Current Federal Tax Developments

Week of May 2, 2022

Edward K. Zollars, CPA
(Licensed in Arizona)

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF May 2, 2022
© 2022 Kaplan, Inc.
Published in 2022 by Kaplan Financial Education.

Printed in the United States of America.

All rights reserved. The text of this publication, or any part thereof, may not be translated, reprinted or reproduced in any manner whatsoever, including photocopying and recording, or in any information storage and retrieval system without written permission from the publisher.

Current Federal Tax Developments

Table of Contents

Section: 104 Disabled Veteran Could Not Exclude Military Retirement Pay in Excess of Amounts Received from VA as Disability Payments 1

Section: 162 Amounts Paid as Management Fees by C Corporation Not Deductible 9

Section: 2010 IRS Provides Rules to Limit the Application of the Anti-Clawback Rules for Certain Gifts Includable in a Decedent's Estate 16

Section: 6011 IRS Provides Date for When MeF Will Be Available to File S Corporation Schedules K-2 and K-3 21

SECTION: 104
DISABLED VETERAN COULD NOT EXCLUDE MILITARY RETIREMENT PAY IN EXCESS OF AMOUNTS RECEIVED FROM VA AS DISABILITY PAYMENTS

Citation: Valentine v. Commissioner, TC Memo 2022-42, 4/28/22

The Tax Court agreed with the IRS that a disabled Army veteran could only exclude from income the designated disability payments she received from the Veterans' Administration, while the payments she received separately as part of her military retirement payments were taxable in the case of *Valentine v. Commissioner*, TC Memo 2022-42.[1]

IRC §104 and Military Disability Income

The case revolves around special provisions related to those disabled due to active service in the military. IRC §104(a)(4) reads as follows:

> (a) In general. Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—
>
> …
>
> (4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 808 of the Foreign Service Act of 1980;

IRC §104(b) provides special rules related to this provision. The relevant provisions for this case are reproduced below:

> (b) Termination of application of subsection (a)(4) in certain cases.
>
> (1) In general. Subsection (a)(4) shall not apply in the case of any individual who is not described in paragraph (2).

---

[1] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/disabled-veteran-can%e2%80%99t-exclude-retirement-payments-from-income/7dflh (retrieved April 29, 2022)

> (2) Individuals to whom subsection (a)(4) continues to apply. An individual is described in this paragraph if—
>
> > …
> >
> > (C) he receives an amount described in subsection (a)(4) by reason of a combat-related injury, or
> >
> > (D) on application therefor, he would be entitled to receive disability compensation from the Department of Veterans Affairs.

Paragraph 104(a)(2) refers to the general exclusion from income for damages received for physical injuries and reads as follows:

> (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;

The opinion outlines how these provisions are potentially applicable in the case of Ms. Valentine as follows:

> Section 104(a)(4) provides the general rule that amounts received as a pension, annuity, or similar allowance are not included in gross income when they arise from personal injuries or sickness resulting from active service in the armed forces of any country. As the Commissioner concedes, this is the provision that, in conjunction with section 104(b)(2)(D), entitles Ms. Valentine to exclude from gross income her disability payments from the VA. She attempts to extend this exclusion to her retirement distributions from the DOD, but section 104(b) limits the exclusion prescribed in subsection (a)(4), as relevant here, to an individual who either "receives [a pension, annuity, or similar allowance] by reason of *combat*-related injury", § 104(b)(2)(C) (emphasis added), or "on application therefor . . . would be entitled to receive [not "is receiving"] disability compensation from the Veterans' Administration," § 104(b)(2)(D) (emphasis added). In the latter case, the amount excludable from gross income is "not . . . less than the maximum amount which such individual, on application therefor, would be entitled to receive as disability compensation from the Veterans' Administration." § 104(b)(4) (emphasis added).[2]

The opinion continues with an analysis of why these provisions at IRC §104(b) exist:

> The restrictions imposed in section 104(b) are discussed in the legislative history underlying the Tax Reform Act of 1976, Pub. L. No.

---

[2] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

> 94-455, § 505(b), 90 Stat. 1520, 1567, in which Congress explained the restrictions as follows:
>
> > At all times, Veterans' Administration disability payments will continue to be excluded from gross income. In addition, even if a future serviceman who retires does [*9] not receive his disability benefits from the Veterans' Administration, he will still be allowed to exclude from his gross income an amount equal to the benefits he could receive from the Veterans' Administration. Otherwise, future members of the armed forces will be allowed to exclude military disability retirement payments from their gross income only if the payments are directly related to "combat injuries."
>
> S. Rep. No. 94-938, at 139 (1976), 1976-3 C.B. (Vol. 3) 49, 176–77 (emphasis added); see also *Reimels v. Commissioner*, 123 T.C. 245, 257 (2004), *aff'd*, 436 F.3d 344 (2d Cir. 2006); *Kiourtsis v. Commissioner*, T.C. Memo. 1996-534. (Ms. Valentine was, by way of contrast, a retiree who did "receive [her] disability benefits from the Veterans' Administration".)[3]

The Court goes on to detail how various situations work under these rules:

> A retired service member may receive both a disability pension from the VA (which is excludable from income) and retirement distributions (such as a service pension) from her respective branch of the armed forces; but payments under retirement plans should generally be included in income regardless of the existence of a VA disability determination, except where certain exceptions may apply. See *Lambert v. Commissioner*, 49 T.C. 57 (1967); *Sidoran v. Commissioner*, T.C. Memo. 1979-56, *aff'd*, 640 F.2d 231 (9th Cir. 1981). We have held that where a petitioner already receives an excludable disability benefit from the VA, "a VA disability determination does not prove that a portion of [additional retirement distributions are] received for injuries sustained during active service" for the purpose of section 104(a)(4). *Holt v. Commissioner*, T.C. Memo. 1999-348, 78 T.C.M. (CCH) 625, 627 (noting that a percentage of disability determination had already resulted in a disability benefit which was excluded from the taxpayers' income).
>
> A retired service member who did not receive a disability determination from the VA and who is not currently receiving disability benefits may exclude from gross income a portion of her retirement benefits under section 104 if she can prove that she would qualify for a disability determination from the VA. See S. Rep. No. 94-938, at 139, 1976-3 C.B. (Vol. 3) at 176–77. Similarly, a service member who receives a retroactive disability determination by the VA may exclude from gross income a portion of the retirement benefits she received during the retroactive period equal to the percentage of her disability determination (if she did not already exclude them prior

