Current Federal Tax Developments

Week of October 19, 2020

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ACCOUNTING
CONTINUING EDUCATION

KAPLAN

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF OCTOBER 19, 2020
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Current Federal Tax Developments

Kaplan Financial Education

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SECTION: PPP LOAN
DEADLINE TO APPLY FOR FORGIVENESS OF PPP LOAN IS LOAN MATURITY DATE, NOT OCTOBER 31, 2020

Citation: Paycheck Protection Program Frequently Asked Questions (FAQs) on PPP Loan Forgiveness, 10/13/20

Some concerns had been raised regarding the expiration date found on the various Forms 3508 to be used to apply for forgiveness under the PPP loan program. Ever since the first Form 3508 was released, the forms have shown an expiration date in the upper right corner of October 31, 2020.

The issue came into sharper focus when the SBA released the Form 3508S in October with that very same expiration date. Some expressed the concern that this might be the date by which borrowers would have to apply for forgiveness—and that date was rapidly approaching. But others noted nothing in the statute or other SBA guidance suggested that such a short deadline applied to the request for forgiveness.

The SBA updated its forgiveness FAQ[1] to address this concern, adding Question 4 on page 2 of the FAQ:

> **4. Question**: The PPP loan forgiveness application forms (3508, 3508EZ, and 3508S) display an expiration date of 10/31/2020 in the upper-right corner. Is October 31, 2020 the deadline for borrowers to apply for forgiveness?
>
> **Answer:** No. Borrowers may submit a loan forgiveness application any time before the maturity date of the loan, which is either two or five years from loan origination.
>
> However, if a borrower does not apply for loan forgiveness within 10 months after the last day of the borrower's loan forgiveness covered period, loan payments are no longer deferred and the borrower must begin making payments on the loan. For example, a borrower whose covered period ends on October 30, 2020 has until August 30, 2021 to apply for forgiveness before loan repayment begins.
>
> The expiration date in the upper-right corner of the posted PPP loan forgiveness application forms is displayed for purposes of SBA's compliance with the Paperwork Reduction Act, and reflects the temporary expiration date for approved use of the forms. This date

[1] Paycheck Protection Program Frequently Asked Questions (FAQs) on PPP Loan Forgiveness, SBA website, October 13, 2020, https://www.sba.gov/sites/default/files/2020-10/PPP%20--%20Loan%20Forgiveness%20FAQs%20%28October%2013%2C%202020%29.pdf (retrieved October 14, 2020)

> will be extended, and when approved, the same forms with the new expiration date will be posted.[2]

This is the first time it appears the SBA has directly provided a specific deadline for applying for forgiveness, allowing borrowers to apply up until the maturity date of their PPP loan. Thus, even if a borrower fails to apply by the date ten months after the end of their covered period and begin to make payments on the PPP loan, the borrower can still apply for forgiveness of the original PPP loan amount.

SECTION: 172
IRS TO SHUT DOWN FAX LINES TO FILE CLAIMS FOR TENTATIVE REFUNDS RELATED TO CARES ACT PROVISIONS AT THE END OF 2020

Citation: "Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19," IRS Website, 10/14/20

The IRS has updated its FAQ on "Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19,"[3] to provide that the ability to fax claims for refund using Forms 1139 and 1045 will continue through December 31, 2020. After that date, the fax numbers can no longer be used for that purpose.

The FAQ, which we've discussed previously, allows those filing tentative refund claims under sections 2303 and 2305 of the CARES Act to fax the claims to the IRS rather than mailing the claims to the IRS. Those covered claims are described as follows by the IRS in the FAQ:

> In response to the COVID-19 Pandemic and solely to implement the following provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), until further notice, the IRS is implementing the temporary procedures described below for digital transmission of Form 1139 and Form 1045:
>
> - Section 2303 makes several modifications to net operating losses, including requiring a taxpayer with a net operating loss arising in a taxable year beginning in 2018, 2019, or 2020 to carry that loss back to each of the five preceding years unless the taxpayer elects to waive or reduce the carryback; and providing a carryback for a two-year period of NOLs arising during a taxable year that began in 2017 and ended during 2018; and

