Infrastructure Investment and Jobs Act (H.R. 3684), which President Biden is expected to sign.

Despite opposition, the bill contains new information reporting requirements for brokers involving digital assets and now includes digital assets as "cash" for purpose of information returns required for cash transaction over $10,000. The provision, called "Information Reporting for Brokers and Digital Assets," is expected to generate $28 billion in new tax revenue during its first 10 years, according to the Joint Committee on Taxation.

BROKER REPORTING REQUIREMENTS

Definitions. Under the bill, a "broker" will be required to report transactions involving "digital assets" for the calendar year to the IRS. The legislation defines "broker" to include "any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person." Under this definition, cryptocurrency exchanges will have to report information to both the IRS and to their customers.

However, the broad definition of "broker" may also capture crypto miners, wallet providers, and protocol software developers, who may not have the capabilities, similar to large institutional brokers, to track user transactional activities for reporting purposes.

The term "digital asset" is broadly defined as "any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary."

The bill also expands the definition of "specified security" in section 6045(g)(3)(B) to include digital assets. This means that, for digital assets acquired on or after January 1, 2023 that were acquired in the customer's account at the broker or transferred from the customer's account at another broker (which are referred to as "covered securities"), additional information regarding the basis and holding period must be reported.

Reporting Requirements. While the legislation does not specify what IRS forms cryptocurrency exchanges and others must send to their customers, it is expected that brokers will be required to send a form similar to Form 1099-B (Proceeds from Broker). Based on comments made by government officials on panels, the IRS may create a new 1099 form for crypto transactions, but the information required will likely be similar. Information included on Form 1099-B includes (1) the name, address, and taxpayer identification number of each customer; (2) a description of the property transferred; (3) the date the property was sold; and (4) the gross proceeds from any sale. For covered securities, the broker must also report the date acquired, cost basis, and whether any gains or losses were ordinary, short-term capital (held for one year or less), or long-term capital (held for more than one year).

REPORTING OF TRANSFERS OF DIGITAL ASSETS

If a broker transfers covered securities to another broker, section 6045A requires the transferor broker to furnish a statement to the transferee broker (but not to the IRS) providing information about the transferred securities. The bill extends this requirement to transfers of digital assets. In addition, under the bill, brokers would be required to report to the IRS transfers of digital assets to non-brokers. This means that the crypto industry will need to come up with a way to identify whether a wallet address belongs to a broker or non-broker.

PENALTIES

As with traditional Form 1099-B reporting, brokers involved with digital assets may be subject to substantial penalties for failure to file an information return with the IRS and to provide a copy to the payee. A broker who fails to timely file a required information return with correct information may be subject to a penalty under section 6721 (a penalty for the failure to file an information return required with the IRS) and under section 6722 (a penalty for the failure to furnish a payee with a proper information statement). The penalty is $250 for each return "for which a failure occurs," not to exceed $3,000,000 in one year. There are exceptions and a broker may avoid the penalty if the failure to timely file the information return is due to reasonable cause and not to willful neglect.

CASH TRANSACTIONS

In addition, the legislation modifies section 6050I to treat digital assets as cash. Under this section, a person that receives more than $10,000 of cash (including digital assets) in one or multiple transactions must file a Form 8300 return with the IRS. This requirement will impose additional reporting requirements on companies that accept cryptocurrency as a form of payment.

EFFECTIVE DATE

These new reporting requirements apply to tax returns filed in 2024. This means that brokers will need to have their systems in place to collect the relevant information, including basis and holding period, in 2023.

Lisa Zarlenga and Richard A. Nessler

NINTH CIRCUIT'S DISTURBING RULING TREATS TAX ADVICE PROVIDED BY LAWYERS AS UNPRIVILEGED BUSINESS ADVICE

In *In re Grand Jury*[3], the US Courts of Appeal for the Ninth Circuit issued a very troubling opinion involving dual-purpose communications in the attorney-privilege context. The Ninth Circuit adopted "*the* primary purpose" test, rejecting the urgings of an unnamed law firm and its client to protect dual-purpose documents created "because of" litigation concerns.

The court also rejected the application of the broader "a primary purpose" test because the communication involved tax advice from an attorney.

The decision is aberrational and raises serious concerns for tax practitioners and clients because the Court concluded that tax advice provided by an attorney is the equivalent of unprotected business advice.

This is a disturbing precedent that vitiates the attorney-client privilege in the tax context and undermines the time-honored principle that communications between tax counsel (not just all other counsel) and their clients are confidential and protected; and, that such confidentiality is intended to foster open and candid communications between the tax lawyer and client. Legal advice provided by tax lawyers is no different than legal advice provided by lawyers in other legal contexts. The Ninth Circuit, in fact, recognized this in *US v. Judson*[4], where it noted that "[T]he ramifications of the tax law are often a stubborn challenge to the most expert legal practitioner. The very nature of the tax laws requires taxpayers to rely upon attorneys and requires attorneys to rely, in turn, upon documentary indicia of their clients' financial affairs." *In re Grand Jury*, will hopefully be subject to panel and *en banc* review and appropriately corrected., because it inappropriately relegates tax lawyers to second-class citizen status. There is no principled reason for treating tax lawyers differently than any other lawyers.

The facts of the case are sparse, because of the nature of grand jury proceedings. We know that a grand jury subpoenaed communications from an unidentified company and law firm. The target of the criminal investigation was a client of the law firm. The law firm declined to produce some documents, citing the attorney-client privilege and the work-product doctrine. The only description of these communications is that they were "dual purpose communications" which included unspecified "tax advice." The government moved to

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[3] 2021 U.S. App. LEXIS 27420 (7th Cir. 2021)
[4] 322 F.2d 460, 468 (9th Cir. 1963)

compel production and the district court granted the motion, holding that the dual-purpose documents were not privileged because their "primary purpose" was seeking tax advice rather than legal advice.[5] The law firm continued to withhold the documents, was held in contempt, and appealed, arguing that the district court should have applied a different test for privilege. Specifically, the law firm argued that the court should have applied the "because of" test, borrowed from the attorney work product context, when dual-purpose communications are implicated. Thus, the Ninth Circuit was confronted with the question of when are dual-purpose communications with an attorney that include tax advice protected by the attorney-client privilege?

