2020 Delaware Tax Institute

Concluding Thoughts on an Unusual Tax Year

Co-sponsored by Widener University Delaware Law School, Society of Financial Service Professionals–Delaware Chapter, and the Delaware State Bar Association

Presentations on 2020 Income Tax Developments/Care Act; Estate Planning and Gift Tax Update; Secure Act; Election Results: Continuation/Changes; State Tax Issues from Telecommuting.

Distinguished Speakers on December 9:
Eric Solomon and David A. Fruchtman,
Steptoe & Johnson LLP

Wed., December 2 and 9, 2020

8:30 a.m.–11:45 a.m.

Two-Day VIRTUAL Presentations Via ZOOM

Delaware Law

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Delaware Tax Institute
2020: Concluding Thoughts on an Unusual Tax Year

Co-sponsored by Widener University Delaware Law School, Society of Financial Service Professionals – Delaware Chapter, and the Delaware State Bar Association

Agenda for Wednesday, December 9, 2020

8:30-8:35 am **Welcome – John "Jack" P. Garnewski Jr., CPA/PFS, CFP, AEP**
Chairperson, Delaware Tax Institute
Family Office Solutions, LLC

8:35-10:00 am Income Tax Developments/Care Act
Moderator:
Kathryn S. Schultz, CPA, AEP
Belfint Lyons & Shuman, P.A.

Panelists:
Charles J. Durante, Esquire
Connolly Gallagher LLP

Michael D. Kelly, CPA
Belfint Lyons & Shuman, P.A.

10:15-11:00 am **Distinguished Speakers**
Eric Solomon, Esquire
Partner, Steptoe & Johnson LLP

David A. Fruchtman, Esquire
Partner, Steptoe & Johnson LLP

11:00-11:45 am **Telecommuting State Tax Issues**
Moderator:
Jennifer R. Hudson, Director
Delaware Division of Revenue

Panelists:
Sharonne Bonardi, Deputy Comptroller
Maryland Office of the Comptroller

C. Daniel Hassell, Secretary
Pennsylvania Department of Revenue

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2020 Delaware Tax Institute Planning Committee

Jocelyn Margolin Borowsky, Duane Morris; John "Jack" P. Garniewski Jr., Family Office Solutions, LLC; Bruce Grohsgal, Widener University Delaware Law School; Daniel F. Hayward, Gordon, Fournaris & Mammarella, P.A.; Carol G. Kroch, Wilmington Trust Company; Kathryn S. Schultz, Belfint Lyons & Shuman, P.A.; W. Donald Sparks II, Richards Layton & Finger, P.A.; Kenneth W. Stewart, Stephano Slack LLC; Leo E. Strine, The Financial House; Vincent C. Thomas, Young Conaway Stargatt & Taylor, LLP

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Course materials are available for download as a pdf at delawarelaw.widener.edu/delawaretax

BIOGRAPHIES

Sharonne R. Bonardi, Esq., J.D., M.B.A.

On October 1, 2015, Comptroller Peter Franchot appointed Sharonne R. Bonardi as the first African American Deputy Comptroller of Maryland. Prior to that appointment, Ms. Bonardi served in numerous roles within the Compliance Division, including: Director (June 2009-October 2015); Deputy Director (May-June 2009); Assistant Director (2006-2009); Manager of the Hearings and Appeals Section (2003-2006); and Attorney Hearings Officer (1997-2006). She has also served as an Administrative Law Judge with the Office of Administrative Hearings. In 1991, while matriculating at the University Maryland School of Law, Mrs. Bonardi began her state employment with the Maryland Department of Labor, Licensing, and Regulations.

Mrs. Bonardi received her B.A. cum laude in English from Trinity University in 1989. She received her J.D. from the University of Maryland School of Law, and her M.B.A. from The Johns Hopkins University's Carey School of Business. She was admitted to the Maryland Bar in 1993. Sharonne was named one of Maryland's Top 100 Women by The Daily Record in 2016 and 2019. She was also a 2019 Maryland Leadership in Law honoree.

Mrs. Bonardi is vice chair at SECU MD; Federation of Tax Administrators Immediate Past-President; Northeastern State Tax Officials Association Past-President; currently serves on Maryland Association of CPA's Education Foundation Board; and State Chair of the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center, a partnership between the IRS, state agencies and corporate tax software vendors.

She is also active in numerous civic organizations: Alpha Kappa Alpha Sorority, Incorporated, The Links, Incorporated and Jack and Jill of America She resides in Woodstock, Maryland with her husband, Jason and their son, Jordan.

Jocelyn Margolin Borowsky, Esquire

Jocelyn Margolin Borowsky, a fellow of the American College of Trust and Estate Counsel ("ACTEC"), practices in the areas of estate planning, probate and estate and trust administration in Delaware, New Jersey, and Pennsylvania. A large part of her practice involves the review of a client's overall estate plan, preparation of wills and revocable trusts, and where appropriate, implementation of sophisticated trusts, such as lifetime spousal trusts, asset protection trusts, life insurance trusts and dynasty trusts. As an active Delaware practitioner, she routinely advises clients with respect to structuring new Delaware trusts or transferring existing trusts to Delaware both judicially and non-judicially. Her clients include out-of-state counsel seeking review or advice with respect to Delaware trusts, high net worth families, corporate executives and charitable organizations. She works with closely-held family businesses on issues involving strategic tax and business planning and the creation of private family foundations. She also handles tax controversy matters, including estate and gift tax audits by the Internal Revenue Service and state taxing authorities. She is AV® Preeminent™ Peer Review Rated by Martindale-Hubbell.

Ms. Borowsky is a 1992 graduate of the University of Pennsylvania Law School and a graduate of New York University School of Law (LL.M. in Taxation, 1997) and the University of Texas (B.A., with highest honors, 1988), where she was elected to Phi Beta Kappa.

Areas of Practice

- Wealth Planning
- Estate Planning
- Estate and Trust Administration

Charles J. Durante, Esquire

Chuck Durante is a founding partner of the Wilmington law firm of Connolly Gallagher LLP, where he heads the Tax, Trusts and Estates Department.

He advises fiduciaries on the administration of trusts and estates, and counsels clients in estate planning, management of nonprofit organizations, statutory trusts, investment holding companies and limited liability companies. His litigation includes fiduciary matters and cases of significant public impact. He is called upon as an expert witness on fiduciary law.

A fellow of the American College of Trust and Estate Counsel, he is recognized in *The Best Lawyers in America* in tax law, in *Top Lawyers in Delaware* in trusts and estates and as a notable practitioner in private wealth law by Chambers and Partners.

Chuck chairs the Board of Editors of Delaware Lawyer, a quarterly magazine, and is Vice President at Large of the Delaware State Bar Association. A leader in many civic and charitable efforts, he received the Haverford College Alumni Award in 1998. A former sportswriter and columnist for *The Philadelphia Inquirer*, Chuck is a member of the Delaware Track and Field Hall of Fame.

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David A. Fruchtman, Esquire

David Fruchtman is the chair of Steptoe's national state and local tax practice, providing state and local tax planning and controversy advice. His representations involve almost all subnational taxes for businesses and individuals, including income, franchise, sales, use, real property transfer, and a variety of other state and local taxes. His clients include public and privately held heavy equipment manufacturers, marketing companies, travel lodging providers, and vehicle rental companies, as well as mid-sized retailers and other businesses.

David's tax planning work includes tax efficient structuring of businesses and transactions, and regularly requires working with tax authorities to obtain favorable guidance, as circumstances require. He advises foreign companies expanding into the United States, and his experience includes assisting an American affiliate of an Israeli company in one of Wall Street's most successful IPOs of 2010.

Clients value David's creativity and ability to negotiate with taxing authorities in contested matters and, when necessary, his effectiveness in advocating for clients' positions before tax tribunals and courts of law across the country. He was a Special Deputy Attorney General to the state of Hawaii in 2003.

David filed an amicus brief with the US Supreme Court in *South Dakota v. Wayfair, Inc.*, 585 US __ (2018), which the taxpayers cited as supporting authority. He also is the author of the Bloomberg Tax Portfolios "Income Taxes: Definition of a Unitary Business" and "Income Taxes: Consolidated Returns and Combined Reporting." A prolific writer and speaker, David has authored some 80 articles and presentations on various state and local tax issues, including the booklets, "Advising Business About US Subnational Taxes" and "Covering the Waterfront, *Wayfair* Amicus Curiae Brief and Collected Articles," each of which features a compendium of his articles and presentations on that topic. For more than 20 years, he has co-authored the Illinois chapter of the ABA's Sales and Use Tax Deskbook.

David is a past chairman of the Income and Franchise Taxes Subcommittee of the American Bar Association's state tax committee. He lectured on constitutional issues, LLC and partnership taxation, and escheat of abandoned property issues at NYU's Summer State and Local Tax Institute for 13 years. David has spoken at Tax Executives Institute programs, American Bar Association meetings, Chicago Tax Club, the Israel Export Institute, the Israel-America Chamber of Commerce, Duke Law School, and Georgetown University Law Center, among other seminars in the United States and Israel.

John "Jack" P. Garniewski Jr., CPA/PFS, CFP, AEP

As a Principal of Family Office Solutions, LLC, Jack leads seasoned professionals who are responsible for delivering advice and service to a national client base of multi-generational families and business owners.

Jack works directly with clients to help manage the multi-dimensional aspects of their family's financial affairs. Jack and his teams work closely with clients and their advisors to develop and support financial strategies that assist clients in meeting their current needs, while planning for long-term goals. For some of his clients, this also means serving as executive director, advisor, and confidant.

Jack has more than three decades of experience in providing advice and overseeing the execution of financially related solutions for wealthy families. This includes the strategic leadership and business management responsibilities associated with oversight of multiple family offices and other entities.

Jack holds an MBA in Taxation from Drexel University and earned his bachelor's degree from Villanova University. Jack is a Certified Public Accountant in Delaware and Pennsylvania. He serves as President to the NAEPC (National Association of Estate Planners and Councils). He frequently speaks at family office and other related professional conferences locally and nationwide.

Born and raised in New Castle, Delaware, Jack currently resides in Chester County, Pennsylvania.

Professor Bruce Grohsgal

Bruce Grohsgal is the Helen S. Balick Professor in Business Bankruptcy Law. He joined the Widener University Delaware Law School faculty in July 2014.

He previously practiced law for more than 30 years, most recently at the Wilmington, Delaware office of Pachulski Stang Ziehl & Jones, LLP. He has represented debtors, creditors' committees, and trustees in chapter 11 bankruptcy cases and litigation, including the debtors in Solyndra, Global Home Products/Anchor Hocking/Mirro/WearEver, Chi Chi's and Trans World Airlines, the creditors' committees in Freedom Communications (Orange County Register) and Jevic Transportation, the medical benefits retirees' committee in Allied Systems Holdings, Inc., and the chapter 11 trustee in Le-Nature's.

Professor Grohsgal is the Co-Editor-in-Chief of the Norton Journal of Bankruptcy Law and Practice, and is the Director of the Institute of Delaware Corporate and Business Law. He was a Senior Fellow at Americans for Financial Reform, Washington, D.C., from October 2012 to January 2013, while on Sabbatical from his former firm, and was the Chair of the Bankruptcy Section of the Delaware State Bar Association in 2008-2009. He has spoken on numerous bankruptcy topics, including "first day" hearings, the sale of a business and other assets in bankruptcy, unsecured creditors' committees, executive compensation, derivatives, repos and financial instruments in bankruptcy, and the discharge of student loans by individuals in bankruptcy.

He received his B.A. from Brandeis University in 1977 and his J.D. from Columbia Law School in 1980, where he was a Stone Scholar.

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Daniel F. Hayward

Director
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DANIEL F. HAYWARD is a Director at the Wilmington law firm of Gordon, Fournaris & Mammarella, P.A. Daniel graduated with a Bachelor of Science degree in Chemical Engineering from the University of Delaware. He received his law degree from Villanova University School of Law in 2006, and received his LL.M. in Taxation from the Villanova University School of Law in 2015. He is a member of the Delaware Bar Association, and also a member of the Estates and Trusts Section, of which he served as Chair during 2015-2016. He is a Fellow of the American College of Trust and Estate Counsel.

Daniel's practice focuses on the unique aspects of Delaware trust law including directed trusts, dynasty trusts, asset protection trusts and all aspects of the validity, construction and administration of Delaware trusts. Daniel routinely petitions the Delaware Court of Chancery to represent interested parties in the reformation of trusts and to transfer the situs of certain trusts to the State of Delaware. He also drafts, reviews and comments on Delaware trust agreements for local and out of state clients and provides legal opinions on the validity of trusts under Delaware law, including Delaware dynasty trusts and Delaware self-settled asset protection trusts.

Daniel also represents and advises Delaware corporate and individual trustees regarding trust administration and the legal aspects of their fiduciary roles. His practice also frequently includes representation of Delaware trustees in fiduciary litigation matters, in particular actions in the

Delaware Court of Chancery seeking construction of trust provisions or instructions from the Court as to various matters of trust administration.

Daniel resides in Hockessin, Delaware with his wife Stephanie and their three children, Charlotte, Lila and Sebastian.

Areas of Practice:

Trusts and Estate Planning [2]
Fiduciary Litigation [3]
Taxation [4]

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Jennifer R. Hudson, Esquire

Jennifer Hudson has served as the Director of the Delaware Division of Revenue since October 1, 2017. As the Director, Jenn is the leader of a dynamic organization of nearly 225 personnel who are responsible for the administration and enforcement of many of the taxes imposed by the State of Delaware, and the collection of approximately two-thirds of Delaware's annual general fund revenue. Following an RFP process to identify a vendor, Revenue launched an IT project in 2019 that will modernize Revenue's tax processing systems.

From 2012 until her appointment as Director, Jenn served as a Deputy Attorney General with the Delaware Department of Justice, representing the Department of Finance, the Division of Revenue, and the Division of Accounting. In this role, Jenn handled tax cases pending before the Tax Appeal Board and Superior Court, worked on legislative issues, and assisted with interpretation of applicable tax laws. Jenn also served as a Unit Head within the Department of Justice, overseeing representation of various State agencies, including DelDOT, the Department of Safety and Homeland Security, the Department of Labor, and the Department of Finance. Jenn was the Chair of the FOIA Committee and was instrumental in publishing the FOIA Manual and providing annual FOIA training to FOIA coordinators statewide.

Prior to joining the Delaware Department of Justice, Jenn was in private practice with the Wilmington-based law firm Young Conaway Stargatt & Taylor, LLP, where she worked for 12 years as an attorney in the Tax Department. Jenn also worked in a variety of other roles at Young Conaway before entering and while attending law school.

Jenn graduated from Widener University School of Law *cum laude* in 2000, having served as a member of the Delaware Journal of Corporate Law, and from Widener University *summa cum laude* in 1997. Jenn completed the Certificate in State and Local Tax at the Georgetown University Law Center in 2017 and received an LL.M. in Taxation with distinction from Georgetown in 2018.

Michael D. Kelly, CPA
Principal – Tax & Small Business

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Michael has over ten years of experience focusing on taxes while working with various types of industries including medical practices, optometrists, law firms, franchises, family-owned businesses, and construction.

Michael specializes in individual and business taxation, trust and estate taxation, state and local taxation, and nonprofit advisory. He frequently assists clients with their accounting questions and has a strong understanding of QuickBooks and other bookkeeping software. Continuously thinking of creative solutions that minimize taxes for his clients and increase client's efficiency are two of the many areas where Michael excels. He also enjoys the challenge of researching uncertain or unusual federal and state income tax issues, including being heavily involved with his clients on the PPP loan and forgiveness application process.

Michael has been published in the Delaware Bankers Association's magazine and has presented tax updates at the Society of Financial Service Professionals and at the Delaware Tax Institute.

Professional Affiliations

- American Institute of Certified Public Accountants
- Delaware Society of Certified Public Accountants
- Estate Planning Council of Delaware
- Wilmington Tax Group

Education

- University of Delaware – Bachelor of Arts Degree in Mathematics Education
- University of Delaware – Bachelor of Science Degree in Accounting
- Villanova School of Business – Masters in Taxation

Carol G. Kroch, Esquire

Carol is an Administrative Vice President at Wilmington Trust and the National Director of Philanthropic Planning. She has extensive experience working with individuals and nonprofit organizations in estate, trust, and charitable gift planning and in advising nonprofit corporations and trusts, including private foundations and public charities.

