

Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.¹ These decisions are summarized below.

In *Altera Corp. & Subs. v. Commissioner*, the Tax Court held Treasury regulations were invalid because the government failed to engage in “reasoned decisionmaking” by articulating a rational connection between the facts and the “arms-length” standard it adopted.²

In 1997, Altera Corp. (Altera), a Delaware corporation, and its foreign subsidiary agreed to share the cost of a research and development project. However, they did not share the cost of the stock-based compensation (*e.g.*, options to purchase Altera stock) that Altera paid to employees who worked on the project. On audit, the IRS exercised its authority under Internal Revenue Code (IRC) § 482³ to increase Altera’s U.S. taxable income for 2004-2007 by the amount it believed the subsidiary would have reimbursed Altera for the employees’ stock-based compensation if the agreement had been negotiated at “arm’s length.”⁴

The IRS has taken the position in court and in regulations proposed in 2002 that related parties must share stock-based compensation costs because that is what unrelated parties would do if dealing at arm’s length.⁵ In response to the IRS’s proposed rule, stakeholders submitted information showing that unrelated parties do not share the cost of stock-based compensation because its value is speculative, potentially large, and outside their control. Commentators also suggested that stock option grants do not change a company’s operating expenses and do not factor into its pricing decisions.

Nonetheless, in 2003, the government issued final regulations requiring that “stockbased compensation must be taken into account ... [to satisfy the] arm’s length standard.”⁶ The government restated its belief that parties dealing at arm’s length “generally would not distinguish between stock-based compensation and other forms of compensation.”⁷ It distinguished the transactions cited by commentators on the basis that they did not involve the “development of high-profit intangibles,”⁸ asserting that “there is little, if any, public data regarding transactions involving high-profit intangibles.”⁹ However, the regulations did not distinguish between transactions involving high- and low-profit intangibles.

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2015, and ending on May 31, 2016. For purposes of this section, TAS used the same period.

2 *Altera Corp. & Subs. v. Comm’r*, 145 T.C. 91 (2015), *appeal docketed*, No. 16-70496 (9th Cir. Feb. 19, 2016).

3 IRC § 482 authorizes the Secretary to allocate income and expenses among related entities if the allocation is necessary to prevent evasion of taxes or clearly reflect the income of the entities.

4 *Altera*, 145 T.C. at 95. See also Treas. Reg. § 1.482-1(b)(1) (“the standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer.”). The IRS could have adopted a different standard based on legislation authorizing it to use the “commensurate with income” standard, particularly in light of legislative history citing the difficulty of finding comparable transfers of high-profit potential intangibles at arm’s length between unrelated parties, but it did not. *Altera*, 145 T.C. at 96-98.

5 Prop. Treas. Reg. § 1.482-7(d)(2), 67 Fed. Reg. 48997, 49002 (July 29, 2002); Action on Decision (AOD), 2010-33 I.R.B. 240 (acq. in result in *Xilinx, Inc. & Subs. v. Comm’r*, 598 F.3d 1191 (9th Cir. 2010), *aff’g*, 125 T.C. 37 (2005), which rejected the IRS’s reallocation of the value of employee stock options under IRC § 482 because “the significance of the Ninth Circuit’s opinion was mooted by the 2003 amendments” to Treas. Reg. §§ 1.482-1(b)(1) and 1.482-7(d)).

6 T.D. 9088, 68 Fed. Reg. 51171, 51173 (Aug. 26, 2003).

7 *Id.*

8 *Id.* The term “high-profit” refers to the “subsequent success of the product.” *Altera*, 145 T.C. at 96. (internal citation omitted).

9 T.D. 9088, 68 Fed. Reg. 51171, 51173 (Aug. 26, 2003) (citation to legislative history omitted).

Following the IRS's proposed tax assessment, Altera filed suit in the Tax Court. It argued the 2003 regulations were arbitrary and capricious, and therefore, invalid under § 553(b) of the Administrative Procedure Act (APA) because the government did not explain why it rejected the comments and analysis it received from stakeholders.¹⁰ Thus, the regulations were not the product of “reasoned decisionmaking,” as required under *State Farm*.¹¹ The IRS countered that the court should give deference to the regulations under *Chevron*,¹² that APA § 553(b) did not apply because they were interpretive (not legislative) rules, and that they were the product of reasoned decisionmaking in any event.¹³

The Tax Court held that the regulations were invalid. APA § 553(b) requires an agency to promulgate “legislative” rules, such as these, using the formal notice and comment rulemaking process.¹⁴ Under this process, agencies must provide the public with notice of the proposed rule (regulation), consider any comments, and provide a concise statement explaining the basis for and purpose of the final rule.¹⁵ Even if a court gives so-called *Chevron* deference to the regulations, they may be deemed arbitrary and capricious, and thus invalid, if an agency does not respond to significant comments and articulate a reasoned explanation for its final rule as required under *State Farm*.¹⁶ An agency meets the reasoned decisionmaking test under *State Farm*, only if it examines the relevant data and contemporaneously articulates a satisfactory explanation for its action including a rational connection between the facts found and the choice made.¹⁷

In this case, the regulations were not a product of reasoned decision-making because the Treasury Department did not: (1) establish a connection between the facts found and the choice made, (2) provide a reasoned explanation for why it clung to the assumption that unrelated parties would share the cost of stock-based compensation after commentators presented evidence to the contrary, or (3) adopt an alternative rationale for the rules.¹⁸ The government did not contemporaneously explain why it did not

10 5 U.S.C. § 706(2)(A) (establishing an “arbitrary, capricious, an[d] abuse of discretion” standard of review); 5 U.S.C. § 553(c) (requiring an agency to consider comments and provide a concise statement explaining the basis and purpose for a final rule when promulgating legislative rules).

11 *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (requiring rules to be the product of reasoned decisionmaking).

12 Under the framework set forth in *Chevron*, agency regulations are entitled to deference unless they (1) contradict an unambiguous statute, or (2) adopt an unreasonable construction of it. *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). If a court determines that a statute is ambiguous under *Chevron* step-one, it generally gives “*Chevron* deference” to agency regulations under *Chevron* step-two unless they are arbitrary and capricious.

