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Top Tax Developments for 2023

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As is often the case in the year before a presidential election, Congress kept relatively quiet in 2023. Nonetheless, it was a busy year for the courts and the IRS. This article summarizes several of the most significant developments in the federal income, estate, and gift tax laws of interest to estate planning professionals. The items described in this article are not in any particular order; it is not a "ranking" and certainly not a "top ten list." (Heck, there are only eight of them.)

1. Property Gifted to a Defective Grantor Trust Does Not Get Stepped-up Basis at Grantor's Death

In March, the IRS confirmed in *Revenue Ruling 2023-2* that the income tax basis of an asset gifted to a so-called "defective grantor trust" is not adjusted to fair market value as of the date of the grantor's death. A defective grantor trust, recall, is an irrevocable trust the assets of which are deemed to be owned by the grantor for federal income tax purposes but are not included in the grantor's gross estate for federal estate tax purposes. Thus, while the trust is a grantor trust for income tax purposes, it is nonetheless "defective" because it is not a grantor trust for estate tax purposes. Yet, this defect is exactly what the grantor wants when creating the trust, for the assets of the trust will not be subject to estate tax at the grantor's death.

Practitioners hoped the ruling would also address the post-death basis of assets *purchased* from a grantor, but the ruling limited itself to discussing the rules applicable to assets *gifted* to a defective grantor trust. The ruling, thus, was disappointing, for it was already well accepted that assets gifted to an irrevocable trust would not be eligible for a stepped-up basis at the grantor's death. Had the ruling said only this much, practitioners could have lived with the disappointment.

But the ruling went on to observe that a defective grantor trust's basis in gifted property is "the same as the basis" of the property "immediately prior" to the grantor's death. Why didn't the ruling simply say that the trust would take the grantor's basis for federal income tax purposes? Does this language simply mean that there is a carryover basis under Section 1015(a)? If so, what do we do about section 1015(d), which provides that the recipient of a gift may add to the gifted property's basis a portion of the federal gift tax paid by the donor in connection with the transfer. If the grantor paid gift tax on the transfer, at what point, if ever, does the trust get basis credit under section 1015(d)? It cannot be before death, as the income tax—which continues to see the grantor as the owner of the gifted property—would say no gift happens until the grantor's death, when the trust becomes a separate taxable entity. Does that mean, then, that any basis adjustment for gift tax paid would come into effect at death? We still lack firm guidance on this point.

At the end of the day, then, *Revenue Ruling 2023-2* doesn't address the question on the minds of most practitioners and goes on to raise new questions that, heretofore, practitioners felt no need to consider.

2. Eighth Circuit Splits from Eleventh Circuit on Whether Corporate-Owned Life Insurance Increases the Estate Tax Value of Stock

In June, the Eight Circuit in *Connelly v. United States* held that corporate-owned life insurance on the life of a deceased shareholder acquired for the purpose of redeeming the deceased shareholder's shares increased the estate tax value of the deceased shareholder's stock. In reaching this result, the court rejected a holding to the contrary from the Eleventh Circuit in *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005). In December, the Supreme Court of the United States granted the estate's petition for certiorari, so resolution of the split will wait until 2024.

The Eight Circuit's case involved two brothers, Michael and Thomas, who were the sole shareholders of a building materials corporation based in St. Louis. They had a buy-sell agreement that provided that, upon the death of the first of them to die, the surviving brother would have a right to purchase the deceased brother's shares. If the surviving brother did not exercise this option, the company would redeem the deceased brother's shares. The agreement further provided that the price to be paid for the deceased brother's stock would be determined by a "certificate of agreed value" to be executed each year by the

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brothers. If they failed to do so (in fact, they never signed any such document at any point), the value of the stock would be determined by reference to at least two appraisals. But when Michael died, the company obtained no appraisals and simply paid $3 million from a $3.5 million life insurance policy it owned on Michael's life to Michael's estate in redemption of his majority stake in the company.

The IRS determined that the estate should have had the stock appraised and that any such appraisal would have included 77 percent of the value of the death benefit. As a result, it determined that the value of Michael's stock was about $5.3 million, resulting in a $1 million deficiency that Michael's estate paid. The estate then brought this refund action, but a federal district court granted summary judgment to the IRS.

On appeal, the Eight Circuit first held that the buy-sell agreement would be disregarded in valuing Michael's shares. It then considered the estate's argument that the value of Michael's stock should not reflect the death benefit paid to the company under the life insurance policy, citing *Blount*. That case famously held that, while corporate-owned life insurance was an asset of the company, it had no effect on the company's value because of the offsetting liability to use the proceeds in a redemption. As the Eleventh Circuit put it, "To suggest that a reasonably competent business person, interested in acquiring a company, would ignore a $3 million liability strains credulity and defies any sensible construct of fair market value." *Estate of Blount* at 1346. But the Eighth Circuit rejected this notion, reasoning "[a]n obligation to redeem shares is not a liability in the ordinary business sense. ... [A] hypothetical willing seller of [the company] holding all 500 shares would not accept only $3.86 million knowing that the company was about to receive $3 million in life insurance proceeds, even if those proceeds were intended to redeem a portion of *the seller's own shares*. To accept $3.86 million would be to ignore, instead of "take[] into account," the anticipated life insurance proceeds." (Emphasis in original.) The court thus affirmed summary judgment for the IRS.

Connelly casts doubt on the validity of *Blount*. For taxpayers outside the Eighth and Eleventh Circuits, there is uncertainty as to how corporate-owned life insurance affects the estate tax value of the company's stock. The Supreme Court will resolve the issue in 2024, and while that resolution will please some, it will, no doubt, frustrate others. Stay tuned.

3. IRS Publishes Safe Harbor Deed Language for Conservation Easements

In April, the IRS issued *Notice 2023-30* in compliance with section 605(d)(1) of the SECURE 2.0 Act of 2022. That provision required that "The Secretary of the Treasury (or such Secretary's delegate) shall, within 120 days after the date of the enactment of this Act, publish safe harbor deed language for extinguishment clauses and boundary line adjustments" applicable to donations of qualified conservation contributions.

Prior to this rule, the IRS had won over 20 cases involving donations of conservation easements by arguing that the deeds conveying the easements to charities violated the requirement that a donation be made "in perpetuity" because those deeds improperly provided that, upon a judicial extinguishment of the easement and sale of the property, the charity would receive a proportionate share of the net sale proceeds (after subtracting the amount of any post-donation improvements made to the property) instead of a proportionate share of the gross sale proceeds. Congress wanted the IRS to provide taxpayers with language regarding extinguishments that would comply with the "in perpetuity" requirement. At the same time, for reasons not entirely clear, Congress also wanted the IRS to offer sample deed language addressing boundary line adjustments.

