Current Federal Tax Developments

Week of July 18, 2022

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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JULY 18, 2022
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Keefer v. United States, USDC ND TX, Case No. 3:20-cv-00836, 7/6/22

In the case of *Keefer v. United States*, USDC ND TX,[1] a taxpayer was denied a deduction for a contribution on two separate grounds. First, the Court found that the taxpayers had failed to give away the entire asset in question, resulting in an anticipatory assignment of income and, second, the taxpayers did not obtain a proper contemporary written acknowledgment of the contribution.

The Facts of the Case

The case involves the donation of an interest in a limited partnership. The opinion begins with the following facts:

> In 2015, when the events giving rise to this suit occurred, Burbank was a limited partnership existing for the purpose of owning and operating a single hotel property ("the Hotel"). See Doc. 66, Appraisal, 50, 54. Kevin was a limited partner in Burbank. Doc. 15, Am. Compl., ¶ 7; Doc. 69-5, Assignment Int., 19.
>
> On April 23, 2015, Burbank and Apple Hospitality REIT ("Apple"), exchanged a nonbinding letter of intent ("LOI") for a deal that included Apple's purchase of the Hotel.1 Doc. 66, Appraisal, 54; see Doc. 69-1, Keefer Dep., 11, 47. Burbank did not sign the LOI but continued negotiating for the Hotel's sale. Doc. 66, Appraisal, 54. Burbank was also considering other offers for the Hotel. Id. at 54–55; see Doc. 69-1, Keefer Dep., 11, 47. On June 18, 2015, Kevin assigned a 4% limited partner interest in Burbank to Pi for the purpose of establishing a donor advised fund ("DAF") at Pi. Doc. 69-5, Assignment Int., 19–20. As of that date, "[Burbank] had tentatively agreed on the sale of [the Hotel to Apple] for $54 million, but the contract for sale had not been signed and Apple had not conducted its review of the property and records." Doc. 66, Appraisal, 54; see Doc. 69-1, Keefer Dep., 11. On July 2, 2015, Burbank and Apple signed a

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[1] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/couple-can't-deduct-donation%2c-not-entitled-to-refund/7dmkd?h=Keefer (retrieved July 16, 2022)

> contract for Apple to purchase the Hotel for $54 million. Doc. 69-4, Purchase Contract, 48–55; Doc. 69-5, Purchase Contract, 1; Doc. 66, Appraisal, 54. The contract provided for a 30-day review period for [Apple] to evaluate the property. Doc. 69-4, Purchase Contract, 54. The sale closed on August 11, 2015. Doc. 69-5, Closing Statement, 7–8.[2]

The opinion describes the appraisal the taxpayers commissioned to provide the value of the donation:

> To substantiate the donation, the Keefers' tax advisor commissioned an appraisal of the donated partnership interest as of June 18, 2015 ("the Appraisal"). See Doc. 66, Appraisal, 50–56. The Appraisal was performed by Katzen, Marshall & Associates, Inc. ("KM") and was prepared and signed by David Marshall ("Marshall"), a Principal of that firm. Id. at 56, 60. It included an appraiser's certification and a description of Marshall's qualifications but did not include either Marshall's or KM's tax identification numbers. See id. at 58–61. Additionally, the Appraisal included a section titled "Partnership Agreement," setting out "[c]ertain provisions of the [Burbank Partnership] Agreement[,]" including that agreement's definition of "Available Cash Flow" and the schedule for "Distribution of Available Cash Flow." Id. at 52–53.[3]

The appraisal noted an additional agreement that was part of the donation:

> The Appraisal indicated that its "purpose [was] estimating the fair market value of a 4.000% limited partnership interest, subject to an oral agreement, . . . in Burbank . . ., owned by Kevin." Id. at 50. Attached to the Appraisal was a "STATEMENT OF LIMITING CONDITIONS" describing the referenced oral agreement as follows:
>
>> [KM] ha[s] been informed that the Donor and Donee have an agreement that the Donee will only share in the next proceeds from the Seller's Closing Statement. The Donee will not share in Other Assets of the Partnership not covered in the sale.
>
> *Id*. at 57.[4]

[2] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[3] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[4] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

The appraisal came to the following conclusion:

> After describing its method for calculating the donated asset's value, the Appraisal concluded that $1,257,000 "reasonably represent[ed] the fair market value, excluding Other Assets of the Partnership, of a 4.000% Limited Partnership Interest in Burbank . . . as of June 18, 2015," with "[a]ll estimates of value . . . subject to the attached Statement of Limiting Conditions and Appraisers' Certification." Id. at 56. The Appraisal indicated that "[Kevin] stated that at the Valuation Date, he was not aware of any material fact or condition that would . . . derail the sale . . . [and that] the Partnership had a second bidder at essentially the same price." Id. at 55. The Appraisal estimated a "5% probability of no sale." *Id*

The taxpayers claimed a charitable deduction for the donation on their 2015 income tax return:

> In October 2016, the Keefers "timely filed their joint federal income tax return (Form 1040) for the year 2015." Doc. 15, Am. Compl., ¶ 9. "[They] deducted the Pi charitable contribution of $1,257,000 from income in their 2015 return on Schedule A." Id. Attached to the Form 1040 was Form 8283, signed by Marshall and listing KM's tax identification number. See Doc. 66, Claim for Refund, 29, 31; Doc. 66, Form 8283, 36. Also attached were the Appraisal, the DAF Packet, and the Acknowledgment Letter. See Doc. 66, Claim for Refund, 29, 31; Doc. 66, IRS Checklist, 66–71.[5]

The IRS would examine the return and would seek to disallow the deduction:

> In late July or early August of 2019 "the IRS sent plaintiffs [an examination report and] a Notice of Deficiency for the year 2015 [(collectively, 'the IRS Notice')] . . . disallow[ing the] 2015 charitable contribution to Pi, and thereby increas[ing] plaintiffs' 2015 tax by $423,304.00, along with penalties or additions of $84,660.80 plus accruing interest." Doc. 15, Am. Compl., ¶ 10; Doc. 66, IRS Notice, 4–22. The IRS Notice stated in relevant part:
>
>> It has not been established that the Taxpayers are entitled to deduct a charitable contribution in the amount of $1,257,000, [because] they did not have [a contemporaneous written acknowledgment ("CWA")] from the donee organization showing that the donor advised fund "has exclusive legal control over the assets contributed" and their

[5] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> appraisal did not include the identifying number of the appraiser. Therefore, this deduction is not allowable.

Id. at 7.[6]

The taxpayers paid the amount of taxes and interest per the IRS assessment and then filed a claim for refund, which the IRS disallowed. The taxpayers then filed suit for refund in U.S. District Court.

The two questions that eventually decided the outcome in the case were:

- Did the agreement limiting the charity's interest to only sharing in the proceeds of the sale amount to an anticipatory assignment of income that would serve to bar the deduction? And
- Were the two documents the taxpayers submitted as their acknowledgment sufficient to meet the requirements found in IRC §170(f)(8) (the general acknowledgment rules) and (18) (special acknowledgment rules for contributions to donor advised funds)?

