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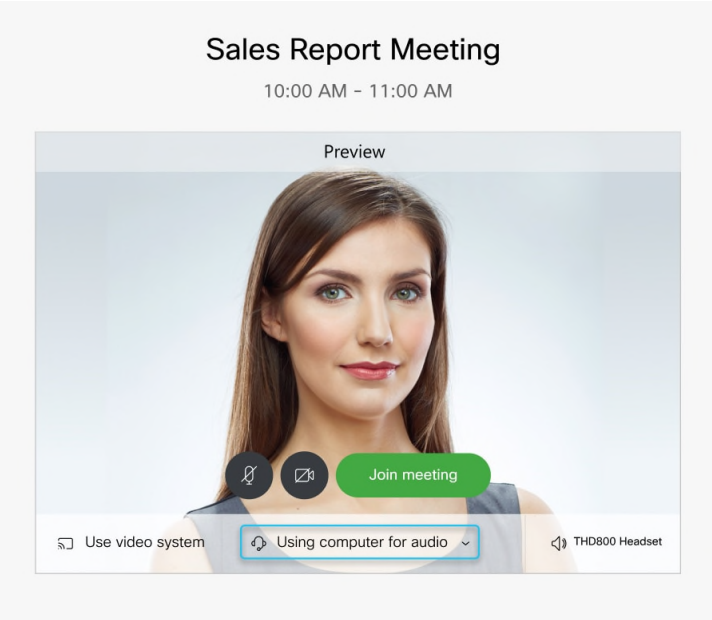

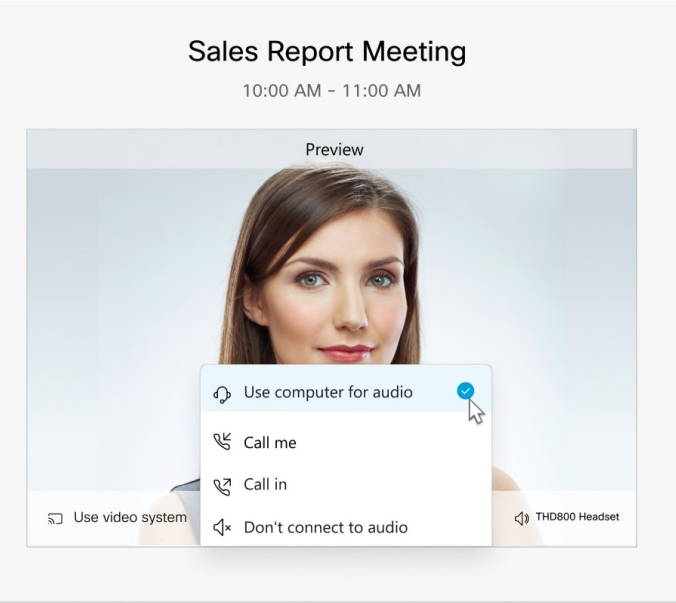

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Conservation Easements: The Wars Continue

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The Battlefronts

- Technical foot faults
  - Proceeds clause
  - Retained rights,
  - Relatively natural habitat/open space
  - RERI issues

- Valuation
- Appraiser penalties
- Criminal investigations
- Injunctions
- Allegations of civil fraud

(A settlement offer?)

Conservation in Perpetuity

- To qualify for a charitable contribution deduction the contribution must be in perpetuity

- Section 170(h)(5)(A) - The conservation purpose must be protected in perpetuity

The Proceeds Clause Regulation to Meet Conservation in Perpetuity

- At the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a **property right**, immediately vested in the donee organization, **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.** . . . That proportionate value of the donee's property rights shall remain constant.

The Proceeds Clause: The Ratio

- Example

$$\frac{\$900{,}000 \text{ value of the conservation easement}}{\$1{,}000{,}000 \text{ value of the property as a whole}}$$

- 90%

The Proceeds Clause: Applying the Ratio

- Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion. . . Must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction

Language of Some Conservation Deeds

- The parties stipulate to have a current fair market value determined by multiplying the fair market value of the Property unencumbered by this Conservation Easement (**minus any increase in value after the date of this Conservation Easement attributable to improvements)** by the ratio of the value of the Conservation Easement at the time of this conveyance to the value of the Property at the time of this conveyance without deduction for the value of the Conservation Easement.

Where Did the Language Come From?

- The IRS interpreted the regulation to apply only to the property interest and precluded the value of the improvements in PLR 200836014

- The Land Trust Alliance drafted sample forms based on the IRS's PLR

Then the IRS changed Its Interpretation of the Regulation

- At some point the IRS changed its interpretation of the regulation and decided that the ratio applies to improvements that the donor has made to the property

How the Proceeds Clause Works

- Bob donates an easement on GreenAcre and retains the right to build a home on the easement
- Before value $1,000,000-after value $100,000 (90%)
- One year later, Bob builds a home worth $500,000 and pays for it with his inheritance
- Year two – the County condemns the property for $600,000
- Donee gets 90% of the $600,000 and Bob gets 10%
- Even though Bob did not donate his home he loses his equity

That Can’t Be Right

- The Tax Court, **in a bench opinion**, interpreted the proceeds clause in PBBM-Rose Hill as requiring that the Conservation Deed pay the improvement proceeds to the donee. The Fifth Circuit upheld the tax court. 900 F. 3d193, 208(5th Cir. 2018)
  - A bench opinion isn’t even binding on the Tax court
  - But the 5th Circuit opinion is binding on cases appealable to the 5th Circuit

The Proceeds Clause Regulation (Not a Model of Clarity)

- At the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a **property right**, immediately vested in the donee organization, **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.** . . . That proportionate value of the donee's property rights shall remain constant.

What Does the Proportion Relate To?

- **Fair market value** – that then remains constant
- **Property right** – so that the proportionate value rises or falls with the value of the property
- **Last antecedent rule of construction** – then the proportion would relate to fair market value (Justice Scalia loved the last antecedent rule of construction)

Oakbrook Land Holdings

- *Oakbrook Land Holdings, LLC William Duane Horton, Tax Matters Partner, Petitioner v. Commissioner, 154 T.C. No. 10 (May 12, 2020)*

- The deed in *Oakbrook* interpreted the proceeds clause as modifying fair market value rather than property right-following the last antecedent rule of construction

- Therefore, the ratio determined the fair market value and that fair market value remained constant

IRS Interpretation of the Proceeds Clause

- All Judges on the Tax Court determined that the proportion relates to the property rights
- According to the IRS and the Tax Court, upon a condemnation, the donee must get a proportion of the value in the entire proceeds including condemnation proceeds relating to retained rights
- But the decision turned on the language in the deed. Had the deed been a standard LTA form deed several judges would have dissented.

Oakbrook Land Holdings Judge Holmes

- Judge Holmes heard the case and determined that the proceeds regulation was invalid since it was promulgated in violation of the Administrative Procedures Act

- Judge Holmes did not get to write the majority opinion on the main issue of whether the regulation violated the Administrative Procedures Act

- Judge Lauber wrote the majority opinion and that is why the taxpayers lost

CLE Code

- IRS

The Administrative Procedures Act

- The Taxpayer in *Oakbrook* argued the regulation was invalid because it was promulgated in violation of the APA
- Under the APA, before the IRS can issue regulations they must open the process up to a period of comments and then the IRS must address those comments in order to be deemed to have engaged in reasoned decision making
- Judge Holmes believed the regulation did not comply with the notice-and-comment procedures of the APA and that the agency did not engage in reasoned decision-making

Chevron Step Two

Under *Chevron* (S. Ct. 1984), Courts give deference to an agency's interpretation of a statute (*Chevron* deference) if:

Step One: Congress did not speak directly to the precise issue in question

Step Two: The agency's answer is based on a permissible construction of the statute.

Chevron Deference

- Four Judges found that the statute did not speak to the precise issue in question – it doesn't talk about value at all – it just talks about duration. This is Chevron step one and the Court found step one was met.

- But they held the regulation violated step two of Chevron in that the agency's answer was not a permissible reading of the statute

- They ruled with the majority because of the language of this particular deed

Timing Is Everything

- The tax bar has been waiting on the Oakbrook decision for years

- While it has been pending and the Judges no doubt had been working on their various opinions, the Supreme Court decided *Kisor v. Wilkie,* but the Court did not address the implications of that case on *Oakbrook*

- The Court had likely been working on their opinions for years

Kisor Supports Chevron Zero

- For ambiguous regulations: agency's interpretation is entitled to deference unless common-law already supplies the answer. In that case the agency's interpretation is afforded no deference.

- Judge Kagan specifically held that an agency's regulation would not be afforded deference if it related to common-law property terms

- In other words when the subject of the dispute falls more naturally to another party (in real estate matters state law would control). *Kisor v. Wilkie, 139 S. Ct. 2400 (2019)*.

Chevron Step Zero

- According to Justice Roberts, Chevron does not apply if congress did not intend to delegate the decision making to an agency. *King v. Burwell* (insert quote)

- The regulation purports to give the donee a property interest it doesn't get under State law.

- Rights in real property are governed by state property laws. *See, e.g.*, *United States v. Mitchell*, 403 U.S. 190, 197 (1970) ("In the determination of ownership, state law controls.")

Circuit Court Cases Challenging Proceeds Regulation

- *Hewitt* (11th Cir.) – validity of regulation and compliance with APA
- *Oakbrook* (6th Cir) – validity of regulation and compliance with APA
- *Bosque Canyon* (5th Cir.) – was remanded to the 5th Circuit after taxpayers won the restriction on use and baseline issues but the deed has a proceeds clause issue and taxpayer expects that Judge Lauber will disallow the easement on that basis

Other Defenses to the Proceeds Regulation

- Reformation based on mutual mistake of law
- Savings clauses
- The remoteness regulation
- Retained rights are insufficient to impact value (and equation)

Reformation of Deeds

- Parties to a deed may reform the deed if due to a mutual mistake of the parties the deed does not express the intent of the parties. *Estate of Holland*, T.C. Memo 1997-302. (Based on Georgia law)

- *Dodge V. U.S.* 413 F. 2d 1239 (5th Cir. 1969). Decisions of the 5th Circuit before October 1, 1981 are precedent for the 11th Circuit

Reformation Due to Mistake

- O.C.G.A. § 23-2-22

- An honest mistake of the law as to the effect of an instrument on the part of both contracting parties, when the mistake operates as a gross injustice to one and gives an unconscionable advantage to the other, may be relieved in equity

- *In re Stalp's Will*, 35 AFTR 2d 1000-1999, the court reformed a deed because the regulations were so confusing it would have been only by happenstance if anyone had drafted the trust correctly

The *Golsen* Rule

- The Tax Court is bound by the laws of the circuit where the taxpayer resides. In the 11th Circuit the taxpayer can amend a deed based on mistake of law.

- *Golsen v. Comm.*, 54 T.C. 742 (1970) aff'd, 445 F. 2d 985 (10th Cir. 1971)

Savings Clauses

- An order of the tax court recently held that a savings clause violated the in perpetuity requirement. *TOT Property Holdings* (appeal pending before the 11th Circuit)
- The savings clause basically said no matter what else is in this deed we intend to comply with the regulations and the deed should be interpreted in compliance with the regulations
- *Comm., v Proctor*, 142 F. 2d 824 (4th Cir. 1944) – an impermissible savings clause unwinds the transaction. For example, if the IRS rules that I owe tax on the gift then I don't intend to make a gift

Remoteness Regulation

- A donation is still enforceable in perpetuity and shall not be disallowed "merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible." Treas. Reg. §1.170A-14(g)(3)

- *Oconee Landing* - Docket No. 011814-19. Petitioners provided a declaration from the county commission that the county had no plans to condemn the property. Court denied the government's motion for summary judgement on the proceeds clause but on another ground.

Negligible Impact on Value

- If the retained rights do not impact value, i.e. they are just maintenance rights and not rights to improve the property then the proceeds clause is not invoked

- *St. Andrews Plantation* - Docket No. 020849-17. The retained rights were just maintenance rights and did not impact value for purposes of the proceeds regulation. The Court denied the government's motion for summary judgement on the proceeds clause.

Government Attacks on Retained Rights

- *Belk v. Commissioner*, 774 F. 3d 221 (4th Cir. 2014). There must be a restriction on a defined parcel of land. Here the donor could swap parcels.

- *Balsam Mountain v. Comm*., T.C. Memo 2015-43. Changing the boundaries of the exterior easement violated *Belk*.

- *Bosque Canyon Ranch, L.P. v. Comm*, T.C. Memo 2015-130, vacated and remanded. *BC Ranch II. L.P. v. Comm*, 867 F. 3d 547 (5th Cir. 2017) – changing interior boundaries of retained rights is okay. The defined parcel is the exterior parcel that was donated.

Pine Mountain and Retained Rights

- In *Pine Mountain*, the taxpayer retained six home sites but the locations were not designated in the conservation deed
- The Tax Court changed the test again. Relying on *Belk*, *Balsam Mountain* and its own decision in *Bosque Canyon*, the Tax Court held that the retained rights within the larger donation must be delineated in the conservation deed.
- How do you do that? An easement is a partial interest in property. 170(f). The donor retains all the rights to the property not inconsistent with the donation.

Pine Mountain and Retained Rights

- Under state law, the entire property-including the retained rights are still subject to all of the restrictions in the conservation deed

- But the Tax Court said those remaining restrictions on the home sites were not sufficiently meaningful for purposes of 170(h)(2)(C)

- The 11th Circuit reversed the Tax Court in *Pine Mountain,* adopting the state law approach that the entire parcel is subject to restrictions. The case was remanded to determine conservation in perpetuity.

Carter v. Commissioner: Another Retained Rights Case

- Next, the Tax Court decided *Carter* and completely confused the test. Is it a restriction on use case or conservation in perpetuity case?