Notice 2023-30 contains safe-harbor language for extinguishment clauses and boundary line adjustment clauses in conservation easement deeds. Here is the safe harbor deed language related to **extinguishments**:

> *Pursuant to Notice 2023-30, Donor and Donee agree that, if a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation of the perpetual conservation restriction renders impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if (1) the restrictions are extinguished by judicial proceeding and (2) all of Donee's portion of the proceeds (as determined below) from a subsequent sale or exchange of the property are used by the Donee in a manner consistent with the conservation purposes of the original contribution.*
>
> <u>Determination of Proceeds</u>. *Donor and Donee agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in Donee, 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 fair market value of the property as a whole at that time. The proportionate value of Donee's property rights remains constant such that if a subsequent sale, exchange, or involuntary conversion of the subject property occurs, Donee is entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.*

Here is the safe harbor language related to **boundary line adjustments**:

> *Pursuant to Notice 2023-30, Donor and Donee agree that boundary line adjustments to the real property subject to the restrictions may be made only pursuant to a judicial proceeding to resolve a bona fide dispute regarding a boundary line's location.*

Congress further provided that existing deeds could be amended to include this language and have those amendments relate back to the date of the original contribution if such amended deeds were conveyed by July 24, 2023. *Notice 2023-30* made clear that, while an amended deed may use this language verbatim, it is enough to use terms that have the same meaning. Thus, for example, if the original deed speaks of a "Grantor" and "Grantee," the amended deed may use those terms instead of "Donor" and "Donee" in the safe harbor language, and if the original deed spoke of an "easement" or "servitude" instead of a "restriction," the amended deed could still use those terms.

4. Supreme Court Holds Foreign Bank Account Report Penalty Applies on Per-Form Basis, Not Per-Account Basis

In February, the Supreme Court of the United States, in a 5-4 decision in *Bittner v. United States*, 598 U.S. 85 (2023), held that the penalty for negligent failure to disclose foreign bank accounts on a required form accrues on a per-report basis and not, as the Fifth Circuit had held, on a per-account basis. As longtime readers of the REPORTER know, the Bank Secrecy Act of 1970 requires United States citizens and residents to file reports related to certain relationships with foreign financial institutions. Pursuant to the Act, Treasury issued regulations requiring an individual to file a Report of Foreign Bank and Financial Account (misleadingly known as an "FBAR") for any calendar year in which the individual has more than $10,000 in a foreign bank account. The Act provides that failing to file an FBAR can lead to a penalty of $10,000 per violation, which increases to $100,000 per violation (or, if more, 50 percent of the value in the foreign account) where the failure to file an FBAR is willful.

In this case, Alexandru Bittner, a dual citizen of the United States and Romania, learned of his obligation to file FBARs after returning to the United States from Romania in 2011. He then submitted FBARs covering the years 2007 through 2011, though the forms did not disclose all foreign bank accounts over which he had signatory authority or a qualifying interest. Ultimately, Bittner filed corrected forms disclosing 61 foreign accounts in 2007, 51 accounts in 2008, 53 accounts in 2009, 53 accounts in 2010, and 54 accounts in 2011. The account balances during these years ranged from $3 million to $16 million. Because the filed FBARs were late and incomplete, the federal government imposed a penalty of $2.72 million, applying the $10,000 penalty separately to each of the accounts (272 accounts over the five years).

Bittner challenged the amount of the penalty, arguing the maximum penalty in his case should be $50,000—one $10,000 penalty for each of the five reports he failed to file timely. He had authority for this position, as the Ninth Circuit had held in *United States v. Boyd*, 991 F.3d 1077 (9th Cir. 2021), that the penalty applies on a per-report basis and not, as the government contended, on a per-account basis. A federal district court agreed with him. *Bittner v. United States,* 469 F. Supp. 3d 709 (E.D. Tex. 2020). But the Fifth Circuit rejected his argument, upholding the $2.72 million penalty. *Bittner v. United States*, 19 F.4th 734 (5th Cir. 2021).

The case is especially noteworthy since the 5-4 split is not along the typical ideological lines. Justice Jackson sided with conservative Justices Gorsuch, Roberts, Alito, and Kavanaugh in reversing the Fifth Circuit and remanding the case for imposition of a $50,000 maximum penalty. Meanwhile, conservative Justice Barrett penned a dissent joined by Justice Thomas and two consistently liberal colleagues, Justices Sotomayor and Kagan. The close vote and atypical allegiances suggest this case was less of a political question and more a question of statutory interpretation in which reasonable minds could disagree.

Writing for the majority, Justice Gorsuch pointed to the Act's mention of a duty to file "reports" and not of a duty to disclose "accounts." As he states:

> the statutory obligation is binary. Either one files a report "in the way and to the extent the Secretary prescribes," or one does not. Multiple willful errors about specific accounts in a single report may confirm a violation … but even a single nonwillful mistake is enough to pose a problem.

Further, he notes, the penalty provision in the Bank Secrecy Act ties the penalty for negligent failure to file complete FBARs to the number of "violations," not the number of "accounts." The only time the Act mentions "accounts" is in relation to the penalty for the willful failure to file FBARs, where the penalty is the greater of $100,000 or 50 percent of "the balance in the account at the time of the violation." Justice Gorsuch reasons that, because the statute specifically refers to accounts only in the case of willful penalties, the penalty for negligent failure to file FBARs must necessarily be applied on a per-report basis and not a per-account basis.

Justice Gorsuch also argued for application of the "rule of lenity," under which statutes imposing penalties are to be strictly construed against the government and in favor of individuals. On this point, however, he was joined only by Justice Jackson.

Justice Barrett's dissent observed that the statute requires an FBAR when an individual "maintains a relation … with a foreign financial agency." In the typical case, that "relation" is a bank account. Thus, in the dissent's view, "each relation with a foreign bank triggers the requirement to file reports. And because each relation is a matter of distinct concern under the statute, each failure to report an account violates the reporting requirement."