Carol was named by Private Asset Management Magazine in June 2016 and May 2015 as one of the 50 most influential women in private wealth. Prior to joining Wilmington Trust in 2005, Carol was senior counsel at The Robert Wood Johnson Foundation, the largest foundation in the United States devoted to health and health care. She was responsible for legal matters related to the Foundation's investment portfolio, including the negotiation of alternative investment vehicles. In addition, she had responsibility for tax, business, corporate governance, and grant-making matters. From 1978 to 1999, Carol was in private practice at Drinker Biddle & Reath LLP in Philadelphia and Cahill Gordon & Reindel LLP in New York.

Carol holds a JD from Boston College Law School, where she was a member of the Law Review and the Order of the Coif, and a bachelor's degree from Wellesley College. She is a Fellow of the American College of Trusts and Estates Counsel and a member of its Charitable Planning and Exempt Organizations Committee. Carol is the past co-chair of the Art and Collectibles Committee of the Section of Real Property Trust and Estate Law (RPTE) of the American Bar Association ("ABA"). She is a past RPTE Council member and served as the Supervisory Council member for the Charitable Planning and Organizations Group. She is also a member of the Exempt Organizations Committee of the ABA Tax Section. Carol was the ABA Advisor to the Drafting Committee of the Uniform Prudent Management of Institutional Funds Act and was an ABA Advisor for the Model Entity Transactions Act Drafting Committee. She is past chair of the Nemours A.I. duPont Hospital for Children Planned Giving Committee and is a member of the Children's Hospital of Philadelphia Legacy Advisors Group and the Barnes Foundation Professional Advisors Council.

Kathryn S. Schultz, CPA, AEP

Kathy Schultz is Director/Chair of Corporate & International Services at Belfint, Lyons & Shuman, P.A. and specializes in providing intricate tax planning and compliance services for individuals, businesses, guardianships, estates and trusts and makes her clients feel comfortable by taking the time to explain each situation in order for them to gain an understanding of their financial situation. She frequently works with a diverse network of professionals, including local attorneys, to ensure her clients' estate and trust tax matters are properly handled. Kathy is instrumental in the firm's International Services team which assists with tax compliance and accounting services for international businesses and individuals. Kathy also assists clients with corporate service matters for Delaware investment holding companies.

Kathy is often asked to present at client, professional and business groups and writes articles about recent tax law changes, domestic and international tax matters and estate and trust planning.

Professional Affiliations

- American Institute of Certified Public Accountants
- Delaware Society of Certified Public Accountants
- Delaware Tax Institute
  - ~ Board Member (2010 – Present)
- Estate Planning Council of Delaware
- PrimeGlobal – International Tax Special Interest Group
- World Trade Center of Delaware
- Wilmington Tax Group
- Delaware State Board of Accountancy – Past Chair

Education

- University of Delaware – Graduated Cum Laude with a Bachelor of Science Degree in Accounting

Community Service

- Philadelphia Chapter and Board Member of the Delaware Chapter of the National Speleological Society o Treasurer of Philadelphia Chapter (2009 – 2015)
- Volunteer for the Delaware Division of Fish and Wildlife for the Department of Natural Resources and Environmental Control

Awards & Recognition

- Recipient of the AICPA and DSCPA’s 2011 Women to Watch for Established Leaders award
- Recognized in “Delaware Today” as a 2012 and 2013 FIVE STAR Wealth Manager

Eric Solomon, Esquire

With more than 40 years of tax experience in private practice and government service, Eric Solomon advises clients on a wide range of transactional tax and tax policy issues.

Prior to joining Steptoe, Eric served as co-director of Ernst & Young LLP's national tax department. Before Ernst & Young, from 2006 to 2009 he served as assistant secretary for tax policy at the US Treasury Department. In this role, he headed the Office of Tax Policy, which serves as the primary advisor to the Treasury secretary on legal and economic matters relating to domestic and international taxation.

Eric joined the Treasury Department in 1999 and served in both the Clinton and George W. Bush administrations. He was senior advisor for policy, deputy assistant secretary (tax policy) and deputy assistant secretary (regulatory affairs) before his confirmation as assistant secretary.

Eric is noted for his contributions in the field of tax law and policy. In recognition of his accomplishments at the Treasury Department, he received the Alexander Hamilton Award, the highest award for Treasury service, and the Distinguished Presidential Rank Award.

Prior to his service with the Treasury Department, Eric was a principal in Ernst & Young's national tax mergers and acquisitions group. Previously, he was assistant chief counsel (corporate) at the IRS, heading the IRS legal division responsible for all corporate tax issues. He began his career in private practice with law firms in New York and Philadelphia.

Eric is an adjunct professor of law at Georgetown University Law Center, where he teaches a course in corporate taxation. He received the 2012-2013 Charles Fahy Distinguished Adjunct Professor Award for Georgetown University's graduate law programs.

W. Donald Sparks II, Esquire

W. Donald Sparks II, Director of Richards, Layton & Finger, P.A., practices primarily in the areas of estate planning, estate administration, tax-exempt organizations and fiduciary litigation. He received his B.A. degree, *summa cum laude*, from Dartmouth College and his J.D. from Yale Law School where he served as a Senior Editor of the Yale Law Journal. He clerked for Judge Caleb Wright of the U. S. District Court for the District of Delaware. He is a fellow of the American College of Trust and Estate Counsel ("ACTEC"). He is a member of the Real Property and Trusts Section of the Pennsylvania Bar Association and the Tax and Estates and Trusts Sections of the American Bar and Delaware Bar Associations. He is a past chairman of the Delaware Bar Association Section of Taxation, a past Chairman of the Delaware Bar Association Estates and Trusts Section, and a past Chairman of the Estate Planning Council of Delaware, Inc. He is a frequent speaker and author on estates, trusts, and other tax-related topics having appeared for ACTEC, The University of Miami Estate Planning Institute, the Delaware Tax Institute and the Delaware Bankers Association Trust Conference. He has also served as a Board member and officer of numerous charitable organizations, including the Brandywine Conservancy & Museum of Art.

Kenneth W. Stewart, CPA

Caring and deeply committed to the firm clients for which he is responsible, Ken serves as a Tax Manager in the Wilmington office of Stephano Slack LLC. He assists clients with tax planning, consulting and advisory services for many situations, including: tax deferred exchange agreements; family income and asset shifting; taxation minimization; deferred compensation planning; education funding; individuals' asset acquisition and the attendant financing issues; charitable giving mechanisms; among others. A fan of straight talk and transparency, one of his mantras to clients is, "If you don't surprise me, I won't surprise you." Another passion of his is mentoring and empowering younger colleagues throughout his career to help them grow as professionals.

Ken is a CPA and earned his Bachelor of Business Administration from Wilmington College. In his spare time he volunteers with Immaculate Heart of Mary Church, helping deliver baked goods to a local soup kitchen and other tasks. His racquetball exercise has been replaced by training/chasing his energetic new English Springer Spaniel puppy while she treats his backyard as her personal race track. A devotee of this lovable breed, this is his third spaniel and he looks forward to (someday) walking her without a leash. In the meantime, they cheer on the 76ers together.

Leo E. Strine, CLU, ChFC, MSFS, MSM

Leo E. Strine is a Chartered Life Underwriter (CLU) and a Chartered Financial Consultant (ChFC), as well as a registered representative with Lincoln Financial Securities Corporation.

He has earned the degrees of Master of Science in Financial Services (MSFS) and Master of Science in Management (MSM) from The American College.

Leo has been in the financial services industry since 1975 and has held many leadership positions. He is past president and member of the National Association of Insurance and Financial Advisors – Delaware (NAIFA-DE) and its local association, NAIFA – NCC. He has served as past president of the Society of Financial Service Professionals (SFSP) Delaware Chapter and as past president of the Estate Planning Council of Delaware and is a member of the Wilmington Tax Group.

Leo is a PACE Emeritus member of the Professional Achievement in Continuing Education (PACE) program and has served on the national Board of Directors of the Society of Financial Service Professionals.

Leo has been a resident of Hockessin, Delaware since 1973.

Vincent C. Thomas, Esquire

When closely-held or public companies seek help in structuring transactions around tax, liability, business succession, and other corporate issues, they call on Vince Thomas to combine sophisticated counsel with sound and practical business judgment. As a partner with Young Conaway Stargatt & Taylor LLP, Vince's transactional skills, often in collaboration with the firm's bankruptcy group, are a unique and valuable complement to his long established practice representing institutional trustees and individuals in issues of Delaware trust and alternative entity law.

Adept at explaining intricate legal concepts in laymen's terms, Vince involves clients fully in the transaction process. In deals where a single word can have enormous future consequences, he meticulously presents his clients with every viable option, arming them with the substantive knowledge they need to make solid business decisions.

From the precise drafting of transaction documents to the complex tax planning and re-domestication of out-of-state trusts into Delaware, Vince immerses himself in the details and nuances, protecting his clients from unwarranted exposures as he guides their matters to successful resolution.

FOCUS:

- Counseling companies in complex business transactions, including, mergers, acquisitions, corporate restructurings, and financing transactions
- Counseling distressed companies on tax issues, Delaware corporate governance, and transactional matters
- Representing large businesses with general tax and transactional advice, including stock and asset purchase agreements, LLC agreements, partnership agreements, corporate charter documents and shareholders agreements.
- Combining tax, trust and transactional experience to advise distressed companies with liquidation structures

- Representing institutional trustees in all aspects of the administration of Delaware statutory and common law trusts, including, transfer of trust situs, trust reviews, tax planning, decanting, merger, and petitions in the Delaware Court of Chancery. This includes extensive experience with DING Trusts, Delaware asset protection trusts, Delaware dynasty trusts, Delaware statutory trusts, liquidating trusts, settlement trusts and other sophisticated tax planning structures.

Education

- Villanova University Charles Widger School of Law (LL.M.)
    - Tax
- Widener University Delaware Law School (J.D., *magna cum laude*)
    - (2nd in Class)
- University of Delaware (B.S.)

Bar Admissions

- Delaware

Distinctions

- American College of Trust and Estate Counsel, Member
- Named leading Delaware practitioner by *Chambers High Net Worth* since 2016
- Voted a top Delaware business attorney in the Delaware Today Magazine from 2015 through 2018
- Rated AV Preeminent by Martindale Hubble
- Recognized by *The Best Lawyers in America®*, Trusts and Estates, 2019

Memberships and Affiliations

- Served as the prestigious Wolcott Fellow for the Delaware Court of Chancery
- Served as a full time law clerk to Myron T. Steele, Chief Justice of the Delaware Supreme Court.

Clerkships

- Honorable Myron T. Steele, Supreme Court of the State of Delaware
- Honorable Stephen P. Lamb, Vice-Chancellor, Court of Chancery of the State of Delaware, Josiah Oliver Wolcott Fellowship Law Clerk

COURSE MATERIALS

2020 DELAWARE TAX INSTITUTE

December 9, 2020

2020 INCOME TAX DEVELOPMENTS

NOTABLE CASES IN FEDERAL INCOME TAX

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NOTABLE CASES IN FEDERAL INCOME TAX

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I. POLICY

Taxes on Exported Oil Held Unconstitutional

Trafigura Trading LLC v. U.S., No. 4:19-CV-170 (S.D. Tex. 9/8/20)

A district court held that the charge for exporting domestic oil under § 4611(b) is an unconstitutional tax and not a legal user fee when the charge is based on its proportion to the quantity of the oil exported and does not fairly match the use of the services for which the fee is imposed.

Under the Constitution, "No Tax or Duty shall be laid on Articles exported from any State." The Supreme Court has found this prohibition not to apply where the charge is actually a "legitimate user fee" The district court found that because the tax is based on the quantity of oil barrels exported and is not specifically tied to the exporter's use of the services, the Export Clause is violated.

Slander Claims Against IRS Agent Dismissed

Bolton, 125 AFTR 2d ¶2020-306 (5th Cir., 12/30/19)

The Fifth Circuit affirmed the dismissal of a lawsuit against an IRS agent who allegedly made slanderous statements about taxpayers during a media interview, in which the agent described their actions after their conviction, finding that the statements were made within the agent's scope of employment as a media representative for the IRS.

The Plaintiffs had stolen over $700,000 worth of food that was meant for inmates and used it in their restaurant and catering business. They were convicted of tax evasion and filing false tax returns. After their sentencing, a special agent, whose job included acting as an IRS media representative, told the press that the plaintiffs had stolen food, paid for by the taxpayers, that was meant to feed inmates at the Forrest County Jail, to use in their private restaurant and catering business and failed to report the value of the stolen food as income. Held, that part of his job was to engage with the media as a representative of the IRS.

IRS Properly Withheld Employee Names, Cellphone Numbers under FOIA

Smith, 125 AFTR 2d ¶2020-379 (DC Dist. Col. 01/23/20)

The IRS properly withheld the names and work cellphone numbers of IRS employees from its response to a researcher's FOIA request, the court holding that IRS employees have a privacy interest in protecting their names and their work cellphone numbers.

The IRS redacted the names of employees who participate in its "pseudonym program," which permits certain IRS employees to use pseudonyms to protect their personal safety, and who hold "sensitive" positions, and redacted the business cell phone numbers for all IRS employees. Held, the redactions were proper under FOIA Exemption 6, which covers information that would constitute an unwarranted invasion of personal privacy.

II. DEDUCTIONS, EXCLUSIONS AND INCLUSIONS

Treaties Do Not Exempt Gravel Mined on Seneca Land from Federal Taxation

Perkins v. Commissioner, No. 19-2481 (2d Cir. Aug. 12, 20200)

Treaties with the Seneca tribe do not create individualized exemptions from income taxes for income "derived from" Seneca land. The taxpayers argued that treaties entered in 1794 and 1842 provided that Seneca Nation land was exempt from tax and therefore, the gravel, as mined and sold on such land, is excluded from taxable income. The court rejected the taxpayers' argument, "because that view is premised upon the erroneous presumption that an exemption from federal taxes for income derived from land held in trust for American Indians extends to land that remains in the possession of the Seneca Nation of Indians."

Gambling Losses Sustained to Offset Winnings Eliminating Tax Liability

Coleman v. Commissioner, T.C. Memo 2020-146 (Oct. 22, 2020)

Gambling losses proven by a taxpayer and corroborated by a gaming expert that were held to eliminate gambling income that the IRS determined on substitute returns. The Taxpayer received a personal injury settlement of $150,000 and had $350,000 of gambling winnings. An expert in the gaming industry presented evidence asserting that Taxpayer suffered gambling losses that with 99 percent certainty would have offset his winnings.

Processed Seismic Data Is Not Qualified Production Property

TGS-NOPEC Geophysical Co. & Subs., (2020) 155 TC No. 3 (Aug. 26, 2020)

Leasing of collected marine seismic data to help the oil and gas industry determine where to drill wells qualifies for the § 199 deduction as an engineering service with respect to the construction of real property, but not as tangible property or sound recordings. A taxpayer is in the business of acquiring, processing, and licensing marine seismic data. The processed data is saved on magnetic tape. A data order from a client would be copied and delivered to the client on a CD, DVD, computer tape, or some other tangible medium, which the purchaser would use to load the data onto its own computer system. Taxpayer earned revenue by licensing the processed seismic data to companies in the oil and gas industry. Taxpayer argues that the seismic data is (1) qualified production property as tangible personal property or sound recordings or (2) an engineering service performed in the United States with respect to the construction of real property in the United States. Held: the seismic data, by its nature, is intangible, and the fact that it is delivered to Taxpayer's clients on a tangible medium does not transform the data into a tangible item. Data, as such, is inherently intangible.

