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Attorney's Responsibility for Conservator Malfeasance

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Litigators representing those with diminished capacity, particularly minors, typically need to establish a conservatorship to handle lawsuit proceeds resulting from judgments and settlements. On occasion, that litigator may be versed enough in probate practice to handle the conservatorship without associating a probate practitioner, but often a probate practitioner is brought in to assist with that process.

Whether the litigator is acting alone, or with the assistance of a probate practitioner, the establishment and funding of a conservatorship account may seem routine. However, in situations when the conservator mismanages or misappropriates the funds, a child, either through a different representative while still a minor or upon reaching the age of majority, may seek to recover. Often, a parent serves as a conservator for the minor. For various reasons, a child may not wish to seek recovery against the parent responsible for mismanagement or misappropriation, especially if the parent is judgment proof. In those cases, the next obvious target is the lawyer involved with the judgment or settlement proceeds and the establishment of the conservatorship. Many of these cases may not be reported, but a recent case presents issues that lawyers might consider in certain situations. The case does not provide definitive answers because it merely dealt with a 12(b)(6) motion, but it does provide a discussion of issues that could be of concern.

Background

In *Nielson v. LeBaron*, 527 P.3d 1133 (Utah App. 2023), a minor child severely hurt her ankle in a classroom exercise when she wore vision-impairing goggles to simulate alcohol impairment during a so-called safety demonstration. Her parents hired an attorney for her, who successfully brought a personal injury action resulting in a settlement of $100,000 in 2014. The trial court approved the settlement, which required the payment of funds into a conservatorship account with the parents serving as co-conservators. The court order prohibited the dissemination of funds without prior court approval and payment to be made to the child when she reached the age of 18. The attorney sent the proceeds from the settlement to the parents. The father absconded with the funds.

In 2020, the child sued the attorney for legal malpractice and breach of fiduciary duty for failing to ensure that the funds were deposited into a conservatorship account. (Reasoning that the issues involving legal malpractice and breach of fiduciary duty were similar, the appellate court opinion focused on the legal malpractice claim.) Arguing the child failed to establish duty or causation, the attorney moved to dismiss under Rule 12(b)(6) for failure to state a cause of action. The trial court granted the motion based on a lack of duty: "once estate assets are paid or delivered to a conservator by a third party, that third party has no continuing duty to ensure the estate assets are properly applied." Consequently, the trial court reasoned, the child failed to establish a more general duty owed by the attorney, and it did not need to reach the issue of causation.

The child appealed on both issues. The attorney contended that the state version of Uniform Probate Code section 5-424 precluded him from owing any duty as to the proper use of the funds by the parents as co-conservators. That section provided that "[a] person is not bound to see the proper application of estate assets paid or delivered to a conservator," which was relied on by the trial court in its decision. The attorney argued additionally that, even if he owed a duty to the child to ensure the proper application of the funds, the criminal act by her father was an intervening cause that "severed the causal chain between [the attorney's] delivery of the Settlement Proceeds and [the child's] injury." The child countered that a broader attorney-client duty subsumed the specific protection afforded by the state version of UPC section 5-424. She also asserted that, if her father absconding with the funds was not reasonably foreseeable, then the trial court approving the settlement would not have imposed the withdrawal restriction requiring prior court approval.

The appellate court noted the general rule about appeals on motions to dismiss — assuming the truth of the plaintiff's allegations and drawing reasonable inferences therefrom, the plaintiff is clearly not entitled to relief. And it recited the general requirements for a legal malpractice action to succeed: the existence of an attorney-client relationship, with the attorney breaching a duty owed

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to the client, causing injury and damages to the client.

Existence of a Duty

The appellate court considered the child's arguments about the existence of a duty. The child offered several rationales for the existence of a duty: the common law, the court's order, and Model Rule 1.15 about safekeeping a client's property. She had the appellate court at her common law argument. The appellate court cited precedent for the determination of a duty as a matter of law on a categorical basis. Precedent provided that duty is determined based on the general relationship between a tortfeasor and the victim, as opposed to the specific circumstances of alleged tortious conduct in any particular case. "When the existence of the duty in question has already been established, the duty inquiry ends; there is no need for the court to reach a case-specific, fact-dependent conclusion regarding the existence of a duty." In other words, if a court finds that a general duty exists, then the specific duty requirements, such as those found in the state version of UPC section 5-424, are applicable to the analysis of proximate cause.

The appellate court eschewed the attorney's invitation to focus on that statute to determine the issue of the existence of a duty and instead ruled that the common law imposition of a general duty satisfied the duty requirement to pursue a legal malpractice claim. According to the appellate court, the common law imposes the general duty for an attorney to act with reasonable diligence for a client, "employing skill, prudence, and diligence as lawyers of ordinary skill and capacity commonly possess and exercise in the performance of the tasks which they undertake." Therefore, if the child could demonstrate that an attorney of ordinary skill and capacity would not have transferred the funds directly to her parents, she may be able to successfully prosecute a legal malpractice claim.

The appellate court was careful to distinguish the possible application of the state version of UPC 5-424. While it did not abrogate the general duty owed to a client for purposes of determining the existence of a duty, it might serve as a viable defense at the breach stage of the malpractice analysis. The statute was not rendered inapplicable; it just did not serve the purpose asserted by the attorney. For purposes of the 12(b)(6) motion, the general common law duty sufficed to get the child over the duty hurdle. "Whether [the attorney's] delivery of the settlement funds directly to the [parents] was a breach of [his] general duty of reasonable diligence is a determination that requires further factual development." As to duty, the appellate court also observed that the trial court misunderstood the child's actual argument. She did not claim that the attorney should have stopped her parents from improperly using the funds once they were transferred; rather, she asserted that the attorney should not have transferred the funds to the parents to begin with, as opposed to creating a conservatorship account.