[3] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

> to the determination). See, e.g., *Strickland v. Commissioner*, 540 F.2d 1196 (4th Cir. 1976), *rev'g* T.C. Memo. 1974-188; see also Rev. Rul. 78-161, 1978-1 C.B. 31.[4]

The Taxpayer's Facts

The court recited the facts of the taxpayer's case as follows, beginning with payments that were not in dispute as to their taxability:

> For 22 years Ms. Valentine served her country in the U.S. Army. She was honorably discharged in 2002, and thereafter she received monthly disability payments from the Veterans' Administration (since 1989 the Department of Veterans Affairs, with both entities referred to as the "VA"), for "service-connected disabilities". The amount of each monthly disability payment correlated with a service-connected disability determination (stated as a percentage of total disability) issued by the VA to Ms. Valentine. In 2014 her combined "service-connected" disability rating was 60%; and in 2016 she received, pursuant to the VA's determination, payments of approximately $1,100 per month in January, February, March, and April. Effective May 1, 2016 (and reported to her by letter of May 27, 2016), the VA increased her combined "service-connected" disability rating to 90%, and thereafter she received payments of approximately $1,700 per month for the remainder of 2016, for a total of $18,000 for the year.
>
> The parties agree that these disability payments are not taxable. The VA's determinations made no reference to Ms. Valentine's disability being "combat-related".[5]

However, the taxpayer was arguing that other payments could be excluded from her income that she received related to her military service:

> In addition to her disability payments, Ms. Valentine received retirement distributions from her Army-based retirement plan in 2016 totaling $23,801. (It is unclear whether her retirement distributions were calculated on the basis of years of service or otherwise.) She received from the U.S. Department of Defense Accounting and Finance Services ("DOD") a Form 1099–R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.", reporting the entire amount of the retirement distributions as "taxable".
>
> The taxability of these retirement distributions is in dispute.[6]

---

[4] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[5] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[6] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

Ms. Valentine reported only $3,158 of this payment as taxable. Her return did not explain how she had determined the taxable and nontaxable portion of that distribution.[7]

The Tax Court's Decision on How the Law Applied in This Case

The opinion begins by stating Ms. Valentine's arguments for expanding her exclusion beyond simply the amounts designated as disability payments by the VA:

> Ms. Valentine argues that the disability determination she received from the VA entitles her to exclude from gross income not only her disability payments (which the Commissioner concedes, pursuant to section 104(a)(4) and (b)(2)(D)) but also a portion of her retirement distributions.[8]

While the Court notes that Ms. Valentine does not cite any specific provision in IRC §104 that would allow for her expanded exclusion, the opinion points out:

> … the two available contentions appear to be that the amounts were received by reason of a combat-related injury, § 104(b)(2)(C), (b)(3), or that the amounts are those that the service member "would be entitled to receive as disability compensation", § 104(b)(2)(D), (b)(4).[9]

The opinion goes on to consider whether either of these two exclusions might apply in these facts.

Taxpayer Fails to Provide Information to Show a Combat Related Injury

The opinion first looks at the combat related injury exclusion that would be available under IRC §104(b)(2)(C). The opinion notes that, before trial, Ms. Valentine made the following reference to combat:

> [I]n 2015 or '14, I was made aware that my retirement income from the Army [is excluded from gross income], if I'm a disabled vet, ***combat-service related*** — and there's other stipulations, but that's the one I fall under. [Emphasis added.][10]

The court was not clear if Ms. Valentine was asserting the contention that she had a combat related, injury as she "conflates two concepts in the exclusion provided in section 104 — payments on account of injury "resulting from active ***service*** in the armed forces", § 104(a)(4) (emphasis added), and payments "by reason of a ***combat***-related injury", § 104(b)(2)(C), (b)(3) (emphasis added)."[11]

---

[7] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[8] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[9] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[10] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[11] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

But the Court concludes that if she was asserting the combat related injury exclusion applied, she failed to produce any evidence of such a combat-related injury:

> …[I]f she did intend the additional or alternative contention that her Army retirement payments were "by reason of a combat-related injury", then this contention fails for lack of evidence.
>
> Ms. Valentine made no showing that the Army or the VA ever determined that she had a "combat-related injury". Rather, the letters Ms. Valentine received from the VA detail her "service-connected disability compensation" (emphasis added), without reference to "combat". Assuming that the Tax Court could make a "combat-related" finding in the absence of such a ruling by the military, Ms. Valentine did not provide evidence to support such a finding. She did not allege (or provide evidence to support a contention) that her injuries were "combat-related" as required by section 104(b)(2)(C) and (b)(3) (emphasis added). In her sworn trial testimony, Ms. Valentine made no reference to combat. She offered no documentary evidence that refers to combat. As to the disability that she suffers, she made no explanation of it that would enable us to infer what caused it.[12]

Ms. Valentine Was Already Receiving What She Was Entitled to Receive as Disability Compensation

Ms. Valentine asserts that she should be able to exclude most of her Army retirement distributions reported on Form 1099R due to the VA disability determinations:

> Ms. Valentine contends that, on account of her 60% and 90% VA disability determinations, she is entitled to exclude from gross income 60% of her Army retirement distributions for each of the first four months of 2016 and 90% of her Army retirement distributions for the last eight months of 2016.[13]

However, the Court notes that this is not how the law works in her case:

> In so arguing, Ms. Valentine multiplies her retirement distributions by her 60% and 90% disability ratings and thereby radically misconstrues the text and meaning of section 104(a)(4) and (b)(2)(D). A retired service member may exclude a portion of her retirement distributions in an amount equal to the benefit that she "would be entitled to receive as disability compensation from" the VA, § 104(b)(4) (emphasis added), but only if she is not currently receiving excludable disability benefits from the VA, as Ms. Valentine was receiving. The legislative history supports this interpretation of section 104(b)(4). See S. Rep. No. 94-938, at 138–39, 1976-3 C.B. (Vol. 3) at 176–77.
>
> The evidence shows that Ms. Valentine was already receiving — as disability payments from the VA — the entire amount that she was