13 The Tax Court acknowledged that its past practice of referring “to regulations issued pursuant to specific grants of rulemaking authority as legislative regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under sec. 7805(a), as interpretive regulations” was inconsistent with general administrative law use of the legislative and interpretive labels. *Altera*, 145 T.C. at 111, n.10. In the future it will refer to regulations issued pursuant to specific grants of rulemaking authority as specific authority regulations and regulations issued pursuant to Treasury’s general rulemaking authority, under IRC § 7805(a), as general authority regulations. *Id.* Under the reasoning of this decision, both specific authority and general authority regulations may be legislative regulations for purposes of the APA if they have the force of law, as discussed below.

14 5 U.S.C. §§ 553(b) and (c). An exception applies when the agency for “good cause” finds that the notice and comment process would be impracticable, unnecessary, or contrary to the public interest. 5 U.S.C. § 553(b). The government did not identify any such good cause in this instance.

15 *Id.*

16 *Altera*, 145 T.C. at 112-13 (citing *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)).

17 *Id.*

18 The government argued that its regulations were based, in part, on the “commensurate-with-income” standard. Some have argued that they should have been upheld on that basis. See *Law Professors Urge Ninth Circuit to Uphold Cost-Sharing Reg.*, 2016 TNT 130-12 (July 7, 2016). However, the court did not sustain the regulations on that basis because the preamble to the regulations indicated that the standard it adopted was consistent with the arm’s-length standard. Under the arm’s-length standard the government was required to consider information about the costs that unrelated parties actually share, according to the court.

distinguish between high- and low-profit intangibles.¹⁹ When the IRS later cited the administrative burden of such a distinction, the court discounted this as a speculative *post hoc* argument.²⁰ In other words, the government's conclusions had no basis in fact because it failed to engage in any fact finding.

The government's errors were not harmless. It was unclear that the government would have adopted the same rule if it had determined the inclusion of stock-based compensation was inconsistent with the arm's length standard. Moreover, the agency's failure to respond to comments frustrated the court's review and was prejudicial to affected entities.

The Tax Court also rejected the government's argument that the regulations were not subject to APA § 553(b). The APA does not require agencies to use the formal notice and comment process to promulgate "interpretative" rules, which include general statements of policy, or rules of agency organization, procedure, or practice.²¹ However, "interpretive rules merely explain preexisting substantive law" and do not, themselves, have the force of law.²² A rule is legislative if "Congress has delegated legislative power to the agency and if the agency intended to exercise that power in promulgating the rule."²³ Congress has expressly delegated such legislative power to Treasury pursuant to IRC § 7805(a).²⁴ Although the preamble to the 2003 regulation states that APA "section 553(b) ... does not apply to these regulations,"²⁵ the court inferred that the agency nonetheless intended to exercise its legislative power because (1) the regulation was necessary to sustain an adjustment to the taxpayer's income (*i.e.*, it had the force of law), and (2) Treasury expressly invoked general rulemaking authority under IRC § 7805(a) in promulgating it.²⁶

This case is significant because it contradicts the IRS's assumption that most of its regulations are interpretive.²⁷ Rather, it suggests that most are legislative regulations that could be overturned if the government did not connect the facts to the final rule and provide a reasoned response to any comments under *State Farm's* reasoned decisionmaking standard. Other Treasury regulations are likely to be challenged on this basis, particularly in light of the fact that until 2014, the IRS's Chief Counsel Directives Manual (CCDM) stated that "[I]t is not necessary to justify the rules that are being proposed

19 *Altera*, 145 T.C. at 125.

20 *Id.* at 126. This analysis may suggest the court would have upheld the regulations if they had (1) required related parties to take stock-based compensation into account only with respect to high-profit intangibles, (2) had explained (and cited data to show) that it would be administratively difficult to distinguish between high- and low-profit intangibles, or (3) clearly explained that the government relied, *in the alternative*, on the "commensurate with income" standard with respect to the rule governing stock-based compensation.

21 5 U.S.C. § 553(b).

22 *Altera*, 145 T.C. at 111 (quotation omitted). While the IRS declined to brief this issue, it has taken the position that interpretive rules carry the force of law. *Altera*, 145 T.C. at 116. See also CCDM 32.1.5.4.7.5.1(10) (Sept. 30, 2011).

23 *Altera*, 145 T.C. at 111 (2015) (*quoting Am. Mining Cong. v. Mine Safety & Health Admin.*, 995 F.2d 1106, 1109 (D.C. Cir. 1993)).

24 *Altera*, 145 T.C. at 116. IRC § 7805(a) provides that "... the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."

25 68 Fed. Reg. 51171, 51177 (Aug. 26, 2003).

26 *Altera*, 145 T.C. at 115 (internal citations omitted).

27 See, e.g., CCDM 32.1.1.2.6 (Sept. 23, 2011); CCDM 32.1.5.4.7.5.1(2) (Sept. 30, 2011). For additional commentary on *Altera's* significance, see, e.g., Jerald August, *Altera: Why the Government Can't Count on Chevron Step Two*, 2016 TNT 109-9 (June 7, 2016). In addition, two groups of tax and administrative law professors filed amicus briefs in support of the government, which discuss significant policy concerns. See *Brief of Amici Curiae Anne Alstott et al.*, Dkt. Nos. 16-70496, 16-70497 (July 5, 2016), <http://ssrn.com/abstract=2805432>; *Brief of Amici Curiae J. Richard Harvey et al.*, Dkt. Nos. 16-70496, 16-70497 (July 1, 2016), <http://ssrn.com/abstract=2805663>.

or adopted or alternatives that were considered.”²⁸ The IRS and Treasury are reportedly making more effort to build the regulation file, explain decisions, respond to significant comments, and limit the issuance of temporary regulations.²⁹ These changes are consistent with the taxpayer *right to be informed*, illustrating how taxpayer rights reinforce what the APA requires.³⁰

In *Florida Bankers Assoc. v. United States Department of Treasury, the United States Court of Appeals for the District of Columbia Circuit held the Anti-Injunction Act (AIA) barred a challenge to information reporting regulations.*³¹

In 2012, the Treasury Department issued final regulations (the 2012 Rule) requiring banks to report interest paid to certain nonresident aliens, even if the aliens were not subject to tax on the income in the U.S.³² If a bank fails to report the interest, it is subject to a “penalty” under IRC § 6721(a). The Florida and Texas Bankers Associations challenged the 2012 Rule. The government argued, in part, that the AIA barred the court from hearing the case.³³

