IRS Insights | A closer look

Court rules wrong form doesn't start IRS's SOL

In *Lagerkvist v. United States*, a district court rejected a taxpayer's argument that the IRS's assessment statute of limitations began when she filed a Form 941 instead of Form 944.[1]

Background

Plaintiff owed an LLC. In 2011, the LLC filed Form SS-4, *Application for Employer Identification Number*. On the SS-4, the LLC elected to file Form 944, *Employer's Annual Federal Tax Return*, instead of quarterly filing Form 941, *Employer's Quarterly Federal Tax Return*. Under Rev. Proc. 2009-51, once an employer elects to file Form 944, it needs IRS permission to change to filing Form 941.

Although the LLC elected to use Form 944, it filed a Form 941 for the first quarter of 2012. The IRS notified the LLC that it needed to file Form 944 instead and that the IRS would not process the Form 941 received. The LLC did not file a Form 944 for 2012.

Subsequently, the IRS prepared a substitute for return for the missing Form 944. In July 2016, the IRS assessed a trust fund recovery penalty against Plaintiff for the LLC's unpaid employment taxes.

Plaintiff disputed the penalty in district court. She argued that the assessment was untimely because it was not within 3 years of when the LLC filed the Form 941.

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District Court's decision

Generally, the IRS has three years from when a tax return is filed to assess additional tax and penalties.[2] However, if the taxpayer does not file a return, the IRS's assessment statute is open indefinitely.[3]

Here, Plaintiff did not file a Form 944 which would start the IRS's assessment statute. But she argues that the LLC provided sufficient information to the IRS to start the assessment statute. Plaintiff maintained that the LLC provided sufficient information on its LLC's Form 941, Form 1120S, and Form W-3, *Transmittal of Wage and Tax Statements*.

The district court rejected her argument. It held that under the *Beard* test the LLC had not submitted an unemployment tax return for 2012. The *Beard* test holds that a submission will be considered a return if it (1) provides sufficient data to calculate tax liability; (2) purports to be a return; (3) is an honest, reasonable attempt to satisfy the requirements of tax law; and (4) is executed under the penalty of perjury.[4]

The court rejected Plaintiff's arguments that the *Quezada* case applied. In *Quezada*, a contractor submitted Forms 1099 for subcontractors but should have also submitted Forms 945 because some of the Forms 1099 lacked TIN numbers.[5] The Fifth Circuit ruled the IRS's assessment statute of limitations started even though the Form 945 was not filed because the taxpayer's Form 1040 and Forms 1099 provided sufficient information to (1) show taxpayer was liable for the assessed taxes and (2) calculate the extent of the tax liability.

The district court noted that the Seventh Circuit had not yet adopted *Quezada* and questioned whether *Quezada* was decided correctly. But the court said even if it had adopted *Quezada*, the Plaintiff still would lose because the returns she submitted did not provide sufficient information to establish she was liable for the employment tax or the amount of the tax liability. Although the Plaintiff may appeal the district court's opinion, the case is a reminder that taxpayers should ensure timely filing of requisite returns to start the applicable statute of limitations.

Tax Court invalidates Treasury Regulation to find petition timely filed

Recently, the Tax Court ruled that section 7508A(d) provides for an automatic, mandatory 60-day postponement period for qualified taxpayers to meet certain deadlines in the event of a declared federal disaster, even if the IRS has not exercised its postponement authority under section 7508(A)(a).[6]

Background

The IRS issued Petitioners, residents of Ohio, a notice of deficiency dated December 2, 2019.[7] The Petitioners had until March 2, 2020 to timely petition the Tax Court. However, the Petitioners did not mail their petition until March 17, 2020.[8]

On March 13, 2020, the President of the United States declared a nationwide emergency in response to the COVID-19 pandemic and approved major disaster declarations for each state.[9] On March 31, 2020, the Ohio Disaster Declaration was signed; the declaration identified the COVID-19 pandemic conditions as beginning on January 20, 2020.[10]

The IRS moved to dismiss Petitioners' Tax Court case on the grounds that the petition was untimely.[11] Petitioners objected and argued that the petition was timely because under section 7508A(d) they had until March 20, 2020 to petition the Tax Court.

Section 7508A(d)

Through section 7508A(a), Congress gave the IRS authority to postpone certain tax-related deadlines for up to one year for taxpayers affected by a federally declared disaster. In 2019, Congress added section 7508A(d), titled "mandatory 60-day extension." The new subsection provides that when the President makes a federal disaster declaration the period between the earliest incident date specified in the declaration until 60 days later is disregarded in the same manner as the period specified under section 7508A(a).[12]

The IRS promulgated Treas. Reg. § 301.7508A-1(g) which held that section 7508A(d) applies only when the IRS exercises its authority to postpone deadlines under section 7508A(a).[13]

Tax Court decision

When deciding whether Petitioners timely petitioned the Tax Court, the Tax Court had to decide the correct interpretation of section 7508A(d).[14] The Tax Court agreed with Petitioners' interpretation and concluded that the 60-day period in section 7508A(d) applies regardless of whether the IRS has executed its authority under section 7508A(a).

The Tax Court focused on the mandatory language in section 7508A(d) and compared it to the discretionary language in section 7508A(a). Section 7508A(d) provides there "shall" be a postponement of certain deadlines, whereas section 7508A(a) merely provides that the IRS "may" postpone certain deadlines. The Tax Court concluded that Congress's use of mandatory language such as "shall" is evidence of the clear intent for section 7508A(d) to be automatic and mandatory in nature.[15]

The Tax Court rejected the IRS's argument that section 7508A(d) is ambiguous because it does not specify which time sensitive acts are postponed pursuant to the section and because Congress did not specify the applicability of the 60-day postponement in the event of a federally declared disaster without a stated incident date, identifying when the disaster conditions began.[16] The Tax Court noted that Petitioners did not argue their entitlement to the 60-day postponement period based on the federal disaster declaration issued without an incident date, but rather the Ohio Disaster Declaration with an incident date of January 20, 2020.