Justice Barrett then observed that the penalty provisions of the Act use the term "violation" in a way that refers to accounts and not just to reporting forms. The reasonable cause exception to reporting, for instance, waives any penalty for negligent failure to file where "such violation was due to reasonable cause" and "the balance in the account at the time of the transaction was properly reported." Since the exception conditions waiver on reporting information about a particular account, Justice Barrett reasons, "this language suggests that the underlying *violation* of [the Act] is similarly tied to a specific account." On this point, she sides with the Fifth Circuit's conclusion that, "if the exception for non-willful violations applies on a per-account basis, then logically the violations the exception forgives must arise on a per-account basis too." 19 F.4th 734, 747-748 (5th Cir. 2021).

While the result in the case is good news for Bittner and for others with many foreign bank accounts that have negligently failed to file FBARs, the reasoning of the dissent is compelling, especially on this last point.

5. IRS Makes Clear There's No Income Tax Deduction for Donations to NIL Collectives

In June, the IRS issued *Advice Memorandum 2023-004*, in which the Office of Chief Counsel concluded that operating a "name, image, and likeness" (NIL) collective does not further a tax-exempt purpose under section 501(c)(3). As a result, contributions to an NIL collective do not qualify for a federal income tax deduction under section 170.

"Collectives" arose following the National Collegiate Athletic Association's (NCAA's) adoption of an interim NIL policy in 2021 that allows collegiate athletes to be compensated for the use of their NIL without affecting their NCAA eligibility. Booster clubs at many universities established "collectives" to develop, fund, and, in some cases, administer NIL deals for their student-athletes. Typically, the collectives are independent of the college or university, and many are formed as nonprofit organizations under state law. Some collectives have even achieved tax-exempt status as section 501(c)(3) organizations.

Most collectives partner with local and regional charities to develop paid NIL opportunities for student-athletes. For instance, a student-athlete might appear in a promotional video for the charity, or the student-athlete might attend a fundraising event or a youth sports camp on behalf of the charity. The student-athletes are then compensated for the use of their NIL rights directly from the collective. The collective might also assist the student-athletes in reporting their activities to comply with state law and university policies. Some collectives even provide student-athletes with advice on brand development, financial planning, and tax advice.

The problem is that a tax-exempt organization must be organized and operated *exclusively* for charitable, educational, religious, or other specifically identified purposes. Regulations make clear that an organization must engage primarily in activities that further an exempt purpose. Treas. Reg. §1.501(c)(3)-1(c)(1). Furthermore, an organization must serve public (as opposed to private) interests. Treas. Reg. §1.501(c)(3)-1(d)(1)(ii). While an occasional private benefit to private interests that is incidental to an organization pursuing its exempt purpose is allowed, any such private benefit must be "clearly incidental to the overriding public interest." Rev. Rul. 76-206, 1976-1 C.B. 154.

Here, the Office of Chief Counsel concluded that the *primary* purpose of the typical NIL collective is for the private benefit of student-athletes:

> Collectives are usually organized by boosters and fans of athletic programs at particular schools. It is reasonable to assume that these organizers, as supporters of a particular school, have an interest in limiting a collective's NIL opportunities to the student-athletes at that school rather than making these opportunities available to any student-athlete willing to participate in the collective's activities. ... Given the role that NIL collectives play in student-athlete retention and recruitment, and the presence of other factors listed above, it is

> apparent that helping student-athletes monetize their NIL is a substantial nonexempt purpose of many nonprofit NIL collectives.

For this reason, the Office of Chief Counsel concluded, many NIL collectives are not tax-exempt because the private benefits provided to student-athletes are not merely incidental to any exempt purpose.

The long-term impact of this advice memo depends on how aggressively the IRS decides to pursue the issue. But it could mean that some collectives face revocation of their tax-exempt status, and donors who were told they could deduct contributions need to be advised against taking a deduction for contributions.

6. Ninth Circuit Says Beneficiaries Receiving Property After Death are Liable for Unpaid Estate Tax

In May, the Ninth Circuit held in *United States v. Paulson,* 68 F.4th 528 (9th Cir. 2023), that certain persons receiving property includible in a decedent's gross estate at any time after the decedent's death are liable for unpaid federal estate taxes, reversing a federal district court's decision holding that only persons who owned or received property at or as of the decedent's death are personally liable for unpaid federal estate taxes.

The case involved the interpretation of section 6324(a)(2), which states in relevant part that:

> If the estate tax imposed by Chapter 11 is not paid when due, then the spouse, transferee, trustee…, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, *who receives, or has on the date of the decedent's death*, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax.

(Emphasis added.) Specifically, the issue before the Ninth Circuit was whether the phrase "on the date of the decedent's death" modifies only "has" or both "has" and "receives." If the former, then those specified transferees who either "had on the date of death" or at any point "received" property included in the decedent's gross estate under the indicated Code sections would face personal liability for unpaid estate tax. But if the latter construction is correct, then only those specified transferees who "had on the date of death" assets included in the decedent's gross estate or "received at the date of death" such assets would be personally liable; beneficiaries receiving property *after* the date of death would not be liable.

A federal district court held that four individuals were not liable for the unpaid estate taxes because they were not in possession of estate property at the time of the decedent's death. But the majority of the Ninth Circuit panel reversed, holding that transferee liability applies to those "who have or receive estate property, either on the date of the decedent's death or any at any time thereafter, subject to the applicable statute of limitations." The majority applied "the rule of the last antecedent," a canon of statutory interpretation that reads a limiting clause as modifying only the noun or phrase it immediately follows. Under this rule, the limiting phrase "on the date of the decedent's death" would modify only the verb "has" and not also the verb "receives." It rejected the argument of the beneficiaries that the "series-qualifier" canon of interpretation should apply. Under the series-qualifier rule, a modifier at the end of a list applies to the entire list. But the majority noted that this canon is better suited to statutes where the modifier is separated from all antecedents by a comma, and such is not the case in this particular statute.

The majority saw no reason to limit transferee liability only to those individuals in possession of the assets included in the gross estate at the time of the decedent's death and those who have an ownership interest immediately as of the date of the decedent's death, like survivors in a joint tenancy. If the argument of the beneficiaries was correct, then the government could only collect tax from surviving joint tenants and those in physical possession of property included in the gross estate; it could never collect estate tax from assets held by the revocable living trust at death once the trust distributed those assets to the beneficiaries. This would not be consistent with the intent of transferee liability.

The beneficiaries argued that if anyone receiving property after death could be subject to transferee liability, then unpaid estate tax could be collected from persons who purchased estate assets. The beneficiaries also argued that if the property depreciates in value after death, transferees could be liable for taxes that exceed the value of the property they received. The majority rejected both of these arguments as failed attempts to invoke the "canon against absurdity," a rule that courts should avoid construing a statute that would produce an absurd and unjust result. Regarding the first argument, purchasers of estate assets are not among the categories of persons listed in section 6324(a)(2), and the statute also provides that any estate tax lien is divested upon transfer to a "purchaser or holder of a security interest."