[12] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[13] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

> entitled to receive from the VA. A 60% disability determination (made in 2014) was applied to the first four months of 2016; and a 90% disability determination (made in May 2016) was applied to the remaining eight months of 2016. These facts indicate that in 2016 Ms. Valentine received from the VA the entire amount that she was "entitled to receive as disability compensation from the Veterans' Administration", for purposes of section 104(b)(4). She suggests no basis for concluding otherwise.[14]

The opinion now looks to another issue Ms. Valentine raises—that there was a retroactive determination of her disability:

> At trial Ms. Valentine seemed to complicate the question by characterizing as "retroactive" the VA's determination of her disability. A retroactive disability determination reflects the VA's decision that a prior disability determination had been incorrect and should be corrected with retroactive effect; and it may indicate that previous payments that were deemed not allocable to a disability when paid should have been so allocated. Therefore, upon receipt of an actually retroactive disability determination from the VA, a service member may be entitled to exclude a portion of the retirement benefits that she received during the retroactive period and that (in hindsight) were mischaracterized as taxable. See Rev. Rul. 78-161.[15]

Again, the Court puts forward the facts that might support such a finding:

> Ms. Valentine's "retroactive" contention might be: that after she had received her 60% and 90% disability payments, she received a retroactive determination that her disability was greater; that she was therefore entitled to disability payments greater than the VA had actually paid her in 2016; and that therefore a portion of her Army retirement paid should be excluded from gross income pursuant to section 104(b)(4).[16]

But, again the Court finds that she failed to produce evidence that any such retroactive determination had been made:

> The VA made no "retroactive" disability determination for Ms. Valentine after 2016 that was "retroactive" to 2016. What Ms. Valentine's evidence shows is only that a determination of 60% made in 2014 was applied prospectively to the first four months of 2016, and that an increased 90% determination made in May 2016 was applied contemporaneously to that month and the remaining months of 2016.
>
> Ms. Valentine did not offer evidence to show — nor did she even allege — that the VA made any post-2016 determination of her disability, nor does she argue that any such post-2016 disability

[14] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[15] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[16] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

> determination should be retroactively applied to 2016. Rather, the letters from the VA that she offered as evidence outline only the "current" disability benefits paid to her as of their dates of April 15 and May 27, 2016. The effective dates of her then-current disability ratings were December 1, 2014 (effective for the first four months of 2016), and May 1, 2016 (effective for the last eight months of 2016); and there is no evidence to support a contention that either of these determinations or any other was retroactive. Section 104(b)(2)(D) and (b)(4) therefore provides no basis for the exclusion she claims; and we hold that the retirement distributions Ms. Valentine received of $23,801 are properly includible in her gross income pursuant to section 61(a)(11).[17]

Misinterpreting an IRS Publication

In a footnote to the opinion, the Court did hint that Ms. Valentine may have misread an IRS Publication to come to her conclusions. The footnote states:

> Ms. Valentine cites IRS Publication 525, "Taxable and Nontaxable Income" (2016), to support her position regarding the nontaxable nature of her retirement distributions. Administrative guidance contained in IRS publications is not binding on the IRS, nor can it change the plain meaning of tax statutes. *Miller v. Commissioner*, 114 T.C. 184, 195 (2000).[18]

This discussion of the fact that IRS Publications aren't binding on the IRS or the courts is standard any time a publication is raised to support a position without citing back to other, authoritative guidance. Essentially, even if Ms. Valentine's interpretation of what is written in the Publication is reasonable, it is only binding if the law actually reads as the Publication suggests.[19]

But in this case it turns out that we aren't looking at a situation where the Publication was wrong about the underlying law. Rather, the taxpayer misconstrued what she read.

> Even so, Ms. Valentine misconstrues IRS Publication 525 to support her contention that a portion of her retirement distributions is nontaxable. IRS Publication 525 provides an example of the disability payment exclusion under section 104(a)(4) and corresponding limitation under section 104(b)(2)(D) and (b)(4). The paragraph entitled "Retroactive VA determination[s]" states that
>
> > [i]f [a taxpayer] retire[s] from the armed services based on years of service and [is] later given a retroactive service-connected disability rating by the VA, [the taxpayer's] retirement pay for the retroactive period is excluded from

[17] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022

[18] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022, Footnote 4

[19] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022, Footnote 4

> income up to the amount of VA disability benefits [the taxpayer] *would have been entitled to receive.*

IRS Publication 525, at 18 (emphasis added). That circumstance can be contrasted with that of a retiree who timely received a prospective disability rating and who in the first instance received from the VA the disability payments appropriate for that rating, and who was not granted any retroactive correction of that disability rating and was therefore not entitled to any retroactive disability payments.[20]

SECTION: 162 AMOUNTS PAID AS MANAGEMENT FEES BY C CORPORATION NOT DEDUCTIBLE

Citation: Aspro v. Commissioner, Case No. 21-1996, CA8, 4/26/22

In the case of *Aspro v. Commissioner*, Case No. 21-1996, CA8,[21] the Eighth Circuit Court of Appeals sustained the Tax Court's disallowance of a deduction of management fees paid to shareholders of a C corporation and the treatment of the payment as disguised distributions taxable as dividends.

There are various reasons why some closely held entities make payments to related parties that are labeled management fees. In this case we aren't told what the ultimate goal was of such fees, but we do know that they had continued for an extremely long period of time.

The opinion summarizes the facts of the case as follows:

> Aspro, Inc. is an asphalt-paving company in Waterloo, Iowa. It is incorporated under Iowa law and treated as a subchapter C corporation for federal income-tax purposes. Between 2012 and 2014, the relevant years, Aspro stock was held by: Milton Dakovich, the president of Aspro; Jackson Enterprises Corp.; and Manatt's Enterprises, Ltd. Aspro has not paid dividends since the 1970s but, except for one year, has paid its shareholders "management fees" for at least twenty years. In addition to receiving management fees, Dakovich received a salary, director fees, and bonuses for each of the relevant years. There were no written agreements between Aspro and its three shareholders regarding fees paid for management services, nor was there an employment contract between Aspro and Dakovich.

