Current Federal Tax Developments

Week of June 14, 2021

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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JUNE 14, 2021

Published in 2021 by Kaplan Financial Education.

Printed in the United States of America.

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Kaplan Financial Education

Contents

SECTION: 1411
SUPREME COURT RULES PLAINTIFFS DID NOT HAVE STANDING TO CHALLENGE AFFORDABLE CARE ACT, NET INVESTMENT INCOME TAX REMAINS IN FORCE

Citation: California v. Texas, US Supreme Court, Case No. 19-840, 6/17/21

When a US District Judge in Texas ruled in 2018 that the Affordable Care Act had been rendered retroactively unconstitutional in its entirety by the Tax Cuts and Jobs Act, a number of advisers rushed to file claims for refunds for years where clients had paid the net investment income tax under IRC §1411. The Supreme Court has now decided the fate of those refund claims, overturning the lower court decision in a 7-2 decision and keeping the entire Affordable Care Act in force.[1]

The case arose once Congress reduced the amount due under IRC §5000A for individuals who failed to maintain minimum essential coverage to zero in the Tax Cuts and Jobs Act. The plaintiffs argued that this change was fatal to the entire Affordable Care Act (which would include the net investment income tax under IRC §1411), as the Supreme Court, in an opinion authored by Justice Roberts, had found the mandate constitutional because it represented a tax on those who failed to obtain insurance rather than making a failure to maintain insurance illegal.

While the trial court had ruled this caused the entire law to be rendered invalid, the Fifth Circuit had sent the case back to the trial court to give reasons why the entire law, rather than just the mandate, had to be rendered invalid by this change.[2] However, before that decision came down the case was appealed to the U.S. Supreme Court who agreed to hear the case.

The opinion, authored by Justice Breyer, joined by Justices Sotomayor, Kagan, Kavanaugh and Barrett along with Chief Justice Roberts, begins by outlining the basic claim of the plaintiffs:

> As originally enacted in 2010, the Patient Protection and Affordable Care Act required most Americans to obtain minimum essential health insurance coverage. The Act also imposed a monetary penalty, scaled according to income, upon individuals who failed to do so. In 2017, Congress effectively nullified the penalty by setting its amount at $0. See Tax Cuts and Jobs Act of 2017, Pub. L. 115–97, §11081, 131 Stat. 2092 (codified in 26 U. S. C. §5000A(c)).

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[1] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021, https://www.supremecourt.gov/opinions/20pdf/19-840_6jfm.pdf (retrieved June 17, 2021)

[2] Brent Kendall and Jess Bravin, "Supreme Court Leaves Affordable Care Act Intact," *Wall Street Journal*, June 17, 2021 10:42 am ET, https://www.wsj.com/articles/supreme-court-leaves-affordable-care-act-intact-11623938948?mod=e2tw (retrieved June 17, 2021 08:10 am MST, subscription required)

> Texas and 17 other States brought this lawsuit against the United States and federal officials. They were later joined by two individuals (Neill Hurley and John Nantz). The plaintiffs claim that without the penalty the Act's minimum essential coverage requirement is unconstitutional. Specifically, they say neither the Commerce Clause nor the Tax Clause (nor any other enumerated power) grants Congress the power to enact it. See U. S. Const., Art. I, §8. They also argue that the minimum essential coverage requirement is not severable from the rest of the Act. Hence, they believe the Act as a whole is invalid.[3]

Justice Breyer does not keep the reader in suspense, as the opinion immediately goes on to give the result the majority arrived at and what they did not decide:

> We do not reach these questions of the Act's validity, however, for Texas and the other plaintiffs in this suit lack the standing necessary to raise them.[4]

Essentially, the Court decided the case on a technicality—but one that may mean no party will be able to bring a case before the Court to decide the specific issues of constitutionality of the mandate or, if the mandate is unconstitutional, require the entire Affordable Care Act, including the Net Investment Income Tax, to be rendered retroactively invalid.