Proximate Cause

Because the appellate court reversed the trial court's decision on the duty issue, it also considered the issue of proximate cause, which the trial court did not need to address. The appellate court noted that the determination of causation is "highly fact-sensitive" and is a matter of law only when reasonable persons could not disagree about the facts. According to the appellate court, it is a rare case when proximate cause can be resolved without a trier of fact. And in this case, the appellate court reasoned that a finder of fact was necessary. As noted above, the child contended that the withdrawal restriction in the settlement order demonstrated the foreseeability that the father would abscond with the funds. The attorney countered that the court's naming of the father as conservator proved that it was not reasonably foreseeable that he would abscond with the funds. The appellate court thought both arguments were rational, so that a trier of fact would need to make the determination.

Consequently, the appellate court reversed the trial court and remanded for further proceedings.

Conclusion

Nielson creates several concerns for the probate practitioner involved with a protected person's property and the creation of a conservatorship, whether directly or associated with a litigator whose lawsuit created funds for the protected person.

First, although it did not impact its conclusion that the attorney had a general common law duty that rendered the specific statutory protection inapplicable, the appellate court noted that the child's actual claim about breach of duty was that the attorney failed to ensure that the funds got placed into a protected account, as opposed to the trial court's understanding that she argued that the attorney should have prevented the father from absconding with the funds. Although unclear in the context of the 12(b)(6) issue before the court, the court could assume that an attorney representing a protected person does have a duty to ensure any court-ordered account is created and that property of the protected person, such as settlement proceeds, be paid to that established account. If that is ultimately the determination in this case, then that could serve as precedent that other attorneys representing protected persons have a responsibility to ensure the proper account is created — a duty that may not necessarily be on the radar of attorneys procuring funds from a lawsuit for a protected person. The attorney argued that it was customary for attorneys to deliver settlement funds directly to conservators rather than directing the funds to specific accounts, but the appellate court found that argument premature given the 12(b)(6) posture of the case. Similarly, although again not clear from the 12(b)(6) posture of this case, one might assume that, once a proper account has been established and funded, an attorney for a protected person no longer needs to look over a conservator's shoulder, which likely matches an existing understanding of attorneys who are involved in such matters.

Second, the child complained that the attorney issued the check payable to her mother "or" her father, which allowed the father to abscond with the funds, apparently without the participation of the mother. Because the child did not raise that issue of appeal, it was not considered in the opinion. However, to be extra careful, attorneys disbursing funds in similar situations should consider issuing any checks payable to both co-conservators, using "and" and not "or," to reduce the opportunity for one of the co-conservators to act improperly.

Third, the opinion did not seem to make a deep dive into whether the attorney was engaged by the parents before or after they became co-conservators. The opinion simply states that the parents engaged the attorney to represent their child. And the order approving the settlement also appears to name the parents as co-conservators at that time. Apparently, under state practice the parents had the authority to engage the attorney for the child without having yet been appointed as co-conservators. In some other jurisdictions, the formal engagement on behalf of the child might not be effective until the parents were appointed as co-conservators. In either situation, but from different perspectives, the attorney might have duties to both the parents and the child, especially in the latter situation. And, as probate practitioners know, when representing a conservator, issues of duty and conflict of interest can be ambiguous, as demonstrated by Model Rule 1.14, which, without much real guidance, tells the attorney for a person with diminished capacity, such as a minor, to treat that person as if in a normal attorney-client relationship yet to be cognizant of the need to appoint a conservator, which is likely if dealing with the property of a minor.

Fourth, at first blush, Uniform Probate Code section 5-424 provides protection for an attorney in a situation like *Nielson* dealing with conservators:

> (a) A person who assists or deals with a conservator in good faith and for value in any transaction other than one requiring a court order

under Section 5-410 or 5-411 is protected as though the conservator properly exercised the power. That a person knowingly deals with a conservator does not alone require the person to inquire into the existence of a power or the propriety of its exercise, but restrictions on powers of conservators which are endorsed on letters as provided in Section 5-110 are effective as to third persons. A person who pays or delivers assets to a conservator is not responsible for their proper application.

Yet the *Nielson* appellate court concluded that any apparent protection for the attorney was overridden by a more general common law duty to a client for purposes of determining the existence of a duty for 12(b)(6) purposes, although that section might apply in the ultimate determination of causation. One might argue that a more specific statutory provision trumps the more general common law iteration of duty, but the appellate court cited state precedent supporting its position.

In any event, attorneys who might obtain comfort from a statute such as UPC section 5-424 might consider the possibility that broader duties could apply and override such a specific statute.

All in all, *Nielson* gives litigators creating lawsuit-derived funds for minor clients, and probate practitioners assisting those litigators, food for thought about prudent procedures — again within the context of a case deciding a 12(b)(6) motion.

Probate Report

- **Devise of Proceeds from Sale of Real Estate Is Specific**

In *Bruno v. Knippen* __ N.E.3d __ (Ill. App. 2023) (2023 Westlaw 2155408), the settlor created a trust providing for 10 specified monetary gifts upon his death. In the paragraph following the 10 specified monetary gifts, the trust gave an option to his nieces and nephews to purchase his real estate and, if those options were not exercised, the trustee was to sell the real estate and distribute the proceeds equally among his nieces and nephews. The nieces and nephews contended that this was a specific devise, entitling them to the proceeds from the sale. The other beneficiaries argued that this latter gift was demonstrative, so that the proceeds from the sale would become part of the residue, which would then be applied first to the general devises in the first 10 paragraphs giving the specified monetary gifts. The parties sought cross-summary judgments, and the trial court ruled for the other beneficiaries as a matter of law that the gift in the latter paragraph was demonstrative.

The appellate court provided a succinct explanation of the difference between general, specific, and demonstrative devises. A general devise is a gift of value, payable from any source and not any particular source. A specific devise is a gift of a particular item or fund that can be distinguished from the rest of a testator's estate. If the particular item or fund is not available as part of the probate estate, then the gift fails under the doctrine of ademption. A demonstrative devise is a gift of a specific sum of money to be paid from a particular fund. It differs from a specific devise because, if the identified fund cannot fulfill the specified amount of the gift, then the estate's general assets can be used for payment. The appellate court noted that courts tend to prefer construing devises as general or demonstrative rather than specific to avoid the threat of ademption.