The Ninth Circuit affirmed on appeal and held that the subpoenaed documents were not privileged. The Court declined to adopt the proposed "because of" test, reasoning that the traditional scope of the attorney-client privilege has always been defined by the purpose of a communication, and not the communication's relationship to anticipated litigation, noting that the attorney-client privilege and the work-product doctrine serve different goals. Instead, the court articulated a strict analysis and adopted "*the* primary purpose" test to dual-purpose communications between attorneys and clients involving tax advice. The "primary purpose" test requires that the primary purpose of the communication must be to give or receive legal advice to be protected. According to the Ninth Circuit, under this test, courts look to the content of a communication to determine its primary purpose and exclude all other purposes from consideration. *In re Grand Jury* resolved a split among the trial courts and aligned the Ninth Circuit with a majority of other circuit courts, such as, the United States Courts of Appeal for the Second, Fifth, and Sixth Circuits, as far as the application of "*the* primary purpose test" to dual-purpose communications is concerned.[6]

The Ninth Circuit also rejected the law firm's argument that the court should adopt the "*a* primary purpose" test (instead of "*the* primary purpose" test)set forth in the United States Court of Appeals for the District of Columbia Circuit's decision in *In re Kellogg Brown & Root, Inc.*[7] Kellogg's approach is broader, asking "was obtaining or providing legal advice a primary purpose of the communication." *Kellogg* recognized that courts applying the primary purpose test should not try "to find the one primary purpose" of a communication. Attempting to do so "can be an inherently impossible task" when communications have "overlapping purposes." The Ninth Circuit distinguished Kellogg, reasoning that *Kellogg* involved a corporate internal investigation that does not apply with equal force to communications involving tax advice. However, the court left open whether it should adopt "*a* primary purpose" test if the dual-purpose communication between the attorney and client did not involve tax advice, once again relegating tax advice provided by lawyers to second-class citizen status.

We believe, to the contrary, that the "a primary purpose" test is particularly apt in the tax context, where the distinction between business advice (*e.g.*, tax compliance advice) and legal advice (*e.g.*, tax consulting advice) is often grayer than the distinction between business advice and legal advice in other contexts.

> The court's rejection of *Kellogg* rests on a rudimentary misperception of what it means for an attorney to provide tax advice.

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[5] The district court's decision is not publicly available.

[6] *In re County of Erie*, 473 F.3d 413 (2nd Cir. 2007); *United States v. Robinson*, 121 F.3d 971 (5th Cir. 1997); *Alomari v. Ohio Dep't of Pub Safety*, 626 F. App'x 558 (6th Cir. 2015)

[7] 756 F.3d 754 (D.C. Cir. 2014).

The Ninth Circuit at least thankfully rejected the government's assertion that dual-purpose communications involving tax advice can never be privileged. However, citing *United States v. Frederick*[8], it went on to posit that "*normal* tax advice – even coming from lawyers – is generally not privileged, and courts should be careful to not accidently create an accountant's privilege where none is supposed to exist." [9] The court apparently neglected to recognize that the federally authorized tax practitioner privilege under IRS section 7525, in fact provides this "accountant privilege," albeit not, inter alia, in the criminal tax context. Under the Ninth Circuit's analysis query whether section 7525 would be rendered a nullity?

The court neglected to define what it means by "normal" tax advice, and the court's support based on *Frederick* is sorely misplaced. In *Frederick*, the Seventh Circuit held that tax workpapers and correspondence relating to the tax returns and documents prepared in connection with audits of the taxpayers' returns prepared by an attorney were not privileged. In its original panel opinion, the court naively stated: "Normally . . . taxpayers in audit proceedings are represented by accountants, or not represented at all, rather than by lawyers; and so the principal effect of equating audits to litigation and thus throwing the cloak of privilege over the audit-related work of the taxpayer's representative would be to create an accountant's privilege usable only by lawyers."[10] The Seventh Circuit, *en banc*, appropriately issued an order modifying the opinion by adding the following: "If, however, the taxpayer is accompanied to the audit by a lawyer who is there to deal with issues of statutory interpretation or case law that the revenue agent may have raised . . . the lawyer is doing lawyer's work and the attorney-client privilege may attach."[11] Accordingly, *Frederick* recognized that tax advice is privileged if it involves legal advice, as opposed to tax preparation or accounting advice.[12]

The facts set forth in *In re Grand Jury* are scant, so it is unapparent if the attorney's "tax advice" involved legal advice, as opposed to tax preparation or accounting advice. However, by stating that "normal" tax advice from an attorney is not privileged, without defining what "normal" means, the court's analysis creates significant uncertainty regarding the attorney-client privilege in the context of a lawyer's tax advice to his or her client. Should one now presume that only "abnormal" tax advice provided by a lawyer is privileged? We think not, because as the Supreme Court has aptly remarked, an "uncertain privilege or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all."[13]

Given the increasingly complex regulatory landscape, more and more attorneys are wearing dual hats as both lawyers and business advisors. *In Re Grand Jury* represents a misguided judge-made erosion of the privilege landscape in the tax law arena. The decision is an unwelcome and unwarranted departure from the overwhelming weight of authority, including *Frederick*, and creates troubling uncertainty by failing to recognize the clear-cut distinction between tax advice involving tax return accuracy and legal advice regarding the interpretation of tax cases, tax statutes, regulations and other authoritative tax guidance.

Lawrence M. Hill and Richard A. Nessler

[8] 182 F.3d 498 (7th Cir. 1999)
[9] 2021 U.S. App. LEXIS 27420, *14, fn 5. (emphasis added)
[10] 182 F.3d at 502
[11] *Id.*
[12] *See* Lawrence M. Hill, *The Waxing and Waning of Privilege in the Federal Tax Context*, 1 J. Tax Prac. & Proc. 13 (1999); Lawrence M. Hill, *Frederick Revisited,* 1 J. Tax Prac. & Proc. 14 (1999).
[13] *Upjohn Co. v. United States*, 449 U.S. 383, 393 (1981)

TAX COURT RULES AGAINST TRIBUNE INVOLVING THE SALE OF THE CHICAGO CUBS

On October 26, 2021, the Tax Court in *Tribune Media Company v. Commissioner*[14], held that part of the Tribune Media Company's debt guarantees for senior and subordinated debt from its sale of the Chicago Cubs baseball team in 2009 was equity for tax purposes and recognizable as a gain.

The Court held the subordinated debt was equity, but the senior debt was bona-fide debt. As a result, the Tribune could not reduce its gains from the sale by the amount of the equity financing and was found liable for a substantial tax deficiency.

BACKGROUND ON THE TRANSACTION

At the time Tribune Media Company (Tribune) acquired the Chicago Cubs in 1981, the company was organized as a C corporation. In April 2007, Tribune engaged in a leveraged buyout and converted to an S corporation. Around the time of the leveraged buyout, Tribune announced plans to sell the Chicago Cubs and to use the proceeds from the sale to pay down the debt incurred from the leveraged buyout.

In 2009, Tribune and the current owners of the Chicago Cubs baseball team, the Ricketts Family, formed Chicago Baseball Holdings, LLC (CBH). Tribune contributed the team, then valued at $769.9 million, to CBH and the Ricketts family, through Rickets Acquisition LLC (RAC), contributed $150 million. On the closing date, CBH made a special distribution to Tribune of $704.9 million.

To finance the transaction, CBH entered into two tranches of debt, one funded with $425 million of senior debt from several commercial lenders and $248.7 million of subordinated debt from the Rickets family through RAC Finance. At the closing, Tribune executed guarantees of both the senior debt and the subordinated debt. Both guaranties included similar terms and neither guarantee could be enforced until (1) CBH failed to make a payment and the debt was accelerated, (2) the lenders have exhausted all creditor remedies against CBH, and (3) the lenders have not collected the full amount of the principal and interest guaranteed Tribune. The senior debt was also required to be paid first before the subordinated debt would be paid.