Cancellation of Debt to Help Purchase Home Includible in Income

Weiderman v. Commissioner, T.C. Memo 2020-109 (July 15, 2020)

Forgiveness of a loan provided to a taxpayer from her employer to help purchase a home, but not secured by the property, was not excludible from income under principal residence debt exception. The Taxpayer received a $500,000 loan from her new employer to help finance the purchase of a home. The note did not memorialize that the loan was secured by the property. After the Taxpayer's employment ended, she agreed with the former employer to cancel a portion of the debt. New promissory notes were established and ultimately a portion was cancelled too. Because the debt was not secured by the property and properly recorded, the debt was unsecured debt and could not be considered acquisition debt for the principal residence debt exclusion.

Employee Not Entitled to Deduct Expenses; Didn't Request Reimbursement

Armstrong v. Commissioner, T.C. Summ. Op. 2020-26 (Sept. 17, 2020)

A sales representative who didn't submit her expenses to her employer was not entitled to deduct them as unreimbursed business expenses. In order to deduct unreimbursed business expenses, a taxpayer must not have had the right to obtain such reimbursement from her employer, which Taxpayer didn't establish to be the case. "The record further reflects that petitioner was entitled to reimbursement of her business expenses pursuant to her employee business expense reimbursement policy." Taxpayer testified that she did not request reimbursement for her business expenses because they might not be accepted by her employer.

Accountant's Malpractice Payment to Settle Increased Tax Liability Includible

McKenny v. United States, No. 2:16-cv-00536-PAM-MRM (11th Cir. Sept. 1, 2020)

Where accounting malpractice was related not to the preparation of a tax return but to the structuring of an underlying transaction, a payment in settlement of a taxpayer's extra tax liability was includible in income. The accountants recommended that Taxpayer structure his consulting business as an S corporation wholly owned by an ESOP where Taxpayer would be the sole beneficiary, so the income would pass through the S corporation without being subject to corporate income tax, then accumulate tax-free in the ESOP until it made distributions to Taxpayer. However, the accountants failed to properly set up the S corporation and the ESOP. This strategy was lawful until 2004 when § 409(p) was enacted. Taxpayer argued that the payment was a return of capital, lost because of the accountant's negligence. The court held that where accounting malpractice is related not to the preparation of a tax return but to the structuring of an underlying transaction, a payment in settlement of a taxpayer's extra tax liability is includible in income.

Cash Grant in Lieu of Energy Credit Based on Actual Use of Property

WestRock Virginia Corporation, 124 AFTR 2d ¶2019-5415 (CA Fed, 11/4/2019)

A Treasury Department grant under § 1603 of the 2009 recovery act, coinciding with the § 48 energy credit, was reduced because the generator (for which the grant was based on) was only partially used to create electricity. Held that the statute unambiguously allows Treasury, in calculating the amount of the grant under the statute, to reduce the basis of qualified property in proportion to its use in a qualifying activity.

III. REAL ESTATE

Enforcement of Tax Liens Allows Collection of Rents

United States v. Jhun, No. 2:19-cv-01749-APG-EJY (D. Nev. Oct. 28, 2020)

The purchaser of property subject to tax liens was ordered to provide the United States with an accounting and to pay any excess proceeds to the government. When indebted to the United States for tax liabilities, homeowners' property was sold at a foreclosure sale. The new owner rented the property. The court previously held that purchaser owned the property subject to the tax liens. Because the government is owed $97,000 and the purchaser only paid $4,000 and is entitled to excess proceeds, the government would be prejudiced if it were not allowed to enforce its tax liens.

Modified AGI for Passive Loss Purposes Includes Retirement Distributions

Sharma v. Commissioner, T.C. Memo 2020-147 (Oct. 29, 2020)

Passive activity loss modified adjusted gross income calculation was held to include retirement distributions, which, as applied, phased out the taxpayers' ability to claim passive rental real estate losses.

Failure to Establish Basis in Rental Property Denies Loss Deduction

Duffy v. Commissioner, T.C. Memo 2020-108 (July 13, 2020)

Taxpayers had rented the property to family and friends. After a default, the Taxpayers' mortgagor accepted $750,000 in full satisfaction of the loan. Taxpayers reported the loss upon the sale of the property and income from the cancellation of indebtedness. Because Taxpayers did not establish that the adjusted basis of the rental property upon its sale exceeded the amount realized, the IRS properly disallowed the loss deduction.

IRS Improperly Levied Property Belonging to Decedent's Children

Goodrich, 125 AFTR 2d ¶2020-558 (DC LA 3/17/2020)

The IRS improperly levied property belonging to a decedent's children. The decedent held a life estate under Louisiana usufruct law in certain property that was willed to the children by their mother and decedent's interest in that property ended when he died. Therefore, the children were entitled to get that property back.

IV. EXEMPT ORGANIZATIONS AND THE CHARITABLE DEDUCTION

Donee's Redemption of Stock After Donation Doesn't Disqualify Charitable Deduction

Dickinson v. Commissioner, T.C. Memo 2020-128 (Sept. 3, 2020)

A charitable deduction was allowed where the taxpayer first donated appreciated stock in a closely-held business to a donor-advised fund that then redeemed the stock in what may have been a prearranged transaction. Citing *Humacid Co. v. Commissioner*, 42 T.C. 894 (1964), the court said it will respect this kind of transaction if the donor (1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale.

Conservation Easement Deduction's Judicial Extinguishment Regulation Held Valid

Oakbrook Land Holdings, LLC, 154 TC No. 10 (5/12/2020)

Regs. § 1.170A-14(g)(6), the conservation easement deduction's judicial extinguishment regulation, was held properly promulgated properly under the Administrative Procedure Act and is a valid interpretation of § 170(h)(5)(A)'s protection in perpetuity requirement in accordance with the *Chevron* doctrine. The regulation states, "If a subsequent unexpected change" in the property conditions "can make impossible or impractical the continued use of the property for conservation purposes," these purposes are still "protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds... from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent" with these purposes; and "At the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right... with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time.... [The donor must also agree that the] proportionate value of the donee's property rights shall remain constant.... [And when the unexpected change occurs, the donee] must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction."

Right to Build Held Not to Disqualify Conservation Easement

Pine Mountain Preserve, LLLP 126 AFTR 2d ¶2020-5400 (CA 11 10/22/2020)

The 11th Circuit reversed a Tax Court decision that a reserved right to build residential units on land that is part of a conservation easement disqualified the conservation easements from being "granted in perpetuity" under § 170(h)(2)(C). The easement included a carve-out for 16 reserved building areas, within which the Taxpayer could construct a single-family residence. The Tax Court, agreeing with the IRS, held that the reserved rights to build residential units and other structures disqualified the conservation easements from being "granted in perpetuity." On appeal, held that§ 170(h)(2)(C) means that to qualify for a deduction, a conservation easement must grant "a restriction" (meaning at least one) on the use to which the subject property can be put, and must do so "in perpetuity," as that term has traditionally been used and understood in common-law practice. An easement granted in perpetuity over a defined conservation area clears § 170(h)(2)(C)'s relatively low threshold, even if it reserves targeted development rights for home-site construction.

V. PARTNERSHIPS

Sham Determination Is Partnership-Level Item

Full-Circle Staffing, L.L.C. v. Commissioner, No. 18-60814 (5th Cir. Oct. 23, 2020)

The determination of whether partnerships should be disregarded for tax purposes is a partnership-level issue that cannot be litigated during an individual partner's case. Partner appealed the Tax Court decision finding partnerships he controlled as shams and making him liable for the income taxes, pointing to the partnership's amended tax filings. Consideration of amended tax returns of partnerships as relevant to factual and legal determinations about the partnerships' income and the tax liability of their partners is a partnership-level issue, the court concluded in dismissing the appeal for lack of jurisdiction.

Partner Couldn't Challenge Adjustments in Collection Due Process Hearing

Davison, (CA 5 2/7/2020) 125 AFTR 2d ¶2020-441

A second-tier partner couldn't challenge, in a collection due process hearing, computational adjustments resulting from the audit of a first-tier partnership return. The second-tier partner had an opportunity to challenge the adjustments when the IRS issued the final partnership administrative adjustments to the second-tier partnership. The Tax Court agreed with the hearing officer, holding that the Taxpayer was precluded from challenging the tax liability related to the FPAA in his CDP hearing because he could have disputed the liability by challenging the FPAA when it was issued. The holding was affirmed.

Partners' Agreements to Extend Assessment Period Applied to Partnership Items

Who515 Investment Partners 124 AFTR 2d ¶2019-5389 (CA Dist Col 10/25/2019)

A tax matters partner's agreements to extend the assessment limitations period for the tax year ended December 31, 2000, applied to items from the partnerships whose tax year ended December 19, 2000. The tax matters partners for two partnerships signed Forms 872-I, which extended to June 30, 2005 the limitations period for assessing tax attributable to any partnership items. Earlier, but after the ordinary three-year limitations period for submitting an FPAA, the IRS issued FPAAs with proposed adjustments for the two partnerships. The partnerships argued that the proposed adjustments were time-barred because the partnerships had tax years ending on December 19, 2000, and the Forms 872-I applied to returns for the period ended December 31, 2000. Held, the signed Forms 872-I extended the assessment period for the partners' individual returns, and extended the assessment period for partnership items from the partnership's tax year that ended December 19, 2000, as well as the partnerships with tax years that ended within that tax year. Therefore, the partners were required to report their distributive shares of the partnerships' gains and losses on their individual returns for the tax year that ended on December 31, 2000.

VI. CORPORATIONS

Supreme Court: State Law Governs Allocation of Refunds from Consolidated Returns

Rodriguez v. Federal Deposit Insurance Corporation, 140 S. Ct. 713 (2020)

The Supreme Court unanimously ruled that state law determines who is entitled to a refund of federal taxes received by a common parent of an affiliated group in absence of a formal or implicit agreement. The court struck down the federal common law principal known as the Bob Richards rule that provided that the refund is presumed to belong to the member whose income and losses generated the refund.

Treasury Regulations say little about how the members of a consolidated group should allocate a refund. Many corporate groups have developed tax allocation agreements that specify what share each member will pay, and what refund each will receive. In *Bob Richards Chrysler-Plymouth Corp., Inc.* (1973), the Ninth Circuit stated that in the absence of a tax allocation agreement, a refund belongs to the group member responsible for the losses that led to it

The Supreme Court has now held that the Bob Richards rule is not a "legitimate exercise of federal common lawmaking" and has struck it down, holding that state law is better-equipped than judge-made federal common law to handle disputes involving corporate property rights, even in cases, like this one, that involve federal bankruptcy and a tax dispute.

No Deduction for Parent's Transfer to Russian Subsidiary

Baker Hughes Incorporated, (CA 5 11/21/2019) 124 AFTR 2d ¶2019-5466

An American parent company was denied a deduction, either as a bad debt or as an ordinary business expense, of a $52 million payment that it made to its Russian subsidiary to keep the subsidiary, for which it guaranteed performance on a service contract, from being liquidated under Russian law. The Taxpayer argued that courts have allowed corporations to deduct as bad debts payments that were made to discharge a guarantee and that under Reg §1.166-9(a)) a payment made by a taxpayer in discharge of all or part of the taxpayer's obligation as a guarantor is treated as a business debt and is deductible under § 166. The court held that under the facts of the case, the payment was more in the nature of equity. There was no documentation evidencing a loan, no provision for or expectation of repayment of principal or interest, and no way to enforce repayment. Instead, the operative agreement stated clearly and succinctly that it was "free financial aid" that would not be repaid.

Nonstock, Nonprofit S Corporation Does Not Have Owners, Shareholders

Deckard v. Commissioner, 155 T.C. No. 8 (Sept. 17, 2020)

A director of nonprofit, nonstock S corporation was held not to have beneficial ownership allowing losses to pass-through to his individual tax return. On its Form 2553, the S corporation identified an individual as its 100% owner – but under state law, the nonstock, nonprofit corporation, could not issue stock nor pay earnings. There is no interest in a nonprofit corporation equivalent to that of a stockholder in a for-profit corporation who stands to profit from the success of the enterprise, the court determined. The corporation's not to obtain federal tax-exempt status has no bearing on its corporate status under state law.

VII. CAPITAL GAIN AND BASIS

Newport Mansion That Was Never Rented Is Considered Capital Asset

Keefe v. Commissioner, No. 18-2357-ag (2d Cir. July 17, 2020)

Failure to engage in "regular and continuous" rental activities on an historic mansion negated the taxpayers' claim they were operating a trade or business eligible for ordinary loss treatment. The taxpayers took six years to rehabilitate property and sold it at a loss. Taxpayers never rented the property although they engaged a broker during construction. The IRS denied the ordinary loss treatment and the Tax Court agreed. Taxpayers contended that they used the house in a rental trade or business despite never having rented it, and that they therefore incurred an ordinary loss, rather than a capital loss, on its sale. The Taxpayers did not perform regular and continuous rental activities. Taxpayers engaged in more time trying to sell the property than rent it.

Corporation Could Not Claim Ordinary Loss Deduction for Worthless Securities

MoneyGram International, Inc. v. Commissioner, 153 T.C. 185 (December 3, 2019)

A corporation was held not to qualify as a bank and therefore was ineligible to claim an ordinary loss deduction on the disposition of worthless asset-backed securities. The taxpayer was a money services business which dealt mainly with money transfers, money orders and payment processing services. The Code allows bad debt deductions on losses realized based on the worthlessness of securities if the taxpayer is a "bank" under Section 581. The Tax Court said the taxpayer didn't meet the code section's third requirement to qualify as a bank—that a business must consist in substantial part of receiving deposits and making loans and discounts.

State Cash Grants for Relocation Program Are Income, Not Contributions to Capital

Commissioner v. BrokerTec Holdings, Inc., No. 19-2603 (3d Cir. July 28, 2020)

State cash grants to entice businesses to moving into the state that did not restrict how the cash could be used and amounts calculated based on the amount of income tax revenue that the new jobs would generate were held to be taxable income, not contributions to capital. The Third Circuit reversed the Tax Court.

The taxpayer's office space in and near the World Trade Center was destroyed on September 11, 2001. The taxpayer negotiated to move its offices to New Jersey with the state offering cash grants under a program to attract businesses. The taxpayer excluded the grant amounts on its returns, arguing that they were nontaxable, non-shareholder contributions to capital. Held: to be a non-shareholder contribution to capital, even a relocation inducement "must become a permanent part of the transferee's working capital structure," the court held in citing Supreme Court precedent. In determining whether a transfer is income or a contribution to capital, considerations include "the intent or motive of the transferor," not "the use to which the assets transferred were applied," the court reasoned. Thus, cash grants provided with no restriction as to their use, fails the test to be a nontaxable contribution, the court explained. The cash grants cannot be used to pay dividends or operating expenses, the court continued.

Lower Tax Basis Upheld Due to Market Value Method Being Only Viable Option

Lucero v. United States, No. 17-1065 JCH/JFR (D.N.M. Oct. 27, 2020)

The market value method was properly used to calculate a lower basis on non-publicly traded stock received in wrongful termination settlement from a corporation under severe financial distress. Due to the corporation's severe lack of cash flow and massive debt, its inability to pay dividends for the foreseeable future, and the absence of a contractually guaranteed price or a court precedent, the only viable valuation approach that remained was a market analysis of similar companies.

VIII. BANKRUPTCY

District Court Retains Jurisdiction Over Tax Liability After Bankruptcy Case Ends

Kerger v. United States, No. 3:17CV00994 (N.D. Ohio July 21, 2020)

In proceedings to determine whether a debtor owes a tax debt, jurisdiction remained with the district court rather than transferring to a bankruptcy court. Debtor requested a declaratory judgment that he owed no federal tax on estoppel grounds due to a government official stating such. The government countered by reducing the tax debts to judgment. The court noted that issues that a bankruptcy court could resolve would be core proceedings or "related to" (non-core) proceedings. The court found that because the declaratory judgment request was at best tenuous to the debtor's bankruptcy case, it would retain jurisdiction.