As for the second argument, the majority observes that the statute sets estate tax liability based on date-of-death values. Just as post-death increases in value inure to the benefit of a beneficiary, post-death decreases in value are a risk borne by the beneficiary. It is on this last point that the panel's dissenting judge takes the greatest exception. That a beneficiary could be liable for tax in an amount exceeding the value of what they have received from the estate, says the dissent, is "not logical." The majority explains at great length why it is unlikely that a beneficiary would be forced to pay more than the value of the bounty they received from a decedent's estate, but the dissent finds the explanations "unpersuasive, even on their own terms."

The court reached the right result. Note the comma after the word "receives" in section 6324(a)(2)—it makes all the difference. Absent the comma, the argument of the beneficiaries would be much stronger. But that comma has to give one pause. (Pun intended.) It serves to set "receives" apart from "has on the date of the decedent's death," indicating pretty strongly that the "at date of death" modifier only applies to those in actual possession of assets included in the gross estate as of the decedent's death.

7. The Year of Late Tax Court Petitions

Section 6213(a) generally gives a taxpayer 90 days after the mailing of a notice of deficiency to file a petition for redetermination of the deficiency with the Tax Court. It states in relevant part that:

> Within 90 days … after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. … [N]o assessment of a deficiency … and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day … period … nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. … The Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition.

The IRS and the Tax Court read this language to mean that if a taxpayer files a petition for redetermination just minutes or even seconds after the applicable deadline, the Tax Court lacks the jurisdiction to consider the petition. Three cases from the year looked at this issue in detail.

In the first case, from May, the Tax Court held in *Nutt v. Commissioner*, 160 T.C. No. 10, that a document electronically filed with the court is filed upon receipt, determined with reference to where the court is located, not where the taxpayer is located. On April 14, 2022, the IRS mailed a deficiency notice to the taxpayers in connection with their joint income tax return for 2019. The deadline for filing a petition in Tax Court was July 18, 2022. The taxpayers resided in Alabama, located in the central time zone. They filed their electronic petition at 11:05pm central time on July 18, 2022, but that was 12:05am eastern time on July 19, 2022. Because the Tax Court is located in Washington, D.C., the eastern time zone applies, so the petition was five minutes too late. The IRS filed a motion to dismiss for lack of jurisdiction, and the Tax Court granted the motion.

The taxpayers did not qualify for the "timely mailing is timely filing" rule of section 7502(a) because their petition was not delivered by the United States Postal Service or any other approved delivery service. Thus, the time of actual receipt determines the time of filing. The court justified this conclusion by noting, first, that the Tax Court's website states in bold print that "**The Court must receive your electronically filled Petition no later than 11:59 pm Eastern Time on the last date to file.**" In addition, this conclusion is consistent with Rule 6(a)(4) of the Federal Rules of Civil Procedure which provides that the deadline for electronic filing ends "at midnight in court's time zone." Finally, the court cited precedents from other federal courts that applied the same principle that electronic filing deadlines are governed by the court's local time zone.

Then, in June, the Tax Court held in *Sanders v. Commissioner*, 160 T.C. No. 16, that an electronic petition for redetermination filed *eleven seconds* after midnight on date after the due date was untimely. While the period for electronic filing may be extended where the filing system is inaccessible on the last day for filing, said the court, such was not the case here. The taxpayer's case was therefore dismissed for lack of jurisdiction.

While the *Sanders* court had no trouble dismissing the taxpayer's arguments for mercy, it considered at length two arguments made in an amicus brief filed by the Tax Clinic at Harvard Law School. The brief first argued that a petition should be treated as filed when a taxpayer relinquishes control over it, akin to the mailbox rule in section 7502. But given the Tax Court's decision in *Nutt,* the "timely mailing is timely filing" rule from section 7502 does not apply to petitions filed electronically. The brief also asked the court to view the taxpayer's petition "through the lens of equitable tolling." But the Tax Court observed that under its own precedent, equitable tolling does not apply to a jurisdictional deadline. Accordingly, the court dismissed the case for lack of jurisdiction.

In July, the Third Circuit in *Culp v. Commissioner*, 75 F.4th 196 (3d Cir. 2023), reversed a Tax Court order dismissing a petition for redetermination of tax liability due to late filing. It held that the Tax Court *has* jurisdiction to review untimely redetermination petitions, contrary to the Tax Court's interpretation of the governing statute as illustrated in *Nutt* and *Sanders*.

In 2015, the taxpayers, a married couple, received over $17,000 in settlement of a lawsuit. They reported the payment on their 2015 joint federal income tax return, but the IRS concluded that payments were not included on the return. In 2018, the IRS mailed a second notice of deficiency to the taxpayers in connection with this matter. After the taxpayers failed to respond to the letter, the IRS levied on their social security benefits and their federal income tax refund. The taxpayers then filed a petition with the Tax Court, but this was more than 90 days after the date the IRS mailed them the second deficiency notice.

The Tax Court concluded that because the petition was filed late, it lacked jurisdiction to consider the claim. But the Third Circuit, applying the Supreme Court's recent analysis in *Beecher, P.C. v. Commissioner*, 142 S. Ct. 1493 (2022), held that the

90-day filing requirement is merely procedural and not jurisdictional. In *Beecher*, the Supreme Court announced that a procedural requirement will be treated as limiting a court's jurisdiction only where Congress "clearly states" that it is. And in this case, ruled the Third Circuit, the statute does not so clearly state:

> The most pertinent part of §6213(a) provides that "[within 90 days ... after the notice of deficiency ... is mailed ... the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency." Nothing in that language links the deadline to the Court's jurisdiction. Yet, elsewhere in §6213(a), Congress specified that "[t]he Tax Court shall have no jurisdiction to enjoin any action or proceeding or order any refund under this subsection unless a timely petition for a redetermination of the deficiency has been filed and then only in respect of the deficiency that is the subject of such petition." 26 U.S.C. §6213(a). So Congress knew how to limit the scope of the Tax Court's jurisdiction. It expressly constrained the Tax Court from issuing injunctions or ordering refunds when a petition is untimely. But it did not similarly limit the Tax Court's power to review untimely redetermination petitions.