By way of background, the Court of Appeals for the District of Columbia held in *Seven-Sky* that the AIA did not bar a pre-enforcement suit challenging the Affordable Care Act’s requirement that individuals obtain insurance (the “individual mandate”).³⁴ In *NFIB*, the Supreme Court agreed.³⁵ The D.C. Circuit also held in *Foodservice* that the AIA did not bar a pre-enforcement suit challenging regulations requiring food and beverage establishments to report amounts that their employees earned in tips.³⁶ Similarly, after oral argument in this case, the Supreme Court held in *Direct Marketing* that the Tax Injunction Act (TIA), a state analogue to the AIA, did not bar a pre-enforcement challenge to a Colorado law which required out-of-state retailers to report purchases by Colorado customers.³⁷

28 CCDM 32.1.5.4.7.3(1) (Sept. 30, 2011); CCDM 32.1.5.4.7.3(1) (Aug. 11, 2004) (same). See also Richard W. Skillman, *The Problems With Altera*, 2016 TNT 11-11 (Jan. 16, 2016) (“If a regulation can be invalidated because of a flaw or gap in its preamble explanation, it will be open season, and in some cases easy pickings, to challenge the validity of many tax regulations that have gone unchallenged for years.”). However, the IRS has recently removed the direction that regulation writers do not have to “justify the rules” (as quoted above). See CCDM 32.1.5.4.7.3(1) (Oct. 20, 2014). In addition, the IRS has long directed its attorneys to respond to comments received in response to proposed regulations. See, e.g., CCDM 32.1.5.4.7.3(3) (Oct. 20, 2014) (“The drafting team should explain why the agency found some comments persuasive, and others not, in issuing the final regulations.”); CCDM 32.1.5.4.7.3(2) (Sept. 30, 2011) (same); CCDM 32.1.5.4.7.3(2) (Aug. 11, 2004) (same).

29 Andrew Velarde, *Reg Process Could Get Slower and Less Stable, Wilkins Warns*, 2016 TNT 123-7 (June 27, 2016).

30 IRC § 780.

31 *Florida Bankers Assoc. v. U.S. Dep’t of Treasury*, 799 F.3d 1065 (D.C. Cir., 2015), *vacating and remanding* 19 F. Supp. 3d 111 (D.D.C. 2014), *reh’g en banc denied*, 116 A.F.T.R.2d (RIA) 6704 (D.C. Cir. 2015), *cert. denied*, No.15-969 (June 6, 2016).

32 T.D. 9584, 77 Fed. Reg. 23391 (Apr. 19, 2012) (promulgating Treas. Reg. § 1.6049-4(b)(5)(i)). The preamble to the regulations explained that the IRS needed this information so that it could provide reciprocal information to foreign countries pursuant to information exchange agreements.

33 IRC § 7421(a) (AIA) (taxpayers are precluded from filing suit for the purpose of restraining assessment or collection of any tax). As the Declaratory Judgment Act (28 U.S.C. § 2201) is generally interpreted as barring the same suits as the AIA (i.e., the statutes are “coterminous”), the courts did not analyze them separately and the Court of Appeals for the District of Columbia referred to both statutes as the AIA. This summary will use the same practice.

34 *Seven-Sky v. Holder*, 661 F.3d 1 (D.C. Cir. 2011), *cert. denied*, 133 S. Ct. 63 (2012), *abrogated on other grounds by Nat’l Fed’n of Indep. Bus. (NFIB) v. Sebelius*, 132 S. Ct. 2566 (2012).

35 *NFIB*, 132 S. Ct. at 2566.

36 *Foodservice & Lodging Inst, Inc. v. Regan*, 809 F.2d 842 (D.C. Cir. 1987).

37 *Direct Mktg. Ass’n v. Brohl*, 135 S. Ct. 1124 (2015). While *Direct Marketing* involved the Tax Injunction Act (TIA), 28 U.S.C. § 1341, which provides that federal district courts “shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law,” the Supreme Court interpreted it as applying the AIA to state taxes, explaining that “[I]n defining the terms of the TIA, we have looked to federal tax law as a guide. Although the TIA does not concern federal taxes, it was modeled on the Anti-Injunction Act (AIA), which does.” *Direct Mktg.*, 135 S. Ct. at 1129 (citations omitted).

The district court found the AIA inapplicable to the 2012 Rule because it only bars suits that would restrain the “assessment or collection of any tax.”³⁸ The court reasoned that this suit was to prevent implementation of reporting requirements before any tax (or penalty) had been incurred. Accordingly, the suit would not restrain the IRS from making an assessment because facts did not yet exist that would trigger a valid assessment.³⁹

A three-judge panel of the D.C. Circuit reversed and remanded, holding the AIA barred the suit. The majority opinion by Circuit Judge Kavanaugh explained that while the AIA does not apply to suits involving tax-related regulatory requirements that are enforced by penalties, it does apply if the penalties are treated as taxes for purposes of the AIA. IRC § 6671(a) provides that the penalty under IRC § 6721(a) for a bank’s failure to comply with the reporting requirement is treated as a tax because it is located in Chapter 68, Subchapter B of the Tax Code. The D.C. Circuit focused on the Supreme Court’s explanation that, “[P]enalties in subchapter 68B” are “treated as taxes under Title 26, which includes the Anti-Injunction Act.”⁴⁰ The opinion distinguished *NFIB*, *Seven-Sky*, *Direct Marketing*, and *Foodservice* on the basis that the penalties in those cases were not treated as taxes for purposes of the AIA.⁴¹

The opinion also cited Supreme Court precedent indicating that an artfully drafted pleading, which challenges the regulatory aspects of a tax (*e.g.*, in the context of tax-exempt entities or child labor taxes) cannot avoid the AIA if, as a result of the suit, the government would be restrained from collecting the tax.⁴² If the AIA were inapplicable to the regulatory component of a tax, a taxpayer could characterize a challenge to a tax as a challenge to its regulatory components, reducing the AIA “to dust in the context of challenges to regulatory taxes,” according to the court.⁴³

A strongly-worded dissent by Circuit Judge Henderson countered that the AIA does not bar a pre-enforcement challenge to regulatory requirements such as the 2012 Rule. First, the dissent argued that the literal language of the AIA does not bar suits just because they involve taxes; rather, they must also seek to “restrain the assessment or collection” thereof.⁴⁴ Suits that merely *inhibit* the assessment or collection of tax are not covered, as the Supreme Court noted in *Direct Marketing*.⁴⁵

Second, an alternative basis for the holding that the AIA did not apply in *Seven-Sky* was that the plaintiff challenged the regulatory requirement and not the associated penalty.⁴⁶ Third, like the penalty for failure to purchase insurance in *Seven-Sky*, the penalty for failure to report payments to nonresident aliens does not implicate the purpose of the AIA to protect the government’s ability to “collect a consistent stream of revenue,” because a penalty is meant to deter violations of the underlying regulatory requirement

38 IRC § 7421(a). The district court went on to uphold the regulations. For prior discussion of this case, see National Taxpayer Advocate 2014 Annual Report to Congress 427, 439 (*Significant Cases*).