TIMING OF TRIBUNE'S CONVERSION TO AN S CORP CREATED TAXABLE BUILT IN GAINS

The timing of the transaction, only two years after the Tribune's conversion to a S corporation, left Tribune liable for tax on built-in gains. S corporations generally do not pay federal income tax, but one exception to this rule is when an S corporation converts to a C corporation. For 10 years after the conversion, a corporate level tax

[14] *Tribune Media Co. v. Comm'r*, T.C. Memo 2021-122, Dkt. Nos. 20940-16, 20941-16, Oct. 26, 2021. The Tax Court previously granted the IRS a partial win in the case in January 2020 by upholding 40% gross valuation misstatement penalties, finding that the government properly followed Section 6751(b)(1) in obtaining managerial approval for the initial determination of that penalty.

applies to any net recognized built in gain.[15] The issue litigated in Tax Court involved the amount of recognized built in gains, which the Court noted was subject to the disguised sales rules.[16]

When Tribune filed it 2009 tax return, the company reported a net-built in gain of $33.8 million from the sale of the Chicago Cubs. Tribune claimed it should be able to reduce its gains from the sale by $673.8 million, the value of the tranches of debt from the transaction, which Tribune guaranteed. In 2016, the IRS notified Tribune of a deficiency in its 2009 return and determined Tribune owed $181.6 million due to built-in gains from the transaction. The IRS claimed Tribune recognized $739.5 million in built in gains for 2009 due to the transaction, which is $705 million more than Tribune reported on its return and the same value of the distribution received by the Tribune from CBH at the closing of the transaction.

TRIBUNE CLAIMED DEBT-FINANCED EXCEPTIONS TO DISGUISED SALE RULES

A disguised sale issue usually arises in the context of a disguised sale of property with a contribution of property followed by a distribution of cash or other property back to the contributing partner. The Tax Court stated that although a disguised sale "might seem pejorative, disguised sales are well recognized and they are taxable."[17]

In 1984, Congress enacted disguised sale rules to limit taxpayers from inappropriately deferring gains on transactions that were actually sales of property. [18] An exception to the disguised sales rules exists for debt-financed distributions. The debt-financed distribution rules allow a partner to receive a debt-financed distribution of property from a partnership as part of a disguised sale tax free up to the amount of debt allocated to that partner.[19] To invoke this exception, the Court noted the partner "must retain substantive liability for repayment of the debt, meaning it must be allocated to the partnership liability."[20]

Tribune claimed the Cubs transaction was a disguised sale, but the special distribution was not taxable because it was a debt-financed distribution. The IRS agreed the transaction was a disguised sale, but claimed the distribution was taxable because (i) guaranties promise repayment in name only, (ii) the senior debt was non-resource, and (iii) the subordinated debt was not bona-fide.

The Tax Court stated that "to the extent Tribune is deemed ultimately responsible for the debt, the distribution would be considered debt financed and would not be taxable."[21] The Court had to determine (1) if the $248.7 million of debt from the Ricketts family was bona-fide debt or equity and (2) if Tribune's guarantee of the $425 million in senior debt would allow Tribune to exclude the amount from its built-in gains from the transaction.

ANALYSIS

The Tax Court held the $248.7 million of subordinated debt did not fall under the debt-financed exception to the disguised sale rules, but rather was equity and could not be allocated to Tribune as resource debt.

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[15] *See* Sec 1374(a); Sec 1374(d)(7).
[16] *Tribune Media Co. v. Comm'r*, T.C. Memo 2021-122, Dkt. Nos. 20940-16, 20941-16, Oct. 26, 2021, *41-42.
[17] *Id.* at *2.
[18] *See* Sec 707(a)(2)(B).
[19] *See* Sec. 1.707-5(b)(1), Income Tax Regs.
[20] *Tribune Media Co. v. Comm'r*, T.C. Memo 2021-122, Dkt. Nos. 20940-16, 20941-16, Oct. 26, 2021, *53
[21] *Id* at *2.

As a result, the subordinated debt portion of the distribution could not be used to reduce Tribune's gains from the sale.

In making its determination of whether an advance is debt or equity, the Tax Court considered the 13 factors outlined in the Tax Court's 1980 opinion in *Dixie Dairies Corp. v. Commissioner*.[22] In ruling that the subordinated debt in this transaction was equity, the Court emphasized the factors that weighted significantly to equity: intent of the parties, right to enforce payment, risk, identity of the interest, and use of the advance.

To determine if the senior debt was allocable to Tribune and would allow Tribune to exclude the amount from its built-in gains from the transaction, the Court looked to determine if Tribune would bear the economic risk of loss in a default. The Court relied on a constructive liquidation test to determine if Tribune would bear the risk of loss and noted "a partner bears the risk of economic loss for a partnership liability if the partner would be obligated to make a payment to the creditor if the partnership were constructively liquidated."[23]

Even though the IRS argued the potential for Tribune to satisfy the guarantee was unlikely and should be disregarded, the Tax Court looked to see if Tribune would still be liable for the debt in a "worst-case scenario". In determining the debt was bona-fide debt and allocable to Tribune, the Tax Court noted no other party was liable for the debt, no partnership assets secured the loan, and if the debt were due in a constructive liquidation, the senior debt creditors would seek repayment from Tribune and no other party. Accordingly, the Tax Court held that the senior debt was bona-fide debt, but the subordinated debt was equity for tax purposes and recognizable as a gain.

Nick Sutter

[22] *Dixie Dairies Corp. v. Commissioner*, 74 T.C. 476, 493 (1980).

[23] *Tribune Media Co. v. Comm'r*, T.C. Memo 2021-122, Dkt. Nos. 20940-16, 20941-16, Oct. 26, 2021, *94; *See also* Sec. 1.752-2(a) and b(1), Income Tax Regs.

EXAM PRESENCE NO LONGER REQUIRED AT APPEALS CONFERENCES

On September 9, 2021, the IRS issued a written assessment of the Appeals conference pilot program, and concluded, based on feedback from practitioners and the Service, that requiring IRS examiners to participate in the initial stage of Appeals conferences in large cases is not always necessary.

Referred to as the Appeals Team Case Leader (ATCL) Conferencing Initiative, the pilot program applied only to Appeals' largest and most complex cases — *i.e.*, cases typically involving multi-national business entities represented by corporate officers or tax practitioners from major accounting and law firms. The IRS will now revert back to its longstanding Appeals' policy that permits, but does not require, Appeals Officers to invite IRS examiners to the non-settlement portion of the Appeals conference.

TRADITIONAL APPEALS

Appeals does not routinely invite IRS examiners or IRS counsel to attend Appeals conferences, even though Appeals technical employees have had the discretion to do so for many years. In most instances, Appeals Officers review the IRS administrative file to understand IRS exam's position and discuss the case only with the taxpayer. As a result, the discretion to invite IRS examiners or IRS counsel has been (and continues to be) rarely exercised across Appeals.