[2] Paycheck Protection Program Frequently Asked Questions (FAQs) on PPP Loan Forgiveness, SBA website, General Loan Forgiveness FAQs, Q&A 4, p. 2

[3] Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19, IRS website, October 14, 2020, https://www.irs.gov/newsroom/temporary-procedures-to-fax-certain-forms-1139-and-1045-due-to-covid-19 (retrieved October 15, 2020)

- Section 2305 modifies the credit for prior-year minimum tax liability of corporations, including to accelerate the recovery of remaining minimum tax credits of a corporation for its 2019 taxable year from its 2021 taxable year and to permit a corporation to elect instead to recover 100 percent of any of its remaining minimum tax credits in its 2018 taxable year.[4]

Tentative refund claims must be filed within one year after the end of the year in which the claim arises.[5] The IRS has decided to end the period during which faxes will be accepted at the same time as the period to file the Forms 1139 and 1045 will end for calendar year taxpayers.

Question 21, added on October 14, provides:

> **21. When does the temporary faxing process described in these FAQs end?**
>
> The last day to fax an eligible refund claim under these procedures is December 31, 2020. The fax numbers listed herein will no longer be operational as of midnight EST on December 31, 2020. The instructions to the Form 1139 and Form 1045 provide the applicable requirements for how to submit these forms to IRS. The end of the faxing process is independent of any filing due dates. For example, the last day to file Form 1139 electing to take the 100% refundable minimum tax credit in 2018, is December 30, 2020. Additionally, if you file one application for a tentative refund and claim both the NOL carryback and the minimum tax credit at the same time, you must file the application by the earliest applicable deadline.[6]

By cutting off the fax lines at that time, the IRS will require all calendar year 2020 claims to be filed other than by fax. As well, fiscal year taxpayers with a 2019 tax year who have not filed a claim by December 31 will also be forced to mail in their claims rather than faxing them in.

Note that while the deadline for the tentative claims for refund is one year from the end of the year generating the claim, net operating loss carrybacks arising from those years may still be carried back using Form 1040X or 1120X even after the one year period ends.

IRC §6511(d)(2) provides that the statute for filing a standard claim for credit or refund arising from a net operating loss shall be "that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year

[4] Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19, IRS website, https://www.irs.gov/newsroom/temporary-procedures-to-fax-certain-forms-1139-and-1045-due-to-covid-19 (retrieved October 15, 2020)

[5] See Form 1045 Instructions, When to File, https://www.irs.gov/instructions/i1045 (retrieved October 15, 2020) and Form 1139 Instructions, When to File, https://www.irs.gov/instructions/i1139 (retrieved October 15, 2020)

[6] Temporary procedures to fax certain Forms 1139 and 1045 due to COVID-19, IRS website, October 14, 2020, https://www.irs.gov/newsroom/temporary-procedures-to-fax-certain-forms-1139-and-1045-due-to-covid-19 (retrieved October 15, 2020)

of the net operating loss or net capital loss which results in such carryback, or the period prescribed in subsection (c) in respect of such taxable year, whichever expires later."

EXAMPLE

Alison has a net operating loss originating in 2019 of $100,000, which is eligible for a five-year carryback period under the provisions of the CARES Act. She filed her 2019 return prior to April 15, 2020. Her loss would go back to 2014, a year in which Alison timely filed her return prior to April 15, 2015. Normally the time period for Alison to claim a refund related to 2014 would have ended on April 15, 2018.

But per the special rule related to claims arising from net operating losses, Alison has until April 15, 2023 (three years from April 15, 2020) to claim a refund of taxes from 2014 that relate to her 2019 net operating loss. Note that *only* a refund related to the net operating loss is covered by this rule—if Alison had failed to claim other allowed deductions in 2014, she could not now claim an additional amount of refund from 2014 related to those expenses.