[20] *Valentine v. Commissioner*, TC Memo 2022-42, April 28, 2022, Footnote 4

[21] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/eighth-circuit-affirms-manager-fees-were-disguised-distributions/7df6s (retrieved April 27, 2022)

> Aspro claimed deductions on its tax returns for management fees for tax years 2012 through 2014.[22]

The IRS examined the corporation's returns and denied the deduction for management fees, finding that the corporation had failed to establish that it had incurred or paid these fees for ordinary and necessary business purposes as required by IRC §162. Rather the IRS found that these payments represented disguised distributions being paid to the corporation's shareholders. The taxpayer filed a petition in the Tax Court challenging these findings of the IRS, but the Tax Court ruled in the IRS's favor. The taxpayers then appealed that decision to the Eighth Circuit Court of Appeals.

The Underlying Law for Deductibility of Such Management Fees

The panel's opinion begins by discussing the general rules for allowing a deduction for trade or business expenses of a corporation.

> …[W]e consider Aspro's challenge to the tax court's holding that none of the management fees paid by Aspro was deductible because they were instead disguised distributions of profits. See *United States v. Ellefsen*, 655 F.3d 769, 779 (8th Cir. 2011) (explaining that distributions of profits are not deductible). Whether payments made to shareholders are distributions of profits rather than compensation for services is a factual determination. *Heil Beauty Supplies, Inc. v. Comm'r*, 199 F.2d 193, 194-95 (8th Cir. 1952). We review the tax court's factual determinations for clear error and "must affirm unless left with a conviction that the tax court has committed a mistake." *Keating v. Comm'r*, 544 F.3d 900, 903 (8th Cir. 2008). We consider all the facts and circumstances when determining whether the compensation paid to a corporation's shareholders is actually a distribution of profits. See *Heil Beauty Supplies*, 199 F.2d at 195; *Charles Schneider & Co. v. Comm'r*, 500 F.2d 148, 151 (8th Cir. 1974). Aspro bore the burden of proving its entitlement to the deductions. See T.C.R. 142(a)(1).[23]

The panel discusses the differences between deductible business payments for a C corporation and amounts that represent distributions to the shareholders, including how to determine if an amount paid that claims to be for a business expense is actually a disguised distribution, structured in this manner to avoid the less favorable tax treatment of paying a distribution. That is, the negative tax consequence that the C corporation will get no deduction for this payment while it will still be taxable income to the shareholders:

> Corporations must pay federal income tax on their taxable income, 26 I.R.C. § 11(a), which is gross income less allowable deductions, § 63(a). Under § 162(a)(1), deductions are allowed for expenses that are "ordinary and necessary" in carrying on a trade or business, including "reasonable allowance for salaries or other compensation for personal services actually rendered." "Ordinary has the connotation of normal, usual, or customary," and describes expenses arising from transactions

[22] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[23] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

> "of common or frequent occurrence in the type of business involved." *Deputy v. du Pont*, 308 U.S. 488, 495 (1940). Necessary means appropriate and helpful to the development of the business. See *Comm'r v. Heininger*, 320 U.S. 467, 471 (1943); *Welch v. Helvering*, 290 U.S. 111, 113 (1933).
>
> "As the language of § 162(a)(1) suggests, a deduction may be made if salary is both (1) 'reasonable' and (2) 'in fact payments purely for services.'" *David E. Watson, P.C. v. United States*, 668 F.3d 1008, 1018 (8th Cir. 2012) (quoting Treas. Reg. § 1.162–7(a)); see also *Wy'East Color Inc. v. Comm'r*, 71 T.C.M. (CCH) 2501, 1996 WL 119492, at *6 (1996) ("A taxpayer may deduct payments for management services under section 162 if the payments are for services actually rendered and are reasonable in amount."). "Usually, courts only need to examine the first prong," although "in the rare case where there is evidence that an otherwise reasonable compensation payment contains a disguised dividend, the inquiry may expand into compensatory intent apart from reasonableness." *David E. Watson*, 668 F.3d. at 1018 (brackets omitted). However, "[t]he inquiry into reasonableness is a broad one and will, in effect, subsume the inquiry into compensatory intent in most cases." Id. In general, reasonable compensation is limited to "such amount as would ordinarily be paid for like services by like enterprises under like circumstances." Treas. Reg. § 1.162-7(b)(3); see also *Home Interiors & Gifts, Inc. v. Comm'r*, 73 T.C. 1142, 1155-56 (1980).
>
> "[C]orporations are not allowed a deduction for dividends paid to the shareholders," *Ellefsen*, 655 F.3d at 779, including distributions that are disguised as compensation. Treas. Reg. § 1.162-7(b)(1); *Charles Schneider*, 500 F.2d at 152-53. Compensation paid by the corporation to shareholders is closely scrutinized to make sure the payments are not disguised distributions. *Heil Beauty Supplies*, 199 F.2d at 194 ("Any payment arrangement between a corporation and a stockholder . . . is always subject to close scrutiny for income tax purposes, so that deduction will not be made, as purported salary, rental or the like, of that which is in the realities of the situation an actual distribution of profits.").[24]

As well, the panel notes how the law is applied to determine if compensation (in whatever form) being paid to the shareholders is reasonable, as required under IRC §162:

> To determine whether compensation paid to a shareholder-employee is reasonable, courts consider factors enumerated in *Charles Schneider*, 500 F.2d at 151-52.6 No single factor is dispositive; rather, the court is to base its decision on a careful consideration of applicable factors in light of the relevant facts. See *Mayson Mfg. Co. v. Comm'r*, 178 F.2d 115, 119 (6th Cir. 1949). Because the factors in isolation offer insufficient

[24] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

> guidance on their application, we view them in the context of the list as a whole.[25]

Why the Taxpayer Failed to Show These Were Deductible Business Expenses

The panel agreed with the Tax Court and the IRS that the taxpayer had failed to demonstrate these payments represented deductible business expenses under IRC §162. The panel pointed out a number of problems with these payments, problems that probably aren't all that unusual for many of the taxpayers that attempt to payout such management fees.