Anticipatory Assignment of Income

The IRS argued that the contribution made just before the sale was to close amounted to an anticipatory assignment of income from that sale, thus requiring the taxpayer to recognize the income from the sale rather than merely getting a charitable contribution deduction for the value of this noncash asset (the interest in the partnership).

The opinion outlines the two criteria looked at in the *Humacid* case to determine if a contribution is an anticipatory assignment of income:

> "Per *Humacid Co. v. Commissioner*, 42 T.C. 894, 913 (1964), [courts will] respect the form of [a donation of appreciated stock shares] if the donor (1) gives the property away absolutely and parts with title thereto (2) before the property gives rise to income by way of a sale." *Dickinson v. Comm'r*, 2020 WL 5249242, at *3 (T.C. Sept. 3, 2020) (first citing *Grove v. Comm'r*, 490 F.2d 241, 246 (2d Cir. 1973); then citing *Carrington v. Comm'r*, 476 F.2d 704, 708 (5th Cir. 1973); then citing *Behrend v. United States*, 1972 WL 2627, at *3 (4th Cir. 1972); and then citing *Rauenhorst v. Comm'r*, 119 T.C. 157, 162–163 (2002)).[7]

While the Court disagreed with the IRS's view that the sale was in such a state at the time of the transfer of the interest that the transfer was after the property gave rise to the

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[6] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[7] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

income, but agreed with the IRS that the interest retained by the taxpayers meant they had not given the property away absolutely and parted with the title.

On the first issue, the IRS was attempting to get the court to find that the sale was a done deal even though there was not yet a binding obligation for the sale to go forward at the time of the transfer. The Court notes:

> In a few cases, courts have extended this doctrine to situations where the stock's redemption was so imminent and certain that "the shareholder's corresponding right to income had already crystallized at the time of the gift." *Dickinson*, 2020 WL 5249242, at *3 (emphasis omitted) (citing *Palmer v. Comm'r*, 62 T.C. 684, 694–95 (1974)); see *Ferguson v. Comm'r*, 174 F.3d 997, 1001–02 (9th Cir. 1999). These courts have generally drawn the line where the corporation's shareholders or directors have already voted to redeem shares, creating a "binding obligation" of redemption. See Dickinson, 2020 WL 5249242 at *3. But the Ninth Circuit has extended this principle to situations where, considering the facts and circumstances of a particular deal, redemption is "practically certain to proceed" without a binding obligation. See id. at *3 n.2 (quoting *Ferguson*, 174 F.3d at 1004).[8]

Specifically, the IRS wanted this Texas District Court to apply the Ninth Circuit's standard outlined in the *Ferguson* case to this fact pattern:

> The Government urges this Court to follow the Ninth Circuit's more expansive approach, as set out in *Ferguson*, in applying *Humacid* to this limited partnership interest. Doc. 68, Gov't's Br., 17. In *Ferguson*, a taxpayer donated shares of appreciated stock during an open tender offer window preceding a proposed merger. 174 F.3d at 998–1000. "[T]he tender offer, and hence the merger agreement, was conditioned on the . . . [tender] of at least 85% of the outstanding shares . . . by the expiration date of the tender offer. . . . However, this minimum tender condition was waivable at the sole discretion of [the acquiring company]." *Id*. at 999. As of the date the taxpayer assigned the shares, with "over one week remaining in the tender offer window," "over 50% of the outstanding . . . shares had been tendered, . . . [which the Tax Court found] was sufficient to ensure that [the acquiring company] would accept the tendered stock and thus unilaterally could and would proceed with the merger." *Id*. at 1004. The Tax Court therefore found this was an anticipatory assignment of the redemption income. *Id*. The Ninth Circuit affirmed the Tax Court's ruling that the anticipatory assignment doctrine applied, finding that the acquiring company's duty to consummate the merger had not been

[8] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> triggered as of the assignment date because the 85% tender threshold had not yet been satisfied, but that given the "momentum" of the deal and the interests of all the parties the merger was "most unlikely" to fail. Id. at 1005–1006.[9]

The Texas District Court was not bound by this Ninth Circuit precedent, since an appeal of this decision would be heard by the Fifth Circuit Court of Appeals, so the IRS was hoping this court would find the Ninth Circuit ruling persuasive even if the Court did not have to follow it.

But the District Court rejected the Ninth Circuit's analysis:

> The Court declines to extend the *Ferguson* approach to the real estate transaction at issue here. The uncontroverted evidence shows that the Keefers executed the agreement to assign the partnership interest to Pi on June 18, 2015. Doc. 69-5, Assignment Int., 19–20. The partnership executed the contract for sale of the Hotel on July 2, 2015. Doc. 69-4, Purchase Contract, 48–55; Doc. 69-5, Purchase Contract, 1–2. So, at the time of the assignment on June 18, 2015, the Hotel was not even under contract. And while Apple had sent an LOI to Burbank before that date, the LOI was nonbinding and was never signed by Burbank. Doc. 66, Appraisal, 54; see Doc. 69-1, Keefer Dep., 11; Doc. 69-1, LOI, 47–49. Moreover, even after the contract with Apple was signed, it provided Apple a 30-day review period. Doc. 69-4, Purchase Contract, 54. Until that review period elapsed, Apple had no binding obligation to close and the deal was not "practically certain" to go through. See *id.*[10]

Thus, the Court concludes that the transfer satisfied the second *Humacid* prong:

> Under these circumstances, the Partnership's right to the income from the Hotel sale had not yet vested when the Keefers assigned the interest to Pi. Thus, the pending sale — even if very likely to occur considering the presence of backup offers and as reflected in the appraiser's estimate that the risk of no sale was only 5% — does not render this donation an anticipatory assignment of income. See Doc. 66, Appraisal, 55; cf. *Caruth Corp.*, 865 F.2d at 649 ("The IRS . . . makes recourse to Justice Holmes['s] metaphor, and urges that we hold *Caruth* taxable upon the dividend because here the fruit was exceptionally ripe. . . . We fail to see why the ripeness of the fruit

[9] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[10] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> matters, so long as the entire tree is transplanted before the fruit is harvested.").[11]

But the last part of the final quoted sentence would prove to create problems for the first prong—the Court found that, in fact, the entire tree was not transplanted. Rather, the taxpayer retained all interests except the interest in the sales proceeds, which amounted to an effective assignment of the income only.