The taxpayers then argued that if the deadline in section 6213(a) is not jurisdictional, the 90-day time limit is presumptively subject to the doctrine of equitable tolling, under which the statute of limitations pauses where a litigant pursued rights diligently but was barred from bringing a timely action because of some extraordinary circumstance. The IRS argued that it was too late for the taxpayers to assert a claim for equitable tolling, but the Third Circuit found no fault on the part of the taxpayers. The statute of limitations is an affirmative defense that the IRS did not raise before the Tax Court. Because the IRS did not raise the statute of limitations, there was no occasion for the taxpayers to ask for equitable tolling. Indeed, *Beecher* cited the rule that "nonjurisdictional limitations periods are presumptively subject to equitable tolling." After parsing the text, context, and place of section 6213(a) in the broader statutory scheme, the Third Circuit found insufficient evidence that Congress sought to except the 90-day filing requirement from equitable tolling. It thus remanded the case to the Tax Court for a determination of whether the taxpayers are entitled to tolling.

The court's opinion ends with a succinct summary:

> Missing a statutory filing deadline is never ideal for the filer. But the specific consequence for doing so depends on the legislature's intent. If the statute clearly expresses the deadline is jurisdictional, the filer's tardiness deprives a court of the power to hear the case. Without a clear statement, courts will treat a filing period to be a claims-processing rule that is presumptively subject to equitable tolling. Because we discern no clear statement that §6213(a)'s deadline is jurisdictional, we hold it is not. And because the presumption that nonjurisdictional time limits are subject to equitable tolling has not been rebutted here, we hold it may be tolled. We thus reverse the Tax Court's dismissal for lack of jurisdiction and remand for that Court to determine whether the Culps are entitled to equitable tolling.

It will be interesting to see how the Tax Court and other jurisdictions view the Third Circuit's rejection of the Tax Court's treatment of the section 6213(a) deadline as jurisdictional. If appealed, *Sanders* would be heard by the Fourth Circuit. Presumably, for taxpayers residing in the Third Circuit, the Tax Court would have the power to apply equitable tolling. But would the result in the *Sanders* case, for example, really be different if equitable tolling was available? Did the taxpayer in *Sanders* "diligently pursue his rights" only to be thwarted by some "extraordinary circumstance?" Is there some degree of assumed risk in waiting until (quite literally) the last minute? If anything, these cases reinforce the basic planning tip to avoid filing at the last minute, even where electronic filing is available. Power outages, service lags, and hardware failures are always possible and should not be discounted. Electronic filings should be done sufficiently in advance such that, if they fail, traditional filings are still an option.

8. Supreme Court's Forthcoming Decision on Realization Could be a Game-Changer

In December, the Supreme Court of the United States heard oral argument in *Moore v. United States*, a case nominally testing the constitutionality of the "mandatory repatriation tax" ("MRT") imposed by section 965. The MRT, enacted as part of the 2017 Tax Cuts and Jobs Act's conversion to a "territorial" system of corporate taxation from a "worldwide" system, was a one-time tax on United States persons owning at least ten percent of the stock of a controlled foreign corporation ("CFC") in 2017 on the CFC's undistributed post-1986 earnings and profits. While the MRT imposed a one-time tax on what could be a huge amount of undistributed earnings, it did so at favorable rates: cash earnings were taxed at 15.5 percent and other earnings were taxed at eight percent. Charles and Kathleen Moore, a married couple from Redmond, Washington, owned 11 percent of the stock in KisanKraft, a CFC that supplies tools to farmers in rural India. The company was profitable, but all profits were reinvested in the business. The Moores never received a distribution from the company. Still, by virtue of owning more than ten percent of the CFC's stock, they became liable for MRT on the company's post-1986 retained earnings. They paid a tax of $14,729 and commenced this refund claim, arguing that the MRT was a retroactive tax on past earnings and thus violative of the Due Process Clause of the Fifth Amendment. The United States District Court for the Western District of Washington granted the IRS's motion to dismiss, holding that although the MRT was indeed retroactive, it did not violate the Due Process Clause. The taxpayers appealed to the Ninth Circuit, again claiming that the retroactive nature of the MRT violated their due process rights. But the Ninth Circuit had little problem affirming the district court, finding that the retroactive application of the MRT had a legitimate purpose, namely preventing a windfall to CFC shareholders who never got a distribution from never having to pay taxes on those profits now that the United States was moving from a worldwide system of tax to a territorial system of tax.

But the taxpayers presented an alternative argument to the Ninth Circuit that would become the focus of their appeal to the Supreme Court: they argued the MRT violates the Apportionment Clause. Article I, Section 9, Clause 4 of the United States Constitution provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." So any "direct tax" must be apportioned so that the amount of tax paid by each state is proportionate to its population. The taxpayers in *Moore* claim that the MRT is an unapportioned direct tax and, therefore, unconstitutional. The federal income tax, of course, is likewise an unapportioned direct tax, but the Sixteenth Amendment authorizes Congress to collect tax on "incomes, from whatever source derived" without apportionment. If the MRT is an income tax, then, the Sixteenth Amendment protects it from attack based on the Apportionment Clause. But the taxpayers assert that the MRT is not an income tax because it taxed them on amounts they have not yet received as income. The Ninth Circuit rejected the argument, finding the MRT was an income tax after all, citing several Supreme Court cases as precedent. In the Ninth Circuit's view, the Supreme Court has been clear that, while realized gains may be indicative of income, realization is not required for income to exist. The MRT is thus constitutional and within the scope of the Sixteenth Amendment.

When the taxpayers appealed, few would have thought the Court would grant review. After all, there was no circuit split, the government was not asking for review, and the Ninth Circuit even refused a rehearing request by the taxpayers. Yet the Court did grant cert, leading to speculation that the case is not so much about the MRT as it is about the possible imposition of a wealth tax. Should the Court decide that realization is a firm prerequisite to income, a wealth tax on unrealized income would be a non-starter. But such a broad holding could affect other Code provisions that impose income taxation absent the actual receipt of some benefit. A realization requirement could invalidate, for example, subchapter K (taxing partnership income to partners even where the partners have not received that income), subchapter S (taxing the income from an S corporation to its shareholders even where the shareholders have received nothing from the corporation), section 7872 (treating certain below-market loans as deemed transfers between borrowers and lenders despite no actual transfers, the original issue discount rules (treating the holder of original issue discount as receiving deemed payments on the instrument despite receiving no actual payment, and section 475 (requiring certain dealers in securities to use the mark-to-market method of accounting despite not yet realizing the appreciation in value of those securities).