The Tax Court concluded Treas. Reg. § 301.7508A-1(g) was not entitled to any *Chevron* defense because section 7508A(d) was not ambiguous. The Tax Court found that the plain language of section 7508A(d) was unambiguous because it

identifies a defined person entitled to the postponement, a defined period of time with a clear start and end date, and by virtue of a cross-reference to section 7508A(a), section 7508A(d) also defines the acts subject to the postponement.[17]

In light of these facts, the Tax Court ruled that section 7508A(d) grants qualified taxpayers an automatic, mandatory 60-day extension to file a petition with the Tax Court by reason of a federal disaster declaration containing an incident date.[18]

Conclusion

It is unclear whether the IRS will appeal the Tax Court's decision. Taxpayers subject to federal disaster areas and who may rely on section 7508A(d) should consult with their tax advisors.

IRS proposes regulations identifying certain charitable remainder annuity trusts as listed transactions

In late March, the IRS published a notice of proposed rulemaking and issued proposed regulations identifying certain charitable remainder annuity trust ("CRAT") transactions as "listed transactions." The proposed regulations, published in the Federal Register on March 25, 2024, are meant to address concern over the use of CRATs and single premium immediate annuities to avoid the recognition of ordinary income and/or capital gains.

A charitable remainder trust is created when (1) a donor transfers property (cash or other assets) into an irrevocable trust, (2) the trust pays income to at least one living beneficiary for either a specific term of years (up to 20) or for the life of one or more of the beneficiaries, and (3) at the end of the term, the remainder of the trust passes to one or more qualified US charitable organizations. Payments from charitable remainder trusts are taxable to the non-charitable beneficiaries and are reported to them on Schedule K-1 (Form 1041), *Beneficiary's Share of Income, Deductions and Credits*. The payments made from the trust are taxed as distributions of the trust's income and gains in a specified order—i.e., ordinary income, capital gains, other income, and corpus.

A CRAT, one of the two types of charitable remainder trusts, will pay a specific dollar amount each year. The amount must be at least 5%, but not more than 50% of the value of the corpus when the trust is established.

According to the proposed regulations, CRAT transactions will be considered listed transactions if:

- the grantor creates a trust purporting to qualify as a CRAT under section 664(d)(1);
- the grantor funds the trust with property having a fair market value in excess of its basis ("contributed property");
- the trustee sells the contributed property;
- the trustee uses some or all of the proceeds from the sale of the contributed property to purchase an annuity; and
- on a federal income tax return, the beneficiary treats the amount payable from the trust as if it were, in whole or in part, an annuity payment subject to section 72, instead of carrying out to the beneficiary amounts in the ordinary income and capital gains tiers of the trust in accordance with section 664(b).

When the proposed regulations are finalized, participants in CRAT transaction, as defined by the regulations, will be required to attach Form 8886, *Reportable Transaction Disclosure Statement*, to their income tax return for each year in which they participate in the transaction. When a disclosure statement is first filed by a participating taxpayer, a copy must also be sent to the Office of Tax Shelter Analysis ("OTSA"). Additionally, participants who filed an income tax return reflecting participation before the date the proposed regulations are finalized and published in the Federal Register will also be required to report such participation on Form 8886 to OTSA for any year in which the period of limitations for assessment of tax has not yet ended at the time the proposed regulations are finalized. These disclosures must be sent to OTSA within 90 days of the proposed regulations being finalized.

Additionally, material advisors that made a tax statement (i.e., any statement, oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction) with respect to the type of CRAT transaction covered by the proposed regulations before the date the proposed regulations are finalize and published in the Federal Register will be required to disclose any such tax statements made during the six years immediately preceding the finalization date on Form 8918, *Material Advisor Disclosure Statement*. Material advisors who make a tax statement with respect to a CRAT transaction after the proposed regulations are finalized be required to make disclosures in accordance with section 6111 and maintain an investor list pursuant to section 6112.

The notice of proposed rulemaking seeks written and electronic comments (and requests to speak at the public hearing) and asks that those be submitted by May 24, 2024. The public hearing is scheduled for July 11, 2024.

Endnotes

1. *Lagerkvist v. United States*, No. 1:22-cv-201-HAB-SLC, 2024 U.S. Dist. LEXIS 35125, at *1 (N.D. Ind. Feb. 29, 2024).
2. IRC § 6501(a).
3. IRC § 6501(c)(3).
4. See *Beard*, 82 T.C. 766, 777 (1984), *aff'd per curiam* 793 F.2d 139 (6th Cir. 1986).
5. *Quezada v. IRS (In re Quezada)*, 982 F.3d 931, 932 (5th Cir. 2020).
6. *Abdo v. Commissioner*, No. 5514-20, 2024 U.S. Tax Ct. LEXIS 813 (T.C. Apr. 2, 2024)
7. Id. at *1
8. Id. at *2
9. Id.
10. Id.
11. Id. at *1
12. IRC § 7508A(d).
13. Treas. Reg. § 7508A-1(g)(1).
14. *Abdo v. Commissioner*, 2024 U.S. Tax Ct. LEXIS 813 at *11. The parties also disputed whether Treas. Reg. § 301.7508A-1(g)(1) and (2) provide a valid construction of section 7508A(d), but the Tax Court decided this issue did not warrant an analysis following its ruling regarding the parties' interpretation of section 7508A(d).
15. Id.
16. Id. at *14
17. Id. at *21
18. Id. at *31

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