Individual Mandate Held Not "Excise Tax on Transaction"

In Re: Chesteen, Jr., (CA 5 2/20/2020) 125 AFTR 2d ¶2020-464

The individual mandate tax imposed under § 5000A on individuals who don't have health insurance was held not to be an "excise tax on a transaction" entitled to priority as a tax under the Bankruptcy Code. The appeals court said that, based on the dictionary definition of excise tax, to be an "excise tax on a transaction," the individual mandate tax would have to be imposed only when an individual, for example, used healthcare services while lacking qualifying health insurance. But, the individual mandate applies even when an individual engages in no activity. Therefore, it cannot be an "excise tax on a transaction" entitled to priority under 11 USC 507(a)(8)(E)(I).

Multimillion-dollar Tax Liability Affirmed as Nondischargeable

Feshbach, (CA11 9/9/2020) 126 AFTR 2d ¶2020-5258

The Eleventh Circuit affirmed that a couple could not discharge in bankruptcy their multimillion-dollar tax liability because the couple willfully attempted to evade or defeat their tax debt. Under 11 USC §523(a)(1)(C), there is no discharge "for a tax with respect to which the debtor... willfully attempted in any manner to evade or defeat such tax." The appeals court found that the taxpayers made inadequate and unrealistic offers-in-compromise given their income and spending; they used the offer-in-compromise process to delay the collection of their taxes; they only offered to sell their home in Florida to delay the collection of their tax debt; there were vast disparities between the income they reported on Forms 433-A and the income they actually earned.

IX. EMPLOYMENT AND PAYROLL

Trust Fund Recovery Penalty is Penalty, Not Tax

Chadwick v. Commissioner, 154 T.C. 84, 154 T.C. No. 5 (2020)

The Tax Court determined that a trust fund recovery penalty is a penalty, not a tax. Therefore, it is subject to the requirement under § 6751(b)(1) that written supervisory approval be secured for the initial determination of its assessment. (A district court has held otherwise. *Rozbruch*, 114 AFTR 2d 2014-5093.

The Tax Court, which had not previously resolved this question, examined the plain meaning of § 6751(b)(1), which provides that no penalty can be assessed unless the initial determination to assess the penalty receives the requisite supervisory approval. Section 6672(a), which authorizes the assessment of TFRPs, provides that a responsible person who fails to collect or pay over any tax is liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. The Court concluded that the plain text of § 6672(a) indicates that a TFRP is a "penalty."

Firm Controlling Payment of Wages Is Entitled to FICA Tip Credit

TriNet Group, Inc. v. United States, No. 19-10997 (11th Cir. Nov. 5, 2020)

A statutory employer was entitled to claim the FICA tip credit because it, not it, not its clients controlled the payment of the wages subject to withholding. A professional employer organization provided employment and human resource services to its clients, including payroll processing. Its clients included restaurants where tipping is customary. The organization paid the clients' payroll from its bank accounts, and claimed tax credits based on its payment of FICA taxes on the tip income of its client companies' employees under § 45B. The IRS asserted that such credits were not allowed because that entity was not the "employer" entitled to claim the credits as that term is defined in Section 3401(d). Held that the organization was entitled to claim the FICA tax credits because it, not its client companies, had "control of the payment of such wages." The person who is entitled to claim the FICA tip credit must be the same person who is responsible for withholding FICA taxes from wage payments. Only one entity under § 3401(d) can be the employer as the option between a common-law employer and a statutory employer is mutually exclusive. The parties' contract is taken into account in determining who is the employer.

Health Trust Plan Considered Listed Transaction, Penalties Upheld

Turnham v. Commissioner, No. 19-12875 (11th Cir. Nov. 6, 2020)

A physician failed to include contributions to a health and welfare trust plan, listed as a reportable transaction, on his return. The plan invested in the equivalent of universal life insurance contracts, the employer contributions were large compared to the cost of insurance, and the trust owned the insurance contracts, as well as other similarities to listed transactions contained in IRS Notice 95-34, the appeals court held. The subject Plan is at a minimum "substantially similar" to the listed transaction described in the IRS Notice, in that the doctor was required to disclose his participation in it, as IRS regulations dictate. Because the doctor failed to report the transaction, penalties were applicable.

X. RETIREMENT PLANS

Garnishment of IRA Not Subject to Limit on Garnishment of Earnings

Berry, (CA 5 2/28/2020) 125 AFTR 2d ¶2020-497

Garnishments against an IRA were not limited by the Consumer Credit Protection Act to 25 percent of the account value, because the IRA funds to be garnished were not compensation for personal services.

Federal law provides for restitution to victims of federal crimes, with a lien on a criminal defendant's property. The Consumer Credit Protection Act sets a maximum rate of garnishment at 25% of "earnings for that week." The taxpayer was convicted of, wire fraud, mail fraud and falsifying a tax return, in connection with theft of funds from her employers. As part of her sentence, she was ordered to pay restitution of $2 million. To enforce the judgment, the government applied, for a writ of garnishment against 50 percent of the account value of the IRA held by the defendant's husband, who had established the IRA after rolling over assets from his employer's retirement plan. IRAs are community property in Texas, sand the spouse of an IRA owner has a 50 percent community property interest in the IRA.

The Fifth Circuit agreed with the district court that the garnishment was not limited by the CCPA, because to be "earnings" under the CCPA, retirement fund payments, "as much as anything," must be "compensation paid or payable for personal services." Even if husband's or his employer's payments into his retirement plan at work might have been "earnings" when the payments were made, he is no longer covered by that plan because, upon retirement, Michael rolled over the retirement plan in a lump sum to an IRA. He was not required to receive periodic payments from the IRA as he would have been from his employer plan, and after his cash-out and deposit into the IRA, a lump-sum payment from the IRA would not be compensation paid for personal services. The court concluded that because the funds to be garnished were not compensation paid for personal services, they were not "earnings" and that the CCPA's limit on garnishment did not apply.

IRA Distribution for Disabled Spouse of IRA Owner Subject to 10% Additional Tax

Merrell, TC Summary Opinion 2020-5 (January 16, 2020)

The disability exception to the 10% additional tax on certain IRA distributions was held not to apply when the IRA owner's spouse was disabled, not the owner himself. In general, § 72(t)(1) imposes an additional tax of 10% on IRA distributions, but it does not apply to a distribution that is attributable to the employee's being disabled. In the case of an IRA, the term "employee" is defined in § 72(t)(5) as "the individual for whose benefit such plan was established." The Tax Court held that, because § 72(t)(2)(A)(iii) specifically requires that a distribution be attributable to the employee's disability for the exception to the 10% additional tax to apply, the exception did not apply here because it was not the IRA owner that was disabled, but his wife.

SEP-IRA Distribution Proceeds Includible When Recipient Has Unfettered Control

Ball v. Commissioner, T.C. Memo 2020-152 (Nov. 10, 2020)

A SEP-IRA recipient's unfettered control of distributed funds required inclusion of income where recipient could not prove he was acting as mere conduit for the IRA's custodian when the funds were loaned out to a third party. The Taxpayer directed the SEP-IRA custodian to distribute funds from his account to his single-member LLC, which lent the funds as real estate loans, on behalf of SEP-IRA. The loans were repaid and Taxpayer deposited the all the repayment checks into the SEP-IRA as either rollover contributions or current-year contributions. Taxpayer did not report the distribution as gross income nor taxes due on the distributions. Taxpayer claimed he was acting as an agent or conduit on behalf of the IRA's custodian to carry out an investment. Taxpayer's unfettered control of the SEP-IRA distribution and lack of evidence that he acted as a conduit or agent of the IRA custodian with respect to the distributed funds requires the distribution to be includible in income, the court held.

Listed Transaction Notice for Welfare Benefits Plans Scrutinized Under APA

Mann Construction, Inc. v. United States, No. 20-11307 (E.D. Mich. Oct. 20, 2020)

Issuance of a tax-shelter disclosure notice, while possibly requiring a notice and comment period, was within the IRS's authority. Taxpayers established a trust to fund whole life insurance for key employees, taking the position that because there was a substantial risk of forfeiture, the premium was includible in income and deductible by the S corporation. IRS Notice 2007-83 states that such arrangements are a form of tax avoidance and must be reported as a listed transaction. The Taxpayers argued that the notice violated the Administrative Procedures Act and that the plan was not a listed transaction. Held, the IRS has a rational and statutorily-grounded interest in monitoring transactions with the potential to abuse the Code and Taxpayers offered no support for the proposition that a reporting regime that sweeps more broadly than strictly necessary is arbitrary and capricious.

XI. ACCOUNTING

Supreme Court Declines to Review Decision Upholding Cost-Sharing Regulations

Supreme Court Docket 19-1009, Altera v. Commissioner (June 22, 2020)

The Supreme Court declined to review a Ninth Circuit decision upholding the IRS's 2003 cost-sharing regulations. Reversing the Tax Court, the Ninth Circuit upheld the validity of a regulation under § 482 that requires controlled entities entering into qualified cost-sharing agreements to share stock-based compensation costs. Under § 482, in a transfer of intangible property between controlled entities, the IRS may make allocations to prevent evasion or to clearly reflect income. To achieve a clear reflection of each entity's income, the IRS considers what each entity's income would be had the controlled entities been dealing at arm's length. Under regulations issued in 2003, controlled participants must share intangible development costs in proportion to their share of reasonably anticipated benefits. Reg. § 1.482-7A(d)(2)(ii) requires controlled parties entering into such agreements to share compensation costs of restricted stock, non-statutory stock options, statutory stock options, stock appreciation rights, and phantom stock. The Ninth Circuit held the regulations did not exceed the authority delegated under § 482, which Treasury reasonably interpreted as an authorization to require internal allocation methods, provided that costs and income allocated are proportionate to the economic activity of the related parties. The regulations reasonably achieved the results required by the statute and were entitled to deference under *Chevron*.

Reallocation of Coca-Cola's Transfer Pricing Upheld

The Coca-Cola Co. & Subs. v. Commissioner, 155 T.C. No. 10 (Nov. 18, 2020)

The Tax Court upheld transfer pricing reallocations in which the IRS used a comparable profits method with third-party suppliers as the tested parties, the U.S. The taxpayer had agreements with third parties around the world to use its intellectual property to bottle and sell its products. Those supply points paid dividends to satisfy their royalty agreements. The taxpayer and the IRS had a 10-50-50 transfer pricing methodology agreement in place for 1987-1995, and continued that methodology after 1995. The taxpayer selected a "dividend offset" treatment on its 2007-2009 returns, but did not include explanatory statements required by Rev. Proc. 99-32. On examination, the IRS determined that Taxpayer's methodology did not reflect arm's-length norms because it overcompensated the third parties and under-compensated Taxpayer for the use of its IP. The IRS reallocated income between the Taxpayer and the supply points, using a comparable profits method that used the taxpayer's unrelated bottlers as comparable parties, thereby increasing Taxpayer's income by $9 billion. Held, the IRS did not abuse its discretion under § 482 by reallocating income to C by employing a method that used the supply points as the tested parties and the bottlers as the uncontrolled comparable. The Service was not bound to the closing agreement after 1995. Despite not filing the required statement, the court found that C substantially complied with the requirements. Not filing the statements considered harmless error as C did timely elect its Section 482 treatment on its tax returns.

XII. PROCEDURE

Underpayment Exists Where Refund Applied to Following Year's Estimated Taxes

Goldring v. United States, No. 18-10756 SECTION: T (E.D. La. Sept. 28, 2020)

Underpayment interest was held to be properly assessed, as a taxpayer's election to apply an overpayment to the following tax year's estimated tax negated giving the IRS control over the funds. Taxpayers' overpayment arose from an IRS assessment where a court ruled in favor of Taxpayers that interest awarded to Taxpayers in an appraisal rights lawsuit was as ordinary income rather than capital gain. This created an underpayment of taxes. Taxpayers claimed that assessed interest was improper because the IRS possessed and controlled enough of Taxpayers' overpayment of funds to satisfy the underpayment and suspended the accrual of interest. The court held that the IRS did not possess nor exercise unfettered control over Taxpayers' overpayment funds. Because Taxpayers' 2010 tax return elected to apply all overpayments to 2011's estimated taxes, Taxpayers' 2011 estimated taxes were deemed paid by Taxpayers' 2010 overpayment credit. Upon payment of Taxpayers' 2011 estimated tax, the credit elect overpayment leftover from 2010 moved into 2011. The overpayment was no longer available to offset Taxpayers' 2010 underpayment, and therefore, did not suspend interest accruing on the underpayment, until paid.

Collective Entity Doctrine Applies to Trusts

Fridman, (CA 2 9/9/2020) 126 AFTR 2d ¶2020-5257

The collective entity doctrine, which says that a custodian of a collective entity cannot invoke the Fifth Amendment with regards to the collective entity, was held to apply to trusts. Thus, the trustee of a trust could not invoke the Fifth Amendment after the IRS subpoenaed trust documents.

The Fifth Amendment's protection against self-incrimination has been applied to permit a person to claim a Fifth Amendment privilege against producing subpoenaed documents. But the Fifth Amendment act of production privilege is limited. Under the "collective entity doctrine," a custodian holding a collective entity's records in a representative capacity generally cannot refuse to produce documents. A "collective entity" has been defined as "an organization which is recognized as an independent entity apart from its individual members." For example, a corporate officer cannot use the privilege to justify a refusal to produce the corporate books and records in response to a grand jury subpoena to the corporation.

The court held that a trust is a collective entity. The trust has a separate legal existence from the trustee. A trust represents a formal institutional arrangement, governed by the trust agreement and legal duties. And a trust's records are distinct from the personal books and records of the trustee. Since the collective entity doctrine applied to the trust, the trustee had to produce the subpoenaed documents

Tax Court Can't Issue Subpoena to Require Document Production Prior to Trial

Johnson v IRS, Tax Court Docket No. 17324-18

The Tax Court has determined that it does not have the authority to issue a subpoena to a third party requiring the party to produce documents prior to the date for which a trial had been set.

The Tax Court has statutory authority to compel, by means of a subpoena, the attendance and testimony of witnesses, and the production of all necessary returns, books, papers, documents, correspondence, and other evidence, from any place in the U.S. at any designated place of hearing. § 7456(a)(1).

In a case scheduled for trial, involving a cancellation of debt deduction related to a taxpayer's stolen credit card, the IRS filed a motion asking the Court to permit the IRS to issue a subpoena directing the bank that issued the taxpayer's credit card to produce documents to the IRS prior to the trial date. The taxpayer did not oppose the IRS's motion.

The Tax Court denied the IRS's motion. Given the wording in § 7456(a)(1) that the Court can authorize a subpoena "at any designated place of hearing," the Court found that the Code does not give it authority to issue a subpoena that requires a third party to produce documents prior to the hearing

IRS Can't Offset Overpayment Made by Person Other than Taxpayer

Laird, (CA 5 10/28/2019) 124 AFTR 2d ¶2019-5394

The IRS cannot offset an overpayment made by a person for tax liability of another taxpayer.

Generally, the IRS must follow a taxpayer's written instructions as to how a payment should be applied. Rev. Proc. 2002-26. But the IRS also has a statutory right of setoff. In general, in the case of any overpayment, the IRS may credit the amount of the overpayment against any liability in respect of a tax on the part of the person who made the overpayment. § 6402(a). The 11th Circuit has held that the right of setoff overrules the voluntary partial payment rule.

The owner of a tax-delinquent corporation sent the IRS a cashier's check, showing the owner as the remitter, accompanied by a note say that the IRS should use the funds only to pay the corporation's employment taxes. After the IRS received the check, it determined that the amount of employment taxes that the corporation owed was less than what the owner sent. He asked for a refund, but the IRS applied the overpayment to offset the corporation's non-employment taxes.

Held, when the person who made the overpayment is different from the person who owed the taxes, § 6402(a) does not permit the IRS to offset one person's tax debt with another person's payments.