39 According to the district court, “[T]he D.C. Circuit has confirmed that [information] reporting requirements related to Chapter 61A of the Internal Revenue Code — as opposed to the associated penalties found in Chapter 68B — are not subject to the AIA....” *Florida Bankers*, 19 F. Supp.3d at 121 (citing *Foodservice and Lodging Inst., Inc.*, 809 F.2d at 842).

40 *Florida Bankers*, 799 F.3d at 1068 (quoting *NFIB*, 132 S. Ct. at 2583).

41 It indicated the penalty at issue in *Foodservice* was under IRC § 6652, which is in Subchapter A.

42 See, *e.g.*, *Bailey v. George*, 259 U.S. 16 (1922) (child labor tax); *Alexander v. “Americans United” Inc.*, 416 U.S. 752 (1974) (tax exemption); *Bob Jones University v. Simon*, 416 U.S. 725 (1974) (tax exemption).

43 *Florida Bankers*, 799 F.3d at 1071.

44 See *id.* at 1075 n.26.

45 See *id.* at 1076 n.33.

46 Circuit Judge Randolph’s concurring opinion disagrees with the dissent’s characterization of *Seven-Sky*, asserting that the AIA would have applied in *Seven-Sky* if the penalty at issue was a tax within the meaning of the AIA. *Florida Bankers*, 799 F.3d at 1072.

rather than raise revenue.⁴⁷ Fourth, the penalty at issue in *Foodservice* was the same one at issue in this case (IRC § 6721), though Congress attached the tax penalty to the tip-reporting requirement after oral argument in *Foodservice* (but three months before the decision). Finally, if a bank cannot obtain preenforcement review of the 2012 Rule then it may only obtain review by incurring a penalty and initiating a refund suit, while risking penalties and imprisonment for willful failure to file under IRC § 7203.⁴⁸ Such a precondition would present constitutional concerns, according to the dissent.

This case is significant because it illustrates the continuing confusion about the scope of the AIA as applied to penalties for failure to comply with regulatory requirements.⁴⁹ Clarity in this area is increasingly important, as Congress has turned to the IRS to administer social programs and regulatory requirements.

In *Z Street, Inc. v Koskinen*, the United States District Court of Appeals for the District of Columbia Circuit held the AIA did not bar a suit alleging the IRS improperly scrutinized and delayed applications for tax exemption from organizations with certain political views.⁵⁰

About eight months after *Z Street* applied for tax-exempt status under IRC § 501(c)(3), it filed suit under the Declaratory Judgment Act, 28 U.S.C. § 2201, alleging the IRS had delayed processing its application due to the special scrutiny it was applying to organizations holding certain political views (the “Israel Special Policy”), in violation of the First Amendment. The IRS moved to dismiss, arguing that the action was barred by the AIA, which prohibits suits to “restrain the assessment or collection of any tax,” and that *Z Street* had adequate remedies at law. For example, if the IRS did not act on the application within 270 days (only 32 more days), *Z Street* could sue for a declaratory judgment under IRC § 7428, or it could obtain judicial review by waiting for the IRS to issue a statutory notice of deficiency (SNOD) and then file a petition with the U.S. Tax Court (under IRC § 6213), or it could pay the tax and file a refund suit in a U.S. district court or the U.S. Court of Federal Claims (under IRC § 7422).

The district court denied the IRS’s motion and the United States District Court of Appeals for the District of Columbia Circuit affirmed.⁵¹ For purposes of the motion, the D.C. Circuit assumed *Z Street*’s allegation of improper discrimination was true. The court explained that the AIA does not apply in situations where the plaintiff has no alternative means to challenge the IRS’s actions. It reasoned that although *Z Street* could potentially obtain judicial review of its exemption status under IRC §§ 7428, 6213, or 7422, a review under those provisions would not address *Z Street*’s alleged injury — special scrutiny and delay resulting from the Israel Special Policy. Because application of the AIA would leave *Z Street* with no alternative means to challenge the Israel Special Policy, it did not bar the suit.

47 *Florida Bankers*, 799 F.3d at 1078 (internal citations omitted).

48 *Florida Bankers* elaborated in its petition to the Supreme Court that banks do not have the option of violating the rule in order to challenge it because many of them could lose their Federal Deposit Insurance Act coverage and, thus, their ability to do business if they incurred a criminal penalty like the one imposed for violation of the reporting regulation. *Florida Bankers*, 2016 WL 369508, No. 15-969 (Jan. 29, 2016) (petition for writ of cert.). The Supreme Court denied certiorari. *Florida Bankers Assoc. v. U.S. Dep’t of Treasury*, 136 S. Ct. 2429 (2016).

49 The Chief Counsel for the IRS has reportedly expressed concern, that “arguments are seriously being put forth in support of the proposition that the Anti-Injunction Act is toothless to forestall out-of-box regulation challenges by interest groups that do not have an actual controversy.” Andrew Velarde, *Reg Process Could Get Slower and Less Stable, Wilkins Warns*, 2016 TNT 123-7 (June 27, 2016).

50 *Z Street, Inc. v Koskinen*, 791 F.3d 24 (D.C. Cir. 2015).

51 *Id.* at 32, *aff’g* 44 F. Supp.3d 48 (D.D.C. 2014).

This case is significant because it suggests that judicial review is more likely to be available to plaintiffs who allege that an IRS process has systemic flaws that would not otherwise be subject to judicial review. If so, it may increase judicial oversight of the IRS's procedures.

In *Dorrance v. United States*, the United States Court of Appeals for the Ninth Circuit held taxpayers had no basis in stock received upon demutualization of their insurance carrier.⁵²

Mr. and Mrs. Dorrance purchased life insurance policies from mutual insurance companies. Mutual insurance companies are owned by policyholders, not stockholders. They return any surplus (profits) to policyholders in the form of dividends. Policyholders also have certain mutual rights normally held by stockholders, such as the right to vote and the right to receive the mutual company's surplus if it liquidates.