The opinion notes:

> The Constitution gives federal courts the power to adjudicate only genuine "Cases" and "Controversies." Art. III, §2. That power includes the requirement that litigants have standing. A plaintiff has standing only if he can "allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief." *DaimlerChrysler Corp. v. Cuno*, 547 U. S. 332, 342 (2006) (internal quotation marks omitted); see *also Lujan v. Defenders of Wildlife*, 504 U. S. 555, 560–561 (1992). Neither the individual nor the state plaintiffs have shown that the injury they will suffer or have suffered is "fairly traceable" to the "allegedly unlawful conduct" of which they complain.[5]

The opinion first looks at the two individual plaintiffs who complain about the requirement to maintain coverage that is provided in IRC §5000A. But the Court found that there's no harm to ignoring the requirement—and thus no real harm to the plaintiffs:

> Their problem lies in the fact that the statutory provision, while it tells them to obtain that coverage, has no means of enforcement. With the penalty zeroed out, the IRS can no longer seek a penalty from those who fail to comply. See 26 U. S. C. §5000A(g) (setting out IRS enforcement only of the taxpayer's failure to pay the penalty, not of

[3] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

[4] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

[5] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

> the taxpayer's failure to maintain minimum essential coverage). Because of this, there is no possible Government action that is causally connected to the plaintiffs' injury—the costs of purchasing health insurance. Or to put the matter conversely, that injury is not "fairly traceable" to any "allegedly unlawful conduct" of which the plaintiffs complain. Allen v. Wright, 468 U. S. 737, 751 (1984). They have not pointed to any way in which the defendants, the Commissioner of Internal Revenue and the Secretary of Health and Human Services, will act to enforce §5000A(a). They have not shown how any other federal employees could do so either. In a word, they have not shown that any kind of Government action or conduct has caused or will cause the injury they attribute to §5000A(a).[6]

To put it simply, the individuals are stuck in a "Catch-22" for a challenge—without a penalty under IRC §5000A there's no way they can be harmed by the government for failing to comply with the toothless mandate. But their challenge is based on the lack of a tax after the TCJA changes and the importance the existence of that tax had on the validity of the law in the majority opinion in *National Federation of Independent Business v. Sebelius*, 567 U. S. 519 (2012).

The opinion also notes that the relief requested must be tied to that injury:

> To consider the matter from the point of view of another standing requirement, namely, redressability, makes clear that the statutory language alone is not sufficient. To determine whether an injury is redressable, a court will consider the relationship between "the judicial relief requested" and the "injury" suffered. *Allen*, 468 U. S., at 753, n. 19. The plaintiffs here sought injunctive relief and a declaratory judgment. The injunctive relief, however, concerned the Act's other provisions that they say are inseverable from the minimum essential coverage requirement. The relief they sought in respect to the only provision they attack as unconstitutional—the minimum essential coverage provision—is declaratory relief, namely, a judicial statement that the provision they attacked is unconstitutional. See App. 61–63 ("Count One: Declaratory Judgment That the Individual Mandate of the ACA Exceeds Congress's Article I Constitutional Enumerated Powers" (boldface deleted)); 340 F. Supp. 3d, at 619 (granting declaratory judgment on count I as to §5000A(a)); 352 F. Supp. 3d, at 690 (severing and entering partial final judgment on count I).
>
> Remedies, however, ordinarily "operate with respect to specific parties." *Murphy v. National Collegiate Athletic Assn.*, 584 U. S. ___, ___ (2018) (THOMAS, J., concurring) (slip op., at 3) (internal quotation marks omitted). In the absence of any specific party, they do not simply operate "on legal rules in the abstract." *Ibid.* (internal quotation marks omitted); see also *Mellon*, 262 U. S., at 488 ("If a case for preventive relief be presented, the court enjoins, in effect, not the

[6] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

> execution of the statute, but the acts of the official, the statute notwithstanding").[7]

The states fair no better for standing, as the Court continued to look at how the change to IRC §5000A (a statute that is unenforceable and is not being enforced) created damages to them:

> As with the individual plaintiffs, the States also have failed to show how this injury is directly traceable to any actual or possible unlawful Government conduct in enforcing §5000A(a). Cf. *Clapper v. Amnesty Int'l USA,* 568 U. S. 398, 414, n. 5 (2013) ("plaintiffs bear the burden of . . . showing that the defendant's *actual action* has caused the substantial risk of harm" (emphasis added)). That alone is enough to show that they, like the individual plaintiffs, lack Article III standing.[8]