- Judge Halpern held, based on *Pine Mountain*, "that because the allowed uses within the building areas would be antithetical to the easement's conservation purposes, the residual restrictions applicable within the buildings areas would not be sufficiently meaningful to be taken into account in applying section 170(h)(2)." (The restriction on use test.)

Qualified Real Property Interest

- A restriction (granted in perpetuity) on the use which may be made of the real property. Section 170(h)(2)(C)
- In *Carter*, the real property consists of 500 acres along fives miles of deep navigable river
- The property had been zoned for up to 827 residential units and up to 160 docks on the river
- After the donation development is restricted to 11 two-acre home sites and nine docks

CLE Code

- **Audit**

Qualified Real Property Interest

- *Carter* and *Pine Mountain* both comply with the 4th Circuit opinion in *Belk*

- The Tax Court changed the rule in *Pine Mountain* (Judge Lauber)

- The building envelopes were subject to site and building approval of the land trust consistent with the treasury regulations. Section 1.170A-14(f)(5)

Application of Georgia Real Property Law

- The regulations define an easement by reference to state property laws. Treas. Reg. Section 1.170A-14(b)(2)

- Under Georgia law, the restrictions apply to the entire property and the specific rights within the property can be determined at a later date. *Jackson Elec. Membership Corp. v. Echols*, 84 Ga. App. 610, 611 (1951)

Conservation Purpose in Perpetuity

- Before the *Carter* case, the test for conservation in perpetuity was outlined in *Butler v. Commissioner*

- In *Butler*, the test is (given the donor exercised every retained right in the deed) whether the conservation purposes would be protected in perpetuity

Conservation Purpose

- *Champions Retreat Golf Founders v. Comm*., Docket No. 18-14817 (May 13, 2020)

- Taxpayer won on relatively natural habitat in the 11th Circuit

- Taxpayer won on open space in the 11th Circuit

Conservation Purpose: Relatively Natural Habitat

- The 11th Circuit held that a “rare,” “endangered,” and “threatened” species is a species that “reasonably warrants protection”
- Before *Champions*, *Atkinson* had held that the species had to be a G-2 or G-1 species (20 or fewer left on the planet)
- At least in the 11th Circuit, all the taxpayer has to prove is that the species reasonably warrants protection

Champions Retreat: Relatively Natural Habitat

- The 11th Circuit confirmed that the inquiry is whether the habitat is relatively natural, not whether the land is natural

- So it wasn't disqualifying that the easement was on a golf course. The Court noted that the bird species of concern found the golf course quite suitable as a habitat

Champions Retreat: Relatively Natural Habitat

- The 11th Circuit addressed coverage of a species.

- In *Champions*, the denseflower knotweed (a rare plant), existed on only 7% of the easement and the Tax Court had found that disqualifying. (Same issue in *Atkinson* with the Venus flytrap)

- The 11th Circuit disagreed noting that full coverage of a species is not required. The Circuit Court was equally unimpressed with the tax Court's ruling that drain off could have harmed the knotweed.

Champions Retreat: Relatively Natural Habitat

- "The relevant question is not so much whether chemicals from the course may harm the knotweed, but whether the easement improves the chance that the knotweed will be preserved." ***This really addresses conservation in perpetuity.***

- Will this sentiment apply in *Carter*?
  - Will the relevant question be not so much whether floating home sites impair conservation, but whether the easement on the entire property improves the chances of preserving the conservation purposes in perpetuity?

Champions Retreat: Relatively Natural Habitat

- The 11th Circuit held

- Were it not for the presence of a golf course on part of this property, the assertion that contributing an easement over property with this array of species does not qualify as a conservation purpose would be a nonstarter

Champions Retreat: Open Space for Scenic Enjoyment

Open space for scenic enjoyment must meet two requirements:

- Be for the scenic enjoyment of the general public; and
- Yield a significant public benefit.

Champions Retreat: Open Space

- The 11th Circuit found that the easement met the open space requirement because people enjoyed the rivers along and around the easement. Natural views were better than condos.

- The 11th Circuit found that preserving natural views along these two rivers – the other side holding a national forest that was also free of development – serves a public interest

Champions Retreat: Open Space

- Were it not for the presence of a golf course on part of this property, the assertion that preserving open space alongside rivers with three- to ten-foot banks cannot be “for the scenic enjoyment of the general public” and provide a public benefit would be a nonstarter

- The notion that banks along the river somehow prevent the scenic enjoyment is a makeweight

Reri Issues

- *Oakhill Wood, LLC v. Comm.,* T.C. Memo 2020-24. The taxpayer failed to put the cost basis on the Form 8283. The Tax Court granted the Commissioner's motion for summary judgment.

- *Belair Woods, LLC v. Comm.,* T.C. Memo 2018-159. The taxpayer failed to put the cost basis on the Form 8283 but the Court did not grant the Commissioner's motion for summary judgment because there was a dispute of material fact over whether the taxpayer had reasonable cause for the failure. The taxpayer subsequently lost on the proceeds clause.

Reri Issues

- *St. Andrews Plantation* – Docket No. 020849-17. The taxpayer donated three easements over two years.
- The first donated easement failed to include the basis information on the Form 8283.
- The Tax Court denied the governments motion for summary judgment because there was a dispute of material fact over whether the taxpayer had reasonable cause for the failure.

Valuation

- Many valuation issues have revolved around the property being valuable enough to avoid the automatic 40% penalty

- *Reri Holdings I, LLC v. Comm.*, 149 T.C. 1, aff''d sub nom *Blau, Jeff v. Comm.*, 123 AFTR 2d 2019-1960 (2019). Judge Halpern held that evidence of a recent sale of the same property is evidence of value.

Valuation

- Two Judge Lauber opinions asking the wrong questions

- *Plateau Holdings, LLC v Comm*., TC Memo 2020-93. It appears from the Judge's opinion and questions he believes the underlying value of the real estate must equate somehow with the value of the partnership interests at the time of an investors purchase of the partnership interest. That is what he held after a trial in this case.

- *Coal Property Holdings, LLC* – Docket No. 27778-16 Order served June 15, 2020

Valuation

- *Plateau* and *Coal Property Holdings* differ from how fair market value has been analyzed in the past

- The IRS has now started to file motions for summary judgement on value. But value has always been a question of fact precluding summary judgment.

Valuation Cases

- *Glade Creek Partners LLC v. Comm.*, T.C. Memo 2020-148. Here Judge Goeke reiterated that valuation, including highest and best use is a question of fact.

- *Kumar Rajagopaian et. al. v. Comm.*, T.C. Memo 2020-159. Judge Holmes, citing PD Wodehouse, determined that the value on the return was correct because of "an amazingly frothy local real estate market in 2006." He stressed this fact pattern was an anomaly.

Valuation

- *Hewitt v. Comm*., T.C. Memo 2020-89 (6/17/2020). These taxpayers lost on the proceeds clause but Judge Goeke found that the value was closer to the taxpayer's appraisal and that the government was too pessimistic. No penalties imposed.

- *Johnson v. Comm*., T.C. Memo 2020-79 (6/8/2020). (Pugh) Upheld easement. Reduced value from $875,051 to $372,919.

- In *Johnson*, the Court criticized the respondent's qualitative analysis and preferred the petitioner's quantitative analysis

Valuation

- *Pine Mountain* involved three easements. The Court allowed the easement that did not retain any rights. Judge Morrison compromised between the petitioner's and government's appraiser.

- For one of the *Pine Mountain* easements that was disallowed, Judge Morrison ruled that the value of the easement was greater than what the taxpayer had taken on the return. The Tax Court had disallowed the deduction because the location of the retained rights could be moved.

Appraiser Audits

- Any appraiser who has appraised a conservation easement will likely be audited

- The government is asserting the Section 6659A penalty

The Section 6695A Penalty

- Appraiser prepares an appraisal that the person reasonably should know will be used in connection with filing a return, **and**

- The value claimed on the return results in a substantial valuation misstatement under 6662(e) or a gross valuation misstatement under 6662(h), **then**

- Penalties will be asserted against the appraiser.

The Section 6695A Penalty

- The amount of the penalty is the greater of either 10% of the amount of the underpayment or $1000, or

- 125% of the gross income the appraiser received for prepapring the appraisal.

- No penalty if the appraiser establishes that the value in the appraisal was more likely than not the proper value

Criminal Investigations

- While the IRS can conduct administrative criminal tax investigations and the DOJ can conduct grand jury tax investigations, no one can be indicted for a tax crime unless and until the DOJ tax division approves the indictment.

- Under Section 6103 disclosure of any criminal investigation is limited. If prosecution is approved the U.S. attorney for the appropriate venue will issue a press release.

Civil Fraud Penalty

- The Commissioner has published notices outlining the government's position regarding asserting civil fraud penalties in syndicated easement cases

- The burden of proving civil fraud is preponderance of the evidence which is an easier burden to prove than criminal fraud, which is beyond a reasonable doubt

- Difficulties in proving fraud based on opinion evidence

Injunctions

- December 19, 2018 – sought a permanent injunction against EcoVest Capital Inc., Alan N. Solon, Robert M. McCullough, Ralph Teal, Nancy Zak, Claud Clark III

- The Justice Department issued a press release asserting inflated appraisals and that the easement are shams. Justice asserted over $2.0 billion in lost revenue because of the transactions.

Government Settlement Offer

For Investors

- Forfeit the deduction
- Pay tax and interest
- Pay up to 20% penalties
- Current deduction of investment

For 8918 Filers

- Forfeit the deduction
- Pay tax and interest
- Pay 40% penalty
- No current deduction

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IRS Audits, Controversies, and Litigation Under the Partnership Audit Rules
"The BBA Partnership Audits Have Arrived"

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IRS Launches Website With BBA Resources

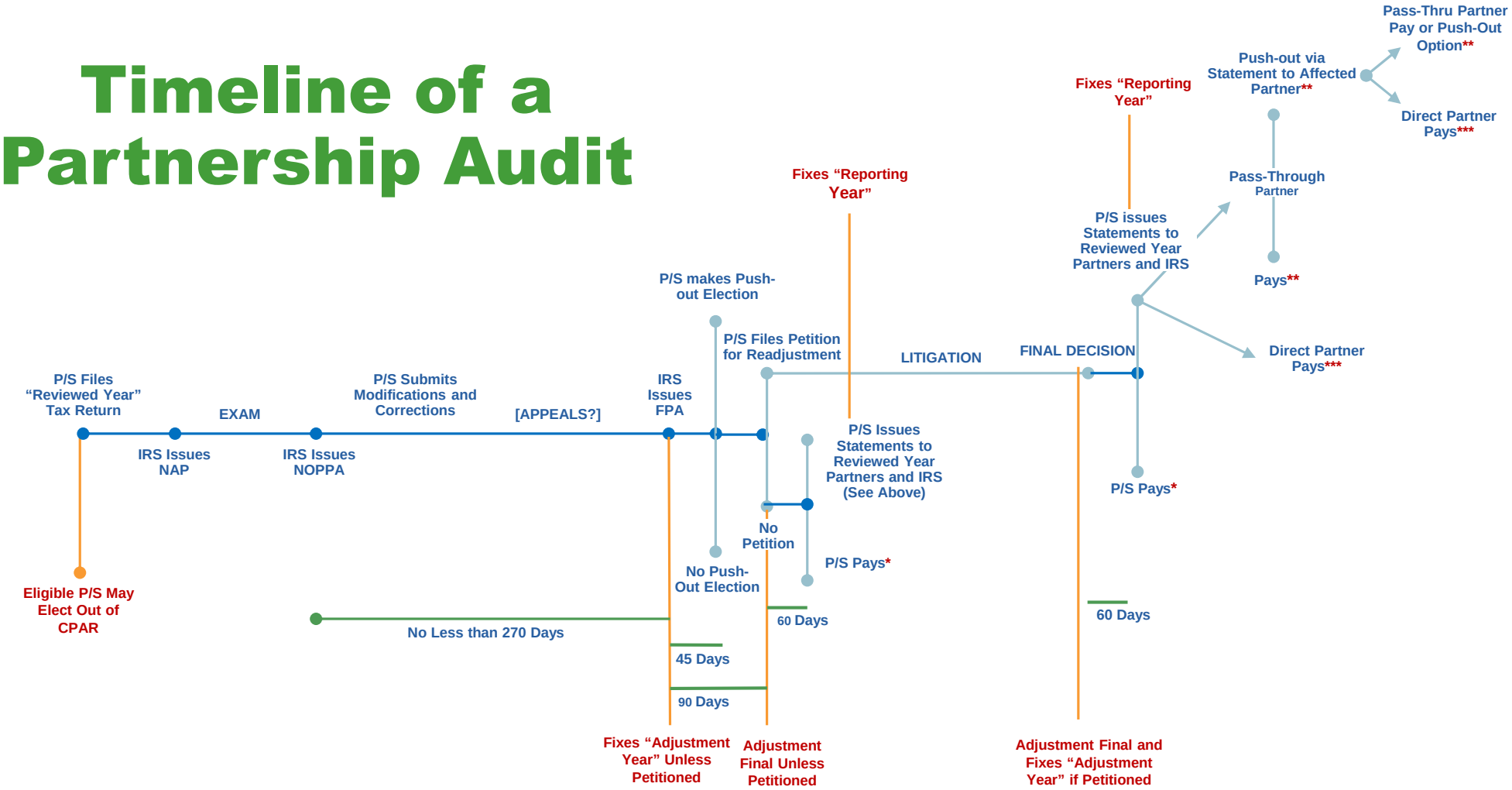
- **Website:** https://www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime
- **Filing Requirements**
  - Partnerships under the BBA centralized partnership audit regime must take certain actions when filing or making changes to a return. These include:
    - Designating a Partnership Representative (PR)
    - Option to elect out of the centralized partnership audit regime, if eligible
    - Filing an Administrative Adjustment Request to change a prior return
- **BBA Partnership Audit**
  - Notices to expect from the IRS and actions to take during a BBA partnership audit, also called an examination