> However, the Court must still consider the first Humacid prong: whether by assigning the 4% interest "subject to an oral agreement" the Keefers "carve[d] . . . a partial interest out of the [assigned] asset." See *Salty Brine I, Ltd, v. United States*, 761 F.3d 484, 491 (5th Cir. 2014). If so, then they retained that partial interest in the asset after the assignment and the anticipatory assignment of income doctrine would apply, as the whole asset was not transferred before the Hotel sale closed on August 11, 2015. See *id.*; Doc. 69-2, Closing Statement, 20–21. In other words, reverting to Justice Holmes's metaphor, did the Keefers transplant the whole tree on June 18, 2015, when Kevin assigned the interest to Pi? See *Caruth Corp*., 865 F.2d at 649.[12]

The taxpayers argued that the oral agreement did not represent an impermissible retained interest. As the Court explained:

> The Keefers explain that "before Kevin . . . transferred the 4% partnership interest to Pi, the partnership owed money to the pre-existing partners for pre-donation earnings that had not been distributed to those pre-existing partners . . . because the partnership, as the owner of the [H]otel, was required . . . to maintain a certain amount of cash reserves . . . to comply with . . . loan and franchise obligations." Doc. 71, Pls.' Resp., 14. Kevin testified that the "oral agreement" referenced in the Appraisal was an agreement between the pre-assignment partners:
>
>> [T]he general partner had made the decision that [the reserve accounts] — since those were amounts withheld from earnings prior to the date of the gift, that the general partner was going to distribute that to the partners in their percentage of ownership prior to that date of the gift. It was his opinion and responsibility to pay those reserves in to the partners from the — where the earnings had been prior to — held back prior to the June 18th. The — what I told the Pi Foundation is we were going to distribute those reserves to a number of re — effectively a distribu — a liability at the time of the transfer to

[11] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[12] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> the partners. And they had — they acknowledged what we were doing and how we were gonna treat it, and so we were sure that the [appraisal] valuation was done that way. So that's what — I consider it an oral agreement in how we were treating that. We treated it as a liability at the time of the transaction, so all those reserves were distribution to the partners prior to June 135 [sic], that we had a liability to pay them, and that's why they weren't included in the valuation.
>
> Doc. 69-1, Keefer Dep., 30.

> The cash reserves in question, Kevin testified, were reflected on the partnership's balance sheet as "equipment reserves" and "working capital reserves." Id. at 32. The reason for keeping these reserves, which had been "reserved from the distributions that [the partnership had] been making from the partners," was so "if the [H]otel sale didn't go through [the partnership] would have the money to [make future renovations to the Hotel as required by the franchise agreement] because the Pi Foundation could not obviously contribute capital for the renovation," he testified. Id. at 34. So, if the Hotel sale occurred and the renovations would not be required "those reserves [would be released as] accrued distribution to those partners prior to the Pi Foundation being admitted." Id. However, Kevin testified that the franchise agreement did not require such cash reserves; they were reserved at the discretion of the general partner. Id. In sum, the Keefers argue that "[t]he partnership's payment of pre-existing liability to its pre-existing partners is not a 'carving out' from the 4% partnership interest to Pi any more than the partnership paying a liability for a pre-existing light bill is a 'carving out' from some partnership interest." Doc. 74, Pls.' Reply, 4.[13]

The IRS argued that the taxpayers' own appraisal noted that they had not given away the entire partnership interest:

> The Government responds that "the Keefer's [sic] own appraisal that takes into account their side oral agreement . . . shows that they did not donate a true partnership interest . . . [but] g[a]ve away 4% of the net cash from the sale of one of the Partnership's assets . . . cash the Keefers would have otherwise received from the sale of the [H]otel. This is the classic assignment of income." Doc. 73, Gov't's Reply, 7–8.[14]

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[13] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[14] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

The opinion sides with the Government on this issue based on the details of the oral agreement provided by the taxpayers and their own appraisal:

> According to Kevin's testimony, the "reserve accounts" were funds that the general partner chose to maintain for compliance with "loan and franchise agreements" and that had been withheld from partner distributions at the discretion of the general partner. See Doc. 69-1, Keefer Dep., 30, 32, 34. Per his testimony, they were not liabilities like a pre-existing light bill. See id. Instead, they were a reserve of cash held back to address future potential liabilities. See id.
>
> Thus, as described by Kevin, the cash reserves fall within the Partnership Agreement's definition of "Available Cash Flow," which is set forth in the Appraisal. See Doc. 69-1, Appraisal, 207 (defining "Available Cash Flow" to include "any other funds, including, but not limited to, amounts previously set aside as reserves by the General Partner, deemed advisable in the discretion of the General Partner, for distribution as cash flow"). And per the Appraisal's recitation of the Partnership Agreement's provisions, "Available Cash Flow, if any, in each calendar quarter of a partnership year shall be allocated to and distributed among the Partners pro rata . . . at such time as the General Partner determines, but in no event later than thirty (30) days after the close of such calendar quarter of the Partnership year." *Id*. at 208. As Marshall noted: "The Agreement provides that available cash flow shall be distributed to the Partners." Id. at 209.
>
> By contrast, the Appraisal indicates that, pursuant to the "oral agreement," the interest donated to Pi would not be subject to the Partnership Agreement's Available Cash Flow provisions but to an alternative arrangement:
>
>> On June 18th, 2015, the donor transferred a 4.000% limited partnership interest in the Partnership to the Pi Foundation. By oral agreement, the Foundation and Donor agreed that the Foundation *would only share in the proceeds from Seller's Closing Statement; the Foundation would not receive its pro rata share in other net assets of the Partnership*.
>>
>> *Id*. at 209 (emphasis added).
>
> Regarding this oral agreement, Kevin testified that upon the Hotel's sale, the partnership intended to take the sale proceeds, deduct the reserve funds from the proceeds and pay them out in shares to the pre-June 18 partners but not to Pi, and then disburse to Pi its 4% share of the remaining net proceeds. See id. He also testified that the donated

> interest as described in the Appraisal "is what [Pi] received." Doc. 69-1. Keefer Dep., 35.[15]

The Court concludes that the agreement described above clearly meant that less than the entire interest was transferred to the charity:

> Based on this evidence, the Court finds that no genuine issue of material fact exists as to whether the Keefers carved out a portion of the 4% partnership interest before donating it to Pi. They did. After the assignment, Pi did not have the right that other partners had to share in a distribution of Available Cash Flow as described in the Partnership Agreement, but only had a right to share in the net proceeds of the Hotel sale. See *id*. at 35; Doc. 69-1, Appraisal, 209 (noting that "the Foundation would only share in the proceeds from Seller's Closing Statement; the Foundation would not receive its pro rata share in other net assets of the Partnership"). Or, in the unlikely event the Hotel sale had not been completed as planned, Pi would not have shared equally with the other limited partners in the duty to contribute funds for renovation, should additional funds be required to fulfill the partnership's obligations under the loan or franchise agreements. See Doc. 69-1, Keefer Dep., 34 (noting that the pre-assignment reserves were needed because "the Pi Foundation could not obviously contribute capital for the renovation"). Reflecting this carve out, the Appraisal calculated a lower value for the donated interest than for a full 4% interest in all of the partnership's assets. Doc. 69-9, Appraisal, 594 ("All assets not included in the $54 million [sale price] have been excluded."); id. at 595 (calculating 4% of net sale proceeds without reserves). Accordingly, the Keefers did not donate their full 4% partnership interest on June 18, 2015, but donated only a portion thereof. They did not transplant the *whole* tree.[16]

Thus, no deduction would be allowed for this contribution, as it amounted to an anticipatory assignment of income.

Contemporaneous Written Acknowledgment Issue

Although the refund claim was doomed by the finding that the transfer was an anticipatory assignment of income, the Court also found that the lack of a proper contemporaneous written acknowledgment (CWA) also would prove fatal to this refund claim.