Disclosures to Non-Third-Party Recordkeepers Violated Statute

Williams Development & Construction v. U.S. 4:18-CV-4033-LLP (D.S.D. 10/8/2020)

Disclosing a taxpayer's taxpayer identification number to non-third-party record keepers during a criminal investigation violates § 6103. In investigating Taxpayer, taxpayer's wife, and his businesses for tax crimes, the IRS issued summonses to financial institutions and other businesses, with Taxpayer's name, address and taxpayer identification number in the summonses. In many instances, the recipient was already in possession of the tax ID. Taxpayer sued under § 7431 for unauthorized disclosure of his tax ID and that Taxpayer was under criminal investigation in violation of Section 6103. The IRS countered, in a motion to for summary judgment, that Section 6103 authorizes the disclosures under the investigatory purpose exception. Disclosure by an IRS criminal investigation agent of a taxpayer's tax ID to a non-third-party record keeper was not considered a necessary disclosure in order to obtain the records sought, the court held. However, disclosure to the financial institutions, as third-party record keepers, was permitted as a legitimate purpose of the investigation to specifically identify accounts of a person with a rather common name. The IRS agent went beyond the guidelines in only speculating that other businesses would need the tax ID for their records.

Unlimited Collection Statute for False Returns Overrides Any Enforceable Extension

DiPierdomenico v. United States, No.19-CV-0854(JS)(ARL) (E.D.N.Y. Nov. 13, 2020)

When a false or fraudulent return is filed, the IRS can collect the taxes at any time, even if a closing agreement extending statute of limitations is enforceable. The Taxpayer, represented by counsel, pled guilty to filing false and fraudulent tax returns. Taxpayer agreed to pay the appropriate amount of tax due for the years at issue. A few years later, IRS agents came to Taxpayer's house to have him sign, without his counsel present, a "closing agreement" for the tax years under the criminal conviction. The IRS then made erroneous refunds to Taxpayer. The closing agreement waived the statute of limitations and restored the tax years for collection. Taxpayer paid the taxes and sued for a refund claiming that the collection notices and closing agreement were void because the IRS violated tax regulations and bypassed his counsel. Taxpayer also argued that he was coerced into signing the agreement and the general three-year collection statute should apply. Filing a false or fraudulent statement allows the IRS to collect the taxes at any time, the court held. Even acknowledging the IRS's conduct in procuring the closing agreement, Taxpayer cannot contractually waive a limitations period that does not exist, the court concluded. As such, the IRS acted within its authority to assess and collect Taxpayer's tax liabilities beyond the three-year statute of limitations. Because Taxpayer should have known he owed the complete taxes due, his reliance on the IRS's statements were unreasonable and do not justify equitable relief.

Jurisdiction for Appeal Is Taxpayer's Residence When Petition Filed

Hahn v. Commissioner, No. 19-1228 (D.C. Cir. Oct. 13, 2020)

The legal residence of a taxpayer when a Tax Court petition was filed is the proper venue for an appeal and a transfer of venue is inappropriate when a taxpayer doesn't identify an error in the court's findings on appeal. Taxpayer filed an appeal in the District of Columbia Circuit from the Tax Court's dismissal for lack of jurisdiction her petition disputing an alleged notice of deficiency and an alleged notice of determination concerning an IRS collection action for several tax years, and her motion to vacate. Taxpayer did not dispute that her legal residence was in Indiana which is within the Seventh Circuit Court of Appeals. Proper venue for appellate review is the United States Court of Appeals for the circuit encompassing appellant's legal residence at the time the Tax Court petition was filed, the appeals court found. Therefore, Taxpayer filed her appeal in the wrong circuit, the court determined. The court noted it has the inherent authority to transfer cases over which it lacks venue, however transfer was not appropriate because Taxpayer did not identify any error in the Tax Court's findings for lack of jurisdiction.

Summonses Investigating Matters Beyond Tax Period Can Be Relevant

Gaetano v. United States, No. 19-mc-51772 (E.D. Mich. Oct. 16, 2020)

IRS summonses seeking tax records for tax periods beyond the tax period under investigation can be relevant to the investigation, a district court held. The IRS issued summonses related to an investigation of Taxpayers for possible criminal tax liabilities of whether Taxpayers understated their tax liability for tax years 2015 through 2018, and quarterly filings for 2019. The summonses at issue seeks documents for the period January 1, 2015, through November 1, 2019. The IRS agent explained, "The request period is not concurrent with the end of a tax year because [the agent is] also investigating quarterly filings, and records beyond the close of the tax periods under investigation may shed light on the accuracy of income reported in the prior tax year." Held, documents outside of the tax period under investigation can be properly sought in a tax summons under a broad relevance theory.

Security Interests Held to be Ahead of IRS Lien

United States v. Allahyari, No. 18-35956 (9th Cir. Nov. 13, 2020)]

Father's security interest in property owned by his son, a tax delinquent, entitled to priority over later-recorded federal tax liens up to the amount of his security interest. Taxpayer borrowed from his parents to purchase real estate. After some payments were made, Father transferred ownership to Taxpayer. Taxpayer took out a deed of trust with Bank but fell behind on the loan payments. Father paid off the loan and took an assignment of the loan and loan security. During the years at issue, Taxpayer became delinquent on his federal income taxes. After learning of the tax debts, Father executed a loan to Taxpayer to thwart off any possible federal tax lien and forced sale of the property. The IRS filed a lien. The district court found the IRS to have a priority tax lien over Father's interest in the second loan but not the security interest from the Bank loan. Despite having either actual or constructive notice of the federal tax liens, Father's security interest was entitled to priority under § 6323, the appeals court held. The deed was filed prior to the IRS's liens, thus maintaining its priority status, the court determined. The court remanded back to the district court to determine whether the security interest became protected under local law before the United States filed its notice of its tax liens. On remand, to determine whether Father "parted with money or money's worth," the district court must determine "whether past consideration is sufficient to support an agreement giving rise to the security interest" under state law, the court stated.

Petition Without Postmark Timely, Based on Attorney's Testimony

Seely, TC Memo 2020-6 (January 13, 2020)

The Tax Court held that a petition was timely filed even through the envelope containing the petition did not have a postmark and was received by the Court more than 90 days after IRS mailed the notice of deficiency. The Court found credible the taxpayers attorney's declaration that he had mailed the petition within the 90-day period.

If the postmark is missing, the Court may look to extrinsic evidence to determine the petition's mailing date, including testimony from the person claiming to have mailed the envelope and evidence regarding the normal delivery time.

The parties stipulated that it mail ordinarily takes 8 to 15 business days from any location in the U.S. to a government office in Washington, D.C. The taxpayers' attorney supplied a sworn declaration that he mailed the petition 15 business days before the statutory deadline. It arrived on the 16th day. The court took note that holiday conditions may temporarily delay mail delivery.

No Jurisdiction to Review Assessment of Sec. 6038 Information Reporting Penalty

Ruesch, 154 TC No. 13 (6/25/2020)

The Tax Court held it did not have jurisdiction to review the assessment of a § 6038 penalty, even though the assessment might have caused the IRS to certify that a taxpayer had a "seriously delinquent tax debt," a condition that is grounds for denial or revocation of a passport. Section 6038 imposes a penalty for failure to file an information report on certain foreign corporations.

If IRS determines that a taxpayer has a serious delinquent tax debt, it will certify that debt to the State Department. § 7345(a). A taxpayer who has been certified cannot be issued a U.S. passport and such a taxpayer who has a passport may have his passport revoked. A "seriously delinquent tax debt" means, a tax debt exceeding $50,000 on which the IRS has filed a notice of lien – but not if collection is suspended because a collection due process hearing is requested. If certified as having a seriously delinquent tax debt, a Taxpayer may petition the Tax Court to determine whether the certification was erroneous. The only relief the Court is authorized to grant is to order the IRS to notify the Secretary of State that such certification was erroneous.

Here, the Taxpayer failed to pay assessed penalties under § 6038 totaling $160,000. She challenged the certification in Tax Court, as well as her liability for the penalties. Because she timely requested a CDP hearing on the § 6038 penalties, the IRS reversed its certification as erroneous and notified the Secretary of State. The IRS then filed a motion to dismiss her Tax Court challenge to the penalties, due to lack of jurisdiction. The Tax Court granted the IRS's motion, holding that its jurisdiction to review passport certification cases is limited to determining whether the IRS erred in certifying (or in failing to reverse a certification) that a taxpayer owes a seriously delinquent tax debt, but that § 7345 does not authorize the Court to redetermine Ruesch's underlying liability for the § 6038 penalties. Her remedy is to pay the liability, file a claim for refund, then pursue a refund suit in District Court or the U.S. Court of Federal Claims.

XIII. PRACTICE

Proper Evidence Presented Showing Preparer Aided in False Returns

United States v. Jeffries, No. 19-3702 (6th Cir. July 13, 2020)

A return preparer's conviction for aiding and assisting in the preparation of false returns was affirmed. An IRS investigation into the returns he prepared noticed a pattern that all the returns claimed all claiming a medical expense deduction, rare in light of the percentage threshold that a taxpayer must exceed. Many returns claimed the earned income tax credit and Schedule C deductions without any supporting documentation. A jury's conviction was affirmed. Because Defendant was in the business of preparing or assisting in the preparation of tax returns, he received a two-level enhancement, and because he was the leader of a criminal activity involving five or more participants, his base level was enhanced by four.

Tax Filing Requirement a Non-Delegable Duty

Baer v. United States, No. 19-1439 (Fed. Cl. Nov. 5, 2020)

The requirement to file a timely tax return is a non-delegable duty even when relying on a tax professional. Taxpayer challenged a late-filing penalty, asserting that his tardiness resulted from a miscommunication with his CPA. Taxpayer believed his CPA submitted a timely request for a tax filing deadline extension; CPA, however, didn't file the form because CPA misunderstood the tax law. Even if Taxpayer's CPA provided him with mistaken advice on the means for filing an extension and failed to file for one, the mistake was unreasonable and doesn't negate Taxpayer's own responsibility.

Refund Not Established By Employee's Failure to Properly Use Tax Software

All Stacked Up Masonry, Inc. v. United States, No. 20-161T (Fed. Cl. Oct. 22, 2020)

Disability of corporation's owner does not equate to corporation's inability to timely file and pay employment taxes regardless of how prudent the owner's delegation to an employee might be. The owner, injured, delegated the duty to file the employment taxes using QuickBooks to Employee, who had problems with QuickBooks which resulted in untimely tax returns and payments. An employee's failures in filing employment taxes were held to be the corporation's failures. A corporation may retain a tax preparer, but any carelessness, reckless indifference, or intentional failure by the corporation's agent is attributable to the corporation. The delegation of tax preparation duties as a matter of business operations bears no relation to whether reasonable cause exists to excuse Corporation's failures to file, deposit, and pay taxes.

Permanent Injunctions Against Return Preparers Affirmed

United States v. Simon, No. 19-12104 (11th Cir. Sept. 14, 2020)

A permanent injunction against return preparers was affirmed. The district court issued a permanent injunction against return preparers who inflated and took false deductions for their clients for several years costing the Treasury millions of dollars. The appeals court agreed with the district court that the fact that the preparer-owner filed false returns for more than six years, even after being told that the deductions were unsupported, made it more likely than not that he would repeat his conduct if allowed to prepare returns.

"Activity" Defined Broadly to Determine Abusive Tax Shelter Promotion Penalty

Tarpey (DC MT 11/7/2019) 124 AFTR 2d ¶2019-5423

"Activity," as used in the section imposing the penalty for promoting abusive tax shelters, should be defined broadly, a district court held. The taxpayer formed a non-profit organization that obtained tax-exempt status from IRS, which facilitated the donation of timeshares and promised potential donors generous tax savings from donations of their unwanted timeshares. The taxpayer performed appraisals of the donated property, receiving fees totaling $540,000. When the organization sold a donated property, it paid fees to for-profit entities controlled by the taxpayer, totaling about $18 million.

The IRS said he should be liable for the 50 percent penalty under § 6700(a) because of inflated appraisals, which encouraged donors to take excessive deductions. Taxpayer conceded that he was liable for the 50% penalty but argued that the activity subject to the penalty was merely his appraisal activity. The district court held that the "activity" giving rise to the penalty against Tarpey encompassed the entire arrangement facilitated and organized by Tarpey to solicit timeshare donations, appraise the timeshares, and direct profits to his other entities. The court declined to view in isolation Tarpey's conduct of performing the appraisals.

Tarpey pointed to Schulz for the proposition that the "activity" must be a "particular, well-defined activity".

But the court declined to view Tarpey's "activity" in such a narrow fashion. Tarpey ran and oversaw the operation of DFC and the related for-profit entities. The court deemed it appropriate to view Tarpey's conduct in a broader context because § 6700(a) allows the government to assess a penalty on "gross income derived or to be derived" from the tax shelter activity.

XIV. INTERNATIONAL

$12.9 Million FBAR Penalty Didn't Violate Eighth Amendment's Excessive Fines Clause

Schwarzbaum, 125 AFTR 2d ¶2020-747 (DC FL 5/18/2020)

A $12.9 million penalty for failure to file a Report of Foreign Bank and Financial Accounts was held not to violate the Eighth Amendment prohibition against excessive fines. The district court found that the Excessive Fines Clause didn't apply to civil FBAR penalties because such penalties are not "fines" for purposes of the Eighth Amendment, but rather a civil penalty.

FBAR Willful Failure Regulation Held Void

Norman, (CA Fed Cir 11/8/2019) 124 AFTR 2d ¶2019-5427

The Federal Circuit held that, because a statutory change increased the penalties for willfully failing to meet FBAR requirements, a regulation that doesn't yet reflect that increase is void.

Failure to file an FBAR may be punished with a civil penalty of up to $10,000, with willful violation subject to penalties of up to $100,000 or 50 percent of the unreported account. These amounts reflect a 2004 statute that increased the maximum civil penalty, which had been $100,000. Regulations that were promulgated before the statutory increase continue to reflect the former $100,000 maximum, without reference to the 50 percent option. Two prior district courts have held that the regulation can be applied consistently with the statute, so the regulation has not been implicitly invalidated or superseded, so that the penalty was therefore limited to the $100,000 limit in the regulation.

The Federal Circuit held that because the regulation is inconsistent with the statute, it is invalid. Because the amended statute dictates that the usual maximum penalty "shall be increased" to the greater of $100,000 or 50% of the account., Congress used the imperative "shall" rather than the permissive "may." Therefore, the amendment did not merely allow for a higher "ceiling" on penalties while allowing the Treasury Secretary to regulate under that ceiling at his discretion. Rather, Congress raised the new ceiling itself, and in so doing, removed the Treasury Secretary's discretion to regulate any other maximum.

PFIC Statute's Plain Language Does Not Require Intent

Shnier v. United States, No. 18-1257 (Fed. Cl. Nov. 17, 2020)

Section § 1297, covering passive foreign investment companies, does not require ownership in a PFIC to be willful for the company to be considered a PFIC. The taxpayer, the beneficiary of a trust, emigrated to the United States and became a citizen. The business owned by the trust was sold, with the proceeds invested in passive investments, including real estate. Taxpayer initially did not report distributions on his federal tax returns, then filed amended returns to include the distribution as passive income after participating in the IRS's OVDP program. Taxpayer then opted out of the OVDP, appealed penalties before the IRS actually assessing them, then sent another letter protesting the assessments. The IRS treated the letter as an informal refund claim and refunded the penalties but rejected the tax assessment protest. Taxpayer sued, arguing that the PFIC laws were misapplied and seeking to enjoin the IRS from classifying the Canadian holding companies as PFICs.

Willfulness in creating and owning a PFIC is not written into the statute's plain language, the court held, denying Taxpayer's claim in finding the statute unambiguous. Cited passages from a Joint Committee on Taxation report that Taxpayer argues require "willful intent" cannot be read into the law, the court concluded, rejecting the Taxpayer's claim that application of the PFIC regime to them discriminates against them based on national origins. The Anti-Injunction Act required dismissal of Taxpayer's request that the IRS be required to stop treating the holdings as a PFIC.

Transition Tax Held Constitutional

Moore v. United States, No. C19-1539-JCC (W.D. Wash. Nov. 19, 2020)

The transition tax in § 965, a one-time mandatory repatriation tax added in 2017, passed constitutional scrutiny. The taxpayers owned an 11 percent interest in a controlled foreign corporation operating in India. From 2006 through 2017, the CFC never distributed its earnings to shareholders. Taxpayers filed a return without paying the mandatory repatriation tax under § 965, then filed an amended return to pay the tax and filed for a refund, arguing that because the MRT taxes accumulated income rather than current income, the MRT is a direct tax on property, thereby violating the Apportionment Clause, or alternatively is a retroactive application of a new tax that violates the Due Process Clause.