Comparison of TEFRA & BBA

https://www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime

Partnership Procedures	TEFRA	BBA
Partnership point of contact for examination	Tax Matters Partner	Partnership Representative
Partner participation rights during examination	Partners have the ability to participate in the examination and challenge partnership adjustments	Partners have no participation right to challenge partnership adjustment
Partner consistency of reporting	Partners must report items consistently with the partnership	Partners must report items consistently with the partnership
Notice requirements	Notice requirements (NBAP, FPAA)	Notice requirements (NAP, NOPPA, FPA)
Items adjusted during examination	Partnership item/Affected item	Partnership related item (PRI)
Where adjustments/assessments occur	Adjustments at the partnership level/tax assessment at the partner level	Adjustment and assessment at the partnership level (imputed underpayment)
Distinct phases of examination	Field examination	Field examination phase
	Not applicable	Modification phase (optional)
	FPAA phase	FPA phase
	Not applicable	Push-out phase (option

Timeline of a Partnership Audit



BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- Ability of partnership to "Elect in" for tax years beginning after November 2, 2015 and before January 1, 2018. Temp. Reg. §301.9100-2T (8/6/2016). BBA §1101(g)(4)
- Notice 2016-23, 2016-13 IRB. Service's list for "comments" on BBA
- Notice of proposed rulemaking REG-136118-15 (6/14/2017) a/r/a "June 14 NOPRM"
  - June 14 NPRM contained rules pertaining to (1) the scope and election out of the new BBA (2) consistency in reporting by partners, (3) the powers and duties of the partnership representative,(4) partnership adjustments made by the IRS and determinations of the amount of the partnership's liability (imputed underpayment), (5) the filing of administrative adjustment requests, and (6) the election for partners to take the partnership adjustments into account (§§ 6221 through 6227 and 6241)

BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- June 14 NPRM reserved comment on (1) how partners take into account basis adjustments and tax attributes in push-outs under §§ 6226 and 6227 for AARs; (2) rules pertaining to foreign entity partners; (3) adjustments to outside basis, capital accounts, partnership's asset basis and book value in property; and (4) rules coordinating the AAR with foreign tax credits
- Proposed Regulations on International Provisions under the BBA. REG 119337-17 (11/30/2017)
- Proposed regulations on push-out elections under Sections 6226 and 6227. 82 Fed. Reg. 60144-01
  - Included rules for tiered partnership structures
  - Applicable rules as to administrative and procedural provisions

BBA Published Guidance from the Internal Revenue Service and Tax Technical Corrections Act

- Final Regulations on Election-Out Under Section 6221(b) (2/2/2018) (discussed below)
  - Coverage: (1) determining number of partners (100 or fewer); (2) who is an eligible partner for an "eligible partnership" per §6221(b); and (3) election-out mechanics and disclosure requirements
  - Requirement of Section 6221(b)(1)(C). Certain partnerships with 100 or fewer partners may elect, by its partnership representative, for a particular partnership taxable year to avoid application of the centralized audit rules, provided that each of the partners is "an individual, a C corporation, any foreign entity that would be treated as a C corporation were it domestic, an S corporation, or an estate of a deceased partner."
  - S Corporation Partners – Section 6221(b)(2)(A)

BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- Preamble to June 14 NPRM: Notice (Rationale) not to expand "eligible partners"
  - "It would undermine the benefits of the new regime to expand the group of partnerships that are eligible to elect out of the new regime. Moreover, it would be unwise to do so at a time before the first returns for taxable years subject to the new regime have been filed."
- **Final Election-out regulations**. Keep the same limitation on who is an eligible partner. Treas. Reg. 301.6221(b)-1
  - Partnership
  - Defective entity S shareholder does not disqualify S Corporation partner
  - Disregarded entity ineligible direct partner
  - Election-out mechanics. Election-out must be made on the eligible partnership's timely filed return—including extensions—for the taxpayer year to which the election applies and must include all information required by the IRS. Notification to partners within 30 days.
  - Election-out by partnership that is itself a partner. Still results in the BBA rules being applied to the upper-tier partner despite its having elected out.
  - De Facto Partnership Issues. See, e.g, *US v. Papandon* 331 F.3d 52 (2nd Cir. 2003)

BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- Proposed Regulations 82 FR 50144-01 (12/19/2017) (December 19 NPRM 2017) Push-Out Election Rules Under Sections 6226 and 6227
  - Rules pertaining to the assessment and collection of tax, penalties and interest, and periods of limitation under the BBA; include judicial review provisions
  - **Allows multi-tiered partnerships to be part of the push-out election process with each level of the partnership tiers having the right to pay the resulting assessment under §6225 or timely push-out the required tax payment to its partners under §6226(b)**
  - **Adopts multiple imputed underpayments for §6225 purposes (see June 14 NRPM 2017).** The partnership could elect to push out the specific imputed underpayment(s) to the affected partners which the partnership could pay the general imputed underpayment.

BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- Requirements for Push-Out Election Under Section 6226(b)
  - Partnership must file push-out within 45 days after the FPA is mailed per §6231
  - Partnership must furnish a statement of each partner's share of adjustments to its reviewed year partners no later than 60 days after the partnership adjustments become final, i.e., expiration to file judicial petition per §6234 or when decision is final. Treas. Reg.§301.6226-2 (statements to IRS/partners)
  - Contents of push-out election statements. See Treas. Reg. §301.6226-2(e)
  - Determination of each partner's share of adjustments. Treas. Reg. §301.6226-2(f)

BBA Published Guidance From the Internal Revenue Service and Tax Technical Corrections Act

- **Two categories of Section 6226(b)(2) Adjustments for push-out elections**. Treas. Reg. §301.6226-3
  - Reviewed or “first affected” year
  - Intervening year(s). Increase for first affected and subsequent years based on push-out statement
  - Adjustments to tax attributes
- **Safe harbor amount or interest safe harbor amount**
  - Applies to reviewed year partner to pay amount of tax and/or interest in lieu of making detailed tax calculations for the reviewed and intervening years. Treas. Reg. §301.6226-3(c). (safe harbor interest is based on underpayment rate plus 5 percentage points)
  - Contrast for push-out purposes reviewed year partners pay interest at the underpayment rate under §6621(a)(2) plus 3 percentage points
- **Penalties, additions to tax, or additional amounts** determined at the partnership level. Partner level defenses may be raised provided payment in full is made. Treas. Reg. §301.6226-3(d)(3)
- **Pass-through partner**. Required filing of partnership adjustment report and file and furnish statements. Treas. Reg. 301.6226-3(e). Penalty provision for failures. Section 6698

Quick Recap of Key Concepts

- **Adjustments to any partnership-related items:** BBA very broadly allows for adjustments to partnership-related items at the partnership level. A partnership-related item is any item or amount with respect to a partnership which is relevant in determining the tax liability of any person under Chapter 1. Compare TEFRA's "affected item" distinction. *Lawrence Gluck*, TC Memo. 2020-66. See Treas. Reg. §301.6226-3(e)(iv)(affected partner must take into account adjustments).
- **Partnership representative**: PR participates in the partnership-level audit proceeding, and is the only person with the statutory right to do so. Actions are binding on all partners and the partnership. Authority with respect to the audit cannot be limited by state law or partnership agreement.
  - PR Considerations: With the rise of Tax Indemnity Insurance products, could a niche field arise where insurance companies fill the role of PR? Possible synergies? Possible misalignment of interests? Discussed in more detail below.
  - Partnership Adjustments that do not result in imputed underpayment. Treas. Reg. §301.6225-3 (adjustments required to be taken into account in the adjustment year).
  - Push-Out Election. Not taken into account by the Partnership for the partnership adjustments. Treas. Reg. §301.6225-3(c)(6)
- **Supremacy of the partnership-level proceeding:** BBA by default (and with narrow exceptions) requires adjustments, assessments, penalties, collection, etc. to be done at the partnership-level; it dispenses with distinction between "partnership" and "affected" items.

A New Regime and New Terminology

- **Partnership Representative:** Partner or other person with a substantial presence in the U.S. designated by the partnership with *sole* authority to act on behalf of and bind the partnership and partners. Section 6223
- **Reviewed Year:** Partnership year being audited §6225(d)(1)
- **Adjustment Year:** Year in which the adjustments become final. §6225(d)(2) via:
  - Decision of court proceeding finalized §6225(d)(2)(A)
  - AAR (year) request is made §6225(d)(2)(B)
  - Notice of Final Partnership Adjustment (FPA) is made
- **Imputed Underpayment:** Amount the partnership is required to pay in the adjustment year. See Section 6225. 301.6221(a)-1(a)
- **Push-Out Election:** Shifts burden of adjustment/collection from partnership to reviewed-year partners. Section 6226(b)
- **Election-Out:** Optional annual election for certain eligible partnerships to elect out of new regime. Section 6221(b)

Partnership Terminology Changes: Section 6241

- **Partnership**: Any partnership required to file a return under section 6031(a)
- **Partnership Adjustment**
- **Partnership-Related Item**
  - "**(i)** any item or amount with respect to the partnership (without regard to whether or not such item or amount appears on the partnership's return and including an imputed underpayment and any item or amount relating to any transaction with, basis in, or liability of, the partnership) which is relevant (determined without regard to this subchapter) in determining the tax liability of any person under Chapter 1, and
  - **(ii)** any partner's distributive share of any item or amount described in clause (i)
- Partnerships in bankruptcy proceedings. Suspension of limitations on adjustment, assessment or collection, judicial review
- Treatment where partnership ceases to exist
- Coordination with other Chapters (2, 2A, 3 or 4)

Tax Treatment of Partnership-Related Items

Partnership-Related Items

- Tax treatment of partnership-related items at PS Level. Treas. Regs. §301.6221-1(a); 301.6241-1(a)(6)(ii)
- Penalties determined at partnership level. Treas. Reg. § 301.6221-1(c) Partner-level defenses to such items can only be asserted through refund actions following assessment and payment. Assessment of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item shall be made based on partnership-level determinations.
- Partner level defenses. Treas. Reg. §301.6221-1(d). Can not be asserted during partnership level audit proceeding

Election-Out Section Treas. Regs. §6221(b); §301.6221(b)-1

Eligible partnership (b)-1(b)(1)

- 100 or fewer partners (k-1s)
- Required statements to eligible partner
- Each partner must be eligible
  - Eligible Partners
    - Individual
    - C Corporation
    - Eligible foreign entity
    - S Corporation (even if one or more shareholders are not eligible)
    - Estate of deceased partner

Ineligible Partners

- Partnership
- Trust
- Ineligible foreign entity
- Disregarded entity

- Special rule for S Corporations
- Effect of an election-out
  - IRS determination that election-out is invalid; impact. 6221(b)-(e)(2)

Poll Question 1

When can a partnership elect out of the BBA?

1. Anytime it wants – it's a free country
2. Only when all partners are individuals
3. Only if all partners are individuals, C Corps, eligible foreign entities, S Corps, or estates of deceased partners
4. None of the above

Imputed Underpayment

- **Imputed Underpayment:** The sum of **total net positive partnership adjustments,** multiplied by the highest federal income tax rate applicable to either individuals or corporations in effect for the reviewed year. Net negative adjustments for a reviewed year are left behind. AAR connection.
- **Bifurcating Underpayment:** Regulations permit an imputed underpayment to be bifurcated into “general” and “specific” underpayments. Specific imputed underpayments represent adjustments to items that were allocated to one partner or group. “General” underpayments represent all other adjustments.
- **Modification of Imputed Underpayment:** Within 270 days of the NOPPA, the partnership may request modification of the imputed underpayment by submitting a request which provides the necessary substantiation for the requested modification.