Justice Thomas pens a concurring opinion where he argues that he agrees with the result based on the case presented by the parties, but does not foreclose a possible standing option for the states as proposed in the dissent authored by Justice Alito—but notes that the states did not argue for standing as Justice Alito proposed it, so it would not be appropriate to consider it in this case.[9]

We should expect the IRS to begin denying those claims for refund that were based on the hope that this case would have resulted in the retroactive repeal of the net investment income tax. And it appears advisers will not need to be concerned with filing additional protective claims unless some plaintiff can come up with damages that give rise to a standing to ask for relief tied to the changes made to IRC §5000A.

SECTION: 6039
EXEMPT ORGANIZATIONS SHOULD FILE FORMS 990-EZ AND 8868 ELECTRONICALLY DUE TO PROCESSING DELAYS FOR PAPER FILINGS

Citation: "Exempt Organizations Update," IRS web page, June 16, 2021 Edition

The IRS is warning exempt organizations that file Form 990-EZ or Form 8868 on paper risk running into issues, either getting premature notices regarding a failure to file the Form 990-EZ or long delays in getting an acknowledgment of the approval of their extension request.[10]

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[7] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

[8] *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

[9] Justice Thomas, Concurring Opinion, *California v. Texas*, US Supreme Court, Case No. 19-840, June 17, 2021

[10] "Exempt Organizations Update," IRS web page, June 16, 2021, https://www.irs.gov/charities-non-profits/current-edition-of-exempt-organizations-update (retrieved June 17, 2021)

The article in the June 16, 2021 edition of the *Exempt Organization Update* indicates the IRS is having processing issues at this time:

> The IRS is experiencing delays in processing paper returns, including Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*, and Form 8868, *Application for Extension of Time To File an Exempt Organization Return*.[11]

The IRS is encouraging organizations to file such forms electronically if at all possible, noting the following potential consequences that may face those filing on paper:

> If you file Form 990-EZ on paper, you may receive a prematurely-issued CP259A notice of non-filing. If you file Form 8868 on paper, there may be a delay in receiving CP211A notice confirming approval of your extension request.[12]

However, if an organization has already filed such documents on paper, the agency warns against now attempting a second filing via electronic means:

> If you filed your return or extension request on paper, you do not need to take any further action. Please don't file a second return or contact the IRS about the status of your filing. We appreciate your patience.[13]

SECTION: 7122
DUE TO BACKLOG OF UNPROCESSED RETURNS, IRS MAKES TEMPORARY CHANGES IN OFFER IN COMPROMISE PROCEDURES

Citation: SBSE-06-0621-0029,6/1/21

The IRS's backlog in processing 2020 and 2021 returns has caused the service to issue a memorandum[14] with special procedures for handling offers in compromise where the taxpayer's 2020 and/or 2021 return has not yet been processed by the IRS.

The IRS is currently facing a massive backlog of returns. Erin Collins, the National Taxpayer Advocate provided the following summary of the backlog as of May 1, 2021

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[11] "Exempt Organizations Update," IRS web page, June 16, 2021

[12] "Exempt Organizations Update," IRS web page, June 16, 2021

[13] "Exempt Organizations Update," IRS web page, June 16, 2021

[14] SBSE-06-0621-0029, release date June 16, 2021 (memorandum date June 1, 2021), https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/memo-provides-temporary-oic-process-due-to-backlogged-returns/76mlk (retrieved June 16, 2021)

in a written statement to the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate:

	Individual	Business	Not Specified	Total
Paper Returns Awaiting Processing				
Calendar Year 2020	1,000,000	1,500,000		2,500,000
Calendar Year 2021	4,900,000	3,700,000	1,800,000	10,400,000
Total Paper Returns Awaiting Processing	**5,900,000**	**5,200,000**	**1,800,000**	**12,900,000**
Paper and Electronic Returns - Processing Suspended	**13,200,000**	**1,900,000**		**15,100,000**
Amended Returns Inventory	**1,900,000**	**500,000**		**2,400,000**
Total Unprocessed Returns	**21,000,000**	**7,600,000**	**1,800,000**	**30,400,000**

(Data from IRS systems and Wage & Investment Division. Totals are not necessarily exact due to rounding)[15]

This backlog of over 30 million unprocessed returns is creating problems for processing offers in compromise, as the officer attempting to process an offer may be unable to access the filings for the last two years—and not know if that is because the taxpayer has not filed those forms or they are just stuck somewhere in the backlog.