APPEALS PILOT PROGRAM

However, in May 2017, in an effort to improve efficiency for ATCL cases, the IRS Independent Office of Appeals initiated a pilot program to test whether inviting IRS Large Business & International examination teams (Compliance) and their IRS Chief Counsel attorneys to engage with taxpayers (and their representatives) would improve our ability to work large, complex cases. In particular, Appeals sought to assess whether requiring Compliance and the taxpayer to participate in a joint discussion at the start of the case would help narrow the scope of the controversy and improve understanding of factual and legal differences in complex cases. Consequently, the pilot program allowed Compliance and Counsel to join the initial case discussion, but not the entire Appeals conference. As in the past, settlement negotiations for all cases were conducted between Appeals and the taxpayer without Compliance present.

Originally set to expire in 2019, the IRS announced in May 2019 that it was extending the pilot for another year. The IRS reviewed data from internal surveys of Appeals and exam personnel who participated in the pilot, customer satisfaction surveys of taxpayers or their representatives conducted by a third-party contractor, written comments from external stakeholders, and informal comments and suggestions from practitioners.

FEEDBACK

According to the Appeals employees who handle large and complex cases, having examiners participate in the initial case discussion improved their understanding of the dispute and helped them identify, narrow, and resolve factual and legal differences between the parties before engaging in settlement negotiations with taxpayers. However, external commentators, including these authors,

raised concerns with the pilot program. According to the report, most of the concerns flagged by external commentators were about maintaining ground rules and ensuring that conferences don't turn into mediation sessions. The following drawbacks were noted in the report:

- Compliance's participation derailed the process when the ATCL failed to limit Compliance's participation to respectful and productive discussion of core factual disputes.
- Compliance's participation in the process often prolongs disputes about collateral and irrelevant issues. Compliance's participation resulted in multiple conferences about immaterial factual claims.
- Compliance's participation increases the likelihood that Compliance will improperly be involved in the hazards discussion – as there was no clear line between the end of the process of identifying the factual and legal issues in dispute and the beginning of the hazards discussion. This lack of clarity chilled a free exchange between Appeals and the taxpayer, which in turn decreases the likelihood of a negotiated settlement.
- Compliance's participation sometimes caused the Appeals teams to abandon their role as independent and impartial evaluators of the hazards of litigation and to slip into the role of mediators.

Following a detailed review of the feedback about the program, Appeals concluded that inviting Compliance and Counsel to the initial discussion of complex cases can be beneficial but is not necessary in every case. As a result, Appeals will not mandate joint case discussions. Instead, Appeals will continue to operate under longstanding Appeals' policy that permits, but does not require, Appeals Officers to invite Compliance to the non-settlement portion of the Appeals conference.

> Our experience, generally speaking, is that the involvement of Exam at Appeals either impairs Appeals' independence or gives the appearance of impairing Appeals' independence.

This is particularly true when exam brings IRS counsel to the conference, making it awkward or problematic for some appeals conferees, who are not legally trained, to "overrule" agents accompanied by lawyers who are vigorously advocating for their mutual employer's position.

Lawrence M. Hill and Richard A. Nessler

TAXPAYERS DO NOT HAVE ABSOLUTE RIGHT TO IRS APPEALS

In *Hancock County Land Acquisitions LLC v. United States*[24], the US District Court for the Northern District of Georgia dismissed Hancock's complaint seeking declaratory and injunctive relief related to the IRS' refusal to grant Hancock's request to have its case reviewed by an IRS Appeals Office prior to the issuance of a Final Partnership Administrative Adjustment (FPAA).

Plaintiffs claimed they had a statutory right to independent review by IRS Appeals before issuance of an FPAA, based on Section 7803(e)(4), a provision enacted in July 2019 under the TFA that provides that Appeals' resolution process "shall be generally available to all taxpayers."

BACKGROUND

In 2016 Hancock donated a conservation easement on its property in Mississippi and claimed a charitable contribution deduction of $180 million and an additional $6 million for other related deductions. In 2018, the IRS opened an examination into Hancock's 2016 partnership tax return and specifically the charitable contribution deduction for the conservation easement. In 2019, the IRS requested that Hancock consent to an extension of the statute of limitations on assessment through September 2021. Hancock did not agree to the extension outright; rather, it offered to extend the statutory period for assessment if the extension were solely for the purpose of allowing the case to be reviewed by the IRS Appeals Office and not for further factfinding. The audit continued without the extension. In April 2020, Hancock proposed the same offer again by sending a letter with the signed IRS Form 872-P– stating that Hancock would agree to an extension of the assessment period until September 30, 2021 so that Hancock could "file a Protest Letter and address matters with the Appeals Office, before the IRS issues an [FPAA] and forces Tax Court litigation." The IRS did not agree to sign the Form 872-P and, in July 2020, issued the FPAA to Hancock. Two days later, Hancock filed suit in district court asking the court to enjoin the issuance of the FPAA, apparently unaware that the FPAA had already been issued. Hancock asserted a statutory right to review by IRS Appeals and that the IRS' refusal to send Hancock's case to IRS Appeals and to extend the statute of limitations period were abuses of discretion. For relief, Hancock sought, in part, a declaratory judgment that it has a statutory right to independent review by the Appeals Office, as well as injunctive relief. The government moved to dismiss the suit, arguing lack of subject matter jurisdiction because the suit was barred by the Anti-Injunction Act[25], and the Declaratory Judgment Act[26], does not confer jurisdiction because it removes federal tax matters.

ANALYSIS

In support of Hancock's claim that it had a statutory right to independent review by the Appeals Office, Hancock argue that the Administrative Procedure Act (APA) waiver of sovereign immunity applied. Under the APA, district courts lack jurisdiction over administrative action when agency action is

[24] __ F.Supp.2d__ (N.D. GA. 2021), 2021 WL 3197336
[25] 26 U.S.C. § 7421(a), which bars any "suit for the purpose of restraining the assessment or collection of any tax,"
[26] 28 U.S.C. § 2201

committed to agency discretion by law, 5 U.S.C. § 701(a), or when the administrative action in question is not "final" within the meaning of 5 U.S.C. § 704.[27] To be considered "final," the agency action must both (1) mark the consummation of the agency's decision-making process, and not be "of a merely tentative or interlocutory nature;" and (2) be one by which rights or obligations have been determined, or from which legal consequences will flow.[28] By contrast, a nonfinal agency action is "one that 'does not itself adversely affect complainant but only affects his rights adversely on the contingency of future administrative action.'"[29] The government asserted that the IRS' decision not to refer Hancock's case to IRS Appeals is within the discretion of the IRS. Specifically, the government argued that the text of 26 U.S.C. § 7803(e) delineates agency discretion in stating that review by the Appeals Office shall be "generally available" and also in acknowledging that the Commissioner will, under certain circumstances, decline to refer cases to the Appeals Office.[30] In addition, the government argued that the agency's decision to settle (or not) is discretionary[31] and that the decision not to refer Hancock's case to the Appeals Office before the issuance of the FPAA was not a final agency action. Defendant asserted that the "consummation of the [IRS'] decision-making process" was the issuance of the FPAA and the steps that led to that point were procedural in nature.

The district court concluded that the IRS' refusal to refer Hancock's case to IRS Appeals before the issuance of the FPAA was interlocutory in nature, not final.