Notice of Inconsistent Treatment

- **Requirement of consistency:** The treatment of partnership-related items on a partner's return must be consistent with treatment on the partnership-return. Treas. Reg. §301.6221-1(a)(1); applies to all partners, including partnerships that are partners .-2(b)(3); applies to election out partnerships. -1(a)(2)
- **No return filed. Per se Inconsistent. -1(a)(3)**
- **Inconsistent treatment without notice:** The IRS can adjust the partner's return to make it consistent with the partnership treatment; any determinations of underpayment can be assessed and collected and are not subject to deficiency proceedings. -1(b)(2)
- **Notice of Inconsistent Treatment:** A partner may provide a statement to the IRS that identifies partnership related items and the inconsistency of treatment. Such notice must be attached the partner-return. -1(c)
  - Does not apply to partnership-related items that are adjusted through BBA procedures (either through binding actions by the partnership or through a final determination)
  - After a NOPPA under section 6233 partner can not notify IRS of inconsistent treatment. -1(c)(5)
- **Effect of notice:** The IRS may still adjust the item, but must do so in a partner proceeding.
- **Considerations for inconsistent treatment**

Partnership Adjustment by IRS §301.6225-1

Imputed Underpayment Based on Partnership Adjustment 301.6225-1(a)(1)

- Partnership must pay amount equal to imputed underpayment Each imputed underpayment is based solely as to a single taxable year. Payment is taken into account in adjustment year. 301.6241-4
  - Interest and penalties as to imputed underpayment. Section 6233
- If no imputed underpayments, adjustments must be taken into account in the adjustment year per 301.6225-3
- May result in more than one imputed underpayment. 301.6225-3(g)
- Included in a Notice of Final Partnership Adjustment (FPA) per 6231(a)(3) unless partnership waives right to FPA. 6232(d)2)
  - Alternative: push-out election by the partnership. 301.6226-1
- Imputed Underpayment In NOPA (Section 6231(a)
  - Modifications. Per Section 6225(c), Treas. Reg. 301.6225-2. IRS may allow modifications to change imputed underpayment in NOPA and must be set forth in the NOPA. 301.6225-2. Amended returns with payments
  - Pull-in filings with payments
  - Reallocation of distributive shares
  - Application of tax-exempt status, lower tax rate or treaty rate

Determination of Imputed Underpayment

- In broad scope. 301.6225-1(b)(1). Sequence of steps
- Grouping partnership adjustments
- Netting the adjustments
- Determining total netted partnership adjustment
  - Sum of all Net Positive Adjustments in the Reallocation Grouping and the Residual Grouping
- Multiplying Total Netting Partnership Adjustment by highest rate per reviewed year
- Increasing or decreasing the product (in last step) by
  - Amounts treated as Net Positive Adjustments and
  - Amounts treated as Net Negative Adjustments
- Adjustments to items for withholding collected under Chapters 3+4
  - Partnership adjustment ignored for imputed underpayment to extent collected by withholding

Grouping of Partnership Adjustments: Treas. Reg. § 6225-1(c)

- Grouping of Partnership Adjustments (Four Groupings)
  - Subgroupings
    - Negative Adjustments (decrease in income or increase in credit) -1(d)(2)(ii)
    - Positive Adjustments (increase in income or decrease in loss)
    - Regulations get fairly complex
    - Netting Adjustments within each grouping or subgrouping
  - Reallocation Grouping -1(c)(2)
    - Reallocations to and from a partner(s)
  - Credit Grouping -1(c)(3)
    - Includes reallocations of credits among a partner(s)
  - Credit Expenditure Grouping -1(c)(4)
    - Includes reallocation adjustment to a creditable expenditure (and creditable foreign tax expenditure)
  - Residual Grouping -1(5) (Section 702 (a)(8)) General Imputed Underpayment Amount
- Recharacterization Adjustment (character of gain and reallocated to each grouping)
- multiple imputed underpayments in a single administrative proceeding 301.6225-1(g)
  - IRS, in its discretion
  - Imputed Underpayments: (i) General (ii) Specific Imputed Underpayment

Modifications of Imputed Underpayment 301.6225-2

- **Partnership request modification of an imputed underpayment** (reflected in NOPPA per 6231(a)(2))
  - Modification must be requested by partnership (partnership representative)
  - As to a Reviewed Year Partner 301.6241-1(a)(9) including a pass-through partner -1(a)(5)
  - As to an Indirect Partner
  - Applicable rules on substantiation; must be submitted on or before 270 days after the NOPA is mailed; extension may be granted or agreed upon.
- **Effect of modification** 301.6225-2(b)(1). (Increase/decrease of imputed underpayment amount in the NOPA)
- **Modifications IRS approves as to a partnership adjustment** 301.6225-2(b)(2)
  - Amended returns and full payment of any amount due 301.6225-2(d)(2) for the first affected year 301.6626-3(b)(2) and all modification years at time amended return filed
- **Statutes of limitations under Sections 6501 and 6511 do not apply** to amended return filed under modification

Modifications to Imputed Underpayment per Section 6225(c)

- **Alternative (pull-in) to filing amended returns**
- **Based on tax exempt status 301.6225-2(d)(3)**
- **Based on tax rates 301.6225-2(b)(3)**
- **Based on closing agreement 301.6225-2(d)(8)**
- **Tax Treaty Modifications if applicable 301.6225-2(d)(9)**
- **Modification for partners that are "qualified investment entities" per §860 301.6225-2(d)(7)**

- **Alternative procedure to filing amended returns (to amended returns). The "pull-in"**
- **Treas. Reg. §301.6225-2(x)(A) (home of the "pull-in")**
  - Tax, penalties and interest are paid by the (reviewed year) partner
  - Such partner agrees to take into account the adjustments to tax attributes of partner
  - Modifications with respect to reallocation adjustments 301.6225-2(d)(4)
  - Files required information with IRS taking all adjustments required into account
  - Reallocation of distributive shares (whether amended return or pull-in) all must conform
- **Section 6225(c)(7) – Year and day for submission of modification requests**: 270 days starting with day of NOPA mailing unless extended with consent

Poll Question 2

Which of the following is a possible modification to the imputed underpayment?

1. Lower tax rate of one partner due to a tax treaty
2. Zero tax rate of one partner due to tax-exempt status
3. Both of the above
4. None of the above

CLE Code

- BBA

Pull-In Observations

- **Pull-in options:** If partnership owes tax due to IRS adjustment, the *reviewed year* partner could pay its allocable share of the adjustment without needing to file an amended return. The partnership can then reduce the imputed underpayment paid in by the partners.
- **Pull-in procedure:** The partner must make the payment within 270 days of the NOPPA and provides the IRS the necessary information to substantiate that the proper amounts were paid
- **Pull-in benefits:** This method avoids need for partners to file complete amended returns. The partnership may collect all the information from the partners using the pull-in method, allowing for centralized tracking without the need to gather complete amended returns.
- **Pull-in considerations:** When should partners use pull-in? When is it not advantageous?

Notice of Proceedings and Adjustment Section 6231

- In general (to the partnership and partnership representative)
  - Notice of Administrative Proceeding NAP
  - Notice of any Proposed Partnership Adjustment resulting from a NOPPA
  - Notice of any Final Partnership Adjustment (FPA) resulting from such proceeding.
    - Last known address of partnership representative or partnership (even if terminated)
    - A NAP includes an AAR filed by partnership under Section 6227
- Timing of notices – Section 6231(b)
  - Notice of NOPPA per Section 6235 (w/o regard to section 6235(a)(2) or 6235(a)(3))
  - Notice of FPA. FPA must be mailed within 270 days on date which NOPPA is mailed.
  - Statute of limitations on adjustment. Section 6235
  - Restriction on Furth IRS Notices if petition is filed by partnership under Section 6234
  - Authority to rescind notice with partnership consent. Section 6231(d)

The Issuance of the FPA

- **Administrative timing:** No earlier than 270 days after the IRS mails Notice of Proposed Partnership Adjustment (NOPPA), subject to any waiver
- **Issuance:** Mailed to last known address of the PR and the partnership
- **Statute of limitations:**
  - **general rule:** Adjustments must be made no later than three years after the latest of (1) filing date of the return; (2) the return due date; or (3) the date of filing AAR
  - **Partnership-specific exceptions:**
    - If the partnership has requested modification of imputed underpayment pursuant to 6225(c), limitation period does not expire until 270 days after partnership has completed such submission
    - If no modification of imputed underpayment is requested, limitation period does not expire until 330 days after the NOPPA

Statutes of Limitation on Making Adjustments (Section 6235)

- No adjustment can be made
  - Three years after the latest to occur of
    - The date on which the partnership return for such year was filed
    - The due date for the taxable year for the partnership return to be filed, or
    - The date on which the partnership filed an AAR with respect to such year under Section 6227
- With respect to any modification of an imputed underpayment per Section 6225(c)
  - 270 days (plus days of permitted extension) after the date on which all requested information was submitted); or
  - As to a NOPPA under Section 6231(a)(2), the date that is 330 days (plus extensions) after date of such notice
- Extension of statute of limitations on making adjustments by agreement
- Extension for fraud, substantial omission of income (six years) false returns. Section 6235(c)
  - Special Rules under Section 905
  - Special Rule for failure to include statement of listed transaction. See Section 6501(c)(10)

Challenging the FPA in Court: Section 6234 Petition for Readjustment (Annual Analysis)

- **Partnership representative:** PR is the only person who can bring suit, non-PR partners cannot file petition.
- **Jurisdiction of the courts:** Within 90 days after the FPA, the partnership may file a petition for a readjustment for such taxable year in (1) the Tax Court; OR (2) district court based on partnership's (not the PR's) principal place of business; OR (3) the Court of Federal Claims. §6234(a)
  - **Venue considerations; *Golsen* Rule**
- **Bankruptcy considerations:** In a Title 11 Bankruptcy case, the running of the 90-day period will be suspended during which the partnership is prohibited by reason of the case from filing a petition and for 60 days thereafter.

Challenging the FPA in Court

- **Considerations for challenges**:
  - **Penalties**
    - Use of amended returns and partner-level defenses
    - Burden of Proof Considerations - Section 7491(c) and *Dynamo Holdings Limited Partnership, TC Memo. 2018-61*
    - Section 6751(b); Graev, 149 TC 485 (2017) – What is the initial determination? Effect of modification/push-out/pull-in?
- **Penalty determined at the partnership-level**: Determine penalties, additions to tax, and additional amounts as if the partnership were an individual taxpayer and the imputed underpayment were an actual understatement or underpayment of tax. No partner-level defenses can be asserted at partnership level.
  - Penalty reductions: Partner-level penalty defenses: The partner may raise defenses that are "personal to the reviewed year partner" after first paying the penalty and then filing a claim for refund for the reporting year
  - Reasonable cause and good faith: The partnership is treated as the taxpayer; and the availability of the defense takes into account the facts and circumstances applicable to the partnership (not partner)
  - No partner-level defenses at partnership level
- **Challenges to imputed underpayment calculations**
- **Challenges to modification of imputed underpayment**
- **Interaction of partner-level determinations** – amended returns, tax-exempt status, tax treaty implications, etc.
- **Impact of adjudication/settlement**. Res judicata/collateral estoppel; closing agreement or just "settlement"

Challenging the FPA by Judicial Review: §6234

- **Partnership representative:** PR is the only person who can bring suit, non-PR partners cannot file petition.
- **Jurisdiction of the courts:** Within 90 days after the FPA, the partnership may file a petition for a readjustment for such taxable year in (1) the Tax Court; (2) district court based on partnership's (not the PR's) principal place of business; or (3) the Court of Federal Claims
  - **Venue considerations; *Golsen* Rule**
  - **Partnerships having principle place of business outside US.** Deemed to be located in the District of Columbia. Section 6241(5)
- **Bankruptcy considerations:** In a Title 11 Bankruptcy case, the running of the 90-day period will be suspended during which the partnership is prohibited by reason of the case from filing a petition and for 60 days thereafter and for collection six months thereafter. §6241(6)

Challenging the FPA in Court

- **Prepayment requirements**: To file in district court or the Court of Federal Claims the partnership must prepay imputed underpayment, penalties, and additions (but only those to which the petition relates). Section 6234(b)(1)
  - **Good faith attempt to prepay:** The courts can order the jurisdictional requirements were met "where there has been a good faith attempt to satisfy such requirement and any shortfall of the amount required to be deposited is timely corrected." **[last sentence, Section 6234(b)(1)]**
  - **Deposit interest:** Prepayments not treated as payment of tax. Section 6234(b)(2)

Challenging the FPA in Court

- **Scope of judicial review:** Jurisdiction to determine all partnership-related items for the partnership taxable year to which the notice of final partnership adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable. Section 6234(c)
- Right of Appeal granted. Section 6234(d)
- **Effect of dismissal:** Any dismissal (other than recession by the IRS) considered decision that the FPA adjustment is correct. Section 6234(e).

Tax Court Rules for BBA Partnership Actions

- Title XXIV. TEFRA Partnership Actions
- Rule 240. General
- Rule 241. Commencement of Partnership Action
- Rule 242. Request for Place of Trial
- Rule 243. Other Pleadings
- Rule 244. Joinder of Issue in Partnership Action
- Rule 245. Intervention and Participation
- Rule 246. Service of Papers
- Rule 247. Parties
- Rule 248. Settlement Agreements
- Rule 249. Action for Adjustment of Partnership Items Treated as Action for Readjustment of Partnership Items
- Rule 250. Appointment and Removal of the Tax Matters Partner
- Rule 251. Decisions

*Note Court of Federal Claims had special procedural (adjunct) rules for TEFRA partnership refund suits. Appendix F

Tax Court Rules for BBA Actions

- TITLE XXIV.A. Partnership actions under BBA Section 1101
  - TC Rule 255.1. General
    - Applicability
    - Definitions
    - Jurisdictional requirements
    - Form and style of papers
  - TC Rule 255.2 Commencement of Partnership Action
    - Commencement of action
    - Content of petition
    - Joinder of parties: (1) Permissive Joinder: (2) Severance or other orders
    - Filing fee
  - TC Rule 255.3. Request for Place of Trial. TC Rule 140.
  - TC Rule 255.4. Other Pleadings
    - Answer. TC Rule 36
    - Reply TC Rule 37
  - TC Rule 255.5 Joiner of Issue in Partnership Action. TC Rule 38.
  - TC Rule 255.6 Identification and Removal of Partnership Representative
    - At The commencement or after commencement of a case
  - TC Rule 255.7. Decisions

Poll Question 3

As to judicial review:

1. There is no Tax Court review of the Notice of Final Partnership Adjustment; the partnership has to pay in full and bring a refund claim.
2. Within 90 days after the FPA, the partnership may file a petition for a readjustment for such taxable year in the Tax Court or the district court/Court of Federal Claims
3. Same as 2, except that the petition can be filed within one year after the FPA
4. None of the above

Assessing the Tax: Section 6232

- **Default rule partnership is assessed: Section 6225(a).** IRS will assess and collect any taxes, interest or penalties relating to an adjustment *at the partnership level* (not at the partner level). The partnership will pay the non-deductible "imputed underpayment" with respect to the *adjustment year* (not the *reviewed year*).
  - If push-out is not elected, highest rate of tax in reviewed years on adjustments (including reallocations)
  - If push-out is elected, partner payments due with current year return
- General Rules under Section 6232
  - With AAR per section 6227(b)(1), payment may be assessed when AAR is filed
  - Limitations on assessment
    - 90 days must expire after FPA is mailed
    - Final determination of court if petition filed per section 6234

Assessment of Tax

- **Partnership fails to pay: Section 6232(f).** If the partnership fails to pay all imputed underpayment, penalties, and interest, the IRS may assess such delinquent amounts against **each adjustment year partner, at close of year, based on each partner's proportionate share. Section 6232(f)(1)(B)**
  - **Two-year assessment against any partner for Section 6232(f)(1) after IRS notices partnership/partnership representative.**
  - **Assessments are not subject to deficiency procedures**. Section 6232(f)(6)(A)
  - Increase in interest by 5% over 3% under Section 6621(a)(2)(B)
  - S Corporations and its shareholders. Treated as partnerships. Section 6232(f)(5)
  - Assessments must be made within two years provides Notice and Demand for payment
- **No underpayment:** If exam adjustment does not result in an underpayment, partnership takes adjustment into account with respect to bottom-line taxable income or loss in the adjustment year.