After listening to the oral argument, many pundits predict that a slight majority will uphold the MRT on very narrow grounds, preserving the constitutionality of the aforementioned Code provisions, but also leaving the constitutionality of a wealth tax up in the air. Here too, we will have to stay tuned for further developments.

Probate Report

- **Trust Standard of Living for Surviving Spouse Determined as of Date of Death**

In *Matter of Katherine E. Reece Trust*, __ P.3d __ (Colo. App. 2023) (2023 Westlaw 6300306), the testator and his wife married in 2004, having entered into a prenuptial agreement. In 2011, the testator executed his will, which created a testamentary trust naming his wife and his children from a prior marriage as beneficiaries. The trust provided that the trustee had the discretion to make distributions for the beneficiaries' health, education, support, and maintenance, with primary consideration given to the wife's needs. The trust further provided that the primary purpose of the trust was to provide for the wife's support, in accordance with "the standard of living enjoyed by [her] during our marriage." (Italics omitted.) In addition, the trust gave the wife the right to live in the marital home for as long as she wished, without having to pay expenses for the home. Two years later, the testator and the wife separated. They entered into a separation agreement providing for support payments to the wife and an agreement by the husband not to seek a final divorce until they had been married ten years so that she could become eligible for social security benefits. The testator died in a plane crash the day before he could seek final dissolution of the marriage under the separation agreement.

In a prior case, the wife and the estate fought over whether she had waived her right to share in the testator's estate. The appellate court ruled for the wife. Upon remand, the initially-appointed trustees refused to serve, and a substitute was appointed, upon condition that it could seek instructions from the probate court about the exercise and limits of the trustee's discretion, especially as to the applicable standard of living provision. The probate court concluded that the wife's standard of living was measured at the date of the testator's death.

Contending that her standard of living changed when the couple entered into their separation agreement through the time of the testator's death, she argued on appeal that the "standard of living" language in the trust should be construed in light of her entire marriage with the testator because she enjoyed a more expensive standard of living before the separation agreement.

While recognizing that the wife's standard of living changed to a markedly less expensive lifestyle when they separated, the appellate court upheld the probate court's conclusion that the applicable measure for the "standard of living" provision would be when the trust became irrevocable, in this case at the testator's death because the trust was testamentary. Citing RESTATEMENT (THIRD) OF TRUSTS § 50. The appellate court reasoned that, because the trust became effective at the testator's death, a responsible construction of his intent should include the circumstances that existed at the time of the effective creation of the trust.

However, the appellate court noted that the interpretation of the "standard of living" phrase was not a total limitation on the trustee's discretion but rather was one factor to consider in the overall discretion granted to the trustee, which included but was not limited to her standard of living. Moreover, again citing the RESTATEMENT (THIRD) OF TRUSTS, the appellate court observed that the wife's standard of living could change after the testator's death for such factors as inflation and possibly deteriorating health.

Editors' Comment: Of course, for many tax reasons estate planners use the HEMS (health, education, maintenance, and support language) as a standard for distributions, but in this case the testator also included language concerning the wife's standard of living. *Reece* illustrates what can happen when estate planning and family court matters intersect.

- **Court Declines to Issue In Terrorem DJ**

In *Application of Follman*, 197 N.Y.S. 3d 682 (2023), husband and wife settlors created a number of trusts benefiting their five children in 1996 and 2011. In 2016 and 2017, they purportedly replaced those trusts with newer versions that treated one son more favorably, and that son also served as agent under their powers of attorney. The husband died in 2018, and the wife died in 2021. Although the children disputed issues involving the trusts, they eventually resolved those disputes, except for one son who continued to fight with the son who received more favorable treatment in the replacement trusts. The trusts contained in terrorem clauses triggered, inter alia, by any contest of the validity of any transfer from the settlors or the validity of the trusts. The petitioning son sought (1) an inquiry, pursuant to a state statute, about which properties were held by the various trusts; (2) an accounting from the son's service as agent under the powers of attorney; and (3) an accounting of the limited liability companies in which the various trusts held interests. More generally, the petition sought direction from the court as to whether these requests would trigger the in terrorem clauses.

The petitioner contended that he was not contesting the validity of the trusts or the transfers. Rather, he asserted that he was merely seeking information, which did not violate the in terrorem clause. The son with more favorable treatment argued that the petitioning son had already violated the in terrorem clause and lacked standing to seek the remedies in the petition.

The court recognized that, although in terrorem clauses are enforceable, they are strictly construed. The court addressed the arguments posed by each son. For example, the court noted that an inquiry about property pursuant to the state statute was normally initiated by a fiduciary, but also observed that, even though there is an inquisitorial first step to such proceedings, they typically result in turnover actions. The court also noted that accountings are "rarely used simply for informational purposes."

It seemed as if the court was going to relate the petition's informational request to an eventual contest over validity, but instead veered into a consideration of what exactly the petition was seeking. The court concluded that the petition was asking the court "for advice" about the proper way to draft a pleading to obtain information without actually triggering the in terrorem clauses. Eventually, the court declined to "offer such legal advice" and denied the sons' cross-motions for summary judgment while explicitly refraining from finding that the in terrorem clauses had been triggered.

Editors' Comment: As has been discussed on a number of occasions in the REPORTER, in terrorem clauses can have a chilling effect on beneficiaries. Although they will not be enforced if the contest is brought in good faith or for probable cause, the penalty of losing a contestant's benefits under a will or trust can be daunting. One possible technique is to first ask a court if in fact a proposed action would trigger a no-contest provision. If the court agrees to issue what is effectively a declaratory judgment, then the potential contestant gets essential guidance. A determination that the proposed action would not trigger the no-contest clause frees the contestant from fear about bringing the proposed action, while a determination that the action would trigger the forfeiture provision at least warns the beneficiary that the contest needs to be worthy of a good faith or probably cause determination.

- **Nursing Home Fails to Compel Arbitration**

In *Nursing and Rehabilitation Center at Good Shepherd, LLC v. Richardson*, 676 S.W. 3d 375 (Ark. App. 2023), the decedent's estate brought a negligence claim against a nursing facility for the decedent's death. The nursing facility moved to compel arbitration, which was denied by the lower court.

The appellate court reviewed the pertinent facts. The decedent's sister signed the nursing facility's arbitration form, which was part of the admissions documents, as the decedent's sister. Although the sister was also the decedent's agent under his power of attorney, she did not indicate that she was signing as agent or even that a power of attorney existed. The nursing facility did not learn of the existence of the power of attorney until after the execution of the documents.