> The court concluded that Hancock failed to meet its burden to establish that the challenged action was a final agency action and failed to refute that the IRS' decision not to refer the case to the Appeals Office was within the IRS' discretion.[32]

Accordingly, the court concluded that absent a waiver of sovereign immunity, it lacked subject matter jurisdiction to adjudicate claims against the United States and its agencies. The court also concluded that Hancock failed to establish a waiver of sovereign immunity through the Declaratory

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[27] *Nat'l Parks Conservation Ass'n v. Norton*, 324 F.3d 1229, 1236 (11th Cir. 2003).

[28] *Bennett v. Spear*, 520 U.S. 154, 177-78 (1997); *see also Franklin v. Massachusetts,* 505 U.S. 788, 797 ("The core question [in the finality determination] is whether the agency has completed its decision-making process, and whether the result of that process is one that will directly affect the parties.").

[29] *Norton*, 324 F.3d at 1237 (quoting *Rochester Tel. Corp. v. United States*, 307 U.S. 125, 130 (1939)).

[30] See 26 U.S.C. § 7803(e)(4))

[31] *See Garcia v. McCarthy,* 649 F. App'x. 589, 591 (9th Cir. 2016) ("[C]ourts that have had occasion to address the issue have uniformly held that an agency's decision to settle falls under the penumbra of agency inaction that has traditionally been subject to a rebuttable presumption against judicial review.")

[32] The court cited to *Facebook, Inc. v. I.R.S.,* 2018 WL 2215743, *10 (N.D. Cal. May 14, 2018). In *Facebook*, after the IRS issued a notice of deficiency (similar to an FPAA), which it challenged in Tax Court. After the issuance of the deficiency, Facebook requested that the IRS transfer its case to the Appeals Office, which the IRS denied. Facebook sued in district court, arguing that it had a right to take its case to the Appeals Office. However, the Facebook Court determined that the IRS' decision not to refer Facebook's case to the Appeals Office was not a final action under the APA because it was not an action by which rights or obligations had been determined or from which legal consequences flowed.

Judgment Act[33], which excludes federal tax matters, concluding that the crux of Hancock's complaint requests that the IRS refer Hancock's case to the Appeals Office to prevent or mitigate the effects of the issuance of the FPAA (the deficiency).

The case has been appealed to the Eleventh Circuit. Hancock contends that the district court contravened congressional intent by ruling that its lawsuit demanding access to IRS Appeals is barred by the Anti-Injunction Act (AIA). Hancock asserts that by creating a statutory due process right to an administrative appeal in the Taxpayer First Act, Congress gave courts the jurisdictional authority to review IRS actions that violate those rights. Plaintiff asserts that the IRS's refusal to send the case to IRS Appeals violated section 7803(e)(4), and that its lawsuit does not run afoul of the AIA because it does not seek to restrain the assessment or collection of any tax. Rather, the partnership was challenging the IRS's unlawful actions. Plaintiff relies on the recently decided Supreme Court case *CIC Services LLC v. IRS*[34], which held that the AIA does not bar pre-enforcement challenges of IRS reporting rules backed by tax penalties.

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[33] 28 U.S.C. § 2201

[34] __ U.S. __ No. 19-930 (S. Ct. 2021).

TENTH CIRCUIT REJECTS TAXPAYER'S CHALLENGE TO TREAS. REG. § 301.6343

On September 2, 2021, the Tenth Circuit in *Seminole Nursing Home Inc. v. Commissioner*[35] rejected a corporation's challenge to the hardship exception under Treas. Reg. § 301.6343 and held that the regulation, which is limited to individual taxpayers was a reasonable interpretation of an ambiguous statute under *Chevron*.[36]

In a collection due-process proceeding brought in response to a levy notice, Seminole challenged the validity of the regulation, contending that the economic-hardship exception must be applied to all taxpayers, including corporations.

BACKGROUND

The IRS, pursuant to section 6330(a), provided notice to Seminole of its intent to issue a levy to collect unpaid federal employment taxes for 2013 plus penalties and interest. In response Seminole requested a collection due-process hearing (CDP), which is provided under section 6330(b)[37]. Before the hearing Seminole proposed an installment agreement permitting it to pay off its debt through monthly payments. In addition, one day before the hearing, Seminole submitted a letter to the Office of Appeals stating that, "[i]n addition to seeking a collection alternative..., [it] also seeks to challenge the appropriateness of the proposed levy on the grounds of economic hardship." Seminole asserted that a levy would cause economic hardship because it could not sustain a levy "and still provide essential care services to the patients residing at [its] nursing facility." Seminole quoted the language of the economic-hardship exception, stating that the plain language of the statute indicated "Congress' intent...to mandate the release of a levy if it creates a financial economic hardship on a taxpayer." It observed that the text of the statute "does not distinguish between businesses and individuals," and that "the term 'taxpayer' is defined in [the Tax Code]...to mean and include an individual, a trust, estate, partnership, association, company or corporation" subject to tax. Seminole argued said that it was clearly eligible for the economic-hardship exception because it is a corporation experiencing economic hardship.

At the CDP hearing, the Appeals officer rejected the proposed installment agreement, and Seminole's economic-hardship argument, explaining that Treasury Regulation § 301.6343-1(b)(4) limits economic-hardship relief to individual taxpayers. IRS Appeals issued a Notice of Determination sustaining the levy. Seminole petitioned the Tax Court for relief.

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[35] __ F3d __ (10th Cir. 2021), 2021 WL 3927265.

[36] *See Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984)

[37] At the CDP hearing the taxpayer may raise "any relevant issue" relating to the tax or levy, including challenges to the appropriateness of the collection action and offers of collection alternatives, such as an installment agreement. Id. § 6330(c)(2)(A). The Office of Appeals issues a determination that takes into consideration the "issues raised" and whether the proposed collection action "balances the need for the efficient collection of taxes with the legitimate concern of the [taxpayer] that any collection action be no more intrusive than necessary." *Id*. §§ 6330(c)(3)(B) and (c)(3)(C).

The Tax Court rejected Seminole's economic-hardship argument because Treasury Regulation § 301.6343-1(b)(4)(i) limited that relief to individual taxpayers, and it had previously held in *Lindsay v. Commissioner*[38] that the regulation was entitled to Chevron deference. It also affirmed that Seminole was ineligible for an installment agreement. Seminole appealed to the Tenth Circuit Court of Appeals.

ANALYSIS

The Tenth's Circuit's analysis began with the two-step framework set forth in *Chevron*.[39]

Under *Chevron* step one the court asks "whether Congress has directly spoken to the precise question at issue." The court "must carefully consider the text, structure, history, and purpose of a [statute]," and proceed to step two only if "the interpretive question still has no single right answer." At step two "the question becomes whether the agency regulation is a permissible construction of the statute." [40] In determining whether a construction is permissible, "[t]he court need not conclude that the agency construction was the only one it permissibly could have adopted to uphold the construction, or even the reading the court would have reached if the question initially had arisen in a judicial proceeding."[41] A construction is a permissible one if it "reflects a plausible construction of the plain language of the statute and does not otherwise conflict with Congress' expressed intent."[42]

Seminole argued that the hardship exception is unambiguous because section 7701 defines taxpayer as "any person subject to any internal revenue tax" and defines person to include "an individual, a trust, estate, partnership, association, company or corporation."[43]

He also argued, that section 6343(a)(1)(D) makes no distinction between an individual taxpayer and a corporate taxpayer.