Push-Out Elections Section 6226(b) Treas. Reg. §301.6626-1

- **Partnership Election. Alternative to payment by partnership of imputed underpayment. Triggered within 45 days of FPA filing.**
- Partnership electing push-out: No longer liable for imputed underpayment related to the election
- Separate elections can be made: with respect to separate issued imputed underpayment per Treas. Reg. § 301.6225-1(g)
- Effect of election
  - Reviewed Year Partners (301.6241-1(a)(9)) Take into account partnership adjustments. Liable for tax, penalties, additions to tax and interest. 301.6226-3
  - Partnership. If election valid, not liable for imputed underpayment
- Election mechanics. 301.6626-1(c)
  - Time for making. Within 45 days FPA is mailed by IRS. NO EXTENSIONS
  - Election made. Signed by part. rep. (PR) with required contents 301.6626-1(c)(2)(ii)
- Determining whether election is invalid. By IRS
  - Notice to partnership and partnership representative within 30 days of determination of invalidity
  - Consequence of invalidity. IRS may assess against the partnership without regard to the limitations under Section 6232(b) and partnership must pay imputed underpayment and penalties and interest. Sections 6225, 6233
  - Timely corrected errors by partnership avoids invalidity. Treas. Reg. §301.6626-2

Push-Out Election

- Statements to partners and IRS from push-out election. Must be sent signed by partnership representative. 301.6222-2(a)
  - Each Review Year Partner. 301.6241-1(a)(() and with IRS. A separate statement must be furnished to each reviewed year partners for each reviewed year subject to the election.
    - Failure to furnish correct statement. Penalty under Section 6722. See Section 6724(d)(2).
    - Address for reviewed partners. 301.6226-2(b)(2). “Reasonable diligence” to identify correct address. See example -2(b)(3), Ex. 1 and 2
  - **Time for filing statements with partners**. 60 days or less after date all partnership adjustments related to statement are “finally determined”. 301.6626-2(b)
    - Final determination (i) expiration of time to file petition under section 6234 or (ii) if petition under Section 6234 I is filed, when the court’s decision becomes final
    - Push-Out Election Statement contents. 301.6226-3(e)
  - **Correction of statements rules**. Errors discovered within 60 days and more than 60 days. 301.6226-2(d)
  - **Consistency reporting required by partner** receiving a push out statement. 301.6222-1(c)(2)

Push-Out Elections Section 6226(b) Treas. Reg. §301.6626-2

- **Binding nature of push-out statements on partners**. Actions under Section 6223 and all adjustments in the push-out statement are binding on the partners
- **Time for filing push out statements to partners**. Within 60 Days after date the partnership adjustments are finally determined. Can not be extended.
- **Push-out and court challenges**: The partnership may still challenge the FPA in court following a push-out election. While the partners are liable for the adjustments following the push-out election, the partnership may still need to make the deposit to gain district court jurisdiction.
- **Partner-level payment:** Under the proposed regulations, each *reviewed year* partner must pay a tax equal to the aggregate of the "correction amounts"
  - **Correction amounts:** Any changes in taxes payable for the first affected year and all intervening years had the adjustments been properly reported. TTCA provided that decreases as well as increases are taken into account.
- **Penalties:** A reviewed year partner may not meet the applicable threshold for some penalties; in such a case no penalty is due from that partner. Partner can raise partner-level defenses in refund claims.

Push-Out Elections Section 6226(b) Treas. Reg. §301.6626-2

- **Determination of each partner's share of push-out adjustments §301.6626-2(f)**
  - Generally, to each reviewed year partner in the same manner each adjusted partnership related item was originally allocated to the reviewed year partner on the partnership return
  - Adjusted partnership-related item not reported on partnership's return for reviewed year. Allocate under the partnership allocation rules and the partnership agreements.
  - Adjustments that specifically allocate items. As provided in the push-out statement to the reviewed year partner.
- **Modifications made under Section 6225(c), Treas. Reg. §301.6625-2 are disregarded** in determining each partner's share of the push-out statement adjustments
- **Adjustments made for withholding amounts under Chapters 3 and 4.** Partnership still liable for withholding.
- **Tiered partnerships:** Adjustments can be pushed out through multiple tiers of entities (e.g., **lower-tier entities may themselves push out adjustments**)
  - **Tracking report:** The pass-through partner must provide the IRS with a "partnership adjustment tracking report" that assist the IRS in determining the ultimate partner. If no statement are furnished, pass-through partner must compute and pay an imputed underpayment
- **Application to CFCs:** US shareholders of CFCs treated as partners, when CFC is a partner in a partnership

Push-Out Elections Under Section 6626(b)

- **Push-Out Statements and Liabilities: Interest on the Correction Amounts**
  - On first year and intervening year or years at 2 added percentage points under Section 6621(a)(2)(B) rate
  - Interest on penalties again at 2 added percentage points
  - Penalties determined at partnership level under push-out election (imposed on reviewed year partners)
  - Amount calculated at partner level. After taking all adjustments into account. 301.6226-3(d)(2)
  - Partner-level defenses. Reviewed year partner, including RPE 301.6241-1(a)(5) **partner-level defense requires partner to first pay the penalty and file a claim for refund for the reporting year. Partner-level defenses are limited to those that are personal to the reviewed year partner (for example, a reasonable cause and good faith defense under Section 6664(c).**

Push-Out Elections Under Section 6626(b)

- **Partners subject to withholding under Chapters 3 and 4**
  - A reviewed year partner that is subject to withholding under § 301.6241–6(b)(4) must file an income tax return for the reporting year to report its additional reporting year tax and its share of any penalties, additions to tax, additional amounts, and interest (notwithstanding any filing exception in § 1.6012–1(b)(2)(i) or § 1.6012–2(g)(2)(i) of this chapter)
  - Tax withheld and paid by partnership
    - Allowed as a credit
    - Substantiation requirements

Poll Question 4

Which of the following is true about push-outs?

1. The partnership representative is responsible for sending out the push out statements to the partners and notifying the IRS.
2. Push-out is only available to single-tiered partnerships
3. The partnership representative must receive written confirmation of receipt from each partner in order for the push out to be valid
4. None of the above

Administrative Adjustment Request Under Section 6227

- **Section 6227: AAR**
  - Partnership may file AAR to correct one or more errors in a prior year partnership return. No partner (unlike TEFRA) may file an AAR.
  - Partnership representative only may file an AAR
  - Period to file AAR: three years from later of filing the partnership return or due date for filing excluding extensions
  - Notice of administrative proceeding (audit). Bars filing AAR.
- **Adjustments from filing AAR**. Where an imputed underpayment results the partnership may approach the issue in the same manner as under §6225 (imputed underpayment) or §6226 (push-out election). See Reg. §301.6227-2(b)(1)(partnership payment as adjusted for permitted modifications). May not be made after a NOPPA is received.
- Net Negative Adjustment impact!

Administrative Adjustment Requests (AAR) Section 6227 Treas. Reg. §301.6227-1

- **Filing an AAR:** Self-reported adjustment to any partnership-related items AAR and to take the adjustment into account in the partnership year in which the AAR is filed. May only be filed by partnership
- **Imputed underpayment and AAR:** If the adjustments result in an imputed underpayment, the partnership pays the amount at the time the AAR is filed
  - If the partnership elects to push out (Treas. Reg. § 301.6227-2(c), the reviewed year partners take into account the adjustments in the reporting year
  - If the adjustments do not result in an imputed underpayment, the partnership must push out the adjustments to the reviewed year partners. Treas. Reg. §301.6627-3
  - Can not be made after a NOPPA is issued for a reviewed year.
- A partner may not file an AAR for a partnership-related item
- Can not file AAR solely to change designation of partnership representative or designation of partnership representative
- Contents of AAR. See Treas. Reg. §301.6227-1(e)

Statute of Limitations on Making Adjustments Under the Centralized Partnership Audit Rules

- **Period of limitations for making adjustments under Subpart C of Chapter 63**.
- **Section 6235**
- (a) In general. Except as otherwise provided in this section, no adjustment under this subpart for any partnership taxable year may be made after the later of—

  (1) the date which is 3 years after the latest of— (A) the date on which the partnership return for such taxable year was filed, (B) the return due date for the taxable year, or (C) the date on which the partnership filed an administrative adjustment request with respect to such year under Section 6227, or

  (2) in the case of any modification of an imputed underpayment under Section 6225(c), the date that is 270 days (plus the number of days of any extension consented to by the Secretary under paragraph (7) thereof) after the date on which everything required to be submitted to the secretary pursuant to such Section is so submitted, or

  (3) in the case of any notice of a proposed partnership adjustment under Section 6231(a)(2), the date that is 330 days plus the number of days of any extension consented to by the secretary under Section 6225(c)(7) [2] after the date of such notice.
- (b) Extension by agreement The period described in subsection (a) (including an extension period under this subsection) may be extended by an agreement entered into by the secretary and the partnership before the expiration of such period

Section 6235 (statute of limitations for adjustments, continued)

- (c) Special rule in case of fraud, etc.

  (1) False return In the case of a false or fraudulent partnership return with intent to evade tax, the adjustment may be made at any time

  (2) Substantial omission of income If any partnership omits from gross income an amount properly includible therein and such amount is described in Section 6501(e)(1)(A), subsection (a) shall be applied by substituting “6 years” for “3 years”

  (3) No return In the case of a failure by a partnership to file a return for any taxable year, the adjustment may be made at any time

  (4) Return filed by secretary For purposes of this section, a return executed by the secretary under subsection (b) of Section 6020 on behalf of the partnership shall not be treated as a return of the partnership.

- (d) Suspension when secretary mails notice of adjustment If notice of a final partnership adjustment with respect to any taxable year is mailed under Section 6231, the running of the period specified in subsection (a) (as modified by the other provisions of this section) shall be suspended—

  (1) For the period during which an action may be brought under Section 6234 (and, if a petition is filed under such section with respect to such notice, until the decision of the court becomes final), and

  (2) For one year thereafter

Assessing the Tax

- **Default rule partnership is assessed:** IRS will assess and collect any taxes, interest or penalties relating to an adjustment *at the partnership level* (not at the partner level). The partnership will pay the non-deductible "imputed underpayment" with respect to the *adjustment year* (not the *reviewed year*). §6532(a).
  - If push-out is not elected, highest rate of tax in reviewed years on adjustments (including reallocations)
  - If push-out is elected, partner payments due with current year return
  - Where an AAR is filed under §6227(b)(1), underpayment shall be paid and tax may be assessed when filed
- **Partnership fails to pay:** If the partnership fails to pay the imputed underpayment, penalties, and interest, the IRS may assess such amounts against each adjustment year partner based on each partner's proportionate share
  - Assessments are not subject to deficiency procedures
  - Assessments must be made within two years provides Notice and Demand for payment
- **No underpayment:** If exam adjustment does not result in an underpayment, partnership takes adjustment into account with respect to bottom-line taxable income or loss in the adjustment year

Poll Question 5

As to penalties:

1. Partners can raise partnership-level and partner-level defenses in a separate Tax Court action after the BBA audit is finalized
2. Partners must pay their penalty assessment and then bring a refund claim and then can raise partnership and partner-level defenses
3. Partners must pay their penalty assessment and then bring a refund claim but are limited to raising partner-level defenses
4. There is no judicial review available of penalties assessed under the BBA procedures if the partnership elects to push out

Collecting the Tax

- **Assessment:** Under default rule, the partnership is assessed. Under push-out, the partners are assessed.
- **Push-Out Election:** The IRS cannot assess the imputed underpayment, levy, or bring a proceeding for the collection of such amount against the partnership
- **No Access to CDP:** Any final determination made under the partnership-audit rules cannot be raised in a CDP hearing

Rules for Partnerships Which Cease to Exist and Other Special Rules

- **Partnership ceases to exist: Section 6241(7).** The IRS may in sole discretion determine that a partnership ceases to exist before a partnership adjustment takes effect. The IRS may determine that partnership ceases to exist if:
  - The partnership terminates because no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. The partnership ceases to exist on the last day of the partnership's final tax return.
  - The partnership does not have the ability to pay assessments for which the partner is liable. The partnership ceases to exist on the date that the IRS determines the partnership ceases to exist.
- **Former partners and adjustments:** If the partnership ceases to exist, the former partners are required to take into account the partnership adjustments. The former partners are the adjustment year partners.

Section 6241 (11) Treatment of Special Enforcement Matters

- (11) Treatment of special enforcement matters.

  (A) In general. In the case of partnership-related items which involve special enforcement matters, the secretary may prescribe regulations pursuant to which—

    (i) this subchapter (or any portion thereof) does not apply to such items, and

    (ii) such items are subject to such special rules (including rules related to assessment and collection) as the Secretary determines to be necessary for the effective and efficient enforcement of this title.