In transactions qualifying as tax-free re-organizations, each of the insurance companies demutualized, distributing shares of stock to policyholders in exchange for their mutual rights. When the Dorrances sold their stock, they reported the proceeds as gain, paid the resulting tax, and then filed for a refund, claiming the sale produced no gain. They argued the sale did not generate gain because the stock represented a return of previously-paid policy premiums. In the alternative, they argued their membership rights were not capable of valuation, and therefore, their premium payments should have been counted toward their basis in the stock under the open transaction doctrine.⁵³ This was the approach adopted in 2008 by the Court of Federal Claims in *Fisher*.⁵⁴ The IRS denied the claim, arguing that the Dorrances had no basis in the stock because they did not prove they had paid anything for the membership rights (and thus the stock).

The district court rejected both parties' positions and, after a bench trial, held that the stock had a basis equal to its value minus the amount of the Dorrances' projected future contributions to surplus under the policies.⁵⁵ Both parties appealed. The United States Court of Appeals for the Ninth Circuit agreed with the IRS. It determined the Dorrances acquired the membership rights at no cost. Accordingly, the Dorrances' stock basis was zero.

This case is significant because the IRS is likely to deny claims it had suspended. Following the *Fisher* decision, taxpayers made protective claims for refunds of taxes paid on the sale of stock received in connection with demutualizations. The IRS sometimes responded by indicating it would hold those claims in abeyance pending resolution of *Dorrance*.⁵⁶ As a result of this case, the IRS will reject the claims, potentially generating additional litigation in this area.

52 *Dorrance v. United States*, 809 F.3d 479 (9th Cir. 2015). For prior coverage of the issues in this case, see National Taxpayer Advocate 2013 Annual Report to Congress 326, 336 (discussing the district court opinion); National Taxpayer Advocate 2008 Annual Report to Congress 468-469 (discussing *Fisher v. United States*, 82 Fed. Cl. 780 (2008), *aff'd without opinion*, 333 F. App'x 572 (Fed. Cir. 2009), which held the open transaction doctrine applied to the sale of stock received in connection with a demutualization).

53 Under this doctrine the transaction would remain open (*i.e.*, basis may be adjusted, but gain or loss is deferred) until the Dorrances dispose of the stock. See *Fisher v. United States*, 82 Fed. Cl. 780 (2008), *aff'd without opinion*, 333 F. App'x 572 (Fed. Cir. 2009).

54 *Id.* Although the IRS has not issued an AOD, it disagrees with *Fisher*. See *Cadrecha v. United States*, 104 Fed. Cl. 296 (2012); *Reuben v. United States*, 111 A.F.T.R.2d (RIA) 620 (D. Cal. 2013), *rev'd*, 628 F. App'x 509 (9th Cir. 2016); Letter from IRS Associate Chief Counsel (Income Tax & Accounting) to Senator Harkin (May 23, 2011), *reprinted as, IRS Will Not Refund Tax Paid on Sale of Life Insurance Company Stock*, 2011 TNT 180-28 (Sept. 16, 2011).

55 *Dorrance v. United States*, 877 F. Supp.2d 827 (D. Ariz. 2012).

56 Memorandum for Technical Services Territory Managers, from Director, Technical Services, *Guidance for Demutualization Claims* (Aug. 24, 2009).

In *Ibrahim v. Commissioner*, the United States Court of Appeals for the Eighth Circuit held that a taxpayer could file jointly even after filing as head of household and timely petitioning the Tax Court.⁵⁷

Mr. Ibrahim and his wife, both immigrants who spoke little English, filed their 2011 tax returns with assistance from Oday Tax Service. Mr. Ibrahim claimed head of household (HOH) filing status, which was improper because he was married and living with his wife. The IRS sent a timely SNOD to Mr. Ibrahim, asserting he should be taxed at the higher rate applicable to those who are married filing separately (MFS). After filing a petition with the Tax Court to challenge the deficiency, Mr. Ibrahim and his wife sought to amend their returns by electing married filing jointly (MFJ) status and claiming the earned income tax credit (EITC) along with other tax benefits.⁵⁸ The IRS argued that after filing his petition, Mr. Ibrahim was no longer eligible for MFJ status.

IRC § 6013(b)(2)(B) specifically bars a taxpayer from electing MFJ status after filing a “separate return” if either spouse has received a SNOD and filed a timely petition with the Tax Court. In *Glaze*, the Fifth Circuit Court of Appeals held that the term “separate return” in IRC § 6013(b) means only a return electing MFS status, and not any other filing status, including HOH.⁵⁹ The Court of Appeals for the Eleventh Circuit follows the reasoning in *Glaze*.⁶⁰ The Tax Court, however, interprets the term “separate return” to mean any return except for a MFJ return.⁶¹ Although the IRS follows *Glaze* in cases appealable to the Fifth and Eleventh Circuits under the *Golsen* rule, it does not do so in other cases.⁶² Because this case was appealable to the Eighth Circuit, the Tax Court held that IRC § 6013(b)(2) barred Mr. Ibrahim and his wife from amending their returns to elect MFJ filing status.⁶³

The United States Court of Appeals for the Eighth Circuit reversed.⁶⁴ It concluded that the term “separate return” as used in IRC § 6013(b) applies only to a MFS return and not an HOH return. Thus, Mr. Ibrahim was permitted amend his return to file as MFJ.

This case is significant because it highlights the inconsistent interpretation of IRC § 6013(b)(2)(B) by the courts. The National Taxpayer Advocate has recommended legislation that would allow all taxpayers to change their filing status, regardless of which circuit court would hear their appeal.⁶⁵

In *Voss v. Comm’r*, the United States Court of Appeals for the Ninth Circuit held that the mortgage interest deduction limits apply on a per-taxpayer (not per-residence) basis.⁶⁶

Bruce Voss and Charles Sophy, unmarried joint owners of two homes, each claimed a home mortgage interest deduction in excess of the statutory limit. For taxpayers other than married individuals filing

57 *Ibrahim v. Comm’r*, 788 F.3d 834 (8th Cir. 2015).

58 To be considered eligible for the EITC, a married taxpayer must file a joint return. IRC § 32(d).

59 *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981).

60 *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981) (adopting all prior decisions of the Court of Appeals for the Fifth Circuit).

61 See, e.g., *Currie v. Comm’r*, T.C. Memo. 1986–71; *Blumenthal v. Comm’r*, T.C. Memo. 1983–737; *Saniewski v. Comm’r*, T.C. Memo. 1979–337.