The memorandum provides temporary guidance through September 30, 2021 for employees of the Specialty Collection Offer in Compromise (SCOIC) section when an Individual Master File (IMF) or Business Master File (BMF) may not have been processed due to the IRS's issues revolving around the COVID-19 pandemic. The memorandum temporarily changes procedures found in various sections of the Internal Revenue Manual.

The memorandum's first section is entitled "Procedural Change — IRM 5.8.2 — Process Examiners (PE)" and provides:

> If a Tax Year (TY) 2019 or 2020 IMF return (or a TY 2020 BMF return, as applicable) is not located, process the incoming offer until notified that IRS has processed all returns. At this time, **do not** return as not-processable if there is an unfiled TY 2019 or TY 2020 IMF return or unfiled TY 2020 BMF return. An OE or OS will need to address these returns during the investigation of the offer and update the AOIC Remarks.
>
> The current guidance under IRM 5.8.2.4.1(4), Unfiled Tax Returns (Both IMF/BMF), states that offers submitted where IDRS does not

[15] Written Statement of Erin M. Collins, National Taxpayer Advocate, Hearing on Internal Revenue Service: Narrowing the Tax Gap and Improving Taxpayer Services, before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate, May 19, 2021, p. 6, https://www.irs.gov/pub/irs-utl/national-taxpayer-advocate-testimony-senate-approps-fsgg-hearing-5-19-2021.pdf (retrieved June 16, 2021)

> indicate a required return has been received will be deemed not processable. *Under this temporary deviation, until all backlogged IMF and BMF returns (as applicable) are processed, do not return as not processable for unfiled returns. (emphasis added)* Forward to the appropriate OE/OS inventory. Update comments on AOIC to state the following: No return(s) on file for (insert MFT and tax period for the missing returns). Offer forwarded to (insert inventory number, for example, 6000).[16]

The second section is entitled "Procedural Change — IRM 5.8.7 — Offer Examiners (OE) and Offer Specialists (OS)" and reads:

> If the taxpayer provides evidence of filing, **do not** return the offer until IRS has processed all backlogged IMF and BMF returns, as applicable. If the offer is acceptable and the returns will have a balance due, hold the offer open until the return has processed. If the TIPRA mandatory acceptance date is within 90 days and the balance due return has not posted, advise the taxpayer that you can continue to recommend acceptance, but without the liability and they will have to fully pay the new balance due when they receive notice. The taxpayer can also choose to withdraw the offer and wait for the assessment.
>
> The current guidance under IRM 5.8.7.2.2.1(2) states that if the return has not posted or is not pending and the offer is going to be accepted, schedule follow-ups during the eight-week period after the due date of the return for the posted return. Under this temporary deviation, until all backlogged IMF and BMF returns (as applicable) are processed, do not return for filing compliance issues.[17]

The final segment is entitled "Procedural Change — IRM 5.19.7 — MOIC Tax Examiners (TE)" and reads:

> If the taxpayer provides evidence of timely filing, **do not** default the accepted offer until IRS has processed all backlogged IMF and BMF returns, as applicable.
>
> The current guidance under IRM 5.19.7.14.4.1(2) states to allow ten (10) weeks for an IMF return and twenty (20) weeks for a BMF return to post to the master file. Under this temporary deviation, until all backlogged IMF and BMF returns (as applicable) are processed, do not default an accepted OIC for failure to adhere to compliance terms.

[16] SBSE-06-0621-0029, release date June 16, 2021 (memorandum date June 1, 2021)

[17] SBSE-06-0621-0029, release date June 16, 2021 (memorandum date June 1, 2021)