If Alison files her claim on or before December 31, 2020, she may use Form 1045 to claim the refund and may fax that claim to the IRS. If she does not file until January 1, 2021 or later, she will file a Form 1040X for 2014 to claim a refund from 2014 related to her 2019 net operating loss.

IRC §6511(c), mentioned as part of the time period to file the claim, refers to an extension of time for assessment of tax entered into under an agreement pursuant to IRC §6501(c).

SECTION: 199A
2020 DRAFT INSTRUCTIONS REMOVE REFERENCE TO REDUCING QBI BY CHARITABLE CONTRIBUTIONS

Citation: Draft 2020 Form 8895 Instructions, 10/9/20

The IRS has issued a draft of the instructions[7] for Form 8995, *Qualified Business Income Deduction Simplified Computation*, for 2020, something that may not initially seem noteworthy. But it turns out that what is no longer found in the instructions may indicate an IRS change of view on the impact of charitable contributions on the calculation of qualified business income under IRC §199A.

Eric Yauch noted in an article published in *Tax Notes Today Federal* on October 14, 2020[8] that the revised instructions no longer contain a reference to, in at least some cases, reducing qualified business income (QBI) by charitable contributions.

[7] Draft 2020 Form 8895 Instructions, October 9, 2020, IRS website, https://www.irs.gov/pub/irs-dft/i8995--dft.pdf (retrieved October 14, 2020)

[8] Eric Yauch, "Practitioners Rejoice at Subtle IRS Change on 199A Calculation," *Tax Notes Today Federal*, October 13, 2020, https://www.taxnotes.com/tax-notes-today-federal/exemptions-and-deductions/practitioners-rejoice-subtle-irs-change-199a-calculation/2020/10/14/2d26d (retrieved October 14, 2020, subscription required)

The 2019 Form 8995 instructions provided, in part:

> Your QBI includes items of income, gain, deduction, and loss from your trades or businesses that are effectively connected with the conduct of a trade or business in the United States. This includes income from partnerships (other than PTPs), S corporations, sole proprietorships, certain estates and trusts that are included or allowed in figuring your taxable income for the year. To figure the total amount of QBI, you must consider all items that are related to the trade or business. This includes, but isn't limited to, ***charitable contributions***, unreimbursed partnership expenses, business interest expense, deductible part of self-employment tax, self-employment health insurance deduction, and contributions to qualified retirement plans.[9] (emphasis added)

In the 2020 draft PDF of the instructions, the last sentence of that paragraph now reads:

> This includes, but isn't limited to, unreimbursed partnership expenses, business interest expense, deductible part of self-employment tax, self-employment health insurance deduction, and contributions to qualified retirement plans.[10]

Note that the reference to charitable contributions is now absent from this sentence.

As the *Tax Notes Today Federal* article notes in quotes from a number of tax professionals, many had been surprised when the reference to charitable contributions being used in computing QBI cropped up in various 2019 IRS instructions and had questioned whether, in fact, the implied position of the IRS could be supported under the law.

SECTION: 461
TAXPAYER COULD NOT CLAIM ACCRUED EXPENSES TO MAINTAIN MANUFACTURING LINE UNTIL FOLLOWING YEAR

Citation: The Morning Star Packing Company, L.P. et al v. Commissioner, TC Memo 2020-142, 10/14/20

The Tax Court sided with the IRS in the case of *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142.[11] The Court found the taxpayers could not

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[9] 2019 Form 8995 Instructions, IRS website, https://www.irs.gov/instructions/i8995 (retrieved October 14, 2020)

[10] Draft 2020 Form 8895 Instructions, October 9, 2020, p. 2

[11] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, October 14, 2020, https://www.ustaxcourt.gov/UstcInOp2/OpinionViewer.aspx?ID=12343 (retrieved October 14, 2020)

claim a tax deduction for certain accrued expenses, finding that not all events had taken place to establish the fact of the liabilities in question.

A taxpayer reporting on the overall accrual method of accounting must generally demonstrate two items in order to be able to claim a deduction on the current year's return.