  (B) Special enforcement matters. For purposes of subparagraph (A), the term “special enforcement matters” means—

    (i) failure to comply with the requirements of Section 6226(b)(4)(A)(ii),

    (ii) assessments under Section 6851 (relating to termination assessments of income tax) or Section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes)

    (iii) criminal investigations

    (iv) indirect methods of proof of income

    (v) foreign partners or partnerships

    (vi) other matters that the secretary determines by regulation present special enforcement considerations

Special Definitions Under Section 6241(12) U.S. Shareholders and Others

(A) CFCs in general – A controlled foreign corporation (CFC) that is a partner of a partnership, each US shareholder as defined as to such CFC is to be treated as a partner of such partnership. For purposes of the preceding sentence, any distributive share of any US shareholder will be such US shareholder's pro rata share with respect to such CFC (as per rules similar to Section 951(a)(2)).

(B) Passive Foreign Investment Companies – A PFIC per Section 1297 each taxpayer making an election under Section 1295 shall be treated in the same manner as US shareholders under Section 6241(12)(A) except that such taxpayer's pro rata share with respect to the PFIC shall be determined under rules similar to the rules of Section 1293(b).

(C) Regulations or other guidance – The Secretary shall issue such regulations or other guidance as is necessary or appropriate to carry out the purposes of this paragraph, including regulations which apply the rules of subparagraph (A) in similar circumstances or with respect to similarly situated persons.

Partnership Representative: Replacement for Tax Matters Partner

- Requirement of each partnership; must designate a partnership representative, but only one
- Designation remains in effect for a taxable year until terminated by: (i) resignation; (ii) valid revocation; or (iii) determination by IRS designation not in effect. The designation may also be superseded by a subsequent designation for such year.
- Designation is for one taxable year. The designation is generally effective on the date that the partnership return is filed.
- Protective election if venture does not consider the venture to be a partnership?
- Should election be made where partnership elects out?

Partnership Representative: Replacement for Tax Matters Partner

- Treas. Reg. § 301.6223-2(c)….sole authority to act on behalf of the partnership
- Eligibility to serve as a partnership representative. Prop. Reg. §301.6223-1(b)(3)
- Any “person” per Section 7701(a)(1) having “capacity to act” per Prop. Reg. §301.6223-1(b)(4)
- Who has a substantial presence in the United States 6223-1(b)(2): (i) available to meet in U.S. and U.S. ID #, street address, phone in the U.S.
- Eligibility of an entity to be a partnership representative provided an individual with a substantial presence in the United States is appointed by the partnership as the sole individual through whom the partnership will act
- Appointment of designated individual at the time of the designation of the entity partnership representative
- If designated individual is not appointment, IRS may determine entity partnership representative designation is not in effect

Partnership Representative: Replacement for Tax Matters Partner

- **Resignation of partnership representative**. Notification to IRS. 301.6223-1(d)(1)
- For any reason by notification IRS by partnership representative/designated individual
- Can only be filed after IRS issues notice of partnership administrative audit proceeding or NPA.
- IRS must confirm to partnership and resigning partnership representative within 30 days
- May include a designation of successor partnership representative for the partnership tax year designation of the resigning partnership representative was in effect provided such designation is made within 30 days
- Resigning partnership representative may NOT designate a successor
- Partnership representative may resign simultaneously with filing of an AAR under Section 6227 for a partnership taxable year, OR after receipt of a notice of administrative proceeding for the taxable year, OR such other time as provided by the IRS in other guidance

Partnership Representative: Replacement for Tax Matters Partner 301.6223-1(e)

- **Revocation of designation. By notification made by the partnership to the partnership representative and the IRS.**
  - Must include the designation of a successor partnership representative for the year in effect. Revocation effective within 30 days on which IRS receives written notification
  - **Failure to meet the requirements of a revocation** and re-designation will be treated as if no revocation had occurred or a determination is made by the IRS that the designation is not in effect
  - **Revocation during an administrative proceeding. Generally partnership may not revoke the designation of a partnership representative before IRS mails NOPA** under Section 6231. Upon receipt of NOPA, the partnership may revoke the partnership representative designation. Proc. Reg. § 301.6223-1(e)(2)
  - **Revocation with an AAR but not filed for sole purpose of revocation of designation**
  - **Partners who may sign revocation**. Proc. Reg. §301.6223-1(e)(4)
  - **Partnership representative designated by IRS**. Proc. Reg. §301.6223-1(a)(4), partnership may only revoke such designation with consent of IRS.

Partnership Representative: Replacement for Partnership Representative

- Designation of the partnership representative by the IRS. Treas. Reg. §301.6223-1(f)
- IRS required to notice the partnership and the most recent partnership representative for that taxable year that a designation is not in effect and will provide the partnership the opportunity to designate a successor
- Partnership receiving notice of designation has failed must designate a successor within 30 days from date of notification
- Otherwise the IRS will designate a successor partnership representative. Treas. Reg. §301.6223-1(f)(1)
- Grounds for IRS determination that partnership representative designation not in effect
- Invalid designation

Partnership Representative: Replacement for Partnership Representative

- Named partnership representative or designated individual does not have a substantial presence in U.S. or capacity to act
- Partnership failed to appoint a designated individual
- No successor designation or appointment made where required
- No opportunity for designation by partnership in case of multiple revocations described in Treas. Reg. § 301.6223-1(e)(7)
- **Designation of partnership representative by the IRS**. Treas. Reg. §301.6223-1(f)
- Notification sent to partnership and effective on date mailed
- **Factors IRS considers when IRS designates partnership representative**. Treas. Reg. § 301.6223-1(f)(5)(ii). "*a principal consideration in determining whom to designate as a partnership representative is whether there is a reviewed year partner that is eligible to serve as the partnership representative in accordance with paragraph (b)(1) of this section or whether there is a partner at the time the partnership representative designation is made that is eligible to serve as the partnership representative*."

Partnership Representative: Replacement for Tax Matters Partner

- Does the partnership representative have too much power?
- There is little accountability for the partnership representative. The government and an “outsider” or someone who is a partner can settle out all issues without any partner participating or even knowing about the audit only to receive a push-out election notice (and push-out K-1).
- Powers of partnership representative: (i) settle audits; (ii) extend statute of limitations without partner approval
- Does the partnership representative designation nullify the power of attorney?
- Why should a terminated or resigning partnership representative be given the ability to appoint a successor for the same taxable year?

Partnership Representative: Replacement for Tax Matters Partner

- Why should a fired partnership representative continue to serve for up to 30 days after the IRS receives notice of their removal?
- Obviously this is an area which should be addressed in the operating agreement
- Can the partnership itself be the designated entity and then it assigns a designated individual? The managing partner?
- Fiduciary duties and conflict of interest issues. Not an IRS concern, correct?
- Partner level conflicts
- What if the partnership representative is the CPA for the majority partner or majority partner group?
- Attorney-client privilege when representing the partnership representative
- State law fiduciary duty issues
- Partnership representative “businesses.” Helpful for foreign partnerships.

Poll Question 6

Which is the following is true about the Partnership Representative (PR)?

1. The former TMP will automatically become the PR
2. The PR has sole authority to act on behalf of the partnership during an IRS audit
3. The PR has to get approval from the majority of the partners in order to enter into a Closing Agreement with the IRS
4. The partnership can elect not to have a PR

Drafting Provisions for Partnership Representative

- Non-partner representative
- Compensation
- Notification of partner provisions
  - The partnership agreement should contain direct and unequivocal instructions placed on the partnership representative to provide each partner with every communication issued by the IRS with respect to any partnership return, filing, audit, appeal, litigation, appeal from litigation, brief filed, notices of discovery, etc.
- Restrictions on partnership representative powers

Drafting Provisions for Partnership Representative

- Fiduciary Duty and Agency Relationship
  - Duty of care
  - Duty of loyalty
  - Reducing standard of care
  - Indemnification
  - Hold harmless
  - Conflict of interest waiver

Drafting Considerations for Partnership Agreements Under C.P.A. Rules

- Important Provisions
  - Election-out
  - Required restrictions on ownership
  - Requirement of disclosing tax information for modification
  - Requirement to agree to pull-in
  - Requirement to provide relevant information
  - Whether the partnership can decide to pay the tax on the imputed underpayment
  - Right of contribution by reviewed year partners (clawback)
  - Whether the push-out election is mandatory
  - Application of push-out election to partner which is a partnership or pass-through entity

Poll Question 7

How often do you represent partnerships in controversies before the IRS?

1. Never before, but I'd like to start
2. Never before, but after hearing about the BBA, I never will
3. Sometimes
4. Most of my practice

CLE Code

- Agreements

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ATTORNEYS AT LAW

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IRS Enforcement 2021

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Agenda

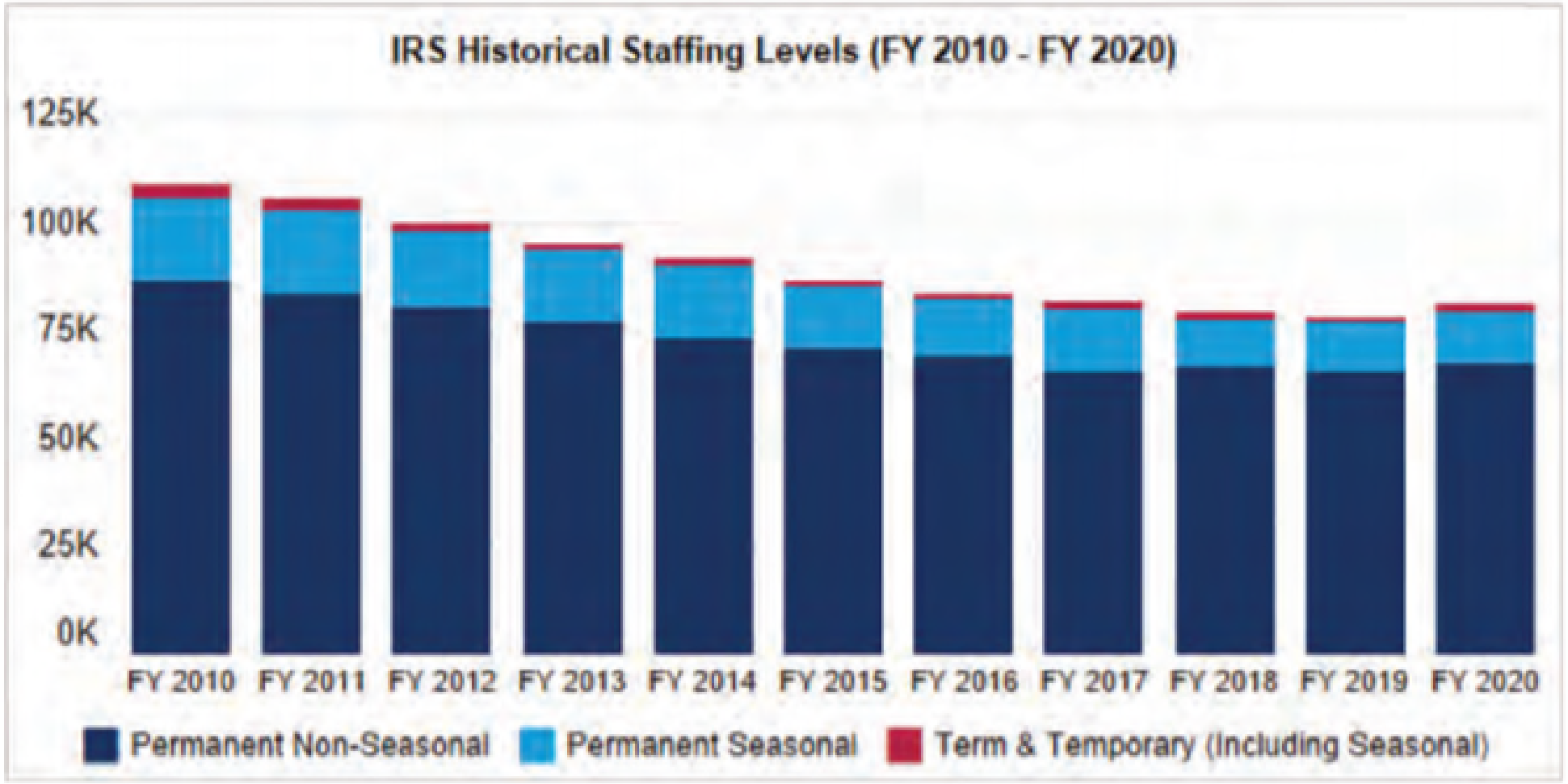
- IRS response to COVID-19
- IRS snapshot
- New personnel in tax enforcement
- High net worth individuals
- Cryptocurrency enforcement
- IRS efforts to fight COVID-19 fraud