Based on the trust's plain language, the appellate court concluded that the settlor intended for the latter devise to be specific rather than demonstrative. The appellate court reasoned that the settlor did not devise a specific sum of money, but instead created a devise of an undetermined amount, depending on whether any option was exercised, and if not, the proceeds from the sale of the real estate. If the settlor had intended to create a demonstrative devise, he could have simply named a specific sum for each niece and nephew, payable from the sales proceeds. Consequently, the nieces and nephews shared in the proceeds from the sale of real estate, to the exclusion of the other beneficiaries.

Editors' Comment: The opinion discussed the classification of devises, legacies, and bequests, which normally applies to wills, yet the gifts at issue in this case were from an inter vivos trust. Presumably, the appellate court applied the common practice of applying to trusts the same rules of construction used for wills.

The opinion noted that normally a dispute about whether a devise is specific or demonstrative hinges on the devise being adeemed if specific because the specified property or fund is not in the probate estate. In this case, the real estate was in the trust at the settlor's death. So rather than the usual case when devisees argue that a devise is not specific because ademption might result, in this case the other beneficiaries were arguing for a demonstrative treatment so they too could share in the proceeds. Apparently, the appellate court found that a less sympathetic argument than the usual case when beneficiaries are trying to avoid ademption of a specific devise.

- **Joint Stipulation of Dismissal of Will Contest Requires Consent of all Interested Persons**

In *Estate of Ryan*, 987 N.W.2d 634 (Neb. 2023), the testator's children disputed the validity of the will offered for probate. His latest will devised his estate to his inter vivos trust. One of his daughters argued that the will was invalid for undue influence and lack of capacity, so that his earlier will, which devised his estate to his children, was the operative will. The testator was the founder of a closely-held corporation, for which another daughter served as CEO. The son appointed as personal representative supported the latest will. A separate action dealt with a dispute over the inter vivos trust. The CEO daughter filed an appearance as an interested party in the will contest. Following a mediation in the trust case, the estate and all the children, except for the CEO daughter, filed a Joint Stipulation for Dismissal with Prejudice. The lower court dismissed the will contest with prejudice based on the joint stipulation.

Contending that the lower court ignored her rights and improperly dismissed the case, the CEO daughter appealed. She argued that state law imposed a procedure for a family settlement, based on Uniform Probate Code sections 3-1101 and 3-1102, which was not followed or even recognized by the lower court. The appellate court agreed with the CEO daughter and found that the lower court's dismissal therefore could not be justified by the statutory family settlement provisions.

The daughter who brought the will contest also argued that the lower court could dismiss the case because she, as the petitioner, had the right to voluntarily dismiss her own action under the applicable state rules of civil procedure. The appellate court disagreed, stating that a will contest is an in rem action, which requires a court dismissing a contest to ensure that the interests of all interested parties are safeguarded. That requirement trumped the civil procedure rule allowing a petition to take a voluntary dismissal in an action, if the action was not in rem.

Editors' Comment: The opinion observed that the UPC family settlement procedure was based on the common law, which allowed a court to approve family settlement agreements. According to the UPC Comment, "[t]he only reason for approving a scheme of devolution which differs from that framed by the testator or the statutes governing intestacy is to prevent dissipation of the estate in wasteful litigation." Consequently, as a safeguard, the UPC process requires a compromise agreement to be approved by a court in a formal proceeding.

- **Illegitimate Children Have Standing to Seek Constructive Trust**

In *Johnson v. Johnson*, 662 S.W.3d 242 (Ark. App. 2023), the decedent died intestate. He was survived by his wife, children born from his marriage to her, and seven illegitimate children born to four other mothers. The wife was appointed as the general administrator of his estate. The illegitimate children argued that property apparently given to his wife by the decedent during his lifetime by various transfers, such as outright transfers or tenancies by the entirety that she claimed vested in her upon his death, was actually intended to be held in trust by the wife. The illegitimate children contended that the decedent was convicted of a felony in 1986 and that, after his release, he began transferring all property that he acquired to his wife to be held in trust. The illegitimate children contended that, by claiming ownership in all of that property, the wife breached her fiduciary duty. Arguing that she was unjustly enriched, the children sought the imposition of a constructive trust. During the pendency of the estate, the illegitimate children all proved paternity through the use of DNA.

The wife moved to dismiss, arguing that the illegitimate children failed to seek the appointment of a special administrator and thus lacked standing because only a special administrator could bring such an action. The illegitimate children countered that they were real parties in interest and had standing, despite the lack of a special administrator.

The lower court concluded that the illegitimate children lacked standing and granted the wife's motion to dismiss.

The appellate court addressed the argument posited by the illegitimate children: a special administrator was not necessary because they had standing as real parties in interest to seek a constructive trust. The appellate court cited the state probate code statute that defined an "interested person" as any heir, devisee, spouse, creditor, or any other having a property right, interest in, or claim against the estate being administered and a fiduciary." It also cited the state statute providing that title to real property passes to the intestate heirs upon the decedent's death. Having proved paternity, the illegitimate children were intestate heirs. Consequently, they were "potential heirs" of the estate. As potential heirs, they had standing to assert a claim for the imposition of a constructive trust — a special administrator was not required.

The appellate court reversed and remanded.

Editors' Comment: Citing case precedent, the appellate court distinguished the remedy sought by the illegitimate children from those for which a special administrator would be appropriate: They were seeking a constructive trust based on their own heirship and interest in the property, as opposed to filing suit on behalf of the estate, to enrich the estate, or to claw back estate assets.

Uniform Probate Code section 1-201(23) defines "interested person" in a manner similar to the state statute in *Johnson*. The UPC also adds: "The meaning as it relates to particular persons may vary from time to time and must be determined according to the particular purposes of, and matter involved in, any proceeding." As the appellate court did in *Johnson*, courts with statutes similar to UPC section 1-201(23) tend to define "interested person" broadly.