- Economic performance with regard to the item in question[12] and
- All events have occurred that determine the fact of a liability and the amount of that liability can be determined with reasonable accuracy.[13]

The taxpayer in question provided bulk-packaged tomato products to food processors and customer-branded finished products to the food service and retail trades. The Court noted that the taxpayers "account for about 25% of the California processing tomato production, supplying 40% of the United States ingredient tomato paste and diced tomato markets."[14]

The taxpayer's facilities operated 24 hours a day from July to October during the period when tomatoes are harvested. The taxpayers are subject to strict rules regarding cleanliness and food safety, with issues that may arise shutting down the entire processing line. If that condition persists for any significant period of time, the taxpayers would face large losses due to spoilage, having to pay farmers for tomatoes they were not able to actually use to create products and being liable to customers who now face a lack of product necessary for their operations.[15]

Because of these risks, the taxpayers have specific covenants in their loan agreements that require the organization to maintain all necessary licenses and keep their equipment in good working order. A failure to meet these objectives would be an event of default under the credit agreements.[16]

The Tax Court discusses the expenses in dispute as follows:

> The costs in issue are costs to restore, rebuild, and retest the manufacturing facilities for use during the next production cycle. The accrued production costs include amounts to be paid for goods and services. The partnerships maintain reserves that they refer to as "production accrual" (production accrual reserve accounts). These reserves are used to account for future costs associated with restoring, rebuilding, and retesting the manufacturing facilities for use during the next production cycle. The production accrual reserve accounts for both TMSPC and LPC included: amounts for production labor, boiler fuel, electricity, waste disposal, chemicals and lubrication, production

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[12] IRC §461(h)(2) taking in account the special recurring item rule found at IRC §461(h)(3)

[13] IRC §461(h)(4)

[14] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, p.4

[15] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 5-6

[16] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 8-10

> supplies, repairs and maintenance, lease, production wages, and administration wages.
>
> The accrued production costs were recurring, and the partnerships determined the amounts to be set aside in the reserves to cover these costs with reasonable accuracy. The partnerships issue payroll checks every other Thursday for work performed for the two-week period ending the Saturday before payday. Thus, payroll was paid between 5 and 19 days after the services were performed. The partnerships generally paid accounts payable 30 days after the goods and services were provided. For many reasons, including the sterility of the facilities when they are in operation, it is most efficient to delay some of the restoring, rebuilding, and retesting work until closer to the beginning of the next production cycle. Except for a de minimis amount of goods and services provided and paid for by December 31, the goods and services are not provided or paid for until the next year. Hence, economic performance of the production accrual liabilities does not occur until the next taxable year.[17]

The IRS argued that these accrued costs could not be included in the current year's cost of sales. The Court notes:

> In two FPAAs for years 2008 and 2009 and years 2010 and 2011 for each partnership, the Internal Revenue Service (IRS) determined that neither was entitled to increase its COGS for the amount of accrued production costs because: (1) the partnership had not shown that all events had occurred to establish the fact of the liabilities and (2) economic performance had not occurred with respect to the liabilities to qualify for accrual for the years claimed. The IRS concluded that if the partnerships' financial accounting years ended on December 31 instead of June 30, their December 31 yearend financial statements would not comply with GAAP because the accrued production costs were included in COGS.[18]

The IRS specifically argued:

> Respondent has conceded that the partnerships determined the accrued production costs with reasonable accuracy and that they complied with the economic performance requirement. However, respondent contends that the accrued production costs consisted of bilateral contracts for goods and services to recondition the partnerships' manufacturing facilities that were provided to and paid for by the partnerships after the December 31 close of their tax year. Respondent argues that all events had not occurred during the years in issue to establish the fact of the liabilities for the accrued production costs.[19]

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[17] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 10-11

[18] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 12-13

[19] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, p. 15

The taxpayer countered with the following argument:

> The partnerships contend that respondent's focus on the bilateral goods and services contracts is misplaced. Instead the partnerships argue that their credit agreements and multiyear contracts to supply customers with tomato products obligated them to incur the accrued production costs to restore, rebuild, and retest the manufacturing facilities.[20]