The panel begins by noting:

> Aspro did not present evidence showing what "like enterprises under like circumstances" would ordinarily pay for like management services. See Treas. Reg. § 1.162-7(b)(3). It also did not quantify the value of the management services provided, nor did it show that similar companies would pay that amount for similar services.[26]

The lack of any written agreement between the parties or any methodology being documented that was used to compute the amount of these management fees was also a major problem in the view of the panel:

> As the tax court noted, Aspro produced no written management-services agreement or other documentation of a service relationship between Aspro and either entity, no evidence of how Aspro determined the amount of the management fees, and no evidence that either entity billed Aspro or sent invoices for any services performed for Aspro. See *ASAT, Inc., v. Comm'r*, 108 T.C. 147 (1997) (holding that the taxpayer was not entitled to deduct consulting fees where there were no written agreements, no documentation providing how the management fees were calculated, and billing invoices containing almost no details); *Fuhrman v. Comm'r*, 102 T.C.M. (CCH) 347 2011-236, 2011 WL 4502290, at *2-3 (same).[27]

The nature of the actual payments appeared much more consistent with payments being made to the shareholders as a return based on their ownership interest in the corporation, something we'd normally refer to as a dividend payment:

> Further, we agree with the tax court that the management fees paid by Aspro to Jackson Enterprises Corp. and Manatt's Enterprises, Ltd. were not purely for services rendered and were instead disguised distributions of profits. See *David E. Watson*, 668 F.3d. at 1019. Aspro has made no dividend distributions since the 1970s but has paid management fees every year but one for twenty years. See *Paul E. Kummer Realty Co. v. Comm'r*, 511 F.2d 313, 315 (8th Cir. 1975) ("[T]he

[25] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[26] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[27] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

> absence of dividends to stockholders out of available profits justifies an inference that some of the purported compensation really represented a distribution of profits as dividends."); *Charles Schneider*, 500 F.2d at 153 ("Perhaps most important [in identifying disguised distributions] is the fact that no dividends were ever paid by any of these companies during [this time], even though they enjoyed consistent profits and immense success in the industry.").[28]

In addition to the fact that dividends never had been paid, the court noted that the actual amount in management fees seemed to be roughly in line with the percentage of ownership interest of the various owners. Again, this is more like something we would expect to see in the payment of dividends then we would for payments based on the value of services actually rendered:

> And Aspro has also paid management fees in amounts roughly proportional to the ownership interests of the stockholders. Jackson Enterprises Corp. and Manatt's Enterprises, Ltd. each owned forty percent of Aspro's stock, and each received forty-three percent of the total management fees paid in 2012, forty-six percent in 2013, and forty-four percent in 2014. See *Paul E. Kummer*, 511 F.2d at 316 (suggesting that payments to shareholders that were "almost identical" to their ownership interest indicated disguised distributions); Treas. Reg. § 1.162-7(b)(1) (stating that a disguised distribution is likely where "excessive payments correspond or bear a close relationship" to ownership interests); *RTS Inv. Corp. v. Comm'r,* 53 T.C.M. (CCH) 171, aff'd, 877 F.2d 647 (8th Cir. 1989) (per curiam). The district court correctly found that Aspro had a "process of setting management fees [that] was unstructured and had little if any relation to the services performed" and "had relatively little taxable income after deducting the management fees," and Aspro does not dispute that it paid the management fees as lump sums at the end of the tax year even though many of the services that Aspro claims justified the management fees were performed throughout the year. See *Nor-Cal Adjusters v. Comm'r*, 503 F.2d 359, 362-63 (9th Cir. 1974) (affirming in a disguised-distribution context the tax court's reliance on factors including an unstructured process of setting shareholder compensation, consistently negligible taxable income, and lump-sum payments to shareholders). Therefore, the tax court did not clearly err in concluding that the management fees paid to Jackson Enterprises Corp. and Manatt's Enterprises, Ltd. were nondeductible because Aspro failed to carry its burden of showing that the fees were reasonable and purely for services.[29]

---

[28] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[29] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

The corporation also failed to show that overall amounts paid to the shareholders for their salaries, bonuses, directors fees and management fees represented reasonable amounts of compensation to the shareholders for services actually rendered:

> We conclude that the district court did not clearly err in finding that Aspro failed to meet its burden to show that the management fees paid to Dakovich "would ordinarily be paid for like services by like enterprises under like circumstances." See Treas. Reg. § 1.162-7(b)(3); *Home Interiors*, 73 T.C. at 1155-56. Aspro did not present evidence showing what similar companies under like circumstances would pay as management fees (over and above salary and bonuses) to an employee like Dakovich for the same type of management services. It also did not quantify the value of the management services he provided, nor did it show that like enterprises would pay that amount for them. In fact, the Commissioner's expert said the exact opposite. Nunes, an expert in valuing compensation arrangements, reviewed deposition transcripts about the services Dakovich provided to Aspro and determined the amount of reasonable compensation that a comparable enterprise would have to pay in the marketplace for the services described in the depositions. He concluded that Dakovich's salary and bonus exceeded the industry average and median by a substantial margin and that management fees in addition to the salary and bonus were not reasonable. When Nunes added Dakovich's excess compensation per year to his management fees, his share of the total management fees over the three years at issue was twenty-two percent, closely aligning with his twenty-percent ownership interest in Aspro; the other two shareholders each received thirty-nine percent, which closely aligned with their approximately forty-percent-each ownership interest in Aspro.[30]

The panel also concluded, not surprisingly, that these payments did not constitute reasonable compensation to the shareholders:

> Factors discussed in *Charles Schneider* strengthen our conclusion that the district court did not clearly err, including "the absence of profits paid back to the shareholders as dividends"; "the nature, extent and scope of the employee's work"; and "a most significant factor," "the prevailing rates of compensation for comparable positions in comparable concerns." See *Charles Schneider*, 500 F.2d at 152-54.[31]

Rather the panel concludes the facts lead to the conclusion that these payments are far more likely to be distributions of corporate profits to the equity holders, something that is not deductible at the corporate level:

> Aspro has not paid any dividends to stockholders since the 1970s, but regularly pays management fees. This "justifies an inference that . . .