Tax Report

- **Conservation Easement Deduction Limited to Basis Because Donated Property Was Inventory**

In *Glade Creek Partners LLC v. Commissioner*, T.C. Memo. 2023-82 (June 29, 2023), the Tax Court held that a limited liability company's conservation easement deduction was limited to its basis in the real property subject to the easement because that property was inventory in the hands of the member that contributed it to the LLC.

An investment entity acquired about 2,000 acres in Tennessee for just over $9 million in 2006. That entity transferred the property to Hawks Bluff Investment Group, Inc., an S corporation, in 2010. In 2012, Hawks Bluff contributed the land to the taxpayer in exchange for a 98-percent interest in the taxpayer. Shortly thereafter, the taxpayer granted an easement on the land to Atlantic Coast Conservancy, Inc., and claimed a charitable contribution deduction of $17.5 million on its 2012 income tax return. The IRS initially disallowed the deduction on the grounds that it violated Regulation §1.170A-14(g)(6)(ii). Known as "the proceeds regulation," it states that, upon an extinguishment of a conservation easement and a subsequent sale of the underlying real property, the charity that possessed the easement must receive a proportionate share of the gross proceeds from the sale. The deed conveying the subject easement in this case, however, provided that the charity would receive only a share of the *net* proceeds in the event of a judicial extinguishment and sale, so the IRS determined that the entire deduction should be disallowed. The Tax Court agreed, consistent with its precedent. *Glade Creek Partners LLC v. Commissioner*, T.C. Memo. 2020-148. But in an unpublished opinion dated August 22, 2022, the Eleventh Circuit vacated the Tax Court's decision, holding the proceeds regulation was invalid under *Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021). It thus remanded the case back to the Tax Court for further determination as to the amount deductible.

The well-accepted practice in valuing a conservation easement is to subtract the value of the property now subject to the perpetual restriction on its use from the value of the property at its highest and best use. The taxpayer initially claimed this resulted in a value of $17.5 million, but the Tax Court held that the taxpayer's expert had failed to follow industry practice and thus overstated the value of the land at its highest and best use. Ultimately, the Tax Court held that the value of the easement was just under $8.9 million. Because the taxpayer claimed a deduction nearly double that amount, the Tax Court held that a substantial valuation understatement penalty applied and that the taxpayer did not qualify for the "reasonable cause" exception from that penalty.

The Eleventh Circuit affirmed all of these decisions. It found no clear error in the Tax Court's computation of the easement's value. It likewise affirmed the lower court's conclusion that the taxpayer did not qualify for the reasonable cause exception because there was no evidence of a good faith investigation by the taxpayer into the value of the property but instead just a blind acceptance of the appraisal.

But on this latest remand, the IRS argued that the taxpayer's deduction should be limited to its basis in the property to which the easement relates because the property was inventory in the hands of Hawks Bluff, the contributing member. If the land was inventory, IRC section 170(e)(1)(A) would effectively limit the deduction to basis, as it requires the amount of the deduction to be reduced by "the amount of gain which would not have been long-term capital gain … if the property contributed had been sold by the taxpayer at its fair market value." As for whether the land was inventory to the LLC, section 724(b) states that if a partner contributes inventory property to a partnership, any gain or loss recognized by the partnership upon a disposition of the property within five years is treated as ordinary income or loss.

The taxpayer argued that the easement was investment property in the hands of Hawks Bluff, but the Tax Court rejected this contention. The court noted that precedent in the Eleventh Circuit identifies seven factors to be considered in determining whether property is “held for sale to customers in the ordinary course of business” and, thus, inventory:

> (1) the nature and purpose of the acquisition of the property and the duration of the ownership; (2) the extent and nature of the taxpayer's efforts to sell the property; (3) the number, extent, continuity, and substantiality of the sales; (4) the extent of subdividing, developing, and advertising to increase sales; (5) the use of a business office for the sale of the property; (6) the character and degree of supervision or control exercised by the taxpayer over any representative selling the property; and (7) the time and effort the taxpayer habitually devoted to the sales.

While the court acknowledged that most of the factors relate to sales and marketing activities (of which there were none), the court quickly noted that the factors do not have equal weight. Instead, said the court, significant weight should be given to the fact that Hawks Bluff took the position on its 2012 federal income tax return that it was in the business of selling real estate and that the subject property was inventory. Indeed, when Hawks Bluff then sold its interest in the property the day after contribution, it reported the resulting loss as an ordinary loss. The taxpayer argued that Hawks Bluff improperly reported the loss as an ordinary loss just to get better tax treatment for the loss, but the court faulted the taxpayer for presenting no evidence that Hawks Bluff or its predecessor ever held the land for investment purposes. With such evidence lacking, the position taken by Hawks Bluff on its 2012 federal income tax return has significant weight.

The taxpayer argued that even a dealer in real property can hold land for investment, but the court observed that in such cases the burden of proof is on the taxpayer to prove that any given parcel was held for investment and not as inventory. Here again, said the court, proof was lacking. “Hawks Bluff did not segregate the easement property … in a manner sufficient to meet petitioner’s burden to show that the easement property was investment property.” *Glade Creek Partners LLC* at 26.

Accordingly, the court held that the deduction would be limited to the taxpayer’s basis in the underlying land. Based on evidence in the record, that would reduce the amount of the deduction to just over $3.86 million.

- **Unpaid Checks Were Not Gifts in Contemplation of Death and Thus Includible in Decedent’s Gross Estate, But IRS Error Works in Estate’s Favor**

In *Estate of DeMuth v. Commissioner*, ___ F.4th ___ (3d Cir. July 12, 2023) (2023 Westlaw 4486739), the Third Circuit Court of Appeals affirmed the decision of the Tax Court in *Estate of DeMuth v. Commissioner*, T.C. Memo. 2022-72 (2022), holding that the value of seven uncashed checks was includible in the decedent’s gross estate for federal estate tax purposes. Although there were ten such checks uncashed as of the date of the decedent’s death, the Tax Court had held that only seven of the checks were includible in the decedent’s gross estate due to an erroneous concession by the IRS in its brief. The Tax Court’s decision was discussed in the August 2022 edition of the REPORTER, but is reviewed here too for the reader’s convenience.