IRS RESPONSE TO COVID-19

Tax Enforcement During COVID-19

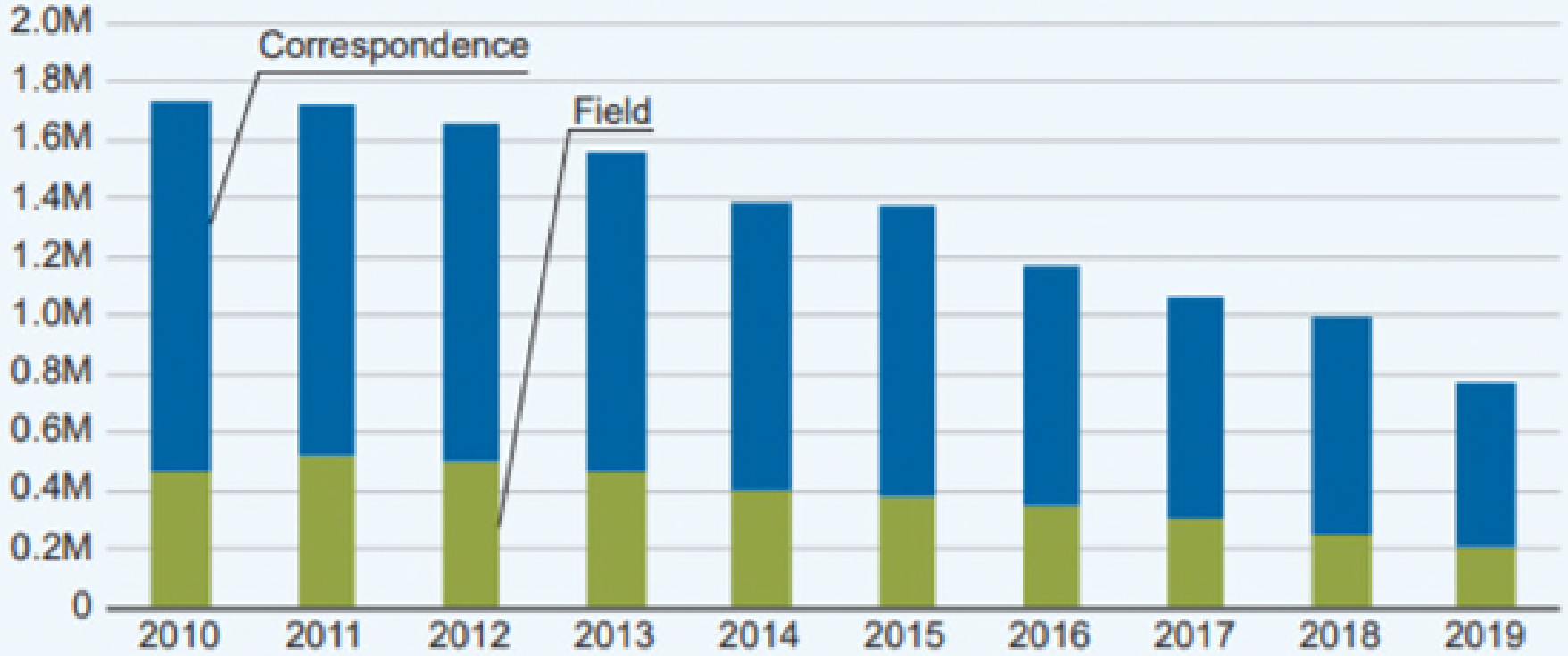
- “People First Initiative” suspended most enforcement activity through July 15, 2020
- Nearly all tax filing and payment deadlines postponed to July 15
- Taxpayer Advocate Service remained open for business and continued to offer assistance to taxpayers facing hardships
- Tremendous correspondence backlog
- U.S. Tax Court has reopened but all trials to be held by Zoom
- Diversion of enforcement resources to fight COVID-19 fraud

IRS SNAPSHOT


IRS Historical Staffing Levels (FY 2010 - FY 2020)
125K
100K
75K
50K
25K
0K
FY 2010
FY 2011
FY 2012
FY 2013
FY 2014
FY 2015
FY 2016
FY 2017
FY 2018
FY 2019
FY 2020
Permanent Non-Seasonal
Permanent Seasonal
Term & Temporary (Including Seasonal)

Internal Revenue Service Data Book, 2019

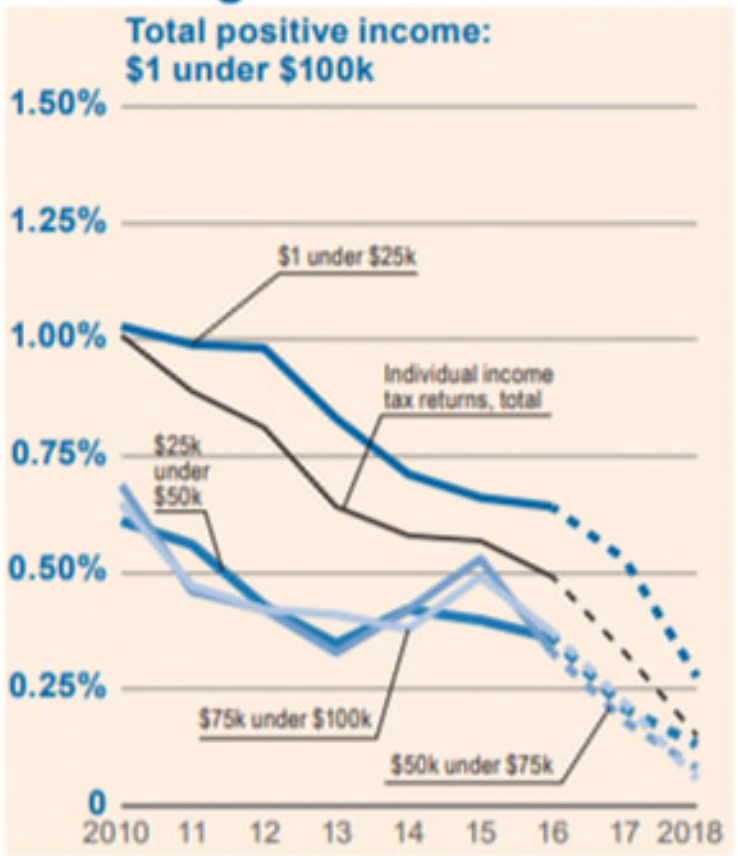
Number of Returns Examined, by Examination Type, Fiscal Years 2010–2019

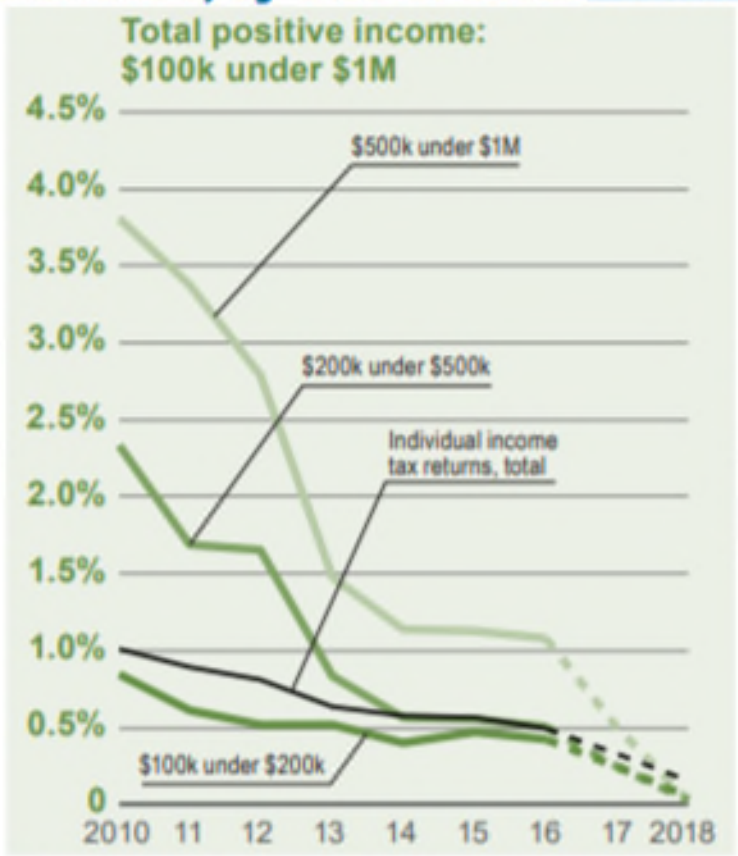


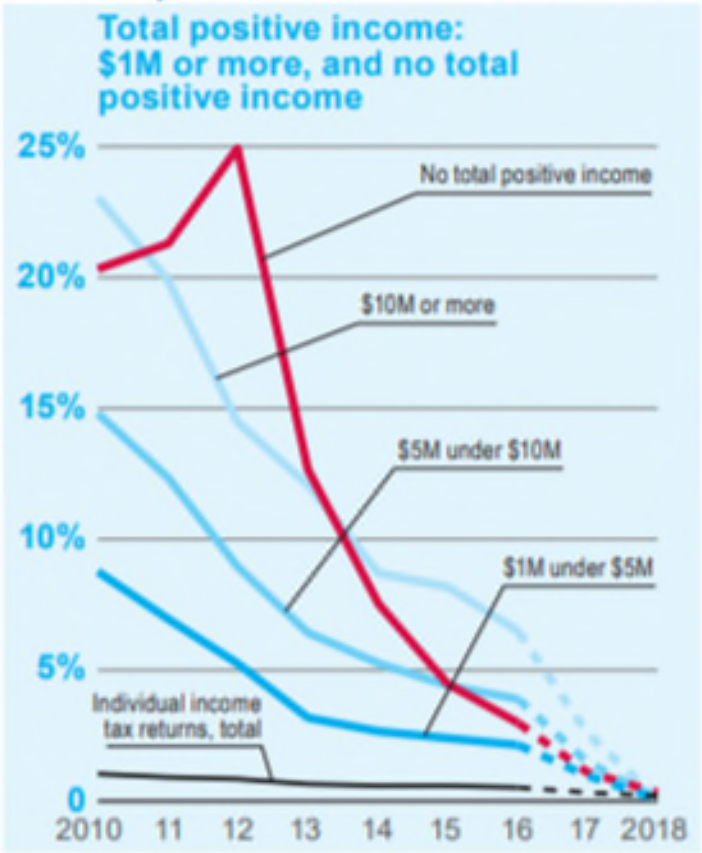
SOURCE: 2019 *IRS Data Book* Table 17b

Internal Revenue Service Data Book, 2019

Percentage of Individual Returns Examined, by Size of Total Positive Income, Tax Years 2010–2018







NOTE: Percentages as of September 30, 2019. Percentages for recent tax years (dashed segments) will increase as additional examinations are opened.
SOURCE: 2019 *IRS Data Book* Table 17a.

NEW PERSONNEL IN TAX ENFORCEMENT

IRS Fraud Enforcement Office

- Established in March 2020
- Part of Small Business/Self-Employed Division
- Headed by Damon Rowe, a 22-year veteran of IRS-Criminal Investigation
- Mission: Strengthen relationships between Criminal Investigation Special Agents and Revenue Agents/Revenue Officers as well as with other government agencies, including state governments and licensing boards
- Reflects agency-wide commitment to fraud awareness among all employees
- “Threat Mitigation Team” formed in June 2020 to focus on:
  - COVID-19 fraud
  - Virtual currencies

IRS Fraud Referral Program

- Upon discovery of a “firm indication of fraud,” IRS revenue agents must suspend audit activity and refer taxpayer to IRS-CID for investigation (IRM Section 25.1.3.1.)
- Revenue agents and revenue officers rely upon specially trained “fraud technical advisors” (FTAs) to assist in preparing IDRs, prepare for taxpayer interviews, and gather evidence for referral to IRS-CID and/or to support assessment of a civil fraud penalty
- Commissioner Rettig has made it a priority to increase fraud referrals from revenue agents and revenue officers
  - Historically, only about 7% of cases received by IRS-CI are fraud referrals

Promoter Investigation Coordinator

- Established in February 2020 to coordinate promoter and material advisor investigations across all IRS operating divisions
- Brendan O'Dell appointed as temporary coordinator while IRS undertakes a national search
- Key areas of initial focus: Conservation easements and microcaptive insurance
- Will focus on the importance of "professional enablers" to various tax schemes and fraud
  - Appraisers, attorneys, bankers, accountants

IRS-CID: A Tale of Declining Resources?

FY 2019 Combined Results

	2019	2018	2017
Investigations Initiated	**2485**	**2886**	**3019**
Prosecution Recommendations	**1893**	**2130**	**2251**
Informations/ Indictments	**1800**	**2011**	**2294**
Sentenced	**1726**	**2111**	**2549**
Incarceration Rate	**79%**	**82%**	**80%**
Average Months to Serve	**43**	**45**	**42**

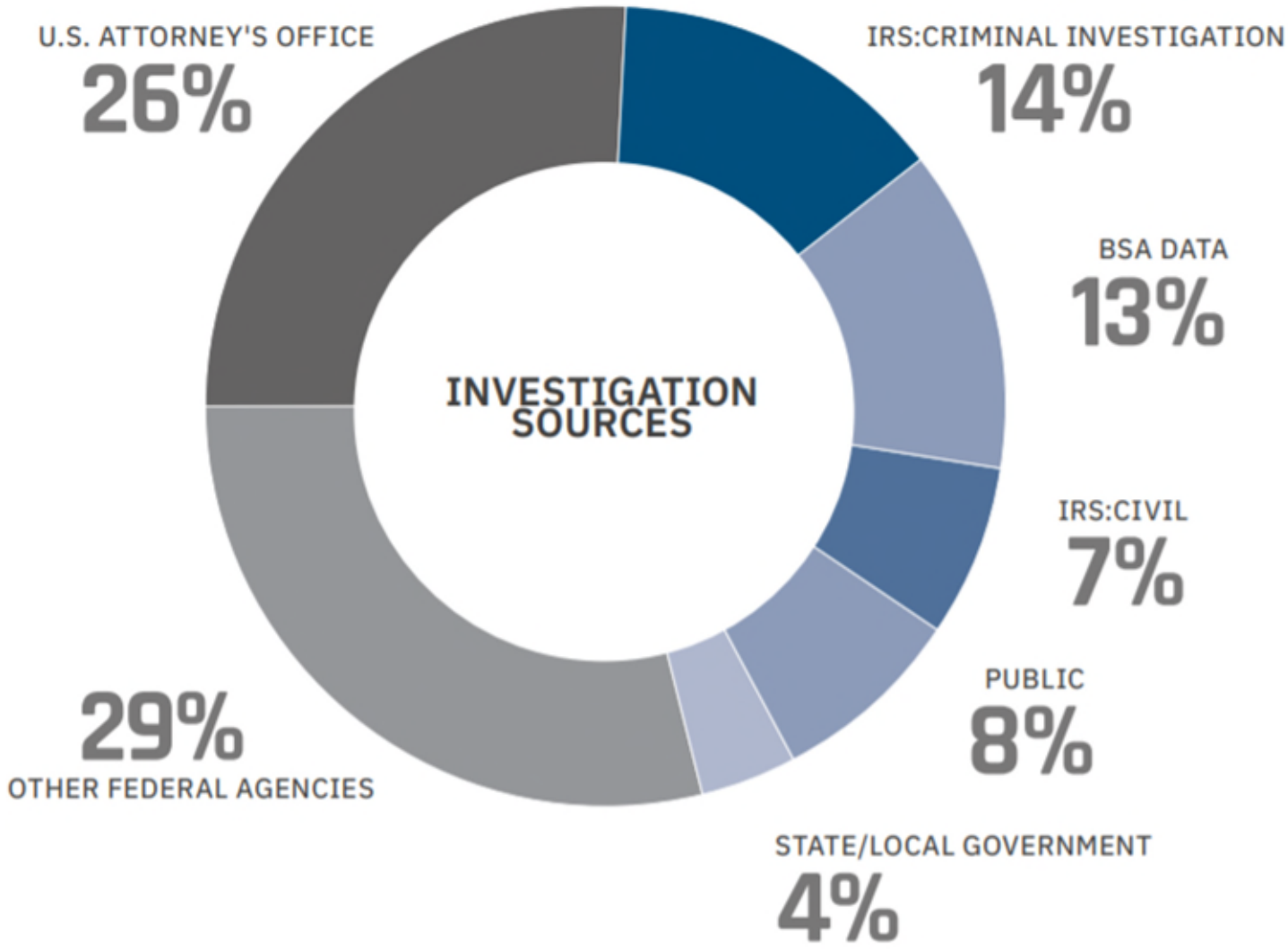
Source:
IRS: Criminal Investigation Annual Report 2019