---

[30] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[31] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

> the purported compensation really represents a distribution of profits." See id. at 153.[32]

The court also noted that these fees were always paid at the end of the year, and generally brought the corporation's taxable income down to a relatively small amount:

> As with Jackson Enterprises Corp. and Manatt's Enterprises, Ltd., Aspro paid the management fees as lump sums at the end of the tax year even though the purported services were performed throughout the year, had an unstructured process of setting the management fees that did not relate to the services performed, and had a relatively small amount of taxable income after deducting the management fees. See *Nor-Cal Adjusters*, 503 F.2d at 362-63. Therefore, the tax court did not clearly err in finding that Aspro failed to carry its burden of showing that the management fees were reasonable and purely for services actually performed.[33]

Lessons from This Case

Advisors can take a number of lessons from studying this case. One of the key ones actually has little to do with the issue at hand, but rather to something that's often used to justify taking positions that the advisor should be aware would be unlikely to survive any sort of review by a taxing agency.

As the panel noted, the corporation had gotten away with making these disguised dividend payments for two decades before the IRS finally examined the corporation and raised the issues. The fact that the IRS had never challenged this before, or, as clients often love to tell their tax advisor, other taxpayers have been doing this for decades and never had an issue, is of no use once the challenge is brought forth. Note that the court never even vaguely considered allowing the taxpayer to claim this deduction merely because it had gone unchallenged for so long.

Second, it is important to carefully document anything dealing with a payment to a related party where the IRS may gain advantage by restructuring that payment under a different view. The lack of any sort of documentation regarding how these management fees had been computed allowed the IRS to easily persuade the court it was likely they were being paid to bail out earnings from the corporation to avoid having a double tax situation eventually, where amounts were going to be taxed at the corporate level and later taxed when distributed to the shareholders. Even worse, there wasn't even the very basic type of documentation regarding the nature of the agreement or what exactly the services were that were to be performed in order to earn these management fees.

The fact that payments were made solely in a lump sum at the end of the year also helped the IRS persuade the court that this was such a tool being used solely to reduce taxable income in the corporation, not an actual payment related to services being rendered to the corporation.

---

[32] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

[33] *Aspro v. Commissioner*, Case No. 21-1996, CA8, April 26, 2022

Again, it's important to note that the taxpayers had years of what they believed was IRS acceptance of this sort of a program. But reality is that the IRS doesn't look at most returns in any detail, even when claiming deductions for things like management fees that you might think could raise some issues. And it's also important to note that the fact you got away with it for 20 years is no defense whatsoever in a year in which the agency decides to ask about the item.

Advisors need to realize that even though this corporation got away with this for 20 years, advisors working with a large number of taxpayers are going to be far more exposed to the IRS running into the issue on one or more of their clients.

So the advisor is far more exposed than any individual client to potentially bad results arising from such sloppy and aggressive tax positions being taken. Such bad results can arise from the IRS taking action against the preparer, but more likely the advisor's client will suddenly be "shocked" to discover that this position was aggressive, regardless of how hard they may have pushed for it or how much they whined that all of their friends and business acquaintances were doing the same thing and they wondered why the advisor was being such a wimp about these matters. That may result in the client either filing a civil claim against the tax advisor or filing a complaint with a licensing agency.

SECTION: 2010
IRS PROVIDES RULES TO LIMIT THE APPLICATION OF THE ANTI-CLAWBACK RULES FOR CERTAIN GIFTS INCLUDABLE IN A DECEDENT'S ESTATE

Citation: REG-118913-21; 87 F.R. 24918-24923, 4/27/22

In proposed regulations, the IRS sought to block potential methods that might be used to extend the increased basic exclusion amount should it be allowed to drop back to a lower level after the end of 2025.[34]

The IRS had previously released what have been referred to as *anti-clawback* regulations in 2019. The regulations sought to prevent an estate from facing a tax bill if the basic exclusion amount (BEA) drops below amounts that have been gifted during life that were covered by the BEA applicable at the time of the gift, when the BEA has now dropped below the amount of those gifts. The regulations explain this as follows:

> On November 26, 2019, the Treasury Department and the IRS published final regulations under section 2010 (TD 9884) in the Federal Register (84 FR 64995) to address situations described in section 2001(g)(2) (final regulations). The final regulations adopted §20.2010-1(c), a special rule (special rule) applicable in cases where the credit against the estate tax that is attributable to the BEA is less at the date of death than the sum of the credits attributable to the BEA allowable in computing gift tax payable within the meaning of section

[34] REG-118913-21; 87 F.R. 24918-24923, April 27, 2022, https://www.taxnotes.com/research/federal/proposed-regulations/proposed-regs-limit-application-of-higher-basic-exclusion-amount/7df65 (retrieved July 27, 2022)

> 2001(b)(2) with regard to the decedent's lifetime gifts. In such cases, the portion of the credit against the net tentative estate tax that is attributable to the BEA is based on the sum of the credits attributable to the BEA allowable in computing gift tax payable regarding the decedent's lifetime gifts. The rule ensures that the estate of a donor is not taxed on completed gifts that, as a result of the increased BEA, were free of gift tax when made.[35]

However, the IRS was aware that it might be possible to use that special rule to make certain gifts during the period a higher BEA applied, but retain significant benefits past the date the new lower BEA took effect. To attempt to stop taxpayers from arranging transactions to make gifts with significant retained level of control to continue to benefit from the higher BEA the IRS has now issued these proposed changes:

> The preamble to the final regulations stated that further consideration would be given to the issue of whether gifts that are not true inter vivos transfers, but rather are includible in the gross estate, should be excepted from the special rule, and that any proposal addressing this issue would benefit from notice and comment.[36]