Facts of the Case

In 2007, the decedent gave his son a durable power of attorney that, among other things, authorized the son to make annual exclusion gifts on the decedent’s behalf. For the next several years, the son did exactly that. At issue in this case are checks written by the son on the decedent's investment account with Mighty Oak Strong America Investment Co. ("Mighty Oak") on September 6, 2015, just days after the decedent received a terminal diagnosis from an undisclosed medical condition. Some 37 beneficiaries received annual exclusion gifts represented by 11 checks. Mighty Oak only paid one of the 11 checks before the decedent's death on September 11, 2015. The other ten checks were paid by Mighty Oak between September 14 and September 30 of that year. In computing estate tax liability, the estate excluded the value of the checks from the decedent's gross estate, presumably under the theory that the checks represented completed gifts to the recipients. In a deficiency notice issued in 2019, the IRS determined that the value of the ten unpaid checks should have been included in the gross estate.

Tax Court's Opinion

The first issue before the Tax Court was whether the gifts represented by the checks were complete before the decedent's death because they were delivered to the donees but were uncashed as of the date of death. Regulation section 25.2511-2(b) provides that a gift is not complete until the donor has so "parted with dominion and control as to leave him in no power to change its disposition." Whether the decedent had parted with dominion and control of the gifted funds before death thus becomes a question of state law. Under applicable state law (Pennsylvania), mere delivery of a check does not complete a gift because the donor can always stop payment on the check until it has been presented for payment. Because Mighty Oak did not accept, certify, or make final payment on any of the ten checks at issue until after the decedent's death, the power to stop payment never expired before death, meaning none of the ten checks represented completed gifts. Gross estate inclusion of the value of these checks was therefore proper.

Normally that would be the end of the matter. But here the IRS conceded on brief that three of the checks were not includible in the decedent's gross estate because they had been "credited by drawee banks" before the decedent's death. While it's true that those checks had been presented to the recipients' depository banks before death, only Mighty Oak was the drawee bank. In fact, Mighty Oak had not paid or credited those three checks. It appears that the IRS's failure to distinguish between the depository bank and the drawee bank led to the concession. The IRS at the last minute tried to withdraw its concession on this point, but the court held it was too late: "to ignore the concession respondent made in his brief *sua sponte* would be prejudicial to the petitioner" in that the estate relied on this concession in preparing a reply brief. The court thus concluded that seven of the checks were includible in the decedent's gross estate.

Third Circuit Affirms

Not content with its partial victory, the estate appealed to the Third Circuit, claiming that the seven includible checks were completed gifts *causa mortis*. Under state law, checks delivered to a recipient before death as gifts *causa mortis* are completed gifts even if the checks are paid after death. But to be a valid gift *causa mortis*, the decedent had to "apprehend death" at the time of the gift. The only evidence indicating the checks were made in contemplation of death were: (1) the decedent's receipt of a terminal diagnosis days before the gifts; and (2) the fact that these checks were delivered in September when the custom was for annual exclusion gifts from the decedent's account to made in December. While this evidence might be probative of the state of mind of the decedent's son (the agent under the power of attorney), it does nothing to prove the decedent's state of mind. Because there was no evidence that the decedent contemplated death when the checks were written on his behalf, the value of the seven checks was properly includible in the decedent's gross estate.

Editors' Comment: This case applies the overwhelming majority view that uncashed checks are not completed gifts because of the donor's power to stop payment. But there are a number of ways to make completed gifts from one's deathbed. A dying donor can make a completed gift by a certified check, by wire transfer, or even through apps like Venmo and Zelle.

Planners should keep in mind that a different rule applies for inter vivos charitable gifts. Checks delivered to charities are treated as donations made in the taxable year of delivery, even if the charity does not cash the check until the next taxable year, provided the check "subsequently clears in due course." Treas. Reg. §1.170A-1(b).

- **IRS Announces Guidance on Required Minimum Distributions Under the SECURE 2.0 Act**

In *Notice 2023-54* (July 14, 2023), the IRS provided guidance related to the change in the required beginning date for required minimum distributions (RMDs) made under the SECURE 2.0 Act of 2022. The notice also offered guidance related to certain RMDs for 2023. Finally, and perhaps most importantly, the notice announced that final regulations related to RMDs will apply for calendar years beginning no earlier than 2024.

Change in Required Beginning Date

The SECURE 2.0 Act changed the required beginning date for RMDs from April 1 of the calendar year following the calendar year in which an individual turns 72 to April 1 of the calendar year following the calendar year in which an individual turns 73 or 75, depending on the individual's date of birth. Because it takes time to update automated payments, apparently, some individuals who reach age 72 in 2023 received or will receive distributions in 2023 that will be mischaracterized as RMDs, making them ineligible for rolling over into an eligible retirement plan.

Notice 2023-54 provides some relief by announcing that any distribution made in the first seven months of 2023 to a participant born in 1951 (or to that participant's surviving spouse) that would have been an RMD under pre-SECURE 2.0 Act law can still qualify as an eligible rollover distribution. The Notice further extends the 60-day rollover deadline in all cases to September 30, 2023.

Final Regulations Not Expected Until 2024 or Later

Prior to the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), a "designated beneficiary"—generally an individual or a see-through trust for the benefit of an individual—was required to withdraw the funds from a deceased participant's plan or individual retirement account over the designated beneficiary's remaining life expectancy. After the SECURE Act, the opportunity for this "lifetime stretch-out" is limited to "eligible designated beneficiaries." The SECURE Act established only four types of eligible designated beneficiaries: surviving spouses, minor children, disabled and chronically ill beneficiaries, and individuals less than ten years younger than the plan participant. IRC §401(a)(9)(E)(ii). For all other designated beneficiaries (like adult children, for example), the SECURE Act imposed a new ten-year payout period. IRC §401(a)(9)(H)(i). Under this rule, an adult child named as the beneficiary of a retirement plan or IRA has ten years to withdraw the funds from the participant's account, regardless of that adult child's own life expectancy.