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[15] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[16] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

The opinion describes the general CWA rules found at IRC §170(f)(8):

> Section 170(f)(8) provides that a charitable deduction "for any contribution of $250 or more" shall not be allowed "unless the taxpayer substantiates the contribution by a [CWA] of the contribution by the donee organization that meets the requirements of subparagraph (B)." 26 I.R.C. §170(f)(8)(A). Subparagraph B requires in relevant part that a CWA state: (1) "The amount of cash and a description (but not value) of any property other than cash contributed"; and (2) "Whether the donee organization provided any goods or services in consideration, in whole or in part, for [the donated property.]" Id. § 170(f)(8)(B)(i–ii). [17]

The charity receiving this donation was a donor advised fund. Such donations are subject to additional requirements found at IRC §170(f)(18):

> A donation to a donor advised fund must also comply with § 170(f)(18), which requires:
>
> > A deduction . . . for any contribution to a donor advised fund . . . shall only be allowed if . . . the taxpayer obtains a [CWA](determined under rules similar to the rules of paragraph (8)(C)) from the sponsoring organization. . . of such donor advised fund that such organization has exclusive legal control over the assets contributed.
> >
> > *Id.* § 170(f)(18). [18]

Finally, the Court notes that taxpayers must strictly comply with these statutory requirements—substantial compliance is not sufficient when dealing with statutory requirements.

> Importantly, "[t]he doctrine of substantial compliance does not apply to excuse compliance with the substantiation requirements of section 170(f)(8)(B*)." Averyt v. Comm'r*, 2012 WL 2891077, at *4, (T.C. July 16, 2012) (citing *Durden v. Comm'r*, 2012 WL 1758655, at *4 (T.C. May 17, 2012)). Strict compliance is required. See *id.*[19]

The taxpayers claimed the two documents they provided complied with all applicable CWA requirements:

> The Keefers claim that they obtained a statutorily compliant CWA, including Pi's acknowledgment that it had full and exclusive legal

[17] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[18] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[19] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> control over the donated property. Doc. 65, Pls.' Br. Am. Mot., 16. They assert that "PI prepared two documents[,] . . . [the] one page [Acknowledgment Letter] dated [September 9]6, 2015, signed by the Executive Director of PI saying PI received the 'donation' and that '[n]o goods or services were provided in exchange' . . . [and the] 12 page [DAF Packet] also on PI letterhead dated June 8, 2015" (collectively, "the Pi Documents"), containing additional terms of the agreement. *Id*. The Pi Documents, collectively, are a statutorily sufficient CWA, the Keefers argue. Id. at 16–19. They argue that the Acknowledgment Letter, which satisfies § 170(f)(8), is supplemented by the DAF Packet, which proves that Pi exercised exclusive legal control over the property after the donation and therefore satisfies § 170(f)(18). *Id*.; Doc. 71, Pls.' Resp., 24.[20]

The IRS presents a number of objections, arguing that the Keefers failed to provide the required CWA:

> The Government responds with several alternative arguments. First, it contends that multiple documents cannot be combined to constitute a CWA unless the documents contain a merger clause. Doc. 72, Gov't's Resp., 18. But even if they could be, the Government argues neither the DAF Packet nor the Acknowledgment Letter contains a statement that Pi had "exclusive legal control." Doc. 72, Gov't's Resp., 16. The Government argues that this exact language is required to satisfy §170(f)(18). Id. at 17. Or, if this specific language is not required, the Pi Documents "still fail[ ] to show that Pi had exclusive legal control," it maintains, because the DAF Packet does not include a merger clause and the interest was transferred subject to an oral agreement that "could wrestle the purported 'exclusive legal control'" away from Pi and back to the Keefers. Id. at 18.[21]

The Court finds that the June 5 packet must be excluded from consideration as part of the CWA and the September 9 letter standing alone is not sufficient to meet the CWA requirements.

One key problem with the June 5 packet is that it was issued *before* the donation took place on June 18 and at a time when there was no binding legal requirement for the Keefers to make the donation—thus it could not be acknowledging anything, as that implies an event that has already taken place:

> Here, the summary-judgment evidence shows, as a matter of law, that the DAF Packet did not complete the donation or legally obligate Kevin to donate the interest to Pi. While the DAF Packet stated that

[20] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[21] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> "Kevin . . . hereby transfers as an irrevocable gift to [Pi] . . . the [4.00% partnership interest]," Doc. 66, DAF Packet, 38, the actual assignment did not occur when Kevin signed the DAF Packet documents on June 8, but ten days later. Doc. 69-5, Assignment Int. Further, the DAF Packet's cover letter states in relevant part: "It is [Pi's] understanding that you intend to donate to [Pi] 4.00% of interest in Burbank. . . . you agree that if 4.00% of interest in Burbank . . . is not donated to [Pi] for any reason, you will be responsible for paying the [Pi]'s legal fees and costs associated with your anticipated donation." Doc. 69-1, DAF Packet, 84 (emphasis added). This establishes that, by signing the DAF Packet, Kevin was not legally obligated to complete the donation; rather, he was only legally obligated to pay Pi's legal expenses whether the donation occurred or not. See id; Doc. 69-5. Assignment Int. So, the DAF Packet is not a CWA because it did not acknowledge a contribution. See 26 I.R.C. § 170(f)(8)(A).[22]

The Court also found that the packet could not be combined with the letter issued following the actual donation to create a CWA, finding that the cases the taxpayer and the IRS cited did not support the view that the packet could be combined with the letter to form a CWA:

First, the court notes that each of the cases cited involve deeds related to conservation easements:

> *Averyt* and *French* each involved the donation of a conservation easement. In *Averyt*, the court held that a letter acknowledging a conservation easement donation was not a CWA because it did not state what portion of the donation was deductible and (incorrectly) indicated that some benefit was provided to the donor in exchange. See *Averyt*, 2012 WL 2891077, at *4. However, the court found that the conservation easement deed itself was a CWA, even though it did not state that "no goods or services were provided" for the donation:
>
> > [T]he conservation deed was signed by a representative from [the donee organization], provided a detailed description of the property and the conservation easement, and was contemporaneous with the contribution. Additionally, the conservation deed in the instant case states that the conservation easement is an unconditional gift, recites no consideration received in exchange for it, and stipulates that the conservation deed constitutes the entire agreement between the parties with respect to the contribution of the conservation easement. Accordingly, the conservation deed,

[22] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> taken as a whole, provides that no goods or services were received in exchange for the contribution. Consequently, we conclude that . . . the conservation deed in the instant case satisfies the substantiation requirements of section 170(f)(8).
>
> Id. at *5 (emphasis added).