Citing the general presumption in favor of arbitration, the appellate court noted the exception to the presumption: a valid and enforceable arbitration agreement must exist. Generally, the burden is on the proponent of the arbitration agreement to prove its validity. Although an arbitration agreement does not generally bind those not parties to it, a person can be bound by a third party with authority to do so.

The appellate court concluded that the nursing facility failed to show that the decedent was bound by a third party who intended to do so. The decedent did not sign the agreement, and the sister signed as "sister" — not someone cloaked with the authority to do so. Thus, the appellate court affirmed the lower court.

Editors' Comment: Good Shepherd is the latest in a recent spurt of cases involving the ability of a nursing facility to compel arbitration when sued by a decedent's estate. Nursing facilities can fail to produce binding arbitration agreements for several reasons discussed recently in the REPORTER, and in this case because the nursing facility accepted the signature of someone signing merely as "sister." Note that the appellate court did not offer an apparent authority type argument, even though the sister was also the agent under the decedent's power of attorney, because she did not assert her status as agent when signing the documents and, perhaps more importantly, the nursing facility was not even aware that she possessed that authority.

Tax Report

- **Ordinary Income Allocated to Limited Partners in Name Only Is Self-Employment Income of a Partnership**

In *Soroban Capital Partners LP v. Commissioner*, 161 T.C. No. 12 (November 28, 2023), the Tax Court held that the exception from self-employment taxes for distributive shares allocable to "limited partners, as such" only applies to distributive shares allocable to those actually functioning as limited partners and not to the shares allocable to those acting as limited partners in name only. The court also held that the determination of whether a partner is truly a limited partner or one acting in name only is a partnership-level determination over which the Tax Court has jurisdiction in a partnership-level proceeding.

The case involves a Delaware limited partnership that operates as an investment firm. The partnership has one general partner (a limited liability company) and five limited partners, consisting of three individuals and two limited liability companies, each of which is wholly owned by one of the individuals. Thus, for federal income tax purposes, there are only three limited partners because the two LLCs are disregarded.

On its federal income tax return for 2016, the partnership reported about $2 million in net earnings from self-employment, and its 2017 return reported about $1.9 million in net earnings from self-employment. In both cases, while the reported amounts included the guaranteed payments made to the limited partners, the reported amounts did not reflect the limited partners' distributive shares of the partnership's ordinary income. In 2022, the IRS determined that the limited partners' distributive shares of the partnership's ordinary income should have been included, which brought the parties to the Tax Court.

Statutory Background

Under section 1401, individuals must pay a tax on "the net earnings derived from self-employment" during the year. The Code defines net earnings from self-employment as "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member." IRC §1402(a). Thus, an individual's distributive share of a partnership's ordinary business income is included as net earnings from self-employment.

But under section 1402(a)(13), net earnings from self-employment *does not include* "the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described in section 707(c) to that partner for services actually rendered to or on behalf of the partnership to the extent that those payments are established to be in the nature of remuneration for those services." This is often referred to as the "limited partner exception."

What's a "Limited Partner" for Purposes of the Limited Partner Exception?

The partnership argued that because its three limited partners were…wait for it…limited partners in a state law limited partnership, the limited partner exception applied without any further examination. But the Tax Court rejected this argument, agreeing with the IRS that the exception only applies to limited partners whose roles are functionally like that of a true limited partner.

The court observed that the purpose of the exception was to prevent limited partners who merely invested in a partnership and did not actively participate in business operations from earning social security coverage on what was, effectively, investment income. It thus makes sense to construe the exception as applying only to the distributive shares of limited partners who are involved merely as investors and not as active participants in the partnership's business. Invoking its decision in *Renkemeyer, Campbell & Weaver LLP v. Commissioner*, 136 T.C. 137 (2011), the court again proclaimed that limited partners who performed services for a partnership in their capacities as partners should be liable for self-employment taxes. In *Renkemeyer*, the court used a "functional analysis test" to determine whether a limited partner was truly a "limited partner, as such" or one who performed services for the partnership in the way in which a self-employed person would act.

But the *Soroban* court also noted that the *Renkemeyer* case involved law partners in a limited liability partnership, while this case involves an entity organized as a state law limited partnership. So the court had to determine whether the functional analysis test should be applied to limited partners in a state law limited partnership. The court concluded in the affirmative, noting simply that:

> If Congress had intended that limited partners be automatically excluded, it could have simply said "limited partner" [in IRC §1402(a)(13)]. By adding "as such," Congress made clear that the limited partner exception applies only to a limited partner who is functioning as a limited partner.

161 T.C. No. 12 at 11. The partnership pointed to excerpts from the legislative history and other cases to support its argument that the exception applied to all limited partners regardless of their roles in the partnership, but the court found those references to be either out of context or merely statements of general rules and not official interpretations of the limited partner exception.

When Does the Court Have Jurisdiction to Examine the Role of Limited Partners?

Having determined that the limited partner exception only applies to those limited partners who truly function as limited partners, the court then had to consider whether the examination of the functions and roles of the limited partners should happen now at a partnership-level proceeding or whether it must wait until a partner-level proceeding. Under section 6226, the court has jurisdiction to redetermine "partnership items" when the tax matters partner petitions the court.

So is the substance of the limited partners' roles and activities for the partnership a "partnership item?" section 6231(a)(3) defines a partnership item as "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level." Accepting the statutory invitation for guidance, Regulations section 301.6231(a)(3)-1(b) identifies items that are more appropriately determined at the partnership level as including "the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." The court concluded that because a functional analysis of the roles and activities of the limited partners involves factual determinations necessary to determine the partnership's total amount of net earnings from self-employment, this is a "partnership item" that can be considered in the current proceeding without having to await a partner-level proceeding.

Editors' Comment: In mid-2024, the Tax Court is scheduled to consider another case in which the taxpayer is a limited liability limited partnership. The decisions in *Renkemeyer* (involving an LLP) and, now, *Soroban* (involving an LP) suggest that the same result will apply to LLLPs. Watch this space for further developments.

- **Dual Citizen's Untimely Claiming of Treaty Benefit Still Effective to Escape FBAR Penalties**

In *Aroeste v. United States*, No. 22-cv-00682-AJB-KSC (S.D. Cal. November 20, 2023), a federal district court held that a Mexican citizen lawfully admitted for permanent residence in the United States is not required to disclose foreign bank accounts because that individual properly elected to be treated as a resident of Mexico for tax purposes under applicable provisions of an income tax treaty, albeit in an untimely way. Accordingly, the citizen was not liable for penalties related to failing to disclose foreign bank accounts, though the citizen was liable for smaller penalties related to the late invocation of the treaty benefit.