Held, the MRT does not violate the Apportionment Clause as it is a tax on income rather than a direct tax. The court held that there is no constitutional bar to taxation of unrealized subpart F income. While the § 965 tax is retroactive, it does not violate Due Process. The MRT levies tax based upon actions taken before adoption of the statute – a CFC's accumulation of earnings and profits – but because the MRT ensures that these amounts, to the extent apportionable to a U.S. shareholder, are subject to U.S. tax, the statute satisfies a legitimate legislative purpose. As for the period of prior earnings subject to the transition tax, it was reasonable for Congress to select all dates after 1986 as the starting point, as this marks the last previous major overhaul of the Tax Code.

U.S. Abode Maintained Where Taxpayer Maintains Strong Domestic Ties

Haskins v. Commissioner, No. 20-10692 (11th Cir. Sept. 8, 2020)

Strong ties to the United States placed taxpayer's abode in the United States and not a foreign country for purposes of the exclusion for foreign earned income, where the taxpayer's wife was stationed by the Army in Afghanistan. He was a construction worker in Arizona. She reported that she qualified for the foreign earned income exclusion. In determining tax home, the court compares the taxpayer's domestic ties with his ties to the foreign country in which he claims a tax home. Held that she maintained strong connections to the United States – driver's license, home in Arizona, bank account, supporting her son's schooling, paying household bills, and buying gift cards for her husband, with connections to Afghanistan transitory or limited. She lived only on military bases, could not travel off of the base, could not meet with local residents in their homes, did not have a choice in where she lived, and her family could not join her.

Electing U.S. "Home Base" Disallows Foreign Earned Income Exclusion

Cutting v. Commissioner, T.C. Memo 2020-158 (Nov. 19, 2020)

The foreign earned income exclusion was denied to a domestic-based airline pilot flying internationally when he selected the United States as his tax home and failed to establish that he was a bona fide resident of a foreign country nor that he met the physical presence test. Taxpayer, an international pilot and U.S. citizen residing in Thailand, chose the United States to be his home base. Taxpayer's employer did not require him to live in the United States, but the collective bargaining agreement required a "home base." Taxpayer reported his entire salary as foreign earned income and claimed the maximum foreign earned income exclusion allowed; he also failed to report the receipt of state tax refunds. The IRS disallowed the Taxpayer's foreign earned income exclusion for his failure to establish either a bona fide residence or physical presence in Thailand. The court rejected Taxpayer's argument holding that the tax home for an international pilot is his duty station, here the United States. Having determined that Taxpayer's tax home was not in a foreign country, the court determined it unnecessary to apply the bona fide residence or physical presence test but stated, in summation, that six factors would weigh against Taxpayer, most significantly that: (1) Taxpayer relied on temporary transit and non-immigrant visas and did not pursue residency; (2) he filed a statement that he was not a resident of Thailand; (3) he did not pay any taxes to Thailand; (4) he was not a tenant under the terms of his wife's lease; (5) his testimony contradicted his tax return in several important respects; and (6) Taxpayer's inconsistencies failed to show good faith. Thus, Taxpayer was not a bona fide resident of Thailand during the years in issue, the court held.

2020 Delaware Tax Institute

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Presented by:

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Economic Impact Payments (Stimulus Checks)

- $1,200/$2,400 based on filing status, plus $500 for dependents under age 17
- Initially based on 2018/2019 tax filing
- Payments are NOT taxable
- Reconciled when you file your 2020 tax return
  - Credit on 2020 return if determined you did not receive enough
  - Do not have to repay if determined that you were advanced too much
- Incarcerated individuals can receive these payments despite contrary position taken by IRS through their FAQ's. Overruled through courts. Important reminder that FAQ's lack substantial authority.

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Unemployment Compensation

- Taxable income for Federal purposes and is reported on a Form 1099-G
- You can elect withholding at 10%
- May still require estimated tax payments even with withholding

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Waiver of 2020 Required Minimum Distributions

- Waiver of 2020 required minimum distributions (RMDs)
  - Includes RMD from inherited IRAs
  - Includes those turning 72 in 2020 that must take their RMD by 4/1/2021
  - Includes those that turned 70 ½ in 2019 that had to take their RMD by 4/1/2020
- Ability to re-contribute RMD back into IRA or retirement account
  - Rollover generally can only be done once every twelve months, but a "recontribution" does not count as a rollover for these purposes
  - 60-day rule applies but special waiver for repayments made by 8/31/2020
  - RMD's required to be made through 4/1/2021 can be waived and rolled over to IRA
  - If there was withholding from RMD, that amount also needs to be returned
  - Required language needs to be in employer plan document to allow the waiver of the RMD

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COVID-19 Related Distributions from IRA and Retirement Plans

- Hardship distributions are not subject to the early withdrawal penalty for those under the age 59½
- Must have been impacted by Covid-19 and needed funds (but can use funds for any purpose)
- Aggregate distribution can be up to $100,000 from each person's respective retirement accounts
- Option to spread tax liability over 3 years OR repay distribution within 3 years and reclaim any taxes paid
  - EXAMPLE 1: Tom takes a COVID-19 related distribution of $60,000 on May 1, 2020 and does not intend to repay it. Tom can report $60,000 as income on his 2020 tax return, with the option of reporting $20,000 in 2020, 2021, and 2022.
  - EXAMPLE 2: Same as above, except Tom is able to repay the $60,000 by May 1, 2022. Assuming Tom was spreading the income over 3 years, he does not report the $20,000 for 2022 and can amend his 2020 and 2021 tax returns to get a refund.
- Can choose to carry amounts forward if repaid in year 2 and potentially avoid amended return
  - EXAMPLE 3: Same as example 1, except Tom is able to repay the $30,000 by May 1, 2021. Assuming Tom was spreading the income over 3 years, he does not report the $20,000 for 2021 and can report $10,000 for 2022

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Who Qualifies for a COVID-19 Hardship Withdrawal?

- Distribution must be made during 2020
- The Act is fairly broad as to who qualifies for a COVID related hardship distribution. To qualify,
  - You, your spouse, or a dependent must have been diagnosed with the COVID-19 or SARS-COV-2 disease, or
  - You must have experienced adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to the virus, being unable to work or only able to work reduced hours due to the lack of childcare due to the virus

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Loans From Employer Plans

- The CARES Act loosened restrictions for loans from employer plans such as 401(k) plans
- Loans are not permitted from IRAs
- COVID-19 related loans can be made up to $100,000 (up from $50,000) or 100% (previously 50%) of the present value of the non forfeitable accrued benefit
- Must be taken within 180 days of the effective date of the Act (mid-September)
- For any outstanding loans with repayments due March 27, 2020 through December 31, 2020, the due date is delayed for one year
- Eligible individuals have the same definition as those who could receive the COVID-19 hardship distribution

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Qualified Medical Expenses

- Expanded definition of "qualified medical expenses" for purposes of payment or reimbursement from an HSA/MSA/FSA/HRA
- Eliminates the requirement for "prescribed" medicine or drugs
- Expanded the definition of qualified medical expenses to include feminine care products
- A high deductible plan will not fail to be treated as an eligible plan for not requiring a deductible for telehealth services
- Notice 2020-15 provides a similar rule for COVID-19 testing

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Charitable Contributions

- Changes made by the CARES Act
  - $300 above the line charitable deduction
  - Modification to limitations on individual and corporate cash charitable contributions
    - Individuals changed from 60% AGI to 100% AGI
    - Corporations 10% to 25%
  - Increased limits on contributions of food inventory from a C Corporation
    - 25% of taxable income instead of 15%
- Definition of a "qualified contribution"

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Provision for Losses

- Temporary repeal of taxable income limitation for NOLs
  - Previously was 80%, but is 100%
- Modification of rules relating to NOL carryback claims
  - Previously could not carryback losses, but can now carry back losses 5 years for losses incurred 2018-2020
- Modification of loss limitation rules for noncorporate taxpayers
  - Previously could not offset 250K (or 500K joint) of losses against nonbusiness income. The limitation was removed for 2018-2020

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Business Interest (163(j))

- Deductibility of interest expense temporarily increased for 2019 and 2020
- 30% limitation increased to 50% for 2019 and 2020
- Election to calculate 2020 limitation using 2019 adjusted taxable income
- Special rules for partners
  - Limitation increase does not apply to 2019
  - ½ of disallowed 2019 interest is moved to 2020 and will not subject to any limits
  - ½ of disallowed 2019 interest continues to be subject to 163(j) limits in future years, meaning it will be suspended until partnership allocates excess taxable income to partner

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Employee Retention Credits

- Refundable payroll credits for 50% of wages paid by **eligible employers** to **certain employees** during the COVID-19 crisis
- Credit can be claimed through payroll tax filings for wages paid after March 12, 2020 through December 31, 2020
- Who are eligible employers?
  - More than 50% reduction in quarterly receipts, measured on year-over-year basis
  - When receipts exceed 80% of comparable quarter in 2019, employer no longer qualifies
  - Not available to employers who receive PPP loans
  - Not available to self-employed individuals
- Which employee wages qualify?
  - 100 employees or less in 2019, any employee's wages count no matter what the status
  - More than 100 employees, only employees who were furloughed count
  - Can't double dip with other credits like Work Opportunity Credit or Sick Leave Credit
  - Capped at $10,000 to each eligible employee

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Payroll Taxes – Employer

- Delay of payment of employer social security taxes
  - Includes self-employed taxpayers
  - Deferral period – March 27, 2020 to December 31, 2020
  - Applicable dates for delayed payments become – December 31, 2021 (50%) and December 31, 2022 (50%)
  - Can receive a PPP loan and delay payroll taxes

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Payroll Taxes by Executive Order - Employee

- Postponement of withholding and remittance of employee payroll taxes
  - Presidential Memorandum issued August 8th
  - Employee's share of social security tax (6.2%) on wages paid from September 1, 2020 to December 31, 2020
  - Postponement of withholding and remittance will be caught up between January 1, 2021 and April 30, 2021
  - Wages of $4,000 or less on a biweekly per pay period basis
  - Optional for the employer

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Bonus Depreciation Technical Correction for Qualified Improvement Property

- TCJA contained original provision, but did not get the job done
- Intent was for Qualified Improvement Property to be eligible for 100% bonus depreciation and 15-year life
- Cares Act fixes the drafting error and provides retroactive relief

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Payroll Protection Program (PPP)

- Loans designed to provide direct government incentive for small business to keep workers on payroll.
- Designed to be forgiven if employee retention criteria are met and funds are used for "eligible expenses"
- Eligible expenses include – payroll costs, mortgages, rent and utilities
- If more than 40% is used for non-payroll costs, a portion of the loan may not be eligible for forgiveness
- Loans issued prior to June 5th have a 2-year maturity and after June 5th have a 5-year maturity
- Interest rate = 1%
- Tax treatment of forgiven loans – is excluded from gross income, however expenses paid with forgiven funds are not deductible
- SBA FAQ kills rent expense derived from self-rental as an eligible expense. Rent expense associated with subleased space also does not count.
- Devil is in the details and guidance on this program continues to evolve

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Hot off the Press – Revenue Ruling 2020-27 & Revenue Procedure 2020-51

- Revenue Ruling 2020-27
  - Issued in late November
  - If taxpayer
    - Knows the amount of eligible expenses that qualified for reimbursement
    - Has a reasonable expectation to seek loan forgiveness and receive it
  - Then cannot deduct PPP related expenses
  - Does not matter if loan is officially forgiven in 2021 or 2020
- Revenue Procedure 2020-51
  - Taxpayer reasonably expects to receive forgiveness
  - Taxpayer applied for forgiveness in 2020 or intends to apply in 2021
  - In 2021, bank notifies the taxpayer that forgiveness for part or all of the loan is denied or the taxpayer withdrawals application
  - Option 1- Taxpayer can then deduct expenses on 2020 originally filed or amended 2020 return.
  - Option 2 –Taxpayer can deduct those expenses on 2021 return

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Grants from Human Health Services for Medical Providers

- On April 10, 2020, the U.S Department of Health and Human Services (HHS) automatically began distributing relief funds to "*providers who billed Medicare-fee-for-service in 2019, be a known Medicaid and CHP or dental provider and provide after January 31, 2020 diagnoses, testing, or care for individuals with possible or actual cases of COVID-19 or prevented in the spread of COVID-19. HHS broadly views every patient as a possible case of COVID-19.*"
- Health Care Related Expenses Attributable to Coronavirus –
  - Use of funds can first be used by a provider that has incurred additional "**incremental costs**" attributable to the coronavirus.
  - Two qualifications when identifying expenses attributable to coronavirus.
    - 2020 overall expense account must have increased when compared to 2019.
    - The provider must be able to specifically identify the additional expenses that are related to the coronavirus.

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Grants from Human Health Services for Medical Providers Expenses Attributable to the Coronavirus

- Administrative Expenses – Only incremental increased expenses due to coronavirus
  - Mortgage/Rent
  - Insurance
  - Personnel
  - Fringe Benefits
  - Lease payments on equipment
  - Utilities
- Health Care Related Expenses Attributable to Coronavirus – Only incremental increased expenses due to the coronavirus
  - Supplies
  - Equipment
  - Information Technology
  - Facilities
  - Other Health Care Expenses

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Grants from Human Health Services for Medical Providers

- Patient Care Lost Revenues
  - Lost revenue is defined as the difference between 2020 and 2019 revenue
  - Paycheck Protection Program Funds received is treated as 2020 revenue
- Important Resources
  - General and Targeted Distribution Port-Payment Notice of Reporting Requirements dated November 2, 2020
  - Cares Act Provider Relief Fund Frequently Asked Questions

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Delaware Relief Grants

- Joint effort between the State and New Castle County to assist Delaware small businesses and nonprofits impacted by the COVID-19 pandemic. The funds for the program come from the federal CARES Act.
- If you're a business, you must meet the U.S. Small Business Administration's definition of a small business for your industry. If you're a nonprofit, you must be a registered 501(c)(6), 501(c)(19) or 501(c)(3) in a "disproportionately impacted industry" organization.
- At least 51% of the business or nonprofit's operations must be physically located in the state of Delaware. Businesses and nonprofits whose sole connection to Delaware is that they are incorporated here, are not eligible.
- Businesses that have received previous grants or loans from the State (EDGE, HELP, DTIP, etc.) are eligible to apply for DE Relief Grants.

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Delaware Relief Grants Based on 2019 Revenue

- The amount a business or nonprofit can receive is based upon 2019 revenue and could be up to $100,000.
- $0-$500,000 in revenue: Up to $30,000 (6 percent of 2019 revenue)
- $500,000-$1 million: Up to $50,000 ($30,000 + 4 percent of 2019 revenue in excess of $500,000)
- $1 million-$2.5 million: Up to $72,500 ($50,000 + 1.5% of 2019 revenue in excess of $1 million)
- $2.5+ million: Up to $100,000 ($72,500 plus 1 percent of 2019 revenue in excess of $2.5 million)

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Delaware Relief Grants Eligible Expenses

- Generally, includes expenses paid during 4/1/20 and 12/21/20
  - Equipment purchased to make business suitable for COVID-19 safety (PPE, plexiglass, air purifiers, etc.)
  - Refinancing of debt incurred due to COVID-19 (including State of Delaware HELP loans)
  - Technological enhancements undertaken in order to adapt business model for COVID-19
  - Advertising efforts undertaken as a result of COVID-19
  - Occupying expenses (e.g. rent, mortgage, utilities, insurance, etc.) – Only for disproportionately impacted businesses

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Delaware Relief Grants

- You must be able to show a 7.5% revenue decline (2020 vs. 2019), or you will have to pay back the grant with interest.
- **Unofficial** guidance from email conversations with DE
  - Problem #1
    - Revenue from other grants will increase 2020 revenue
  - Answer #1
    - State will focus on gross revenue line on tax return when comparing 2020 to 2019.
    - State would expect you to put other grants on other income lines
  - Problem #2
    - Loan agreement has some tough language in it, including the need to get audits on GAAP basis.
  - Answer #2
    - State has unofficially said they will not require this unless they suspect fraud. The client will need to sign these agreements at their own risk.