The Circuit Court noted that refence to "taxpayer" in other parts of the Tax Code makes clear that the word can be implicitly limited to individuals. The court referenced section 6343(e), which provides that the Secretary should release a "levy on the salary or wages payable to or received by the taxpayer, upon agreement with the taxpayer that the tax is not collectible." The court recognized that this provision is necessarily limited to individuals, the only taxpayers who receive salary or wages. But the court viewed the critical question whether it makes sense to apply the hardship exception to a corporation.

While a corporation can experience "economic hardship", the court concluded that there is an

[38] 148 T.C. 235, 261 (2017),

[39] *See Mayo Found. for Med. Educ. & Rsch. v. United States,* 562 U.S. 44, 55 [107 AFTR 2d 2011-341] (2011) ("The principles underlying our decision in Chevron apply with full force in the tax context.").

[40] *K Mart Corp. v. Cartier, Inc.,* 486 U.S. 281, 291-92 (1988).

[41] *Chevron,* 467 U.S. at 843 n.11

[42] *Rust v. Sullivan,* 500 U.S. 173, 184 (1991). If the agency's construction is permissible, the court "must give deference to the agency's interpretation of the statute." *K Mart Corp.,* 486 U.S. at 292.

[43] Section 7701(a)(1) and (a)(14)

essential difference between an individual and a nonindividual entity. The court stated:

> We care, care deeply, about the survival of the individual. More than that, we want the individual to have the minimal comforts of life. Taking everything that the individual possesses is not acceptable. This policy is reflected in the statutory provision exempting 13 items from levy. See 26 [pg. 2021-5744] U.S.C. §§ 6334(a). All apply to individuals; and the two that might (at least linguistically) also apply to nonindividuals are so limited (books and tools of the trade up to $3,125 in value, and undelivered mail) that they probably would not help a business survive.

However, as to a corporate entity, the court concluded that "relieving a business from a levy is questionable policy" that could "create incentives that undermine public policy." As the Sixth Circuit said, "[T]he government is not required to continue subsidizing failing businesses by foregoing tax collection. Any other conclusion would create a bizarre tax system with perverse incentives for businesses to maintain themselves on the edge of insolvency in order to enjoy immunity from tax enforcement."[44] In addition, the court also noted that Seminole made no attempt to illustrate what an economic-hardship regulation for nonindividuals would look like. And the court noted that when the Secretary promulgated Treas. Reg. § 301.6343-1(b) as a proposed regulation, no one suggested expanding the economic-hardship exception to include nonindividuals.[45]

The court concluded that the language of the exemption does not compel interpretation that it apply to corporations and that the contours of the exemption are properly left to the expertise of the Secretary. Thus, in *Chevron* terms, the court concluded that section 6343(a), subparagraph (D), is ambiguous and the present regulation Treas. Reg. §301.6343-1(b)(4)(i) is a reasonable interpretation.

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[44] *Living Care Alts. v. United States,* 411 F.3d 621, 628 [95 AFTR 2d 2005-2668] (6th Cir. 2005); *see also Finley v. United States*, 123 F.3d 1342, 1348 [80 AFTR 2d 97-6321] (10th Cir. 1997) (narrowly construing reasonable-cause exception to liability under 26 U.S.C. §§ 6672 to "avoid making the government an unwilling partner in a floundering business"

[45] *See* 60 Fed. Reg. 33-01, 34-35 (Jan. 3, 1995).

"WILLFUL BLINDNESS" REQUIRES PROOF OF SPECIFIC INTENT

On July 6, 2021, the Ninth Circuit Court of Appeals in *Rodgers v. United States*[46] held that in order to impose a penalty on a tax return preparer under section 6694 based on "willful blindness" the IRS must prove that the tax preparer "acted with the specific intent to understate the reported tax liabilities."

The court held that to prove willful blindness it is not sufficient to show that tax preparer merely "knew there was a high probability that he was understating the tax."

BACKGROUND

For the 2009 and 2010 tax years, Rodgers prepared tax returns for two individuals and their related companies. After determining that the returns understated taxes, the IRS assessed penalties against Rodgers under sections 6694(b)(2)(A) and (b)(2)(B).[47] Rodgers filed suit contesting the penalties. The district court held a bench trial and entered judgment for the government, which was vacated by the Ninth Circuit and remanded for the district court to apply the correct willfulness standard.[48] On remand, the district court once again found Rodgers liable for willfully understating taxes — this time, under a theory of willful blindness. Rodgers appealed, argues that the willful blindness doctrine alone cannot satisfy the willfulness requirement of section 6694(b)(2)(A) because, while willful blindness allows the factfinder to impute knowledge, the statute also requires a finding of specific intent.

ANALYSIS

The Ninth Circuit agreed with Rodgers that section 6694(b)(2)(A) requires proof of specific intent. Specifically, the Court stated:

> Precedent dictates this conclusion. *In Richey v. IRS*, 9 F.3d 1407 (9th Cir. 1993), we held that "'willful' has the same meaning under both sections 7206 and 6694." Id. at 1411. And three years prior to *Richey*, we held that "willful" under § 7206 requires a showing of "specific intent to defraud the government." *United States v. Salerno*, 902 F.2d 1429, 1432 (9th Cir. 1990). Thus, it is settled law that willfulness under § 6694(b)(2)(A) requires specific intent to understate tax liability on tax returns or claims.
>
> The district court based its willfulness conclusion solely on a finding that Rodgers was "willfully blind" to the fact that he was preparing understated tax returns. Specifically, the court found the willfulness standard satisfied because "Rodgers knew there was a high probability that he was understating the tax on the 2009 and 2010 tax returns" and

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[46] __ Fed. Appx. __, 2021 WL 3855706.

[47] Section 6694(b)(2) provides:

> Willful or Reckless Conduct – Conduct described in this paragraph is conduct by the tax return preparer which is:
> (A) a willful attempt in any manner to understate the liability for tax on the return or claim, or
> (B) a reckless or intentional disregard of rules or regulations.

[48] *Rodgers v. United States*, 772 F. App'x 555, 556 (9th Cir. 2019).

> "took deliberate actions to avoid learning of these facts," which established willful blindness under the two-part test of *Global-Tech Appliances, Inc. v. SEB S.A.*, 563 U.S. 754, 769 (2011). But that conclusion does not encompass the full meaning of "willful" under § 6694(b)(2)(A). The court must determine whether Rodgers acted with the specific intent to understate the reported tax liabilities. And because the district court did not make that finding, we vacate the order and remand for further proceedings on whether the willfulness standard is satisfied.