The conventional wisdom was that this ten-year rule would operate like the five-year rule long in effect where, for example, trusts are named as beneficiaries of the decedent's IRA or retirement plan. Under the five-year rule, the custodian must make sure funds are fully distributed by the end of the fifth year after the decedent's year of death, but there is no requirement that a minimum distribution be made in any one year. Indeed, a custodian may make a one-time distribution of the entire account balance to the trustee at or near the end of the fifth year following the year of the participant's death.

In February, 2022, however, the IRS proposed regulations regarding RMDs that contained a surprising rule. As explained in the March 2022 edition of the REPORTER, the proposed regulations provided that when: (1) the ten-year payout period applies to an IRA or qualified plan; and (2) the participant had started taking annual RMDs before death, RMDs must be taken by the designated beneficiary starting the year after the year of death of the employee, with a full and final distribution required by the end of the tenth calendar year after the year of the employee's death. In other words, heirs and beneficiaries cannot wait until the end of the ten-year period to make one lump sum distribution like they could under the five-year regime.

Since this rule was not in the statute and was only first announced in the 2022 proposed regulations, the heirs and beneficiaries of employees who died in 2020 very likely did not take an RMD in 2021 and were unsure whether they had to take an RMD in 2022. This very much matters because section 4974 imposes a penalty for failure to take an RMD equal to 50 percent of the amount by which the amount actually distributed falls short of the RMD amount. In their comments to the proposed regulations, some of these individuals who would otherwise face a penalty for not taking RMDs in 2021 and 2022 asked that, if the final regulations adopt the interpretation of the ten-year rule contained in the proposed regulations, the IRS provide transition relief.

That relief came in *Notice 2022-53*, 2022-45 I.R.B. 437 (October 7, 2022). As explained in the November 2022 edition of the REPORTER, the IRS announced in *Notice 2022-53* that: (1) final regulations would apply no earlier than the 2023 distribution year; and (2) the IRS would not assert the section 4974 penalty for RMDs not made in 2021 or 2022 where the new ten-year payout rule applies. Now, in *Notice 2023-54*, the IRS pushed the proposed effective date even further out: "Final regulations regarding RMDs under §401(a)(9) and related provisions will apply for calendar years beginning no earlier than 2024."

Extended Waiver of Penalty

Notice 2023-54 also provides that the IRS will not assert the section 4974 penalty for RMDs not made in 2023 where the ten-year payout rule applies. Though this is welcome news, the announcement signals that the final regulations will in fact retain the requirement that RMDs be made in each year of the ten-year payout period. When the old five-year payout period applied, a taxpayer had the flexibility to wait until the fifth year after the employee's year of death to commence distributions, subject only to the requirement that the account be depleted by the end of that fifth year. Lost flexibility is never cause for celebration.

- **Bargain Sale Not Deductible for Lack of Proof Regarding Consideration Received and for Lack of Substantiation**

In *Braen v. Commissioner*, T.C. Memo. 2023-85 (July 11, 2023), the Tax Court upheld the disallowance of a charitable contribution deduction in connection with the sale of real property to a local government. While the taxpayers thought they had made a deductible bargain sale, they lost the deduction for failing to value all of the consideration received in the transaction and for failing to obtain a contemporaneous written acknowledgment of the donation that complied with the strict substantiation requirements.

In 1998, an S corporation owned by the taxpayers (seven family members) purchased 505 acres of land in Ramapo, New York, for $3.5 million. The plan was to operate the land as the company's fifth granite quarry, but the corporation struggled with getting permits. In 2004, Ramapo enacted a comprehensive zoning ordinance that changed the zoning of most of the land from a "planned industrial" district to a "low-density rural residential" district. The company filed suit opposing the change, resulting in a settlement under which Ramapo agreed to buy 425 acres of the property for $5.25 million in a "bargain sale" transaction. Ramapo also agreed to rezone the remaining 80 acres back to its industrial status.

The sale closed in 2010. On its 2010 federal income tax return, the corporation claimed a charitable contribution deduction of $5.22 million. In an attachment to the return, the corporation stated that the property sold had a fair market value of $17.47 million (reflecting both the property's land value and its mineral value). While under normal bargain sale rules that would generate a deduction of $12.22 million ($17.472 million less $5.25 million sale price), the company explained it was "only" claiming a deduction of $5.22 million to avoid a valuation dispute and the potential imposition of a valuation misstatement penalty. On their individual income tax returns for 2010, the taxpayers claimed their proportionate shares of the company's $5.222 million deduction. The IRS disallowed the deductions, bringing us to the current matter before the Tax Court.

Consideration Received in a Bargain Sale

The IRS based its disallowance in part on its conclusion that neither the corporation nor the taxpayers established that the conveyance of 425 acres to Ramapo was a "bargain sale" — that is, that the value of the property transferred to the city exceeded the value of any consideration it received from the city. The Tax Court agreed, noting that in addition to the sale proceeds, the city also agreed to rezone the unsold 80 acres back to its former status as industrial property. This was "central to the overall deal," *Braen v. Commissioner*, T.C. Memo. 2023-85 at 19, and therefore should have been valued for purposes of establishing the amount of the deduction. Because it was not, the court held the taxpayers were not entitled to the claimed deduction.

Contemporaneous Written Acknowledgment

The IRS also based disallowance of the deduction on the taxpayers' failure to secure a contemporaneous written acknowledgment of the contribution from the city. Although the city furnished an acknowledgment letter to the corporation in 2011, the letter did not comply with the requirements for a contemporaneous written acknowledgment because it only identified the cash proceeds as the consideration furnished—it neither mentioned the zoning change that was part of the settlement agreement nor provided a good-faith valuation of the zoning change. The taxpayers argued that the acknowledgment letter's reference to the sale being approved by court order was sufficient for this purpose, but the Tax Court had no patience for the claim. The IRS should not have to look beyond the acknowledgment itself for all of the information required to substantiate the deduction, said the court, and even if that was not the case, the court order gives no good-faith estimate of the value of the zoning change. On this ground too, then, the court upheld disallowance of the deduction.