Requirement for United States Persons to File FBARs

The Bank Secrecy Act requires United States persons to disclose their interests in foreign financial accounts for any year in which the maximum aggregate balance of all the foreign accounts exceeds $10,000 at any point during the calendar year. 31 U.S.C. §4314. Traditionally, the disclosure was made on a Report of Foreign Bank and Financial Accounts, known in finance circles as a "foreign bank account report," or "FBAR." The Act imposes a civil penalty of $10,000 for a negligent failure to file a required FBAR, with a civil penalty for the willful failure to file equal to the greater of $100,000 or fifty percent of the value of the accounts. Today, the required disclosure is made on Form 114 of the Financial Crimes Enforcement Network ("FinCEN Form 114").

Note that the filing requirement applies to United States persons. Under section 7701(b)(1)(A)(i), an individual lawfully admitted for permanent residence in the United States at any time during a year is considered a "United States person." Section 7701(b)(6) clarifies that one is a lawful permanent resident of the United States at any time if one holds a green card that has not been revoked or abandoned. But that paragraph also provides that:

> An individual shall cease to be treated as a lawful permanent resident of the United States if such individual commences to be treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country, does not waive the benefits of such treaty applicable to residents of the foreign country, and notifies the Secretary of the commencement of such treatment.

Thus, anyone allowed to reside permanently with the United States by virtue of holding a green card is considered a United States person unless an applicable tax treaty allows that person to be treated as a resident of a foreign country for tax purposes.

Facts of the Case

Alberto Aroeste is a Mexican citizen who has maintained his permanent residence in Mexico City for over 50 years. In 1984, Aroeste applied for lawful permanent residency in the United States, and he has held a "green card" in all years since his application was approved. Aroeste and his spouse own a Florida condominium that they use as a vacation home, but that was their only contact with the United States during 2012 and 2013, the years at issue in the case.

During these years, Aroeste had five bank accounts in Mexico, and the aggregate balance in those accounts exceeded $10,000. But Aroeste did not file FBARs for either year. In 2014, his advisors counseled him to enter into the Offshore Voluntary Disclosure Program, which he did. But in 2016, acting on the advice of new counsel, Aroeste opted out of the program. That prompted an IRS investigation that led to the assessment of penalties totaling $100,000 in 2020. Aroeste paid just over $3,000 of that amount in 2022, then commenced this action for refund.

Did Aroeste Waive Treaty Benefits?

On his original United States tax returns for 2012 and 2013, Aroeste did not include a Form 8833, Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b). This was the form required to invoke Article 4 of the United States – Mexico Income Tax Convention, which would have allowed him to be treated as a resident of only Mexico for tax purposes. When he submitted amended tax returns for those years in 2016, he likewise did not include Forms 8833. It was only when he filed a corrected amended return for these years that he finally attached Forms 8833. By that time, argued the IRS, it was too late—by failing to include the completed Forms with his original returns and first amended returns, he had effectively waived the benefit of the treaty, as contemplated by the language from section 7701(b)(6) quoted above.

But the district court agreed with Aroeste that the late submission of the Forms 8833 did not result in a waiver of treaty benefits. The court bought his argument that section 6712 imposes the sole consequence for failure to comply with the requirement to submit a Form 8833: a penalty of $1,000. The statute does not indicate that late filing of a Form 8833 likewise leads to waiver of applicable treaty benefits.

The IRS then argued that, even if Aroeste had timely filed Forms 8833, he neglected to attach Forms 8854, Initial and Annual Expatriation Statement, as required by *Notice 2009-85*, 2009-45 I.R.B. 598. But the court agreed with Aroeste that *Notice 2009-85* is void for failing to comply with the Administrative Procedure Act's "notice-and-comment" rulemaking procedures, citing both *Green Valley Investors LLC v. Commissioner*, 159 T.C. No. 5 (2022), and *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022).

Result Under the Treaty

The remaining question, then, is whether Aroeste is a Mexican resident under the United States – Mexico Treaty. Article 4 of the Treaty provides that when an individual is a resident of both the United States and Mexico and has a permanent home in both countries, the individual is deemed to be a resident of the country that is the individual's "center of vital interests." In this case, said the court, Aroeste's center of vital interests is Mexico: he spends over 75 percent of the year there, "most of his friends are in Mexico, his cars and personal belongings are in Mexico, as well as his doctors and dentist, his health insurance and cell phone carrier are in Mexico, and he receives all his mail in Mexico."

The court thus granted summary judgment to Aroeste, discharging him from liability for FBAR penalties. But the court also held that he owed penalties totaling $2,000 for failure to timely claim the benefit of the Treaty, as required by section 6712.

- **Two Time Extensions Applied to Taxpayer's Petition to Tax Court**

In *Sall v. Commissioner*, 161 T.C. No. 13 (November 30, 2023), the Tax Court held in a reviewed opinion that a taxpayer's deadline for petitioning the Tax Court for redetermination of an alleged deficiency was twice extended, once because the Tax Court was closed on the original deadline date, and again because the extended due date fell on a weekend.

The IRS sent the taxpayer a notice of deficiency for the 2017 and 2018 tax years by certified mail on August 26, 2022. Under section 6213(a), the taxpayer had 90 days to file a petition for redetermination with the Tax Court. Accordingly, the deadline for filing the petition would normally be Friday, November 25, 2022. But that was the day after Thanksgiving, and the Tax Court was closed that day. Under section 7451(b), when "a filing location is inaccessible or otherwise unavailable to the general public on the date a petition is due," the deadline for filing is extended by "the number of days within the period of inaccessibility plus an additional 14 days." By operation of this rule, then, the taxpayer's deadline would be extended by 15 days to December 10, 2022.

But December 10, 2022, was a Saturday. Under section 7503, when a deadline falls on a Saturday, Sunday, or legal holiday, the deadline is extended to the next day that is not a Saturday, Sunday, or legal holiday. That pushed the taxpayer's deadline to Monday, December 12, 2022. Fortunately, the taxpayer mailed his petition from his home in Colorado on Monday, November 28, 2022, and it arrived at the Tax Court on Thursday, December 1, 2022. Accordingly, the court ruled his petition was timely.

Editors' Comment: One wonders why the IRS insisted that the Tax Court lacked jurisdiction, as the extensions applied by the court were plainly authorized by the Code. It's not a good look for the IRS to be contesting jurisdiction in light of a clear statutory mandate.

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