In remanding the case back to the district court, the Ninth Circuit noted that willfulness under section 6694(b)(2)(A), including specific intent, may be established by circumstantial evidence.[49]

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[49] *See United States v. Conforte*, 624 F.2d 869, 875 (9th Cir. 1980) (holding that willfulness may be inferred from all the facts and circumstances in part because "[d]irect proof of a taxpayer's intent to evade taxes is rarely available").

LB&I EXTENDS VIDEO MEETINGS WITH TAXPAYERS AND THEIR REPRESENTATIVES

The IRS recently announced that the Large Business and International Division (LB&I) will accommodate taxpayer requests to meet with agency employees using videoconferencing, extending the practice started during the pandemic with taxpayers who sought more than meeting with an IRS employee over telephone calls.

The announcement represents another step forward in the IRS' effort to work with taxpayers in a virtual environment.

According to the IRS' announcement (IR-2021-204), effective October 18, 2021, "if a taxpayer requests a secure video meeting with IRS-approved platforms in lieu of an in-person or telephone discussion, the employee will grant such request. Employees who prefer to engage in video discussions from their post of duty rather than their telework site may do so consistent with IRS protocol on office presence." Current IRS-approved video conferencing includes WebEx and ZoomGov, with a later phase-in of Microsoft Teams. Certain protocols must be followed for video conferencing to address privacy considerations and to ensure authentication. For example, the transfer of files containing taxpayer information are not permitted on these platforms. In addition, taxpayers and tax professional should be ready to verify their identity when calling the IRS. The announcement appears to be an extension, and not a permanent adoption of videoconferencing, with an expiration date of October 18, 2023.

In addition to video conferencing, the IRS has expanded the use of secure email and the launch of a virtual reading room environment to enable LB&I taxpayers and IRS agents to share certain privileged taxpayer documents in a read-only capacity.

CHIEF COUNSEL DEFINES FALSE OR FRAUDULENT STATEMENTS UNDER SECTION 6700

On August 27, 2021 the Office of Chief Counsel of the IRS issued a memorandum (Chief Counsel Advice 202134016) to define what constitutes a false or fraudulent statement for purposes of assessing a tax shelter promoter's penalty under Section 6700 for micro-captive insurance transactions.

Section 6700(a) defines a tax shelter promoter as a person who:

- organizes (or assists in organizing) an entity, investment plan, or other arrangement, or participates (directly or indirectly) in the sale of any interest in an entity, plan, or arrangement, and
- makes a statement about the allowability of any deduction, credit or other tax benefit to be obtained by holding an interest in the entity or participating in the plan or arrangement that the person knows or has reason to know is false or fraudulent as to any material matter.

In its analysis, the Office of Chief Counsel noted the following:

> There are two types of statements that fall within the statutory bar of section 6700(a)(2)(A): statements directly addressing the availability of tax benefits and those concerning factual matters that are relevant to the availability of the tax benefits. Advice and recommendations are considered statements for purposes of section 6700. False statements under section 6700 include representations that a plan qualifies for special tax treatment when the plan does not comply with the law.
>
> Further, statements are false when assertions are not qualified and customers are not notified that following the advice could subject them to IRS scrutiny. Where a promoter has knowledge of the risks incident to a tax shelter, the promoter must clearly and unambiguously inform its agents, prospective clients, and current clients of that risk.

In the context of micro-captive insurance arrangements, statements include opinions, promotional materials, reports, tax savings projections, or other statements (or materials relied upon in making such statements) that are false or fraudulent as to any matter material to exclusion of income under section 831(b) or tax deductions under section 162 for premiums paid by the insured.

Chief Counsel Advice 202134016 provides notice to taxpayers and tax advisors when a promoter makes certain statements or representations that may be construed as a fraudulent statement for purposes of assessing a tax shelter promoter's penalty under Section 6700. While directed to micro-captive insurance arrangements, the CCA can be read more broadly to provide guidance that taxpayers should be wary of all representations that he or she knows (or has reason to know) are false or fraudulent.

Richard A. Nessler

IRS LAUNCHES WEBPAGE ON JOINT COMMITTEE ON TAXATION REVIEW

On September 22, 2021, the IRS issued news release 2021-192 which introduced a new webpage that provides information to taxpayers whose large refunds are subject to further review by the Joint Committee on Taxation (JCT or Joint Committee).

By law, when taxpayers claim a federal tax refund or credit of more than $2 million ($5 million for a C corporation), the IRS must review the refund or credit and provide a report to the JCT, a non-partisan committee of the US Congress. Refunds subject to this review are known as "Joint Committee Refund Cases."

The purpose of the new webpage is to provide taxpayers with answers to most questions about Joint Committee case reviews and links to additional resources about large tax refunds and credits subject to review by the JCT.

If a refund claim is subject to JCT review, the IRS prepares a written report for the Joint Committee. The report contains a brief history of the taxpayer and explanation of the reasons for any refunds. Generally, the report includes supporting documents prepared by the IRS. These documents discuss the amount of, and reason for, all the adjustments considered by the IRS for taxable years under review.

The JCT's review of these reports focuses on the technical aspects of the case and the IRS's resolution of the issues presented. This review enables JCT to become familiar with specific issues in individual industries and to find problems in the administration of the law. Of particular concern to the Joint Committee staff are transactions in which taxpayers obtain unintended benefits. If the problem emanates from the statutory language, JCT may recommend an amendment to the Code. When the problem comes from IRS pronouncements, such as rulings or regulations, the JCT may request that the IRS clarify or reconsider its published position. When the problem is lack of uniform application of the law, or lack of authority, the JCT may request that the IRS publish guidance on the issue. Both the Joint Committee staff and the IRS view the review process as a way of improving tax administration.

The JCT review also permits identification of issues that, as a technical matter, were not handled correctly by Exam or Appeals. In these instances, JCT may recommend an adjustment to the amount of the refund when the tax effect in the case is significant. Adjustment also is recommended when, as a result of the correction, loss or credit carry forwards will be reduced significantly even though there is no effect on the proposed refund.

The IRS is not required to comply with JCT's requests for reconsideration of adjustments. As a matter of agency policy, the IRS will not pay any part of a refund until the JCT concludes its review of the case. The conclusion of a case can be that the IRS initial position was correct; that the IRS concurs with the JCT's recommendation; or that no change will be made because the IRS does not agree with the JCT's recommendation.

A JCT Case may arise from the following:

- A refund claim for previously assessed and paid taxes. A refund claim may be made on an amended return or be made by a claim submitted during an examination. A refund claim would be reviewed by the IRS and reported to the JCT before being paid.
- A tentative refund from tentative carrybacks of net operating losses, capital losses or credits.

The tentative refund would be claimed on Form 1139, Corporation Application for Tentative Refund, or on Form 1045, Application for Tentative Refund. A tentative refund would be paid prior to IRS and JCT review.

- A refund or credit of income taxes due to certain losses relating to federally declared disasters.

Excluded from JCT review are the following:

- A refund or credit of employment, windfall profit or certain excise taxes.
- A refund of trust fund recovery penalties.
- A refund or credit of estimated payments or income tax withholdings made without an IRS audit.
- A refund or credit of an unassessed advance payment or deposit made before IRS determines the taxpayer's liability.
- A refund or credit of an amount paid on an early-filed return that is more than the amount of the tax liability reported on a subsequent return filed by the return due date.
- An abatement (reduction) of an unpaid liability, even if the amount of the reduction is more than $2 million ($5 million for C corporations).