Substantial Valuation Misstatement Penalty

The corporation's income tax return reported the value of the property sold to Ramapo at $10.47 million. If that figure is 150 percent or more of the property's value, section 6662 imposes a 20-percent accuracy-related penalty. After considering reports from experts retained by the taxpayers (concluding the property was worth $11 – 12.19 million) and the report from the expert hired by the IRS (concluding the property was worth $4.85 million), the court determined that the value of the property sold to the local government was $5.22 million.

The significant difference in the valuations was largely attributable to the different conclusions as to the highest and best use of the property. To the taxpayers' experts, the highest and best use of the property was for quarrying; to the IRS's expert, it was "limited residential development." Given the significant trouble the corporation had in seeking to commence mining operations on the land, reasoned the court, quarrying could not reasonably be the highest and best use of the property. That left residential development as the highest and best use of the land, resulting in a valuation much closer to the conclusion offered by the IRS's expert. And because the reported value of the land was double the value determined by the court, the accuracy-related penalty applied. The court also rejected the claim of the taxpayers that any penalty would be excused for reasonable cause.

- **Retirement Distributions Paid to Scammer Still Subject to Tax**

In *Gomas v. United States* (Middle D. Fla. July 17, 2023), a federal district court awarded summary judgment against the taxpayers in a case described by the court as "disturbing," "egregious," and "unjust." Nonetheless, the court correctly determined that amounts withdrawn from retirement accounts and paid to a con artist are still includible in gross income. The court further determined, again correctly, that amounts paid to the con artist were neither deductible as theft losses—thanks to a current suspension of that deduction—nor as business expenses.

The taxpayers, Dennis and Suzanne Gomas, a married couple, inherited an online raw pet food business in 2010. The couple relocated the business from New York to Florida in 2014 and hired Suzanne's daughter, Suzanne Anderson, to assist. When the taxpayers decided to close operations in 2016, Anderson convinced them to transfer the business to her. In 2017, Anderson conned the taxpayers into thinking that Dennis was facing arrest because former employees of the business had opened accounts using Dennis's birthdate and social security number and used those accounts to defraud customers. Anderson suggested that the couple hire a lawyer that required a $125,000 retainer. They provided the money to Anderson, thinking she would forward the money to the lawyer. But there was no lawyer. Heck, there were no opened accounts and no defrauded customers. When the taxpayers insisted on meeting with the lawyer, Anderson created a fake email account and posed as the lawyer in correspondence with the taxpayers. Over the next several months, Anderson coaxed the taxpayers into transferring more and more cash to her, ostensibly for payment to the lawyer. By the end of 2017, the taxpayers had forked over about $700,000 total to Anderson, all funded by withdrawals from their IRA and pension plan. The taxpayers did not realize they were duped until 2019, when friends who had likewise been taken by Anderson informed them of her scam. Anderson was ultimately arrested on multiple charges of theft and fraud, and she pleaded guilty to seven total felonies in 2022.

The taxpayers originally reported their pension and IRA distributions as gross income on their 2017 joint federal income tax return. In 2020, they filed an amended return in which they claimed a deduction for the amounts paid to Anderson as "fictitious invoices, fake attorneys' fees, and other fraudulent mechanisms." When the IRS rejected the amended return, the taxpayers brought this refund action. But the court granted summary judgment to the IRS. Although the facts give rise to a theft loss, it is well accepted that a theft loss occurs in the year the theft is discovered. In this case, discovery was in 2019, which is most unfortunate. Under section 165(h)(5), the deduction for theft losses is suspended for the tax years 2018 – 2025. The taxpayers therefore could not deduct the amounts paid to Anderson as a theft loss.

The taxpayers then tried to "salvage a tax benefit from their immense losses" under two other theories. They first argued the distributions from the IRA and the retirement plan should not be included in gross income because they did not enjoy the benefit of those funds. The problem with this theory, though, is that the distributions were first paid to the taxpayers' bank account before they then authorized transfer to Anderson. Everything was under the authorization of the taxpayers, and because they had the control over these funds, they did enjoy the benefit of them, however briefly.

The taxpayers then argued that the payments to Anderson were deductible as business expenses because they related to their former pet food business. But they were barking up the wrong tree, for the taxpayers were no longer carrying on their business activity in 2017. They had retired in 2016 and transferred the business to Anderson that year. The couple claimed the payments were related to the business because they thought Anderson used the money to pay legal fees related to past business operations, but their subjective belief as to the use of the funds did not matter. In fact, no legal fees were ever paid. Because there were no legal expenses, there could be no deduction for legal expenses.

The court summarizes the case aptly:

> In view of the egregious and undisputed facts presented here, it is unfortunate that the IRS is unwilling—or believe it lacks the authority—to exercise its discretion and excuse payment of taxes on the stolen funds. It is highly unlikely that Congress, when it eliminated the theft loss deduction beginning in 2018, envisioned injustices like the case before this Court. Be that as it may, the law is clear here and it favors the IRS.

Gomas v. United States, at 11-12.

- **Tax Court Has Jurisdiction to Review Late Redetermination Petitions**

In *Culp v. Commissioner*, ___ F.4th ___ (3d Cir., July 19, 2023) (2023 Westlaw 4612024), the Third Circuit Court of Appeals 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.

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.

Resolution of the case turned on the proper interpretation of section 6213(a), which states in relevant part as follows:

> 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 to mean that, if a taxpayer files a late petition for redetermination of a deficiency, the Tax Court lacks the jurisdiction to consider it. But the Third Circuit, applying the Supreme Court's recent analysis in *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493 (2022), held that the 90-day filing requirement is merely procedural and not jurisdictional. In *Boechler*, the Supreme Court announced that a procedural requirement will be treated as limiting a court's jurisdiction only when 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

> "[w]ithin 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.

Culp v Commissioner, at 10.

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. This doctrine essentially pauses the statute of limitations when 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, *Boechler* cited the rule that "nonjurisdictional limitations periods are presumptively subject to equitable tolling." *Boechler* at 1500. 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 an eloquent 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.