The Tax Court agreed with the IRS's view and did not accept that the credit agreement covenants created a liability at the end of the tax year

> The credit agreements involved in these cases do not specifically set forth the partnerships' obligations to provide a comparably sufficiently fixed and definite basis. Instead the credit agreements include nonspecific text and generalized obligations. The agreements merely require that the partnerships "maintain all material licenses, Permits, [and] governmental approvals", comply with "all laws", and "keep all property useful and necessary in its business in good working order and condition". The credit agreements neither specify which laws or regulations must be complied with nor identify exactly which property must be kept in good working order. Accordingly, we conclude that the generalized obligations found in the credit agreements do not establish the fact of the partnerships' liabilities for the accrued production costs for the years in issue.[21]

The Court also rejected the argument that multi-year contracts with some customers created the liability as well:

> The partnerships alternatively assert that their multiyear production contracts with various customers establish the fact of their liabilities for the accrued production costs. While these production contracts involve extensive product quality specifications, the partnerships' efforts to comply with their customers' specifications are production-run specific. Such compliance necessarily takes place before and during the production run of tomato products for a given customer. The accrued production costs in issue were for goods and services provided after the production run in each year in issue. Furthermore, the parties have stipulated that the accrued production costs in issue are to restore, rebuild, and retest the manufacturing facilities for use during the next production cycle. We conclude that the partnerships' multiyear production contracts fail to establish the fact of the liabilities for the accrued production costs for the years in issue.[22]

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[20] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 15-16

[21] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, p. 17

[22] *The Morning Star Packing Company, L.P. et al v. Commissioner*, TC Memo 2020-142, pp. 17-18

SECTION: 7422
IRS FAQ ON EIP FOR INCARCERATED INDIVIDUALS SUBJECT TO COURT REVIEW UNDER ADMINISTRATIVE PROCEDURES ACT

Citation: Scholl, et al v. Mnuchin, et al, USDC ND CA, Case No. No. 4:20-cv-05309, 10/14/2020

The IRS has been issuing a large number of frequently asked questions pages (referred to as FAQs) to deal with tax law in recent years, particularly with regard to issues under the Tax Cuts and Jobs Act and later legislation. The agency, in the case of *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309[23] had argued, among other things, that these FAQs are not "final agency actions" and thus not subject to review by the courts under the Administrative Procedures Act (APA) even in cases where the IRS is taking action directly related to the FAQ holdings.

The case involved the IRS FAQ, published on May 6, 2020, that in Q&A 15 took the position that incarcerated individuals were not eligible to receive an economic impact payment (EIP) under the CARES Act. The agency eventually took action to retrieve payments that had already been made to such individuals, asked any who had received them and not had them retrieved to send the money back and refused to issue any additional payments to such individuals.

The IRS took the position that the FAQ, being an informal IRS publication on the agency's web page, was not subject to review under the APA since it was a not a final agency action—no regulations had been issued, nor had any sub-regulatory ruling been issued by the agency at that time. The District Court disagreed with that position in this case.

The opinion outlines the conditions that must exist for a court to be able to review the agency's actions under the APA:

> There are two conditions for an agency action to be final under the APA: "First, the action must mark the consummation of the agency's decision-making process — it must not be of a merely tentative or interlocutory nature. And second, the action must be one by which rights or obligations have been determined, or from which legal consequences will flow." *U.S. Army Corps of Eng'rs v. Hawkes Co.*, 136 S. Ct. 1807, 1813 (2016) (quoting *Bennett v. Spear*, 520 U.S. 154, 177–78 (1997)); see also *Or. Nat. Desert Ass'n v. U.S. Forest Serv.*, 465 F.3d 977, 982 (9th Cir. 2006) ("[T]he core question is whether the agency has completed its decisionmaking process, and whether the result of that

[23] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, October 14, 2020, Copy of case can be downloaded from https://caresactprisoncase.org/resources/ link (https://www.lieffcabraser.com/pdf/order-re-summary-judgment.pdf retrieved October 16, 2020)

> process is one that will directly affect the parties." (alteration in original) (citation omitted)).[24]