> In *French*, taxpayers who did not receive a contemporaneous letter acknowledging their conservation easement donation similarly attempted to rely on their conservation easement deed as a CWA. *French*, 2016 WL 1160152, at *4. As in *Averyt*, the deed did not state that "no goods and services were received in exchange" for the donation. *Id*. But unlike in *Averyt*, the deed did not contain a merger clause stating that it was the entire agreement between the parties. *Id*. "Without such a provision," the court concluded, "the IRS could not have determined by reviewing the conservation deed whether petitioners received consideration in exchange for the contribution of the conservation easement . . . [and] the conservation deed taken as a whole is insufficient to satisfy section 170(f)(8)(B)(ii)." *Id*. Therefore, the court denied the charitable donation deduction. *Id.*[23]

The Court, noting that these cases merely show that deeds can serve as a CWA and that neither the IRS nor the taxpayers cited any cases expanding these holdings beyond deeds, comments on how they could apply to documents other than deeds:

> If these cases can be applied to documents other than deeds — which by their nature, substantiate a completed transfer of interest — they suggest that a court might consider outside documents to supplement an otherwise-deficient CWA so long as the plain text of the CWA directs and limits the inquiry. Cf. *French*, 2016 WL 1160152, at *4 ("[T]he deed taken as a whole must prove compliance." (emphasis added)); Izen, 148 T.C. at 78; Albrecht, 2022 WL 1664509, at *3 (noting that the court construes "the plain text of the deed"). But see *Irby v. Comm'r*, 139 T.C. 371 (2012).[24]

And here the September 9 letter falls short:

> Here, as discussed above, only the September 9, 2015 Acknowledgment Letter is a CWA on which to base this inquiry. The body of this letter reads in full:
>
> > Thank you for your donation to The Pi Foundation, Inc. of a 4.00% interest in Burbank HHG Hotel, LP. The Pi

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[23] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[24] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> Foundation, Inc., is a 501©(3) nonprofit organization. Your contribution is tax-deductible to the extent allowed by law. No goods or services were provided in exchange for your generous financial donation. Please keep this page for your records.
>
> 69-1, Acknowledgment Letter, 98.

> Critically, the Acknowledgment Letter does not incorporate by reference or otherwise refer to the DAF Packet. See *id*. It does not reference the Keefer DAF at all, state that the donated interest is destined for any DAF, or even state that Pi is a provider of DAFs. See *id.* Therefore, the text of the Acknowledgment Letter does not provide the Court any basis on which to incorporate the DAF Packet's provisions.[25]

Effectively, the Court is agreeing with the IRS that only if this acknowledgment has incorporated the provisions of the packet by explicit reference could the contents of the packet have been considered as part of the CWA.

Thus, the Court finds the taxpayers failed to comply with the requirements of IRC §170(f)(18) for donations to donor advised funds even though the acknowledgment did comply with the general rules of §IRC 170(f)(8):

> So, the Court cannot read the DAF Packet together with the Acknowledgment Letter but must consider whether the Acknowledgment Letter alone proves compliance with each requirement of § 170(f)(8) and (18). As the Keefers admit, their tax advisor testified, and the IRS reviewer noted, the Acknowledgment Letter proves compliance with § 170(f)(8) but does not prove that Pi received exclusive legal control as § 170(f)(18) requires. See Doc. 71, Pls.' Resp., 24 (arguing that the DAF Packet establishes exclusive legal control); Doc. 66, IRS Checklist, 69 (indicating no statement of exclusive legal control); Doc. 69-3, Horowitz Dep., 341 (stating that the one-page CWA was "the acknowledgment required by Section 170(f)(8) of the [C]ode" and the DAF Packet was the acknowledgment issued "[i]n accordance with Section 170(f)(18)"). Therefore, because the Acknowledgment Letter does not reference the Keefer DAF or otherwise affirm Pi's exclusive legal control, as required by § 170(f)(18), the Keefers did not obtain a CWA satisfying each statutory requirement.[26]

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[25] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[26] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

IRC §170(f)(18)(B), Like §170(f)(8), Requires Strict Compliance With the Statute

The Court moves on to consider if IRC §170(f)(18)(B) requires the same strict statutory compliance as IRC §170(f)(8) and concludes that answer is yes.

> The Keefers argue that § 170(f)(18)(B)'s "only requirement is that there be an acknowledgment, in writing, in some form or fashion that acknowledges the fact that the charity has exclusive legal control of the contributed asset . . . after the donation." Doc. 74, Pls.' Reply, 8. But this is not what the Tax Code says. As noted above, § 170(f)(18) provides that:
>
>> A [charitable] deduction . . . for any contribution to a donor advised fund . . . shall only be allowed if . . . (B) the taxpayer obtains a contemporaneous written acknowledgment (determined under rules similar to the rules of paragraph (8)(C)) from the sponsoring organization (as so defined) of such donor advised fund that such organization has exclusive legal control over the assets contributed.
>>
>> 26 I.R.C. § 170(f)(18) (emphasis added).
>
> By its plain text, § 170(f)(18)(B) supplements and cross references the CWA requirements of § 170(f)(8), which require strict compliance. See *Averyt*, 2012 WL 2891077, at *4; *Albrecht*, 2022 WL 1664509, at *2. Therefore, the Court holds that § 170(f)(18)(B) likewise requires strict compliance.[27]

The opinion does not agree with the IRS argument that the specific words "exclusive legal control" must appear in the document—just that the CWA must acknowledge that such control exists:

> However, strict compliance with § 170(f)(18)(B) does not mean that the exact words "exclusive legal control" must appear in the CWA, as the Government argues. See Doc. 68, Gov't's Br., 27. Instead, it means that the CWA must prove that the "organization has exclusive legal control," which might be accomplished without that specific language. Cf. *Schrimsher v. Comm'r*, 2011 WL 1135741, at *2 (T.C. 2011) (quoting H.R. Rep. No. 103–213, at 565 n.32 (1993) (Conf. Rep.) ("The contemporaneous written acknowledgment 'need not take

[27] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

> any particular form' . . . [but] must include [the statutorily required] information.").[28]

But in this case the document falls short of meeting that standard:

> Here, as the Court has explained above, the only CWA the Keefers obtained completely fails to address legal control over the donated property. So, the CWA does not contain the information required by § 170(f)(18)(B). The IRS properly denied the deduction for this reason. See Doc. 66, IRS Checklist, 71 (indicating "not met" as to the exclusive legal control requirement).[29]

SECTION: 6331 COURT REJECTS TAXPAYERS' ARGUMENT THAT COLLECTION STATUTE SHOULD NOT TOLL FOR TIME IRS SPENT PROCESSING THEIR NUMEROUS FLAWED OFFERS-IN-COMPROMISE

United States v. Ward, USDC AK, Case No. 3:21-cv-00056, 7/6/22

In the case of *United States v. Ward*, USDC AK,[30] the taxpayers' attempt to argue that some of the time period the statue for collections was suspended due to the taxpayers filing multiple times for collection relief should be ignored due to defects in those filings made by the taxpayer. The court decided the taxpayers would not be allowed to use their own mistakes to their advantage.