Culp v. Commissioner, at 17.

- **But to the Tax Court, Eleven Seconds Late Is Still Late**

In *Sanders v. Commissioner*, 160 T.C. No. 16 (June 20, 2023), the Tax Court held unanimously that an electronic petition for redetermination filed eleven seconds after midnight on 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, such was not the case here. The taxpayer's case was therefore dismissed for lack of jurisdiction.

The taxpayer received a notice of deficiency that stated the last day for filing a petition with the Tax Court was December 12, 2022. At 9:59 pm the evening of December 12, the taxpayer downloaded the PDF forms to his Android mobile phone, but he was unable to complete the forms on his phone. Later, between 11:03 pm and 11:44 pm, the taxpayer made several attempts to upload the documents from his phone to the Tax Court's electronic filing system. He finally switched to his personal computer just before midnight, logging in at 11:57 pm. The filing system logs show that the taxpayer began uploading his petition nine seconds after midnight and that the filing was complete eleven seconds after midnight.

The IRS filed a motion to dismiss for lack of jurisdiction. In his objection to the motion, the taxpayer simply argued:

> On December 12, 2022 I attempted several times to upload documents well before midnight. Finally I was able to get it uploaded and it literally did not finish the upload until exactly 12a.
>
> I am sure it can be proven that the system had errors and that my upload was loading before cut off time.

Sanders v. Commissioner, at 4. In fact, the system had no errors, so that argument went nowhere fast. "To the extent that Mr. Sanders experienced difficulties in filing his Petition, they were unique to him and not the result of the system's being inaccessible or otherwise unavailable to the general public." *Id.* at 12. But an amicus brief filed by the Tax Clinic at Harvard Law School made two arguments in support of the taxpayer that the court considered at length.

The amicus 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 as readers of the June 2023 edition of the REPORTER know, the Tax Court ruled earlier this year in *Nutt v. Commissioner*, 116 T.C. No. 10 (2023), that the "timely mailing is timely filing" rule from section 7502 does not apply to petitions filed electronically. Instead, electronic petitions are considered filed when received. Moreover, said the court, the proposed rule that a petition is filed when it is outside the taxpayer's control would not change the result in this case, as the taxpayer did not begin the upload until nine seconds after the deadline.

The amicus 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. This conclusion, said the court, has the support of Congress:

> Indeed, Congress reinforced the notion that section 6213(a) is jurisdictional in 2021 when it enacted section 7451(b), which extends the deadline for filing a petition when a filing location is inaccessible or otherwise unavailable to the general public. When adding this provision, Congress clearly viewed the *timely* filing of a petition as a prerequisite to the Court's jurisdiction, stating in the effective date provision: "The amendments made by this section shall apply to petitions *required* to be timely filed (determined without regard to the amendments made by this section) after the date of enactment of this Act." Infrastructure Investment and Jobs Act § 80503(c) (emphasis added). Notably, Congress made this provision applicable only to petitions, and not to documents that lack the jurisdictional significance of petitions.

Sanders v. Commissioner, at 13 – 14.

Editors' Comment: 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 in *Culp v. Commissioner*, discussed above. If appealed, this case 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 this case really be different if equitable tolling was available? Did the taxpayer "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?

- **Losses in 2020 Don't Wipe Out Cryptocurrency Gains from 2013 and 2017**

  In *Kim v. Commissioner*, T.C. Memo. 2023-91

(July 20, 2023), the Tax Court held that, despite suffering significant losses from cryptocurrency transactions realized in 2020, the taxpayer was still liable for tax on capital gains from cryptocurrency transactions recognized in 2013 and 2017, rejecting the taxpayer's "unclean hands" argument.

The taxpayer reported gains from cryptocurrency transactions on timely-filed returns for the years 2013 through 2017. That last year was a big one, with the taxpayer reporting over $18.5 million in sale proceeds from virtual currency transactions. But the 2017 return showed a short-term capital gain of only $42,069. The IRS examined the return, and when the taxpayer did not supply records to prove how he computed the gain, the revenue agent used records received from the virtual currency exchanges to reconstruct the various sale transactions. That led to the determination that the taxpayer had the following net short-term gains and losses:

Year	Net Short-Term Gain (Loss)
2013	$75,400
2014	($35,408)
2015	($14,125)
2016	$23,422
2017	$4,066,629

The $49,000 of losses from 2014 and 2015 carried over to 2016, wiping out the short-term gain for that year and leaving the taxpayer with a $26,000 carryforward loss coming into 2017. But that still leaves the taxpayer with short-term capital gain of over $4 million for 2017, leading the IRS to assert a $1.57 million deficiency for 2017 and a $12,310 deficiency for 2013.

The taxpayer did not contest the math. Instead, he argued that the crypto assets giving rise to the 2017 gains "were completely wiped out" in 2020, that the federal government's mishandling of the COVID pandemic "directly caused" that loss, and that "under the Clean Hands doctrine of US law," the IRS was estopped from collecting on the deficiencies. But the Tax Court rejected the argument for having "no legal basis." As the court noted:

> [T]he "unclean hands" principle is designed to withhold equitable relief from one who has acted improperly. (citation omitted) Respondent is not seeking equitable relief but is endeavoring to recover taxes determined to be due from petitioner under the Internal Revenue Code. And while petitioner may disagree with the Government's policy response to the COVID epidemic, he has not shown that any agency of the Government (much less the IRS) acted improperly.

Kim v. Commissioner, at 5. Accordingly, the court confirmed that the taxpayer owed tax on the net gains from both 2013 and 2017.

Editors' Comment: While corporations have the luxury of carrying net capital losses both forward and backward (see section 1212(a)(1)) individuals may only carry such losses forward. See section 1212(b)(1). The fact that the taxpayer may have suffered significant losses in 2020 does not absolve him from paying tax on gains from earlier years, even when the later losses effectively offset the entirety of the prior gains. This case underscores one of the side effects of the annual accounting principle — the notion that "every year stands alone." The tax treatment of gains in one year is not affected by losses in a subsequent year.

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