Proposed Effective Date

The proposed regulations provide for the following effective date:

> Once these regulations have been published as final regulations, it is proposed that these regulations be applicable to the estates of decedents dying on or after April 27, 2022. The special rule will not be needed until the basic exclusion amount has been decreased by statute; under current law, that is scheduled to occur for the estates of decedents dying after 2025. However, if such a decrease is enacted on or after April 27, 2022, but before the issuance of final regulations, the best way to ensure that all estates will be subject to the same rules is to make this proposed exception to the special rule applicable to the estates of decedents dying on or after April 27, 2022.[37]

Items Subject to the Special Rule

The regulations provide that the increase in the BEA under the special rule of Reg. §20.2010-1(c) does not apply to transfers includible in the gross estate, or treated as includible in the gross estate for purposes of IRC §2001(b). Such transfers will include, without limit, the following transfers:

- Transfers includible in the gross estate pursuant to section 2035, 2036, 2037, 2038, or 2042, regardless of whether all or any part of the transfer was deductible pursuant to section 2522 or 2523;

[35] REG-118913-21; 87 F.R. 24918-24923, April 27, 2022, Supplementary Information, Background

[36] REG-118913-21; 87 F.R. 24918-24923, April 27, 2022, Supplementary Information, Background

[37] REG-118913-21; 87 F.R. 24918-24923, April 27, 2022, Supplementary Information, Background

- Transfers made by an enforceable promise to the extent they remain unsatisfied as of the date of death;

- Transfers described in Regs. §25.2701-5(a)(4) (Section 2701 interest) or §25.2702-6(a)(1) (indirect holding of interests under Section 2701); or

- Transfers that would have been described in the prior three bullets but for the transfer, relinquishment, or elimination of an interest, power, or property, effectuated within *18 months* of the date of the decedent's death by the decedent alone, by the decedent in conjunction with any other person, or by any other person.[38]

Note that the regulation provides that the affected items *includes* those specific items. Thus, the list is not meant to be taken as an exclusive list of what would be covered by this rule. So if Congress adds other provisions to the law that are similar in nature, they would be caught by this rule even if the IRS doesn't update the regulation.

However, the *special rule* (expansion of the BEA) will continue to apply to the following transactions (so they are exempted from the new rules meant to limit the applicability of the special rule):

- Transfers includible in the gross estate in which the value of the taxable portion of the transfer, determined as of the date of the transfer, was 5 percent or less of the total value of the transfer (a *de minimis* rule); and

- Transfers, relinquishments, or eliminations described in the last bullet point of the previous list effectuated by the termination of the durational period described in the original instrument of transfer by either the mere passage of time or the death of any person.[39]

The 18 month rule does provide for an option to terminate such interests if it becomes clear the donor is likely to pass away in the near, but not too near, future. However, it is clear this step would need to be taken to allow enough time for 18 months to pass before the decedent passed away, something that obviously can't be assured at the time the interest is terminated. But it is important to note that 18 months is a shorter period than the three years that otherwise would apply to certain of these transactions to bring them back into the decedent's estate.

IRS Examples of Applying the Proposed Regulations

The IRS provides the following examples of applying the newly proposed regulations:

EXAMPLE 1, REG. §20.2010-1(C)(3)(III)

Individual A made a completed gift of A's promissory note in the amount of $9 million. The note remained unpaid as of the date of A's death. The assets that are to be used to satisfy the note are part of A's gross estate, with the result that the note is treated as includible in the gross estate for purposes of section 2001(b) and is not included in A's adjusted taxable gifts.

---

[38] Proposed Reg. §20.2010-1(c)(3)(i)

[39] Proposed Reg. §20.2010-1(c)(3)(ii)

Because the note is treated as includible in the gross estate and does not qualify for the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section, the exception to the special rule found in paragraph (c)(3) of this section applies to the gift of the note. The credit to be applied for purposes of computing A's estate tax is based on the $6.8 million basic exclusion amount as of A's date of death, subject to the limitation of section 2010(d). The result would be the same if A or a person empowered to act on A's behalf had paid the note within the 18 months prior to the date of A's death.

EXAMPLE 2, REG. §20.2010-1(C)(3)(III)

Assume that the facts are the same as Example 1 except that A's promissory note had a value of $2 million and, on the same date that A made the gift of the promissory note, A also made a gift of $9 million in cash. The cash gift was paid immediately, whereas the $2 million note remained unpaid as of the date of A's death. The assets that are to be used to satisfy the note are part of A's gross estate, with the result that the note is treated as includible in the gross estate for purposes of section 2001(b) and is not included in A's adjusted taxable gifts. Because the $2 million note is treated as includible in the gross estate and does not qualify for the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section, the exception to the special rule found in paragraph (c)(3) of this section applies to the gift of the note. On the other hand, the $9 million cash gift was paid immediately, and no portion of that gift is includible or treated as includible in the gross estate. Because the amount allowable as a credit in computing the gift tax payable on A's $9 million cash gift exceeds the credit based on the $6.8 million basic exclusion amount allowable on A's date of death, the special rule of paragraph (c) of this section applies to that gift. The credit to be applied for purposes of computing A's estate tax is based on a basic exclusion amount of $9 million, the amount used to determine the credit allowable in computing the gift tax payable on A's $9 million cash gift.

EXAMPLE 3, REG. §20.2010-1(C)(3)(III)

Assume that the facts are the same as in Example 1 except that, prior to A's gift of the note, the executor of the estate of A's predeceased spouse elected, pursuant to §20.2010-2, to allow A to take into account the predeceased spouse's $2 million DSUE amount. Assume further that A's promissory note had a value of $2 million on the date of the gift, and that A made a gift of $9 million in cash a few days later. The cash gift was paid immediately, whereas the $2 million note remained unpaid as of the date of A's death. The assets that are to be used to satisfy the note are part of A's gross estate, with the result that the note is treated as includible in the gross estate for purposes of section 2001(b) and is not included in A's adjusted taxable gifts. Because A's DSUE amount was sufficient to shield the gift of the note from gift tax, no basic exclusion amount was applicable to the $2 million gift pursuant to paragraph (c)(1)(ii)(A) of this section and the special rule of paragraph (c) of this section does not apply to that gift. On the other hand, the $9 million cash gift was paid immediately, and no portion of that gift is includible or treated as includible in the gross estate. Because the amount allowable as a credit in computing the gift tax payable on A's $9 million cash gift exceeds the credit based on the $6.8 million basic exclusion amount allowable on A's date of death, the special rule of paragraph (c) of this section applies to that gift. The credit to be applied for purposes of computing A's estate tax is based on A's $11 million applicable exclusion amount, consisting of the $2 million DSUE amount plus the $9 million amount

used to determine the credit allowable in computing the gift tax payable on A's $9 million cash gift.