62 See *Golsen v. Comm’r*, 54 T.C. 742, 757 (1970), *aff’d*, 445 F.2d 985 (10th Cir. 1971). See also *Glaze*, 641 F.2d at 339, *action on dec.*, 1981-140 (June 2, 1981); Chief Counsel Notice CC-2006-010 (Mar. 2, 2006).

63 *Ibrahim v. Comm’r*, T.C. Memo. 2014-8.

64 *Ibrahim*, 788 F.3d at 841.

65 See National Taxpayer Advocate 2014, Annual Report to Congress 346-350 (Legislative Recommendation: *Clarify the Definition of “Separate Return” in IRC § 6013 and Allow Taxpayers Who Petition the Tax Court to Change Their Filing Status to Married Filing Jointly in Accordance with the Tax Court’s Rules of Practice and Procedure*).

66 *Voss v. Comm’r*, 796 F.3d 1051 (9th Cir. 2015), *rev’g* 138 T.C. 204 (2012).

a separate return, IRC § 163(h)(3) limits the deduction for interest to \$1 million of home acquisition debt and \$100,000 of home equity debt on a qualified residence. If the limits apply to each taxpayer, then two unmarried taxpayers could deduct interest on up to \$2.2 million of debt. If the limits apply to a qualifying residence, two co-owners could only deduct interest on up to \$1.1 million of debt (assuming they do not own other qualifying residences). After an audit, the IRS disallowed a portion of their mortgage interest deductions, arguing that the limits apply on a per-residence basis. The taxpayers challenged the IRS's assessment in the Tax Court, arguing that the statute's limits apply on a per-taxpayer basis. The Tax Court agreed with the IRS, but a majority of the United States Court of Appeals for the Ninth Circuit agreed with the taxpayers.

The United States Court of Appeals for the Ninth Circuit focused on the parentheticals in IRC § 163(h)(3)(B)(ii) and (C)(ii) that halve the debt ceilings (*i.e.*, reduce them to \$550,000) “in the case” of a married individual filing a separate return. It explained that by doing so, “Congress implied that unmarried co-owners filing separate returns are entitled to deduct interest on up to \$1.1 million of home debt each.”⁶⁷ While this created a marriage penalty, the court observed that was Congress's decision.⁶⁸ It also pointed out that applying a per-residence ceiling would be unworkable in situations where two or more unmarried taxpayers each had an individual primary residence and also co-owned a secondary residence, which were in each case, qualified residences.⁶⁹

This case is significant because unless the IRS acquiesces in the result, unmarried taxpayers in different circuits may be subject to different mortgage interest deduction limits. Specifically, the Tax Court may continue to apply the limits on mortgage interest deductions on a per-residence basis under the *Golsen* rule (discussed above),⁷⁰ but apply it on a per-taxpayer basis for cases appealable to the Ninth Circuit.

In *United States v. Norcal Tea Party Patriots*, the United States Court of Appeals for the Sixth Circuit held the names, addresses, and taxpayer identification numbers of applicants for tax-exempt status do not constitute “return information” under IRC § 6103(b)(2)(A).⁷¹

The Norcal Tea Party Patriots filed suit seeking to certify a class of organizations whose applications for tax exemption were allegedly targeted by the IRS for special scrutiny. They sought to discover fellow members of the putative class that were on the IRS's “Be on the Lookout” (BOLO) list.⁷² The IRS argued that any information contained in an application for tax-exempt status, including the applicant's name, is confidential “return information” that is barred from disclosure under IRC § 6103.

67 Voss, 796 F.3d at 1068.

68 *Id.* at 1065. The court was unpersuaded by the analysis of CCA 200911007 (Mar. 13, 2009), which concluded that unmarried co-owners are limited to \$1,000,000 of total, aggregate acquisition indebtedness.

69 Voss, 796 F.3d at 1064 (“For example, two individuals might each have a separate primary residence but go in together on a vacation home in Maui. For such co-owners, filing tax returns under the Tax Court's per-residence approach would be like running a three-legged race. The co-owners are tied together for one home but not the other. This would mean that the two (or it could be three or four) co-owners would have to coordinate their tax returns to ensure that the aggregate amount of acquisition debt for each taxpayer's ‘qualified residence’ does not exceed \$1 million. It would also mean that one co-owner's deduction might depend on the size of another co-owner's mortgage on a home in which the first co-owner has no interest.”).

70 See *Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

71 *United States v. NorCal Tea Party Patriots*, 817 F.3d 953 (6th Cir. 2016).

72 For more information about the BOLO list, see *National Taxpayer Advocate Special Report to Congress: Political Activity and the Rights of Applicants for Tax-Exempt Status* and Treasury Inspector General for Tax Administration (TIIGTA), Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 14, 2013).

The district court agreed that the plaintiffs' requests encompassed "return information," but held that the IRS could disclose the documents under IRC § 6103(h)(4)(B), which permits disclosure where "the treatment of an item reflected on such return is directly related to the resolution of an issue" in a judicial proceeding.⁷³ The district court ordered the IRS to produce the documents, but permitted the IRS to redact employer identification numbers. The IRS filed a petition for a *writ of mandamus*, arguing that IRC § 6103(h)(4)(B) did not apply.⁷⁴ According to the IRS, IRC § 6103(h)(4)(B) authorizes disclosure only of information reflected on a return. It argued that because names on a BOLO list are return *information*, which is not reflected on a return, they may not be disclosed pursuant to IRC § 6103(h)(4)(B).

The United States Court of Appeals for the Sixth Circuit agreed with the IRS that IRC § 6103(h)(4)(B) only authorizes disclosure of information reflected on a return and not all return information. However, it ordered the IRS to disclose the names on the BOLO list because it concluded they are neither information on returns nor return information. The court reasoned that "return information" as defined by IRC § 6103(b)(2)(A) includes "a taxpayer's identity," which means the name of a person with respect to whom a return is filed. Because an application for exemption is not a return, the name of an applicant for tax-exemption is not a "taxpayer's identity" as that term is defined in IRC § 6103(b)(6) and used in IRC § 6103(b)(2)(A).⁷⁵

The court also rejected the IRS's argument that the names of applicants for tax-exempt status are return information under IRC § 6103(b)(2)(A) because the names are "other data ... with respect to the determination of the existence, or possible existence, of liability" for a tax. The court reasoned that if "data collected" includes the name of an applicant for tax-exempt status, then it also includes the name of a taxpayer who files a return. But, if that were true, then Congress was wasting its time when it included "taxpayer identity" as a type of return information under IRC § 6103(b)(2)(A), because a taxpayer's name would already be "data collected" (and thus return information) under the IRS's interpretation of that term.