Taxpayers Filings for Relief

The opinion provides the following details on the original assessment dates and the taxpayers' various attempts to obtain collection relief:

> Defendants' 1996 tax deficiency and penalty, plus the Tax Court's additional penalty, were assessed on November 25, 2002. Their 1997 deficiency and penalty were assessed on December 9, 2002. While the statute of limitations would have run out in late 2012, the Government asserts that Defendant-initiated events tolled the IRS's

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[28] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[29] *Keefer v. United States*, USDC ND TX, Case No. 3:20-cv-00836, July 6, 2022

[30] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/court-reduces-couple's-20-year-old-assessments-to-judgment/7dmpy (retrieved July 16, 2022)

collection deadline out to July 2021, a few months after the Government filed suit. The tolling events are as follows:

> (1) Offer-in-Compromise dated 12/27/2002;
>
> (2) Due Process Hearing request dated 7/15/2003;
>
> (3) Offer-in-Compromise dated 3/5/2004;
>
> (4) Offer-in-Compromise dated 12/4/2008;
>
> (5) Due Process Hearing request dated 12/16/2011;
>
> (6) Offer-in-Compromise dated 3/6/2014; and
>
> (7) Offer-in-Compromise dated 9/23/2015.[31]

The key items being disputed are some of the taxpayers' filings for offer-in-compromise relief. The process is explained by the Court as follows:

> A taxpayer files an offer-in-compromise through IRS Form 656, wherein he sets forth an offer to settle a tax debt for less than the assessed amount. An IRS official then decides whether the form is administratively processable and, if so, signs the form. At that time, the statute of limitations tolls while the IRS considers the offer on its merits. The statute of limitations begins to run again 30 days after the IRS makes a final decision about the offer.[32]

None of these attempts to obtain relief were successful. The Court details these various attempts as follows:

> Defendants' first offer-in-compromise argued that the assessments were erroneous. The offer was rejected, and the IRS notified Defendants that it was going to record a lien against their property. In response, Defendants requested a Due Process Hearing with the IRS Office of Appeals as provided for under 26 U.S.C. § 6330. The reviewing appeals officer explained to Defendants' representative that they could not use the § 6330 hearing process to contest a liability already affirmed by the Tax Court. After months of discussions with Defendants' representative, the appeals officer sustained the liens and closed the appeal. However, by that time, Defendants had filed a second offer-in-compromise. For this offer, Defendants requested a reduced payment for reasons based on "effective tax administration," which means when the debtor does not contest liability but argues that

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[31] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[32] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

collection would cause economic hardship or would be unjust. Defendants submitted "a large file of documentation" with their offer, but it ultimately was rejected for lack of any special circumstances that would justify a finding of hardship or unfairness. Defendants filed an appeal. The reviewing appeals officer sustained the examiner's decision, and the offer was formally rejected in April 2005.

Defendants filed another offer-in-compromise in late 2008, again based on hardship and fairness. As with the previous offer, an IRS examiner rejected it, Defendants appealed, and the reviewing appeals officer affirmed the rejection. Afterwards, in 2011, the IRS sought to levy against Defendants' property but again Defendants requested a Due Process Hearing to challenge the levy. The appeals officer saw that the assessments originated from a Tax Court judgment and sustained the levy. Defendants appealed the decision to the Tax Court.

At this time, the IRS assigned the case to a lawyer who failed to realize what the reviewing appeals officer did — that the assessments originated from a Tax Court judgment in 2002 — and therefore agreed to allow Defendants to submit another proposed offer-in-compromise in exchange for dismissal of the case. Six months later, Defendants filed their fourth offer, asserting that they were not liable for the 1996 and 1997 tax deficiencies and offering to settle with the IRS for $1. They submitted four boxes of documents they claimed supported their position. The form was accepted for processing. It was rejected on the merits five days later. Defendants appealed, but the rejection was upheld and the offer was formally rejected in April 2015.

Defendants filed a fifth offer-in-compromise in September 2015, asking the IRS to settle the assessments for $2,808 based in part on their inability to pay. After a rejection of the offer and a failed appeal, the IRS formally rejected the offer in February 2017. After not receiving full payment, the IRS filed this lawsuit to reduce the long-standing assessments to a civil judgment.[33]

Taxpayers Argue Statute on Collections Should Have Expired

As the Court noted, if there had been no suspensions of the statute, the IRS collection statute would have expired years ago in 2012. In total the IRS argued the various taxpayer actions caused the statute to be extended 3,154 days, moving the statute expiration dates on both years well into the second half of 2021. The IRS filed suit to reduce the assessments to a civil judgment in March 2021, months prior to the extended statute expiration date should the entire 3,154 days be added to the normal

[33] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

statute expiration. The balances due at this point, including taxes, penalties and interest, exceed $1 million. The opinion notes:

> Consequently, the IRS is entitled to summary judgment as to the amounts owed by Defendants if it can demonstrate that the ten-year deadline for filing a collection action against Defendants extended through March 8, 2021, the date it filed suit.[34]

Initially the taxpayers argued that the tolling should not take place since the IRS allowed the process to drag on for too long. The Court was not impressed with this argument:

> Defendants argue that the statute of limitations should not toll for these events because the IRS allowed the process to linger unreasonably. There is no reasonableness exception to tolling under the statute. It is tolled while an offer-in-compromise or due process hearing remains pending. The tolling period remains pending until the matter is terminated, withdrawn, or formally rejected by the government. Indeed, the IRS rejected each offer within the 24-month time limit created by Congress in 2005 and applicable to any offer-in-compromise submitted on and after July 16, 2006.[35]

The opinion also notes that the taxpayers themselves were responsible for this extreme delay:

> Moreover, as noted by the Government, Defendants caused much of the delay themselves through numerous filings and appeals. This is not a case where Defendants submitted offers and then waited years for answers. The record shows continuous correspondence with the IRS, and Defendants repeatedly appealed the IRS's initial determinations, regardless of merits. Defendants "made these offers and chose to see them through. There is no legal or equitable basis to hold that against the IRS."[36]

The taxpayers clarified that they were complaining that the IRS processed a number of meritless offers, arguing that a number of offers they made were invalid on their face and thus the IRS should have rejected them without processing the offers:

> They argue that the IRS was unreasonable not because of delays in processing their offers, but because it processed their meritless offers. That is, Defendants concede that the 2002 Tax Court judgment precluded them from contesting the underlying tax liability, and now

[34] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[35] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[36] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

> assert that their first and fourth offers-in-compromise, which improperly attempted to contest liability, were invalid on their face and thus could not have tolled the statute of limitations. That is, they argue that the IRS knowingly accepted at least two offers-in-compromise for processing that it had no basis to consider and that it did so to stall the IRS's collection deadline.[37]

The Court appeared even less impressed with this argument, stating:

> This argument is nonsensical and baseless. "[W]ithout denying that they voluntarily made these offers, [Defendants] attempt to weaponize [their own] supposed impropriety to their benefit."[38]

Specifically, there was no evidence that shows the IRS processed these numerous offers simply to stretch out the statute:

> There is no factual basis to support Defendants' argument that the IRS tried to delay collection or would want to do so.
>
>> No single IRS official reviewed all five of [Defendants'] offers. It was many employees, from examiners to appeal officers, across 15 years. [The] surviving work product shows a good-faith effort to resolve each offer appropriately. To allege the opposite, and claim without evidence that the IRS played out a 15-year scheme to toll the statute, is absurd.[39]

The opinion goes on to note that the multiple filings indicate it was the taxpayer who sought to delay the collection process by these various filings, many of which they now assert were clearly improper:

> It was Defendants who primarily benefitted from these delays: "While the offers remained pending, the IRS could not collect payment on the underlying assessments. . . . [B]y filing so many offers, [Defendants] successfully blocked collection for years."[40]

The opinion also notes there's no authority for arguing that a taxpayer voluntarily submitting an offer will not toll the statute:

> Moreover, there is no legal support for the argument that an offer-in-compromise contesting liability after a Tax Court judgment will not toll the statute. Indeed, any such rule "would have the perverse effect of allowing tax debtors to freeze collection against them by filing

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[37] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[38] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[39] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[40] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

> frivolous offers, without the return cost of tolling the statute." The Seventh Circuit recognized as much in *United States v. McGaughey*, acknowledging that even an offer preordained to fail is nonetheless a *quid pro quo* where the offeror agrees to suspend the collection deadline in exchange for the IRS to consider his offer.[41]

FORM 1099-R MAILED TO PRIOR ADDRESS DID NOT CREATE REASONABLE CAUSE FOR FAILING TO REPORT $238,000 DISTRIBUTION

LaRochelle v. Commissioner, TC Summary Opinion 2022-12, 7/12/22

In the case of *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12[42] the taxpayers argued they should not be liable for an accuracy related penalty under IRC §6662 related to their failure to report an IRA distribution when the Form 1099-R had been sent to their former, rather than current, address. The Tax Court found, in these circumstances, that there was not reasonable cause for their failure to report the distribution despite the Form 1099-R being sent to the wrong address.