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Economic Injury Disaster Loans (EIDL)

- To meet financial obligations and operating expenses that could have been met had the disaster not occurred
- 3.75% for businesses (fixed)
- 2.75% for nonprofits (fixed)
- 30 years
- No pre-payment penalty or fees
- Working capital and normal operating expenses
- Example: Continuation of health care benefits, rent, utilities, fixed debt payments.

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EIDL Advance (no longer available but… important for PPP forgiveness purposes)

- EIDL Advance does not have to be repaid.
- Recipients did not have to be approved for an EIDL loan to receive the EDIL Advance.
- The amount of the loan advance was deducted from total loan eligibility.
- **Businesses who received an EDIL Advance in addition to the Paycheck Protection Program (PPP) loan will have the amount of the EDIL Advance subtracted from the forgiveness amount of their PPP loan.**

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SBA Debt Relief

- For loans made after March 27, 2020 and fully disbursed prior to September 27, 2020, SBA will begin making payments with the first payment due on the loan and will make six monthly payments.
- Prior Loans – SBA will pay 6 months of principal, interest, and any associated fees that borrowers owe for all current 7(a), 504, and Microloans in regular servicing status as well as new 7(a), 504, and Microloans disbursed prior to September 27, 2020.

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Don’t forget good ole § 61

- … “gross income means all income from whatever source derived…”
- Therefore, expect any governmental assistance to be taxable

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Disaster Loss Refunds – IRC 165(i)

- Tax rules allow businesses to claim certain losses attributable to a disaster on a prior-year tax return
- President Trump's COVID-19 disaster declaration designated all 50 states, DC and US territories as disaster areas
- Businesses could claim a COVID-19 related disaster loss occurring in 2020 on a 2019 amended return for a quicker refund
- Could apply to losses on inventory or supplies, closure of office, stores and plants

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State Tax Considerations

- State Tax Filing for COVID-19
  - AICPA tracking on State Tax Guidance Chart (https://www.aicpa.org/advocacy/tax/covid-19.html)
  - Over 500 pages of guidance
- This is a mess, lots of variation and uncertainty on many provisions, for example:
  - Telecommuting and establishing nexus and withholding requirements
  - Taxation of unemployment compensation
  - Follows TCJA and/or Cares Act Provisions
- Wayfair – still relevant and protections of Public Law 86-272 continue to be eroded
- Consistency of guidance/rules between corporations and pass-throughs

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Gambling Losses

- Chief Counsel Advice clarified that daily fantasy sports fee is considering a wagering transaction and therefore the deductions are limited to winnings
- Reminders:
  - Gambling losses are reported on Sch. A and cannot exceed gambling income
  - Professional gamblers who file a Schedule C are no longer able to deduct expenses incurred in their profession plus gambling losses in excess of gambling income

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Estates/Trusts Excess Deduction on Termination

- Final Regulations issued to allow excess deduction on termination
- Deductions retain their character as they are passed out to beneficiaries
- IRS released 2020 Instructions for Schedule K-1 (Form 1041) that revised Box 11, code A to be "Excess deductions – Section 67(e) expenses and Box 11, code B to be "Excess deductions – Non-miscellaneous itemized deductions"
- May want to amend prior year tax filings that did not claim this deduction
    - Guidance issued how to report on 2018 and 2019

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Estates/Trusts Excess Deduction on Termination

Example from IRS Final Regulations

Dividends	$3,000
Interest	$ 500
Rent	$2,000
Capital Gain	$1,000

Determination of character:

1. Apply rental expenses against rental income
2. Executor exercise discretion under § 1.652(b)-3(b) to allocate other expenses against remaining income

Allocate remaining excess deductions among beneficiaries under § 1.642(h)-4

Section 62(a)(4): rental real estate expenses	$2,000
Section 67(e): Probate fees	$ 1,500
Section 67(e): Estate tax prep fees	$8,000
Section 67(e): Legal fees	$2,500
Non-miscellaneous itemized: personal property taxes	$3,500

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Marijuana Industry Updates

- IRS issued FAQs
- My business is a marijuana dispensary that I operate in compliance with my state's laws. The federal government considers this an illegal activity. Do I have the same income and employment tax filing obligations as any other business?
- I operate a business that consists of selling marijuana. Can I claim deductions to determine my taxable income?
  - IRC 280E disallows deductions for amounts paid in carrying on any trade or business that consist of illegal trafficking
  - However, you are allowed to reduce gross receipts by cost of goods sold
  - Side note: No comments on how costs may be allocated to inventory

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Partnerships

- Capital Accounts on K-1s must be on tax basis
  - Do not include 754 step-ups
  - Draft instructions issued recently
- Electing out of BBA
- Amending Returns
- New Schedule B Question – foreign corporation acquisitions
- Codes no longer listed on Page 2
- Request for Section 754 Revocation – new Form 15254

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Schedule K-2 and K-3

- IRS Proposal to add Schedule K-2 and K-3 for International partnerships
  - If partnership has items of international tax relevance (typically international activities or foreign partners)
  - For tax year 2021 (filing season 2022)
  - Standardized format to report international tax information
  - K-2 (20 pages) replaces portions of existing Schedule K, Lines 16(a) to 16(r)
  - K-3 (22 pages) replaces portions of existing Schedule K, Part II, Boxes 16 and 20
  - Similar revisions planned for Form 1120-S

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QBI Deduction and S Corporation Health Insurance

S-Corporation Return

- Health insurance included as a deduction in the owner's wages.

Individual Return

- Owner reports the wages on her tax return.
- Owner reports a separate deduction for health insurance.

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QBI Deduction and S Corporation Health Insurance

- **Q33.** Health insurance premiums paid by an S-Corporation for greater than 2% shareholders reduce qualified business income by reducing the ordinary income used to compute allocable QBI. If I employed health insurance deduction for these premiums on mine, I have to also include this deduction when calculating my QBI.
- **A33.** Generally, the self-employed health insurance deduction under section 162(l) is considered attributable to a trade or section 199A and will be a deduction in determining QBI. **This may be reduced at both the entity and the shareholder level.**

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Charitable Deduction as a Reduction of QBI

- **2019** Form 8995 instructions state that charitable contributions related to a trade or business reduce QBI, implying passthrough charitable deductions would reduce QBI.
- **2020** Draft instructions remove this language.

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Notice 2020-75 –Forthcoming Regulations Regarding the Deductibility of Payments y Partnerships and 5 Corporations for Certain State and Local Income Taxes

- *Certain jurisdictions described in section 164(b)(2) have enacted, or are contemplating the enactment of, tax laws that impose either a mandatory or elective entity-level income tax on partnerships and S corporations that do business in the jurisdiction or have income derived from or connected with sources within the jurisdiction. In certain instances, the jurisdiction's tax law provides a corresponding or offsetting, owner-level tax benefit, such as a full or partial credit, deduction, or exclusion. The Treasury Department and the IRS are aware that there is uncertainty as to whether entity-level payments made under these laws to jurisdictions described in section 164(b)(2) other than U.S. territories must be taken into account in applying the SALT deduction limitation at the owner level.*

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IRS Notice 2020-75 – November 9, 2020

- If a partnership or an S corporation makes a Specified Income Tax Payment during a taxable year, the partnership or S corporation is allowed a deduction for the Specified Income Tax Payment in computing its taxable income for the taxable year in which the payment is made.
- Specified Income Tax Payments will be reflected in a partner's or an S corporation shareholder's distributive or pro-rata share of nonseparately stated income or loss reported on a Schedule K-1 (or similar form).
- Any Specified Income Tax Payment made by a partnership or an S corporation is not taken into account in applying the SALT deduction limitation to any individual who is a partner in the partnership or a shareholder of the S corporation.
- Some retroactive application – payments made after 12/31/2017 and before 11/9/2020

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Notice 2018-99: Interim Guidance on Parking Expenses for Qualified Transportation Fringes

- No deduction is allowed for the expense of any QTF provided by the taxpayer to their employees
- Includes any transit pass and qualified parking
- When a taxpayer owns or leases all or a portion of a parking facility then two methods proposed to calculate the disallowed deduction
  - Until further guidance is issued, disallowance may be calculated using any reasonable method
  - Taxpayer may allocate 5% of following expenses to parking facility
    - Lease or rental agreement expenses
    - Property taxes
    - Interest Expense
    - Expenses for utilities & insurance
- Special rules for multi-tenant buildings

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Proposed and Final Regulations Issued on Meals and Entertainment from TCJA

- Three basic requirements for meals
  - The expense is not lavish or extravagant under the circumstances
  - The taxpayer, or an employee of the taxpayer, is present at the furnishing of such food or beverages
  - The food or beverages are provided to a business associate
- Travel Meals
  - 274(d) Substantiation Requirements
    - The amount of such expense or other item
    - The time and place of the travel or the date and description of the gift
    - The business purpose of the expense or other item
    - The business relationship to the taxpayer of the person receiving the benefit
  - Explicit rules on dependents or spouse who travel
    - Employment
    - Business purpose
    - Otherwise deductible by dependent or spouse

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Proposed and Final Regulations Issued on Meals and Entertainment from TCJA

- Employer can avoid 50% limitation for food or beverage provided to employee if value is included on tax return of employee (aka – include on the employee's W-2)
- 50% limitation does not apply to recreation, social, or similar activities primarily for the benefit of employees (holiday parties, annual picnics, summer outings)
  - Must be primarily for rank and file
  - Snacks in breakroom do not count as a "social activity". Therefore, subject to 50% limitation. Question: What about your fridge or microwave in the breakroom?
  - Meals provided for the convenience of the employer subject to 50% limitation

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Proposed and Final Regulations Issued on Meals and Entertainment from TCJA

- Entertainment
  - Expenditures related to a facility used in connection with an entertainment activity (including dues or fees paid to any social, athletic or sporting club or organization)
  - Amounts paid or incurred for membership in any club organized for business pleasure, recreation or other social purpose.
- Deduction no longer available
- Meals must be on a separate invoice

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Qualified Opportunity Zones (QOZ) and Qualified Opportunity Zone Funds (QOF)

- 2017 Tax Cuts and Jobs act
- A QOZ is an economically distressed community where new investments, under certain conditions, may be eligible for preferential tax treatment. Localities qualify as QOZs if they have been nominated for that designation by a state, the District of Columbia, or a U.S. territory and that nomination has been certified by the Secretary of the U.S. Treasury via his delegation of authority to the Internal Revenue Service.
- A QOF is an investment vehicle that files either a partnership or corporate federal income tax return and is organized for the purpose of investing in QOZ property.
- Only long-term capital gains (including 1231 gains) that would be recognized for federal income tax purposes before January 1, 2027.
- Generally, you have 180 days to invest an eligible gain in QOF. The first day of the 180-day period is the date the gain would be recognized for federal income tax purposes if you did not elect to defer the recognition of the gain.
- An investor must include the remaining deferred gain on the earlier of an inclusion event or December 31, 2026. The amount of deferred gain included in income depends on (i) the fair market value of your qualifying investment in the QOF on the date of the inclusion event and (ii) adjustments to the tax basis of that qualifying investment.

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Qualified Opportunity Zones (QOZ) and Qualified Opportunity Zone Funds (QOF)

- An inclusion event, in general, is an event that reduces or terminates your qualifying investment in a QOF.
- If you hold your investment in the QOF for at least 5 years, 10% of deferred gain is eliminated.
- If you hold your investment in the QOF for at least 7 years, an **additional** 5% of deferred gain is eliminated.
- If the investment stays within the QOF for ten years, any additional appreciation from investment is not subject to tax.

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Proposed Regulations Issued on Like Kind Exchanges under 1031 from TCJA

- Focus is on definition of real property now that is the only property eligible for like kind exchange treatment
- Many definitions of real property in the Code so needed clarity on this definition
- Defined as
  - Land;
  - Improvements to land;
  - Unsevered natural products of land; and
  - Water and airspace adjacent to land
- Interests include
  - Fee ownership;
  - Co-Ownership;
  - A leasehold;
  - An option to acquire real property;
  - An Easement; or
  - A similar interest

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Proposed Regulations Issued on Like Kind Exchanges under 1031 from TCJA

- Improvements to land
  - Inherently permanent structures
  - Structural components of Inherently permanent structures
- Inherently permanent structures – any building or structure that is a distinct asset that is permanently affixed to real property and will ordinarily remain affixed for an indefinite period of time.
  - Houses;
  - Apartments;
  - Hotels and motels;
  - Enclosed stadiums and arenas;
  - Enclosed shopping malls;
  - Factories and office buildings;
  - Warehouses;
  - Barns;
  - Enclosed garages;
  - Enclosed transportation stations and terminals; and
  - Stores

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Proposed Regulations Issued on Like Kind Exchanges under 1031 from TCJA

- Affixation
  - The manner in which the distinct asset to real property;
  - Whether the distinct asset is designed to be removed or to remain in place;
  - The damage that removal of the distinct asset would cause to the item itself or to the real property to which it is affixed;
  - Any circumstances that suggest the expected period of affixation is not indefinite; and
  - The time and expense required to move the distinct asset.

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Proposed Regulations Issued on Like Kind Exchanges under 1031 from TCJA. Other Inherently Permanent Structures

In-ground swimming pools	Inherently permanent outdoor lighting facilities
Roads	Railroad tracks and signals
Bridges	Telephone poles
Tunnels	Power generation and transmission facilities
Paved parking areas	Permanently installed telecommunications cables
Parking facilities, and other pavements	Microwave transmission, cell, broadcasting and electric transmission towers
Special foundations	Oil and gas pipelines
Stationary wharves and docks	Offshore drilling platforms, derricks, oil and gas storage tanks
Fences	Grain storage bins and silos
Inherently permanent advertising displays for which on election under section 1033(g)(3) is in effect	Enclosed transportation stations and terminals

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Proposed Regulations Issued on Like Kind Exchanges under 1031 from TCJA. Structural Components

Walls	Ceilings
Partitions	Permanent coverings of walls, floors, and ceilings
Doors	Insulation
Wiring	Chimneys
Plumbing systems	Fire suppression systems including sprinkler systems and fire alarms
Central air conditioning and heating systems	Fire escapes
Pipes and ducts	Security systems
Elevators and escalators	Humidity control systems
Floors	

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Calling all Tax Preparers

- PTIN User Fee
  - Required for tax preparers who receive compensation
  - Stopped charging in 2017
  - United States District Court for District of Columbia concluded Treasury lacked the authority to charge a fee
  - United States Court of Appeals reversed the decision
- Electronic Filing
  - 2019 Amended Returns can now be electronically filed
  - IRS receives 3 Million amended returns each year
- Digital Signatures

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Digital Signatures

- Form 706, U.S. Estate (and Generation-Skipping Transfer) Tax Return;
- Form 706-NA, U.S. Estate (and Generation-Skipping Transfer) Tax Return;
- Form 709, U.S. Gift (Generation-Skipping Transfer) Tax Return;
- Form 1120-ND, Return for Nuclear Decommissioning Funds and Certain Related Persons;
- Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; and
- Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner
- Form 3115, Application for Change in Accounting Method;
- Form 8832, Entity Classification Election;
- Form 8802, Application for U.S. Residency Certification.

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More Digital Signatures

- Form 1066, U.S. Income Tax Return for Real Estate Mortgage Investment Conduit;
- Form 1120-RIC, U.S. Income Tax Return For Regulated Investment Companies;
- Form 1120-C, U.S. Income Tax Return for Cooperative Associations;
- Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts;
- Form 1120-L, U.S. Life Insurance Company Income Tax Return;
- Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return; and
- Form 8453 series, Form 8878 series, and Form 8879 series regarding IRS e-file Signature Authorization Forms.