In the situation in question in this case, the Court found that the FAQ and related IRS actions amounted to a final agency action:

> …[S]everal facts indicate that the IRS's decision-making process was final and not interlocutory or tentative. In the preliminary injunction order, the court determined that the action was final because the FAQ took the unequivocal position that incarcerated individuals were ineligible to receive EIPs, defendants submitted a declaration that did not indicate any change to the agency's position was forthcoming, the IRS changed its internal manual, and the timing of the CARES Act made further agency determination unlikely. Dkt. 50 at 15–16.
>
> Defendants do not contest these facts, but rather characterize them as a response to a rapidly developing situation that has continued to evolve in the months following enactment of the CARES Act. While this is an accurate description of the initial roll-out of the CARES Act, once the IRS changed its mind and determined that incarcerated individuals are ineligible for EIPs in early May 2020, the agency has been consistent in that interpretation and has shown no indication whether publicly or in this litigation that it intends to further change its position. For that reason, this case is similar to San Francisco Herring Association v. Department of the Interior, 946 F.3d 564, 575 (9th Cir. 2019), where the Ninth Circuit determined an agency's decision to be final where the agency "repeatedly declared its authority . . . in formal notices, refused to change its position when pressed, and then enforced its fishing ban against individual fishermen. . . ."
>
> Second, as the court determined in its prior order and reaffirms in this order, the CARES Act requires the IRS to issue EIPs to eligible individuals who meet the criteria established by Congress. Accordingly, the decision to deny those payments to a specific segment of the population is one where a right has been determined.
>
> Accordingly, the court finds that the IRS's determination that incarcerated individuals are ineligible for an EIP is a final agency action.[25]

The opinion notes that even if there is a final agency action, the court cannot grant relief under the APA if adequate remedies exist. The IRS argued that since this was merely an advance payment of a refundable 2020 credit, the taxpayer could take action when and if the IRS denied their claim for the credit on the 2020 tax return.

But the opinion notes, citing its original preliminary injunction's reasoning, that:

- There is no refund action for the lack of the EIP itself and

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[24] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, pp. 15-16

[25] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, pp. 16-18

- As well, a refund claim on a 2020 return is not an adequate remedy to the harm done through the denial of the EIP.[26]

The opinion reasons that the refund claim section (IRC §7422(a)) is not applicable to the matter at hand:

> Generally, section 7422(a) requires a taxpayer to file a claim with the IRS before bringing suit for the recovery of any internal revenue tax. See *United States v. Clintwood Elkhorn Min. Co.*, 553 U.S. 1, 4 (2008) ("A taxpayer seeking a refund of taxes erroneously or unlawfully assessed or collected may bring an action against the Government either in United States district court or in the United States Court of Federal Claims." (citations omitted)). In its prior order, the court reasoned that plaintiffs' claims fell outside section 7422 for two reasons. First, plaintiffs did not allege that a tax was erroneously or illegally assessed or collected, a penalty was collected without authority, or any sum is alleged to be excessive. Dkt. 50 at 18–19. Second, plaintiffs sought injunctive and declaratory relief and such equitable relief fell outside the relief permitted by the statute. Id. at 19 (citing *King v. Burwell*, 759 F.3d 358, 366 (4th Cir. 2014), *aff'd*, 576 U.S. 473 (2015); *Cohen v. United States*, 650 F.3d 717, 732 (D.C. Cir. 2011) (*en banc*)).[27]

But even if the court were to ignore that issue, the opinion finds that §7422(a) relief of an eventual 2020 claim for a credit would not be adequate in this case:

> A remedy is inadequate if it only offers "doubtful and limited relief." Bowen, 487 U.S. at 901. For example, in *Hawkes*, 136 S. Ct. at 1815, the Court rejected an alternative remedy where "a landowner [would] apply for a permit and seek judicial review in the event of an unfavorable decision" because "the permitting process can be arduous, expensive, and long." As persuasively reasoned by the district court in *Amador v. Mnuchin*, — F. Supp. 3d — , 2020 WL 4547950, at *9 (D. Md. Aug. 5, 2020), forcing plaintiffs to file a 2020 tax return, wait until the IRS denies their request for a CARES Act tax credit, file an administrative claim with the IRS seeking reconsideration, and only then file a suit in district court would amount to the "arduous, expensive, and long process" that was rejected in *Hawkes*. For this separate reason, plaintiffs have no adequate alternative remedy to the APA.[28]