Accuracy Related Penalty for Substantial Understatement and Reasonable Cause Relief

IRC §6662(a) outlines a 20% accuracy related penalty:

> (a) **Imposition of penalty**. If this section applies to any portion of an underpayment of tax required to be shown on a return, there shall be added to the tax an amount equal to 20 percent of the portion of the underpayment to which this section applies.

[41] *United States v. Ward*, USDC AK, Case No. 3:21-cv-00056, July 6, 2022

[42] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/couple-liable-for-penalty-for-failure-to-report-ira-distribution/7dmyj (retrieved July 16, 2022)

IRC §6662(b) has a list of nine circumstances in which this penalty will apply. Of concern for this case is the circumstance outlined in IRC §6662(b)(2):

> (b) **Portion of underpayment to which section applies**. This section shall apply to the portion of any underpayment which is attributable to 1 or more of the following:
>
> …
>
> (2) Any substantial understatement of income tax.

A substantial understatement is defined at IRC §6662(d). The general definition is found at IRC §6662(d)(1)(A) which provides:

> (d) Substantial understatement of income tax.
>
> (1) Substantial understatement.
>
> (A) **In general**. For purposes of this section, there is a substantial understatement of income tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of--
>
> (i) 10 percent of the tax required to be shown on the return for the taxable year, or
>
> (ii) $5,000.

And understatement itself is defined at IRC §6662(2)(A):

> (2) Understatement.
>
> (A) **In general.** For purposes of paragraph (1), the term "understatement" means the excess of--
>
> (i) the amount of the tax required to be shown on the return for the taxable year, over
>
> (ii) the amount of the tax imposed which is shown on the return, reduced by any rebate (within the meaning of section 6211(b)(2)).
>
> The excess under the preceding sentence shall be determined without regard to items to which section 6662A applies.

This penalty does not apply if the taxpayer can meet the reasonable cause exception found at IRC §6664(c)(1):

> (c) **Reasonable cause exception for underpayments**.
>
> > (1) **In general**. No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.

Reg. §1.6664-4(b)(1) provides much more detail on what constitutes reasonable cause in such circumstances, beginning with:

> (1) **In general.** The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances.

The regulation goes on to describe key factors that will be used to determine if a taxpayer qualifies for this relief (and which the taxpayer must demonstrate to obtain this relief) with the key one being the following:

> Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability.

The regulation notes that honest misunderstandings of fact or law may qualify, along with isolated errors

> Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. An isolated computational or transcriptional error generally is not inconsistent with reasonable cause and good faith.

The regulation cautions that reliance on the advice of a professional or an information return does not necessarily demonstrate reasonable cause and good faith:

> Reliance on an information return or on the advice of a professional tax advisor or an appraiser does not necessarily demonstrate reasonable cause and good faith. Similarly, reasonable cause and good faith is not necessarily indicated by reliance on facts that, unknown to the taxpayer, are incorrect. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith.

The regulation then discusses when such reliance on erroneous information can demonstrate reasonable cause and good faith:

> For example, reliance on erroneous information (such as an error relating to the cost or adjusted basis of property, the date property was placed in service, or the amount of opening or closing inventory) inadvertently included in data compiled by the various divisions of a multidivisional corporation or in financial books and records prepared by those divisions generally indicates reasonable cause and good faith, provided the corporation employed internal controls and procedures, reasonable under the circumstances, that were designed to identify such factual errors.

Later in the same portion of the regulation the IRS addresses reliance on an information return, the item at issue today:

> A taxpayer's reliance on erroneous information reported on a Form W-2, Form 1099, or other information return indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Generally, a taxpayer knows, or has reason to know, that the information on an information return is incorrect if such information is inconsistent with other information reported or otherwise furnished to the taxpayer, or with the taxpayer's knowledge of the transaction.

Fundamentally, a taxpayer cannot rely on advice or information returns to escape the penalty if the taxpayer knows or should have known the advice or information return was in error.

Facts of the Case

The Tax Court provided the following summary of the taxpayers' move from Washington, DC to Florida, as well as the mail forwarding in place during the period in question:

> During 2016 petitioners moved from Washington, D.C., to Florida. During 2017 petitioners lived in Florida, but they also owned a house in Washington, D.C. Petitioners signed up for and used mail forwarding through the U.S. Postal Service to forward mail from their Washington, D.C., house to their new residence in Florida. After starting mail forwarding, petitioners received mail at their Florida residence that had been mailed to their Washington, D.C., house, including monthly bills.[43]

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[43] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

The opinion continues noting the mailing of two Forms 1099-R:

> Petitioners received a Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, from Fidelity with respect to a distribution of $60,000 during 2016 from an Individual Retirement Account (IRA). That Form 1099–R listed petitioners' address in Florida. Petitioners reported that distribution on their 2016 tax return. National Financial Services, LLC, issued a Form 1099–R to Mr. LaRochelle with respect to a distribution of $238,000 from an IRA during 2017. That Form 1099–R listed petitioners' Washington, D.C., address.[44]

The $238,000 distribution was not reported by the taxpayers on their tax return. Not surprisingly, the IRS's computer systems noted this failure to report and issued a notice to the taxpayers:

> The IRS Automated Underreporter (AUR) program detected a mismatch between the income reported on petitioners' 2017 tax return and the amount that petitioners' IRA custodian, National Financial Services, LLC, reported to the IRS. As a result the IRS issued petitioners a computer-generated CP2000 notice and proposed a deficiency stemming from the missing $238,000 IRA distribution.[45]

The taxpayers eventually conceded that the notice was correct (though after ignoring the initial notice), but asked that the penalty be waived:

> Petitioners did not respond to the CP2000 notice. The IRS subsequently issued petitioners the notice of deficiency. Petitioners gave the notice of deficiency to Mr. Lander and asked him to investigate and verify the proposed deficiency. After Mr. Lander verified that the proposed deficiency was correct, petitioners paid it in full on January 27, 2020. On February 5, 2020, petitioners requested that the IRS abate the accuracy-related penalty.[46]

The IRS denied the request to abate the penalty, stating that the taxpayers had failed to establish reasonable cause for the failure to report this item.