This case is significant because it holds that "the names, addresses, and taxpayer-identification numbers of applicants for tax-exempt status are not 'return information' under IRC § 6103(b)(2)(A)."⁷⁶ As a result, it appears that such information may be disclosed to the public, even if tax-exempt status is not granted.⁷⁷

In *Peterson v. Commissioner*, the United States Court of Appeals for the Eleventh Circuit held that a payee was bound to report payments as provided by a contract that was unilaterally amended by the payor.⁷⁸

Mrs. Peterson was an independent contractor for Mary Kay who reached the highest level of its sales network to become a National Sales Director (NSD). She earned commissions on wholesale purchases of

73 *NorCal Tea Party Patriots v. I.R.S.*, 114 A.F.T.R.2d (RIA) 5358 (S.D. Ohio 2014).

74 A *writ of mandamus* is an extraordinary remedy whereby a court may order an inferior court or government official to fulfill their official duties or correct an abuse of discretion. See, e.g., *Cheney v. United States Dist. Court*, 542 U.S. 367, 380 (2004) (explaining a *writ of mandamus* is only appropriate in "exceptional circumstances amounting to a judicial usurpation of power, or a clear abuse of discretion...") (internal citations omitted).

75 The court did not discuss the broad interpretation applied to the term "taxpayer" in other circumstances. See, e.g., *U.S. v. Williams*, 514 U.S. 527, 529 (1995) (concluding that a "taxpayer" includes someone who pays the tax of another).

76 *NorCal Tea Party Patriots*, 817 F.3d at 965.

77 See, e.g., *Lloyd Hitoshi Mayer, NorCal Tea Party Patriots Opens a Crack in Taxpayer Privacy Protections* (June 2016), http://www.americanbar.org/content/dam/aba/publishing/aba_tax_times/16jun/att-16jun-005-at-court-norcal-tea-party-patriots-mayer.authcheckdam.pdf (concluding the decision appears to "open the door for interested parties to seek disclosure, both in litigation and through FOIA requests, of documents listing applicants for recognition of exemption").

78 *Peterson v. Comm'r*, 117 A.F.T.R.2d (RIA) 1815 (11th Cir. 2016).

Mary Kay products by her network of independent beauty consultants, sales directors, and other NSDs. As an NSD, Mrs. Peterson became eligible for two non-employee retirement programs, the Family Security Program (FSP) and the Great (or Global) Futures Program (GFP). Payments under the FSP and GFP were based on her pre-retirement commissions in the United States and the post-retirement wholesale purchases by her international network, respectively. In exchange for payments under the programs, Mrs. Peterson agreed to retire (*i.e.*, sever her NSD agreement and cease earning regular commissions) at a certain age and not to compete with Mary Kay.

The FSP and GFP agreements, which Mrs. Peterson signed in 1992 and 2005, respectively, did not address the character of the program payments. However, Mary Kay retained the right to terminate or modify them at any time. In 2008, immediately before Mrs. Peterson retired, Mary Kay unilaterally modified them to clarify that the payments were deferred compensation. According to Mary Kay, it modified the agreements to ensure the programs complied with the requirements of IRC § 409A.⁷⁹ When Mrs. Peterson retired and received payments under the FSP and GFP, she took the position that they were for the sale of her business and her covenant not to compete. She argued they were not deferred compensation, which would be subject to self-employment tax. Self-employment tax is only due on income “derived by an individual from any trade or business carried on by such individual.”⁸⁰ It is not due on the sale of a business.

The IRS determined the FSP and GFP payments were subject to self-employment tax. Both the Tax Court and the U.S. Court of Appeals for the Eleventh Circuit agreed. According to the Tax Court, the FSP and GFP payments were “derived” from Mrs. Peterson’s prior labor. The payments would only be made after a minimum number of years of service and were based on her pre-retirement commissions and the post-retirement wholesale volume of her network (*i.e.*, how well the network performed based on her prior services), respectively.⁸¹ The Tax Court also noted that the FSP and the GFP agreements, as amended, expressly provided that the distributions were deferred compensation (*i.e.*, related to Mrs. Peterson’s prior labor) and Mrs. Peterson had not shown they were unenforceable. It cited *Comm’r v. Danielson*, which established the so-called *Danielson* rule that unless a contract is unenforceable, a taxpayer generally cannot use substance-over-form principles to disavow the form of a transaction that he or she agreed to.⁸²

Relying on the *Danielson* rule, a majority of an Eleventh Circuit panel affirmed. The majority was not concerned that Mary Kay had unilaterally amended the program agreements to characterize the payments solely for tax purposes, or that it did so immediately before Mrs. Peterson retired.⁸³ It reasoned that when Mrs. Peterson agreed to allow Mary Kay to make unilateral modifications to the agreements, she implicitly agreed to Mary Kay’s characterization of the payments under them. A dissenting opinion

79 IRC § 409A generally provides that participants in a nonqualified deferred compensation plan that fails to satisfy certain requirements are immediately subject to current taxation, plus interest, on all compensation deferred under the plan. It also imposes an additional 20 percent tax on certain non-complying compensation. Mary Kay claimed it had always viewed the payments under the plans as deferred compensation (deductible by Mary Kay) and made the amendments to protect participating NSDs from the consequences of not complying with IRC § 409A.

80 IRC § 1402(a).

81 *Peterson v. Comm’r*, T.C. Memo. 2013-271.

82 *Id.* (citing *Plante v. Comm’r*, 168 F.3d 1279, 1280-1281 (11th Cir. 1999), and *Comm’r v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967)).

83 In some circumstances, however, the timing of a unilateral contract modification can support a finding of bad faith, which can make the modification unenforceable. See, e.g., Earle K. Shawe and Mark J. Swerdlin, *You Promised! - May an Employer Cancel or Modify Employee Severance Pay Arrangements?*, 44 *Mb. L. Rev.* 903 (1985), <http://digitalcommons.law.umaryland.edu/mlr/vol44/iss3/6>.

by Judge Rosenbaum (concurring in part) observed that the agreements Mrs. Peterson signed did not characterize the payments as deferred compensation. The dissenting opinion takes “issue with the Majority’s second-order conclusion that Peterson’s consent to unilateral amendments *to the Programs* somehow permitted Mary Kay to bind Peterson to its post-hoc characterization of the Program payments for purposes of applying the judicially crafted *Danielson* rule.”⁸⁴ One rationale for the *Danielson* rule is to prevent a party from unjustly enriching itself by unilaterally altering the intended tax consequences of a transaction after consummation.⁸⁵ The dissent argues that applying the *Danielson* rule in circumstances like these — where the contract was unilaterally modified by one party after execution by the other — actually incentivizes parties to engage in the very post-hoc tax liability shifting that the rule is meant to guard against.⁸⁶

While another rationale for the rule is to prevent the IRS from having to pursue a taxpayer’s counterparty in whipsaw litigation in a particular set of cases, the dissent argues this is not one of those cases. Because no prior court has applied the *Danielson* rule in situations where one party unilaterally modified the contract after execution by the other, the majority’s conclusion does not prevent unnecessary whipsaw litigation. Rather, it prevents necessary whipsaw litigation, according to the dissent.