IRS:CI STAFFING

https://www.irs.gov/pub/irs-pdf/p3583.pdf

Data Analytics is the Answer

- IRS has data from a multitude of sources:
  - Grand jury subpoenas and John Doe summonses
  - Bank Secrecy Act reporting by financial institutions
  - Whistleblowers
  - Cooperators
  - Other government agencies (federal, state, local)
  - IRS Voluntary Disclosure Program (including prior OVDP)
  - Swiss Bank Program
  - Treaty requests
  - Foreign Account Tax Compliance Act reporting
  - Panama Papers/Paradise Papers/leaks
- IRS is using data analytics, forensics, and artificial intelligence to mine the data, follow the money, and build cases


U.S. ATTORNEY'S OFFICE
26%
IRS:CRIMINAL INVESTIGATION
14%
BSA DATA
13%
IRS:CIVIL
7%
PUBLIC
8%
STATE/LOCAL GOVERNMENT
4%
29%
OTHER FEDERAL AGENCIES
INVESTIGATION SOURCES

Whistleblowers Are Key IRS Resource

TABLE 1: AMOUNTS COLLECTED AND AWARDS UNDER IRC § 7623, FISCAL YEARS 2018 TO 2020

	FY 2018	FY 2019	FY 2020
Total Claims Related to Awards	423	510	593
Total Number of Awards	217	181	169
Total IRC § 7623(b) Awards	31	24	30
Total Amounts of Awards[2]	$312,207,590	$120,305,278	$86,619,032
Proceeds Collected	$1,441,255,859	$616,773,127	$472,080,014
Awards as a Percentage of Proceeds Collected	21.7%	19.5%	18.3%

NOTE: *Data reported as of September 30, 2020*

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- Treaty

HIGH NET WORTH INDIVIDUALS

High-Income Nonfiler Initiative

- Unveiled in February 2020
- Focus on individual taxpayers with annual incomes exceeding $100,00 who haven’t filed returns in 2018 or prior years
- Revenue Officers to make unannounced face-to-face visits to taxpayers
- Revenue Officers are empowered to initiate civil enforcement efforts, such as liens or levies, and/or make referrals for criminal investigation
- IRS intends to make increased use of SFR program and Delinquent Return Refund Hold program as leverage against targeted taxpayers

LB&I Focus on High Net Worth Taxpayers

- TIGTA Report May 2020: Found that the IRS is failing to work cases involving high-income non-filers owing billions in taxes
- LB&I Commissioner announced that hundreds of high-income audits would start on July 15, 2020
- FY2021 LB&I Focus Guide: “We will prioritize our efforts across a range of sectors and issues, including high-income taxpayers and pass-through entities.”
- LB&I continues to utilize “wealth squad” to conduct examinations of high net worth individuals and they entities they control

CRYPTOCURRENCY ENFORCEMENT

Prior IRS Guidance Regarding Taxation of Cryptocurrency

- Notice 2014-21 (treated as property)
- Revenue Ruling 2019-24 (hard forks and airdrops)
- https://www.irs.gov/businesses/small-businesses-self-employed/virtual-currencies
- https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-on-virtual-currency-transactions

GAO Report (February 2020)

- Key findings and recommendations:
  - "Tax forms, including the information returns filed by third parties such as financial institutions, generally do not require filers to indicate whether the income or transactions they report involved virtual currency."
  - "Taking steps to increase reporting could help IRS provide taxpayers useful information for completing tax returns and give IRS an additional tool to address noncompliance."
  - "FinCEN and IRS [should] address how foreign asset reporting laws apply to virtual currency."
    - Both FBAR and Form 8938

SCHEDULE 1
(Form 1040 or 1040-SR)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

► **Attach to Form 1040 or 1040-SR.**
► **Go to *www.irs.gov/Form1040* for instructions and the latest information.**

OMB No. 1545-0074

2019

Attachment Sequence No. **01**

Name(s) shown on Form 1040 or 1040-SR	**Your social security number**

At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? . . . . . ☐ **Yes** ☐ **No**

Form **1040** Department of the Treasury—Internal Revenue Service (99)

U.S. Individual Income Tax Return

2020 | OMB No. 1545-0074 | IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box.

☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)

If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name	**Your social security number**
If joint return, spouse's first name and middle initial	Last name	**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ **You** ☐ **Spouse**
City, town, or post office. If you have a foreign address, also complete spaces below.	State / ZIP code	
Foreign country name	Foreign province/state/county / Foreign postal code	

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ **Yes** ☐ **No**

Draft Form 1040 Instructions for 2020

"Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency ("real currency"), that functions as a unit of account, a store of value, or a medium of exchange. Some virtual currencies are convertible, which means that they have an equivalent value in real currency or act as a substitute for real currency. The IRS uses the term "virtual currency" to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. Regardless of the label applied, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for Federal income tax purposes."

Draft Form 1040 Instructions, Continued

"If, in 2020, you engaged in any transaction involving virtual currency, check the "Yes" box next to the question on virtual currency on page 1 of Form 1040 or 1040-SR. A transaction involving virtual currency includes, but is not limited to:

- The receipt or transfer of virtual currency for free (without providing any consideration), including from an airdrop or hard fork;
- An exchange of virtual currency for goods or services;
- A purchase or sale of virtual currency;
- An exchange of virtual currency for other property, including for another virtual currency; and
- An acquisition or disposition of a financial interest in virtual currency."

Draft Form 1040 Instructions, Continued

- A transaction involving virtual currency does not include the holding of virtual currency in a wallet or account, or the transfer of virtual currency from one wallet or account you own or control to another that you own or control
- If you disposed of any virtual currency that was held as a capital asset through a sale, exchange, or transfer, use Form 8949 to figure your capital gain or loss and report it on Schedule D (Form 1040)
- If you received any virtual currency as compensation for services or disposed of any virtual currency that you held for sale to customers in a trade or business, you must report the income as you would report other income of the same type (for example, W-2 wages on Form 1040 or 1040-SR, line 1, or inventory or services from Schedule C on Schedule 1)

Foreign Asset Reporting?

- AICPA Virtual Currency Tax Force sought guidance last year. FinCEN responded that current regulations do not define virtual currency held in an offshore account as reportable on FinCEN Form 114 (FBAR)
- No guidance from IRS as to reporting on Form 8938, Statement of Specified Foreign Financial Assets

FinCEN Notice Issued December 30, 2020

Report of Foreign Bank and Financial Accounts (FBAR)
Filing Requirement for Virtual Currency

FinCEN Notice 2020-2

Currently, the Report of Foreign Bank and Financial Accounts (FBAR) regulations do not define a foreign account holding virtual currency as a type of reportable account. (*See* 31 CFR 1010.350(c)). For that reason, at this time, a foreign account holding virtual currency is not reportable on the FBAR (unless it is a reportable account under 31 C.F.R. 1010.350 because it holds reportable assets besides virtual currency). However, FinCEN intends to propose to amend the regulations implementing the Bank Secrecy Act (BSA) regarding reports of foreign financial accounts (FBAR) to include virtual currency as a type of reportable account under 31 CFR 1010.350.

Cryptocurrency Enforcement Efforts

- “John Doe Summons” to Coinbase
- IRS enforcement letters sent to taxpayers starting in July 2019
- LB&I Virtual Currency Compliance Campaign
  - Note: “The IRS is not contemplating a voluntary disclosure program specifically to address tax non-compliance involving virtual currency.”

First Criminal Tax Cases Involving Cryptocurrency

- *United States v. Volodymyr Kvashuk* (W.D. Wash. Nov. 9, 2020)
- Defendant was a Microsoft software engineer convicted of stealing $10 million in digital gift cards from the company
- Defendant then sold the cards in exchange for $2.8 million in Bitcoin, and used a Bitoin “mixing” service to disguise source of funds received in his bank accounts
- Defendant filed tax returns claiming the Bitcoin was a gift from a relative
- Defendant was sentenced to 9 years in prison in November 2020

First Criminal Tax Cases Involving Cryptocurrency, Continued

- *United States v. Amir Bruno Elmanni* (S.D.N.Y. Dec. 9, 2020)
- Defendant promoted new cryptocurrency known as Pearl tokens which were sold to public through ICO
- Defendant retained "founder's share" of tokens and also a separate "ownership stake" of tokens
- Defendant made millions of dollars from sale of tokens but did not report any income on his tax returns
  - 2017: tax return reported only $15,000 of income
  - 2018: no tax return filed
- Defendant spent $10 million to purchase several yachts; $700,000 to purchase two homes; and hundreds of thousands of dollars of other personal expenses
- Note: one of the Defendant's U.S.-based exchanges issued a Form 1099 in 2018 to report $12.5 million in cryptocurrency proceeds

CLE Code

- Cryptocurrency

IRS EFFORTS TO FIGHT COVID-19 FRAUD

Summary of PPP Approved Lending

Loan Count	Net Dollars	Lender Count
5,212,128	$525,012,201,124	5,460

Lender Size	Lender Count	Loan Count	Net Dollars	% of Amount
>$50 B in Assets	34	1,696,961	$190,260,579,519	36%
$10 B to $50 B in Assets	88	769,963	$100,975,416,018	19%
<$10 B in Assets	5,338	2,745,204	$233,776,205,586	45%

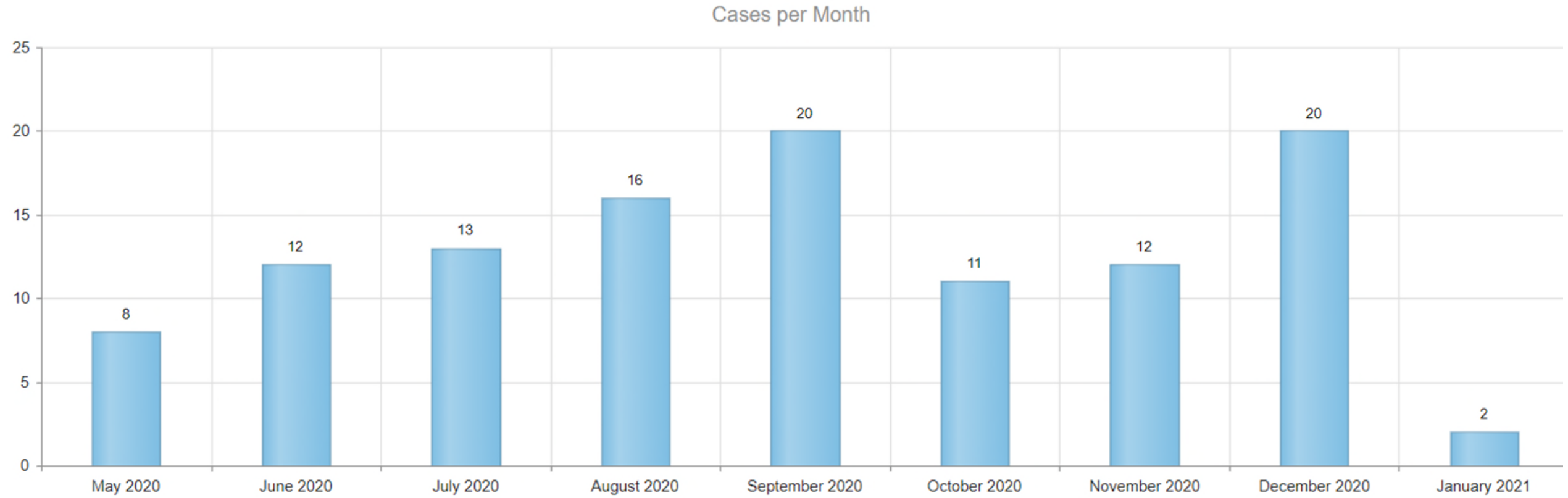
The Paycheck Protection Program (PPP) closed to new loan applications at 11:59pm on August 8, 2020.

Source: *SBA Paycheck Protection Program (PPP) Report (Approvals through 08/08/2020)*

An Avalanche of Criminal Cases

- 158 borrowers have been criminally charged throughout the U.S. since May 2020
- IRS-CI is playing a key role in investigating these cases along with SBA and FBI

PPP Criminal Cases to Date, By Month



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