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[44] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[45] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[46] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

Why the Taxpayers Failed to Show Reasonable Cause and Good Faith

The Tax Court notes that the taxpayers asked for reasonable cause relief based on the simple fact that they did not remember receiving the Form 1099-R:

> Petitioners assert that they should not be liable for the penalty because they did not remember receiving the Form 1099–R for the unreported retirement distribution.[47]

However, the taxpayers did not dispute the fact that they had received the $238,000 distribution during the year, just stating that they did not recall receiving the Form 1099-R:

> However, petitioners did not dispute that they received the $238,000 distribution sometime in 2017. Nonreceipt of tax information forms, such as a Form W–2, Wage and Tax Statement, or a Form 1099, does not excuse a taxpayer from his or her duty to report the income. See *Du Poux v. Commissioner,* T.C. Memo. 1994-448 ("[F]ailure to receive tax documents [such as Form 1099–MISC] does not excuse taxpayers from the duty to report income."). Further, nonreceipt of a Form 1099–R does not constitute reasonable cause to prevent the application of a section 6662(a) accuracy-related penalty. See *Ashmore v. Commissioner*, T.C. Memo. 2016-36 (holding that any error by the company responsible for issuing the taxpayer a Form W–2 did not provide reasonable cause because the taxpayer should have known of his missing second Form W–2); *Jones v. Commissioner,* T.C. Memo. 2010-112 (failure to receive a Schedule K did not constitute reasonable cause where the taxpayer acknowledged she received a distribution from the entity); *Brunsman v. Commissioner*, T.C. Memo. 2003-291 (rejecting the reasonable cause defense where the taxpayer received only one Form 1099–MISC but knew he had held two jobs).[48]

Note that the taxpayers did not assert they were unaware that $238,000 of funds had been distributed from their retirement account in the year, just that didn't recall receiving a Form 1099-R.

An unsophisticated taxpayer who had failed to receive a Form 1099 for income the taxpayer might not have otherwise been aware should be reported would have a better chance of prevailing on these facts, but that would be because the taxpayer was reasonably unaware that he/she had entered into a taxable transaction during the year. But the taxpayers here did not assert such facts nor does it appear likely, given both the

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[47] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[48] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

amount of the distribution and the taxpayer's business background, that such an argument would have been found plausible.

The taxpayers then fall back on reliance on their tax professional as showing reasonable cause for this failure. Interestingly, that same professional was representing the taxpayers before the Tax Court which may have played a role in limiting the effectiveness of this defense, though I suspect it likely had little impact.

The Court described the taxpayer's position as follows:

> Mr. LaRochelle asserted that petitioners relied on their tax professional, Mr. Lander, to handle their tax return.[49]

And then the decision goes on to outline how to evaluate that claimed reliance to see if it works to get penalty relief under the reasonable cause exception.

> The decision as to whether a taxpayer acted with reasonable cause and in good faith takes into account the pertinent facts and circumstances, including the taxpayer's knowledge, education, and experience, as well as the taxpayer's reliance on professional advice. *Thomas v. Commissioner*, T.C. Memo. 2013-60, at *7; Treas. Reg. § 1.6664-4(b)(1).[50]

But the opinion found that the taxpayer failed to explain the nature of this reliance on the tax professional:

> Mr. LaRochelle did not explain what was meant by petitioners' relying upon Mr. Lander to handle their tax return.[51]

Mr. LaRochelle's background was consulted to note that, without needing to get professional advice, he was aware of the importance of financial records and the need to keep such records, including, presumably, the need to track things like distributions he took from retirement plans that would be subject to income taxes.

> Mr. LaRochelle is a sophisticated businessperson who during 2017 was the general manager of a real estate partnership, was involved in more than ten other partnerships, and was responsible for recordkeeping for those partnerships. Therefore, Mr. LaRochelle was aware of the need to keep records concerning financial receipts.[52]

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[49] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[50] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[51] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[52] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

A key item not provided to the tax professional was any information beyond the one $60,000 Form 1099-R related to distributions from retirement plans, thus reliance on the tax preparer to somehow realize there was this reportable item was not reasonable:

> The record shows that petitioners did not provide Mr. Lander with all of the information that was necessary to prepare an accurate income tax return, namely information about the $238,000 IRA distribution that petitioners acknowledged they received, or even any information that they had an IRA account. Reliance on the professional advice of a tax return preparer does not constitute reasonable cause where the taxpayer did not provide the representative with all the information necessary to prepare an accurate income tax return. *Enoch v. Commissioner*, 57 T.C. 781, 802 (1972).[53]

Rather, the Court found that the taxpayers paid little attention to the preparation of their tax returns and, as well, presented no evidence they had reviewed their tax returns prior to filing:

> Other than handing over most of their documents to Mr. Lander, petitioners did not appear to actively participate in the return preparation process. Further, the record does not show that petitioners reviewed the completed return before it was filed.[54]

As was noted earlier, the same person represented the taxpayers before the Tax Court as prepared the return. In a footnote the Court noted that the taxpayers had been made aware that using their preparer to represent them in the Tax Court proceeding meant the preparer could not present testimony:

> Arthur Lander represents petitioners in this case. At trial the Court apprised the parties of Rule 24(g)(2)(A), which provides that "[c]ounsel may not represent a party at trial if the counsel is likely to be a necessary witness within the meaning of the ABA Model Rules of Professional Conduct," with several narrow exceptions. Petitioners stated that Mr. Lander was not likely to be a necessary witness, and Mr. Lander did not testify.[55]

Note the key factors involved with a successful use of the defense of reliance on a tax professional to obtain reasonable cause relief is that the taxpayer both engaged the professional to provide advice on the issue at hand and provided that professional with all necessary information. The tax professional obviously testify regarding exactly what information was provided to him/her and the nature of the engagement.

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[53] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[54] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

[55] *LaRochelle v. Commissioner*, TC Summary Opinion 2022-12, July 12, 2022

Not being able to have that person testify about those items makes the reliance defense tougher to successfully argue. An adviser testifying that he/she was provided all necessary information to see if any taxable event took place for the retirement account and that he/she had advised the taxpayer only the $60,000 distribution had to be reported would have greatly helped in this case.

But that brings us to why the loss of this testimony may not have hurt the taxpayer—given the Court's comments that Mr. LaRochelle wasn't involved in the return process aside from turning over documents, it is very possible that the only document Mr. LaRochelle gave his preparer was the single Form 1099-R showing a $60,000 distribution. If that was the case, the professional's testimony would not have done the taxpayer much good.

Tax Preparers and Client Expectations

The mere hiring of a tax preparer does not provide a taxpayer with an automatic reasonable cause defense against penalties. And, in this case, the Court opinion seems to suggest that all the taxpayer could show was that they paid someone who prepared their return from the information they handed over.

But tax professionals need to be aware of this belief on the part of their clients that merely hiring the professional and dropping off the documents they decided were relevant means the return they get back will contain no errors. It is important to remind clients that it is their responsibility to provide all relevant information for their return and to make use of tools the professional may provide (like questionnaires, checklists and organizers) to help insure they are aware of the information they should be providing.

It is not reasonable to assume a client knows all of the various types of information that may be relevant to assuring their tax returns properly report all income and deductions for the year in question. While it is understandable that some clients will balk at filling in questionnaires and organizers, the adviser still must find some mechanism to educate the client regarding items that could impact their tax situation that need to be provided to the professional.