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Tax Planning Impact/Opportunities

- Lower income means lower tax liability
  - May be a good time for a Roth conversion
  - If other income causes you to be in a lower tax bracket, maybe take your RMD or additional distributions – the tax would be lower and you are reducing future RMDs
  - May be a good time to cash in capital gains to offset capital losses and utilize the lower 0%/15% bracket on net capital gains
  - Rental real estate losses up to $25,000 can be claimed if AGI goes below $100,000 (phased-out as AGI increases between $100,000 and $150,000)
  - Low income could lower Medicare Part B and D premiums in 2022
  - Increase retirement plan contributions and traditional IRA/Roth contributions if employer match has been reduced or eliminated

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Wealth-Transfer Strategies Brought on by COVID-19

- A low-interest environment and depressed asset values could provide opportunities using the following strategies:
  - Grantor Retained Annuity Trust (GRAT)
  - Intra-Family Loans or Sales to an Irrevocable Trust
  - Use of Swap Powers within an Irrevocable Grantor Trust (“Defective” Grantor Trust)

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Where are we going?
President-elect Joe Biden's Tax Proposals

White House: Biden

House : Democrat control

Senate: ???

- Income Taxes – Individual
- Income Taxes – Corporate
- Payroll Taxes
- Estate Tax

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Where are we going?
President-elect Joe Biden's Tax Proposals

Income Taxes - Individual

- Taxpayers with income > $400k
  - Increase top tax rate from 37% → 39.6%
  - Limits itemized deductions to 28% of value
  - Pease limitation on itemized deductions
  - Phase out of the QBI deduction
- Taxpayers with income > $1 million
  - Capital gains and qualified dividends taxed at ordinary income tax rates
- Expand & Establish Credits
  - Child & Dependent Care: increase & make fully refundable
  - Child Tax Credit: increase & make fully refundable
  - First-Time Homebuyers
  - Low-income renter

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Where are we going?
President-elect Joe Biden's Tax Proposals

Income Taxes - Corporate

- Increase corporate income tax rate from 21% → 28%
- 15% Minimum tax for corps with book income over $100 million
  - Would still permit foreign tax credits and NOLs to be considered in calculation
- GILTI (global intangible low-taxes income) rates doubled
  - Taxes on offshore earnings by U.S. parented business
  - Would be on a country-by-country basis
- Expand & Establish Credits
  - Manufacturing Communities Tax credits
  - New Market Tax credits
  - Small business Credits for retirement savings plans
  - Renewable energy related credits

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Where are we going?
President-elect Joe Biden's Tax Proposals

Payroll Taxes

- Additional 12.4% OASDI payroll tax on earned income > $400k which would be paid half by employer and half by employee
  - Tax Policy Center estimates this would generate $740 billion over 10 years

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Where are we going? President-elect Joe Biden's Tax Proposals

Estate Taxes

- Reduce lifetime exemption amount to $3.5 million ($7 million for married couples)
- Increase top tax rate to 45%
- Tax unrealized capital gains at death

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Thank You

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Delaware Tax Institute

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U.S., International, and State Tax Policy Overview

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Results of the Federal Election

- Despite fears, the November election occurred efficiently across the country and apparently without foreign interference.
- Presumptive President-Elect Biden (Democratic)
- House of Representatives:
  - Democrats will have a small majority in the next session of Congress starting in January.
  - Democrats lost approximately 10 seats in the election.
- Senate current status:
  - 50 Republicans
  - 48 Democrats
  - Two Georgia Senate seats will be decided by run-offs on January 5, 2021.

Effect of the Federal Election

- Assuming Mr. Biden wins, Democrats need to have 50 seats to take control of the Senate. The Vice President would have the tie-breaking vote.
- Republicans appear likely to win at least one of the two run-offs and maintain control of the Senate.
- If the Republicans maintain control of the Senate, Democrats will not be able to use the budget reconciliation process to pass tax legislation in the Senate by a mere majority.
- Democrats will need 60 votes to prevent a filibuster.
- In addition, if they do not control the Senate, Democrats would not be able to eliminate the filibuster.

Effect of the Federal Election (cont'd)

- Before the election, some taxpayers considering transactions expressed concern that the Democrats would take control of the White House and both Houses of Congress, and consequently there would be tax hikes in 2021. The current likelihood that there will be divided government appears to have lessened the urgency to close transactions in 2020.
- If there is divided government, consensus between Democrats and Republicans will be needed to enact tax legislation.
- The fact that Mr. Biden is a former Senator might help in making deals.
- The Senate must approve the Biden cabinet and other nominees, including judges. Will the nominees need to be moderates to obtain Senate approval?
- Will a Biden Administration return to more conventional and predictable policy processes?

Some Potential Legislation in the Lame-Duck Session?

- Government funding expires on December 11.
- Dealing with the coronavirus is a high priority. Will there be Phase Four coronavirus legislation during the lame-duck session?
  - Some areas at issue include relief for working families and small businesses, support for state and local governments, and unemployment insurance.
  - Democrats support a $2 trillion package, but Senate Republicans support a $500 to $650 million bill.

Some Potential Legislation in the Lame-Duck Session? (cont'd)

- Extension of paycheck protection program (PPP)?
  - Deductibility of reimbursed expenses?
- CARES Act tax provisions expiring at the end of 2020?
  - Employee retention credit
  - Expanded deduction for charitable contributions
  - Five-year carryback of 2018-2020 net operating losses (NOLs)
  - Postponement to 2021 of 80% limit on use of NOL carryovers
  - Relaxation of section 163(j) interest limitations for 2019 and 2020
  - Postponement to 2021 of section 461(l) limitation on excess business losses of noncorporate taxpayers

Some Potential Legislation in the Lame-Duck Session? (cont'd)

- Tax Extenders?
  - More than 30 tax provisions expire at the end of 2020.
    - Examples of expiring provisions include the new markets tax credit, work opportunity tax credit, several energy credits, the CFC look-through rule, and the reduction in rate of the craft beverage excise tax.
    - Extenders are often extended retroactively after expiration, but that solution is problematic for excise taxes that are collected upon sale.
  - Can extenders get enacted without a coronavirus bill?

Potential Legislation in 2021?

- The debt limit expires in 2021.
- Infrastructure bill?
- Retirement savings bill?
- Bill to encourage pharmaceutical and other companies to engage in production in the United States?
- If there is a Republican-controlled Senate, many of Mr. Biden’s campaign proposals are unlikely to be enacted, such as:
  - Increasing the maximum individual tax rate from 37% to 39.6%;
  - Taxing capital gains at the ordinary income rate;
  - Changing the estate tax; and
  - Increasing corporate taxes, such as by raising the corporate tax rate.

Potential Legislation in 2021? (cont'd)

- TCJA changes effective in 2022 include:
  - Tightened section 163(j) interest deductibility; and
  - Required amortization of research expenses.
- Phase-down of section 168(k) expensing begins in 2023.
- Could some TCJA items be dealt with along with Democratic priorities, such as expanding the child tax credit and the earned income tax credit?

2022 and beyond?

- November 2022 elections
  - 34 Senate seats will be up for election in 2022, most of which are currently held by Republicans. If the Democrats do not take control of the Senate as a result of the Georgia run-offs, they would have another opportunity to take control in the 2022 elections.
  - However, in 2022 Republicans hope to maintain control of the Senate and retake control of the House.
  - Republicans are likely to benefit in the House elections from redistricting and reapportionment as a result of the 2020 census.
  - The President's party often does not fare well in mid-term elections.

TCJA Provisions Expiring at the End of 2025

- More than 20 TCJA provisions affecting individuals will expire at the end of 2025. Some examples include:
  - Reduced income tax rates;
  - Increased exemption for the individual alternative minimum tax;
  - Increased standard deduction;
  - Section 199A deduction for pass-through businesses and sole proprietorships;
  - Increased estate and gift tax exemption; and
  - Limitation on the deduction for state and local taxes.
- What other unforeseen events will occur in coming years that will affect government policy?

Long-Term Issues

- Rising deficits and debt
  - The deficit for the fiscal year that ended Sept. 30, 2020 was $3.1 trillion, up from $1 trillion for the previous fiscal year.
  - Federal debt is now about 100% of GDP, the largest percentage since the end of World War II.
- Interest rates on the debt are currently low, but will they remain low?

Long-Term Issues (cont'd)

- Large federal debt balances could have a number of adverse consequences, including:
  - Crowding out private investment;
  - Upward pressure on interest rates;
  - Pressure for tax increases or spending cuts in the future;
  - Reduced ability to respond to economic problems; and
  - Greater chance of a fiscal crisis.
- Will additional types of tax need to be considered someday, such as a value-added tax or a carbon tax?
- Trust funds for important federal programs are depleting, including Social Security and Medicare.

Tax Regulations

- The Trump Administration is working hard to finalize as many TCJA-related tax regulations as possible before the end of 2020.
- It is customary for a new administration to review regulations issued during the prior administration.
  - For example, the Trump Administration reviewed various regulations issued by the Obama Administration.
  - What regulations might a Biden Administration revisit?

Tax Regulations (cont’d)

- Like the initially issued regulations, the process to amend regulations generally requires adherence to the notice-and-comment procedures of the Administrative Procedure Act.
- Furthermore, like the initially issued regulations, the amended regulations must satisfy the *Chevron* standards.
- What would be the regulatory priorities of a Biden Administration?

Global Matters

- A Biden Administration is likely to take a more multilateral approach to global issues as compared to the Trump Administration.
  - Climate change
  - Trade
- An “Inclusive Framework” of 137 countries is working on a project of the Organisation for Economic Co-operation and Development (OECD) to address taxation of the digital economy.
- Both the Obama and Trump Administrations have been part of the OECD negotiations to try to reach a global consensus in this area.
- What position would a Biden Administration take in the OECD negotiations?

OECD Digital Economy Project

- Market countries believe that they should have jurisdiction to tax foreign companies that earn profits from digital commerce in a market country, even if the foreign companies do not have a physical presence in the market country.
  - Physical presence is the longstanding basis for taxing jurisdiction.
  - Compare the 2018 *Wayfair* case, in which the U.S. Supreme Court held that an out-of-state seller can be required to collect and remit a state's sales tax even though it has no physical presence in the state.
- Compelling foreign companies to "pay their fair share" is a political issue.
- In addition, governments especially want to increase tax revenue now as a result of the diminution of revenues caused by the pandemic.

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OECD Digital Economy Project (cont’d)

- Many countries have enacted digital services taxes (DSTs) or plan to enact DSTs, which the United States and U.S. companies vigorously oppose.
  - DSTs are targeted at U.S. technology giants.
  - The enactment of DSTs would likely result in complexity, multiple taxation and disputes.
  - In order to protect the U.S. tax base, the U.S. Treasury Department recently issued proposed regulations that would deny foreign tax credits for DSTs.
- The objective of the OECD project is to reach a global consensus that countries will implement rather than DSTs.
- It is hoped that reaching a global consensus will deter countries from taking unilateral action, and that countries that have enacted DSTs will repeal them.

OECD Digital Economy Project (cont'd)

- The OECD is working on a proposal (so-called Pillar One) that would permit a market country to impose a tax on a portion of "excess profits" from digital activity in the market country.
- The OECD is also working on a proposal (Pillar Two) to ensure that companies pay a minimum amount of tax in each jurisdiction in which they operate, to discourage companies from moving operations and income to low-tax jurisdictions.
- The OECD has set a deadline of mid-2021 to reach a consensus on both pillars.
- If consensus is not reached, more countries are expected to take unilateral action and enact DSTs.

State Tax Policy Issues Regarding Services
Income and Sales Taxes

Income Taxes:

- Move to single-factor, market-based sales, apportionment formula. Consequences:
    1. Nexus determinations via apportionment results
    2. Apportionment via single-factor, market-based sales, formula
- P.L. 86-272 interpreted to not protect sales of services

Sales Taxes

- States will increase taxation of sales of services
- Three issues to be resolved to do this properly
    1. Defining the service
    2. Avoiding pyramiding
    3. Avoiding drag on the national economy

State Tax Policy Issues Regarding Services Income Taxes (1/6)

History in 120 seconds:

- 1957: UDITPA developed. Equally-weighted three-factor apportionment formula with cost of performance (COP) for other than TPP. Q: *Why this approach? Seeking each state's "contribution…toward the production of the income…"* (Pierce, *Taxes* "The Uniform Division of Income for State Tax Purposes" Oct. 1957 at 780).

- 1966/7: Multistate Tax Compact: Incorporated UDITPA.

- 1978: *Moorman Manufacturing Company v. Bair, Director of Revenue of Iowa*, 437 U.S. 267. *Q: What did the Supreme Court actually say? And see Brennan, J. dissent, which also references a dissent from 1964.*

- 2015 and 2016: State courts held that the Multistate Tax Compact is not binding on the states.

State Tax Policy Issues Regarding Services Income Taxes (2/6)

2020 – Where are we now?

- 38 states (plus D.C. and NYC) have moved away from an equally weighted three-factor formula using COP for sales
- 33 states have adopted a market sourcing rule for sales of other than tangible personal property
- 23 states (plus D.C. and NYC) have adopted a single-factor (sales) formula
- 22 states have a single-factor formula and market sourcing

Source: Bloomberg Law: Tax Chart Builder Nov. 22, 2020

State Tax Policy Issues Regarding Services Income Taxes (3/6)

2021 and beyond: Using market-based apportionment to determine tax presence -- A *primary* exposure that the states have created for themselves

- The states are using (and increasingly will use) these formula to evaluate tax presence
- Under *Complete Auto Transit v. Brady,* 430 U.S. 274 (1977) substantial nexus and fair apportionment are distinct tests of validity under the Commerce Clause
- Using apportionment results to determine income tax presence is presumptively improper, and the states know it. *See e.g.*, Illinois reg. 100.9720 ("However, the fact that Article 3 of the IITA requires a non-resident taxpayer to allocate or apportion income to this State does not create a presumption that the taxpayer has nexus.")

State Tax Policy Issues Regarding Services Income Taxes (4/6)

2021 and beyond:

- Using market-based apportionment as the exclusive basis for apportioning income – A *secondary* exposure that the states have created for themselves

- How can it be true that:
  a) an equally weighted three-factor formula with sales of services sourced based on cost of performance fairly measures a state's *"contribution…toward the production of the income…"* and that

  b) the revenue driven adoption of a single-factor (sales) formula based on market-sourcing also fairly measures a state's *"contribution…toward the production of the income…"* ?

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State Tax Policy Issues Regarding Services
Income Taxes (5/6)

2021 and beyond: Public Law 86-272 (15 U.S. Code §381). Does it protect vendors of services lacking physical presence in the state? The statute provides that

> "No State…shall have power to impose…a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following: (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property…"

State Tax Policy Regarding Services Income Taxes (6/6)

2021 and beyond: Public Law 86-272. Some pro-tax advocates believe that P.L. 86-272 is limited to sellers of tangible personal property (i.e., the law does not protect vendors of services who lack physical presence in the state):

- What the law says: No State…shall have power to impose…a net income tax on the income derived within such State by any person from interstate commerce…
- What the states read: No State…shall have power to impose…a net income tax on the income derived within such State by any person from the sale of tangible personal property in interstate commerce…

State Tax Policy Issues Regarding Services Sales and Use Taxes (1/3)

7X

During 2019, the states collected seven times more tax revenue from basic transaction taxes (general sales and use taxes, motor fuel taxes, tobacco taxes, and alcohol taxes) than from corporate income taxes; In all, corporate income taxes comprised a mere 5.3% of state tax collections. *See e.g.*, "State Government Tax Collections Summary Report: 2019," U.S. Department of Commerce (May 1, 2020).

State Tax Policy Issues Regarding Services Sales and Use Taxes (2/3)

2021 and beyond: Despite decades of failures, the states will expand the types of multistate services on which they attempt to impose sales taxes.

- The potential tax collections are enormous.

- This is discussed in detail in the amicus brief I filed with the U.S. Supreme Court in *Wayfair* on behalf of neither party. (Available on the Supreme Court website and by request.)

State Tax Policy Issues Regarding Services
Sales and Use Taxes (3/3)

2021 and beyond: Despite decades of failure, the states will expand the types of multistate services on which they impose sales taxes.

- Issues include defining the service, pyramiding, and sourcing. The states struggle with each of these. Potential solutions include:

  a) To reduce pyramiding: Limit tax to retail sales to nonbusinesses. *But political problems.*
  b) To reduce the drag on the national economy: Experiment with intrastate transactions first. *But political problems.*

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