After concluding that the payments were not deferred compensation, the dissent agreed with the majority’s conclusion that the FSP payments were subject to self-employment tax. They had sufficient nexus to the quality of Ms. Peterson’s prior work for Mary Kay. However, the dissent concluded that the GFP payments were not subject to self-employment tax. It reasoned they were based on the quality of work subsequently performed by members of Mrs. Peterson’s network, and thus, lacked sufficient nexus to the quality of her work.

This case is significant to the extent it expands the scope of the *Danielson* rule.⁸⁷ It may suggest that one party to a contract may require another party to characterize a transaction in a way not contemplated at the outset, provided he or she has enough bargaining power and foresight to obtain the right to make unilateral modifications.⁸⁸ Although the unilateral modification of a contract can render it unenforceable, such provisions are not uncommon in the context of employment contracts.⁸⁹ As workers are increasingly

84 *Peterson v. Comm’r*, 117 A.F.T.R.2d (RIA) 1815 (11th Cir. 2016).

85 The majority observes that Mary Kay was not enriched because its amendment was to clarify the characterization of the programs, as it had always intended to deduct payments under them. If the transaction were properly characterized as Mary Kay’s purchase of Mrs. Peterson’s business or her goodwill under the non-compete, however, the dissent points out that its payments would not have been fully deductible.

86 A related function of the *Danielson* rule is to promote certainty. However, permitting one party to bind the other to a new tax treatment of a transaction after execution of the agreement could result in less certainty, according to the dissent.

87 Litigation over application of the *Danielson* rule may have abated in recent years due to its partial codification. See IRC §1060(a)(flush) (“If in connection with an applicable asset acquisition, the transferee and transferor agree in writing as to the allocation of any consideration, or as to the fair market value of any of the assets, such agreement shall be binding on both the transferee and transferor unless the Secretary determines that such allocation (or fair market value) is not appropriate.”).

88 The majority’s holding could possibly be distinguished from other cases on the basis that Mrs. Peterson implicitly ratified the unilateral modification through her actions because she did not object when informed of the modification. She may have thought that protesting would be fruitless, however, because Mary Kay did not negotiate and tailor the program terms for her. *Peterson*, 117 A.F.T.R.2d (RIA) at n.29 (“Neither standard Program agreement was personalized for Peterson...”).

89 See, e.g., *Michael L. DeMichele and Richard A. Bales, Unilateral-Modification Provisions in Employment Arbitration Agreements*, 24 HOFSTRA LAB. & EMP. L.J. 63 (Fall 2006).

hired as independent contractors rather than employees,⁹⁰ unilateral modification provisions may find their way into more contracts with non-employees.

In *May v. United States*, the United States District Court for the District of Arizona held the IRS’s receipt of “information” triggered the limitations period for assessing the penalty under IRC § 6707A for failure to report a listed transaction, even though the taxpayer did not file the proper form.⁹¹

More than a year after Mr. May disclosed information about a listed transaction to the IRS, it assessed a penalty against him under IRC § 6707A for failing to disclose the transaction on Form 8886, *Reportable Transaction Disclosure Statement*. Mr. May had executed two timely Forms 872, *Consent to Extend the Time to Assess Tax*. One extended the limitations period for income and excise taxes for tax years (TYs) 2003 and 2004. Another extended the limitations period for IRC § 6707A penalties for TYs 2005 and 2006, but not 2004. Mr. May paid the penalty, submitted a claim for refund, and filed suit on the basis that the penalty was time barred as to 2004.

Under IRC § 6501(c)(10), the IRS must assess the IRC § 6707A penalty within one year after the earlier of “(A) the date on which the Secretary is furnished the information so required, or (B) the date that a material advisor” provides the same information. The government argued that only the filing of Form 8886, and not the mere delivery of “information,” triggers the running of the statute of limitations period.⁹² Even if the period would normally have expired, the government argued that Mr. May extended it by signing Form 872, which covered all “income and excise taxes” for 2004. According to the government, the word “tax” on Form 872 included additions to tax and penalties, such as the IRC § 6707A penalty.

The court first concluded that under the plain language of the statute, it is the furnishing of information, and not the submission of a particular form, that starts the limitations period. Next, the court concluded that the Form 872 covering 2004 extended the period for assessing tax, but not the IRC § 6707A penalty. Based on the parties’ conduct and testimony, the court found they only intended the Forms 872 to extend the period for assessing the IRC § 6707A penalty when they specifically referenced that penalty. The only Form 872 applicable to 2004 did not specifically cover the IRC § 6707A penalty. Thus, the IRS’s assessment was time barred.

This case is significant because it suggests the one-year limitations period for assessing a penalty for failure to report a listed transaction begins when someone provides information about the transaction to the IRS, even if someone other than the taxpayer does so and even if the information is not provided on Form 8886. The case is also significant to the extent it suggests that Forms 872 covering “taxes” do not automatically cover penalties, particularly if the IRS’s practice is to address penalties by specifically referencing them on separate Forms 872.

90 See, e.g., *The Sharing Economy: A Taxing Experience for New Entrepreneurs: Hearing Before the H. Comm. on Small Business*, 114th Cong. (2016) (statement of Nina E. Olson, National Taxpayer Advocate), https://www.irs.gov/pub/tas/nta_written_testimony_the_sharing_economy_5_26_2016.pdf.

91 *May v. United States*, 115 A.F.T.R.2d (RIA) 2155 (D. Ariz. 2015).

92 See, e.g., Treas. Reg. § 1.6011-4(d) (“If the form is not completed in accordance with the provisions in this paragraph (d) and the instructions to the form, the taxpayer will not be considered to have complied with the disclosure requirements of this section.”).