EXAMPLE 4, REG. §20.2010-1(C)(3)(III)

Individual B transferred $9 million to a grantor retained annuity trust (GRAT), retaining a qualified annuity interest within the meaning of §25.2702-3(b) of this chapter valued at $8,550,000. The taxable portion of the transfer valued as of the date of the transfer was $450,000. B died during the term of the GRAT. The entire GRAT corpus is includible in the gross estate pursuant to §20.2036-1(c)(2). Because the value of the taxable portion of the transfer was 5 percent or less of the total value of the transfer determined as of the date of the gift, the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section is met and the exception to the special rule found in paragraph (c)(3) of this section does not apply to the gift. However, because the total of the amounts allowable as a credit in computing the gift tax payable on B's post-1976 gift of $450,000 is less than the credit based on the $6.8 million basic exclusion amount allowable on B's date of death, the special rule of paragraph (c) of this section does not apply to the gift. The credit to be applied for purposes of computing B's estate tax is based on the $6.8 million basic exclusion amount as of B's date of death, subject to the limitation of section 2010(d).

EXAMPLE 5, REG. §20.2010-1(C)(3)(III)

Assume that the facts are the same as in Example 4 except that B's qualified annuity interest is valued at $8 million. The taxable portion of the transfer valued as of the date of the transfer was $1 million. Because the value of the taxable portion of the transfer was more than 5 percent of the total value of the transfer determined as of the date of the gift, the 5 percent de minimis rule in paragraph (c)(3)(ii)(A) of this section is not met and the exception to the special rule found in paragraph (c)(3) of this section applies to the gift. The credit to be applied for purposes of computing B's estate tax is based on the $6.8 million basic exclusion amount as of B's date of death, subject to the limitation of section 2010(d).

EXAMPLE 6, REG. §20.2010-1(C)(3)(III)

Assume that the facts are the same as in Example 4 except that B's qualified annuity interest is valued at $2 million. The taxable portion of the transfer valued as of the date of the transfer was $7 million. B survived the term of the GRAT. Because B survived the original unaltered term of the GRAT, no part of the value of the assets transferred to the GRAT is includible in B's gross estate, and the exception to the special rule found in paragraph (c)(3) of this section does not apply to the gift. Moreover, because the amount allowable as a credit in computing the gift tax payable on B's $7 million gift exceeds the credit based on the $6.8 million basic exclusion amount allowable on B's date of death, the special rule of paragraph (c) of this section applies to the gift. The credit to be applied for purposes of computing B's estate tax is based on a basic exclusion amount of $7 million, the amount used to determine the credit allowable in computing the gift tax payable on B's transfer to the GRAT.

EXAMPLE 7, REG. §20.2010-1(C)(3)(III)

Individual C transferred $9 million to a grantor retained income trust (GRIT), retaining an income interest valued at $0 pursuant to section 2702(a)(2)(A). The taxable portion of the transfer valued as of the date of the transfer was $9 million. C died during the term of the GRIT. The entire GRIT corpus is includible in C's gross estate pursuant to section 2036(a)(1) because C retained the right to receive all of the income of the GRIT. Because the transferred assets are includible in the gross estate and do not qualify for the 5 percent de minimis rule

in paragraph (c)(3)(ii)(A) of this section, the exception to the special rule found in paragraph (c)(3) of this section applies to the gift. The credit to be applied for purposes of computing C's estate tax is based on the $6.8 million basic exclusion amount as of C's date of death, subject to the limitation of section 2010(d).

SECTION: 6011
IRS PROVIDES DATE FOR WHEN MEF WILL BE AVAILABLE TO FILE S CORPORATION SCHEDULES K-2 AND K-3

Citation: Schedules K-2 and K-3 Frequently Asked Questions (Forms 1065, 1120S, and 8865), April 27, 2022 update, IRS website, 4/27/22

The IRS has updated information in Question 7 in "Schedules K-2 and K-3 Frequently Asked Questions (Forms 1065, 1120S, and 8865)" found on the IRS website.[40] The question now discloses that the electronic filing version of the 1065 Schedules became available on March 20 and that the S corporation electronic filing option will be available on July 24, 2022. As well, the question indicates that taxpayers may use the PDF attachment filing option for the entire 2022 filing season.

The revised question and answer now reads:

> **7. May these schedules be filed electronically and what is the timeline? (updated April 27, 2022)**
>
> Yes, these schedules are currently available to be electronically submitted. However, Modernized e-File (MeF)/Extensible Markup Language (XML) electronic filing capability for the schedules K-2 and K-3 for tax year 2021 will not be available as of the beginning of the 2022 filing season (January 2022). The timeline for the MeF/XML filing capability is provided below. The MeF/XML filing capability for the Form 1065 was available starting on March 20, 2022. If you electronically file your return before the time frames, submit the schedules as separate PDF files attached to the return. Taxpayers will also be able to file their Schedules K-2 and K-3 via PDF attachments for the entire 2022 filing season.

Form Number	Date Available
Form 1065, Schedules K-2 and K-3	March 20, 2022
Form 1120-S, Schedules K-2 and K-3	July 24, 2022

---

[40] "Schedules K-2 and K-3 Frequently Asked Questions (Forms 1065, 1120S, and 8865)", IRS website, April 27, 2022 version, https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865 (retrieved April 28, 2022)

Form Number	Date Available
Form 8865, Schedules K-2 and K-3	January 2023