IRS ISSUES GUIDANCE ON QUALIFIED SICK LEAVE

On September 9, 2021, the IRS issued Notice 2021-53 to provide guidance on Form W-2 reporting of the amount of qualified sick and family leave wages paid to employees for leave taken in 2021.[50] The American Rescue Plan Act of 2021 (ARP) amended and extended the tax credits available to employers providing paid sick and family leave consistent with the leave provided under the Families First Coronavirus Response Act (FFCRA).

Under ARP, refundable tax credits are available to employers that provide sick and family leave wages, which otherwise would have satisfied the requirements of the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act, paid with respect to leave taken by employees April 1, 2021 through September 30, 2021.

Reporting paid sick and family leave on a 2021 Form W-2, employers will be required to report sick and family leave amounts paid to employees either on Form W-2, Box 14, or in a separate statement provided with the Form W-2. In addition, the Notice provides employers with model language to use as part of the Instructions for Employee for the Form W-2 or on the separate statement provided with the Form W-2.

MODEL LANGUAGE FOR EMPLOYEE INSTRUCTIONS

As part of the Instructions for Employee, under the instructions for Box 14, for the Forms W-2, or in a separate statement sent to the employee, the employer may provide additional information about qualified sick leave wages and qualified family leave wages and explain that these wages may limit the amount of the qualified sick leave equivalent or qualified family leave equivalent credits to which the employee may be entitled with respect to any self-employment income. The following model language (modified as necessary) may be used.

> "Included in Box 14, if applicable, are amounts paid to you as qualified sick leave wages or qualified family leave wages under the Families First Coronavirus Response Act and/or sections 3131 and 3132 of the Internal Revenue Code. Specifically, up to six types of paid qualified sick leave wages or qualified family leave wages may be reported in Box 14:
>
> - Sick leave wages subject to the $511 per day limit paid for leave taken after December 31, 2020, and before April 1, 2021, because of care you required.
> - Sick leave wages subject to the $200 per day limit paid for leave taken after December 31, 2020, and before April 1, 2021, because of care you provided to another.
> - Emergency family leave wages paid for leave taken after December 31, 2020, and before April 1, 2021.
> - Sick leave wages subject to the $511 per day limit paid for leave taken after March 31, 2021, and before October 1, 2021, because of care you required.

[50] Notice 2021-53, 2021-39 IRB

- Sick leave wages subject to the $200 per day limit paid for leave taken after March 31, 2021, and before October 1, 2021, because of care you provided to another.
- Emergency family leave wages paid for leave taken after March 31, 2021, and before October 1, 2021.

If you have self-employment income in addition to wages paid by your employer, and you intend to claim any qualified sick leave or qualified family leave equivalent credits, you must report the qualified sick leave or qualified family leave wages on Form 7202, Credits for Sick Leave and Family Leave for Certain Self-Employed Individuals, included with your income tax return, and may have to reduce (but not below zero) any qualified sick leave or qualified family leave equivalent credits by the amount of these qualified leave wages. If you have self-employment income, you should refer to the instructions for your individual income tax return for more information."

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.

EDITORS

LAWRENCE M. HILL
Partner
New York, NY
+1 212 506 3934
lhill@steptoe.com

RICHARD A. NESSLER
Of Counsel
New York, NY
+1 212 3787504
rnessler@steptoe.com

NEW ADDITIONS TO THE CONTROVERSY PRACTICE

Steptoe is pleased to announce the further expansion of its Tax Litigation & Controversy practice with the arrival of Steve Dixon as a partner and Nick Sutter as a law clerk.

STEVEN R. DIXON
Partner
Washington, DC
+1 202 429 6223
sdixon@steptoe.com

Steve Dixon has been litigating federal tax cases for corporate and individual taxpayers for more than 17 years. He has represented Fortune 500 taxpayers in high-profile trials before the Tax Court (including a multi-billion-dollar transfer-pricing case in that venue), the Court of Federal Claims, and in federal district court.

Steve represents taxpayers across a broad range of industries, including energy, consumer goods, technology, defense, real estate development, healthcare, insurance, transportation and banking/financial firms. The tax subject matters are equally broad, and have included transfer pricing, intangible valuation, accounting methods, debt-equity classification, insurance, and excise tax disputes, among others.

Steptoe Chair Phil West, who also co-chairs the Tax Group, commented: "Steve is an extremely able, accomplished, and energetic tax controversy and trial lawyer. He is another great addition to our storied tax controversy and litigation practice, which recently welcomed Larry Hill and Richard Nessler, and includes Matt Frank, Greg Kidder, Amanda Varma, Aaron Nocjar, and other talented lawyers. As we see tax enforcement increase, our corporate and high-net-worth clients will benefit from the world-class team we have in place."

Larry Hill, who co-heads the firm’s tax controversy practice added: "We are very excited to have Steve join our premier tax controversy team. His trial skills, depth of experience, drive and enthusiasm are rare commodities and add strength to strength."

NICK SUTTER
Law Clerk
Washington, DC
+1 202 429 1335
nsutter@steptoe.com

Prior to joining Steptoe, Nick was director of government relations at The Glover Park Group, where he served as a lobbyist representing companies and trade associations in the energy, financial services, automotive, and transportation sectors. Nick also previously worked on Capitol Hill for seven years for Senator Maria Cantwell, the Senate Energy Committee, and the Senate Small Business Committee.

TAX CONTROVERSY HIGHLIGHTS

Below are some of the Tax Controversy lawyers' latest recognitions and speaking engagements and the launch of a podcast.

RECOGNITIONS

The Best Lawyers in America has named Lawrence M. Hill "Lawyer of the Year" in 2022 for Litigation and Controversy-Tax.

RECENT SPEAKING ENGAGEMENTS

- "The New International Tax Controversy Paradigm," NY Tax Club Presentation, November 10, 2021.
- "Ethics in Tax Controversy and Administrative Practice," Wall Street Tax Association Seminar, November 3, 2021
- "International Tax Audits: Hiding Income and Assets Internationally from Tax Authorities," 17th Annual University of San Diego School of Law International Tax Institute, October 28, 2021
- "Death and Taxes: What is Certain Today?," Estate Planning Council of NYC, October 21, 2021
- "John Doe Summonses: The Tool to Close the Crypto Compliance Gap and Implications for Privilege," Virtual 2021 Fall ABA Tax Section Meeting, Administrative Practice and Court Procedure & Practice Committees, September 22, 2021

PODCAST

Northwestern Pritzker School of Law Tax Program and Steptoe are pleased to jointly announce the launch of "Substantial Authorities: The Tax Podcast," a series of conversations with distinguished tax figures on matters relating to tax administration, tax controversy, and tax litigation. The video podcast is hosted by Steptoe tax partner Matt Frank.

Click here to view Episode 1 featuring an in-depth conversation with Albert G. Lauber, a senior judge on the US Tax Court.

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.