The court then moves on to see if the agency acted in an arbitrary and capricious manner in issuing this guidance and taking the related actions. The Court found that the arbitrary and capricious standard was met:

> Here, plaintiffs argue that defendants' policy is arbitrary and capricious because defendants have failed to provide an adequate reason for its decision. MSJ at 13. Next, the policy relies on factors that Congress

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[26] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, p. 18

[27] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, pp. 18-19

[28] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, p. 20

> did not intend it to consider. Id. at 14. Plaintiffs contend that, to the extent defendants claim the policy was adopted as an anti-fraud measure, that reason is a post-hoc declaration offered in this lawsuit and defendants have not logically connected instances of fraud to the broader decision not to disburse any payments to incarcerated individuals. Id. In response, defendants argue that because section 6428 does not require the IRS to issue advance refund payments to plaintiffs, the IRS has not acted arbitrarily and capriciously. Dkt. 70 at 16.
>
> The court's prior order determined that plaintiffs were likely to succeed on the merits because defendants had not directed the court to any evidence indicating that the Treasury Department or the IRS gave any reason for the decision to exclude payments to incarcerated individuals, much less an adequate one. Dkt. 50 at 27–28. Defendants have not advanced any convincing explanation or reason to deviate from the court's prior finding.[29]

The opinion significantly notes that the agency has to give its reasons supporting the position taken when it issues the guidance, something it did not do here, advancing a reason only after the fact in this litigation:

> For example, defendants cited a concern on the part of the IRS that it regularly received information about possible fraudulent tax refunds or other frivolous tax activity involving incarcerated individuals. See Dkt. 70 at 6–7; Dkt. 44-1, ¶¶ 5–6. Yet, this explanation was not publicly advanced by the agency at the time it reached its determination and therefore constitutes an impermissible post hoc rationalization. See *Dep't of Homeland Sec. v. Regents of Univ. of Cal.*, 140 S. Ct. 1891, 1909 (2020) ("While it is true that the Court has often rejected justifications belatedly advanced by advocates, we refer to this as a prohibition on post hoc rationalizations, not advocate rationalizations, because the problem is the timing, not the speaker. The functional reasons for requiring contemporaneous explanations apply with equal force regardless whether post hoc justifications are raised in court by those appearing on behalf of the agency or by agency officials themselves.").[30]

It is important to note that the facts of this situation are a bit unique, so it remains to be seen how broad a net is cast over the flood of IRS guidance by FAQ by this ruling. But at least it suggests that the agency does not avoid having to explain its positions in all cases by posting its position on its website and calling it an FAQ.

The IRS may be reacting to this case and other criticism of issuing material guidance by FAQ. In an article published on October 7, 2020 in *Tax Notes Today Federal*[31], Nathan

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[29] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, pp. 33-34

[30] *Scholl, et al v. Mnuchin, et al*, USDC ND CA, Case No. No. 4:20-cv-05309, p. 34

[31] Nathan J. Richman, "IRS Open to Placing More FAQs in the Internal Revenue Bulletin," *Tax Notes Today Federal*, October 7, 2020, 2020 TNTF 194-3, (https://www.taxnotes.com/tax-notes-today-federal/practice-

Richman quoted IRS Chief Counsel Michael J. Desmond from a webcast sponsored by Crowell & Moring, LLP as stating the agency was open to adding some FAQs to the Internal Revenue Bulletin, allowing taxpayers to rely on them or converting some FAQs to published guidance such as notices.

and-procedure/irs-open-placing-more-faqs-internal-revenue-bulletin/2020/10/07/2d1c2 retrieved October 16, 2020, subscription required)