



Current Federal Tax Developments

July 24, 2023

Kaplan Financial Education



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This Week We Look At:

IRS memo makes it clear the agency is very skeptical about extended supply chain ERC claims

Third Circuit rules that equitable relief is available for failure to file Tax Court petition in 90 day period for a deficiency

IRS asked by Tax Court to justify suspense account method for losses deducted in excess of basis in closed years

Taxpayers had to pay tax on funds taken from IRA/pension funds that were paid to fraudster

2

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IRS GLAM Indicates Agency's Skepticism Regarding Extended Supply Chain ERC Claims



Photo by [Dominik Lückmann](#) on [Unsplash](#)

- Generic Legal Advice Memorandum AM 2023-05, July 21, 2023
- IRS memorandum discusses the attempts to expand Q&A 12 in Notice 2021-20 on supplier issues in ERC claims
- Has a discussion of the justification for supply chain partial suspension, something missing from Notice 2021-20

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/21/irs-memorandum-makes-clear-the-agencys-rejection-of-many-extended-supply-chain-justifications-for-the-erc>

IRS GLAM Indicates Agency's Skepticism Regarding Extended Supply Chain ERC Claims



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- Generic Legal Advice Memorandum AM 2023-05, July 21, 2023
- IRS Analysis:
 - Supplier option not mentioned in the law - was added by the Notice
 - Solely having a supply chain disruption is not enough - no government order
 - But can “step in the shoes” of a supplier to link to orders that suspended their operations

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 - What's needed:
 - **Specific government orders:** Documentation that proves the existence of relevant government orders imposed on a supplier or business that affected the supply chain.
 - **Issues caused for the supplier:** Evidence illustrating how the government orders or other issues directly caused challenges for the supplier, forcing the supplier to suspend operations.

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 - What's needed:
 - **Inability to obtain critical supplies:** Documentation indicating the employer's inability to procure critical and necessary supplies due to the issues faced by the supplier.
 - **Impact on the employer's business:** Clear documentation showcasing how these supply chain issues led to a full or partial suspension of the employer's own business operations.

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 - Scenario 1 - Taxpayer had sufficient supplies on hand
 - Did not show specific government order that impacted supplier
 - But never ran out of the critical product due to existing supplies

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 - Scenario 2 - Port bottleneck
 - Supplies couldn't move out of port
 - Speculation on various causes, TV said might have been COVID-19 orders
 - Could not show a specific order, nor how it impacted shipments out of the port

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 - Scenario 3 - Disruption Past End of Order
 - Had order that shuttered both supplier and ERC applicant
 - Order concluded, but supply problems continued
 - Unable to claim past the date the order ceased to apply

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 - Scenario 4 - Alternative Supply Available at Higher Cost
 - Regular supplier was unable to provide critical supply
 - Alternate supplier supplied product, but at higher cost
 - Higher cost and lower profit are not a suspension

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 - Scenario 5 - Limited Number of Products Unavailable
 - Retailer sells large number of products, a few are unavailable or became more costly
 - Impact not sufficient to provide a suspension

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 - This is a nonbinding document, but does give insight on what IRS national office thinks (and likely what position examiners will take)
 - Similarly, the Notice itself is not on the same level as regulations, but agents are going to follow it
 - Fact a Notice **could** be considered in error by a Court does not mean a court will—especially if the taxpayer doesn't have their own analysis

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Third Circuit Rules that Equitable Relief is Available for a Late Tax Court Deficiency Petition



Photo by [Tingey Injury Law Firm](#) on [Unsplash](#)

- *Culp v. Commissioner*, CA3, Case No. 22-1789, July 19, 2023
 - The Tax Court has traditionally held that the 90-day deadline for filing a deficiency petition under §6213(a) is jurisdictional - equitable relief is not available
 - In *Boechler PC v. Commissioner*, 142 S. Ct. 1493 (2022) SCOTUS ruled that §6330 (CDP petitions to the Tax Court) was not jurisdictional
 - Tax Court in *Hallmark Research Collective v. Commissioner*, 159 TC No. 6 held that *Boechler* was limited to only §6330

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- *Culp v. Commissioner*, CA3, Case No. 22-1789, July 19, 2023
 - Taxpayer filed Tax Court petition well after the 90-day deadline
 - Taxpayer in *Culp* claimed either IRS had never mailed the notice or they had never received it
 - CA3 found IRS had shown it had been properly mailed
 - Also, receipt of the notice is not required to run the statute

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- But CA3 found that the Tax Court erred in holding that it could not consider equitable relief
 - Relied upon *Boechler* to find that the statute did not clearly indicate Congress meant the deadline to be jurisdictional
 - Found the context of the statute did not indicate that equitable relief wasn't allowed

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- *Culp v. Commissioner*, CA3, Case No. 22-1789, July 19, 2023
- However CA3 did concede in one sentence that the Ninth Circuit had disagreed on whether the context made it clear the limit was jurisdictional (*Organic Cannabis Found., LLC v. Comm'r*, 962 F.3d 1082, 1095 (9th Cir. 2019))
- Under *Golsen* rule, this decision is binding on the Tax Court in the Third Circuit (Pennsylvania, New Jersey, Delaware, and the U.S. Virgin Islands)

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- *Culp v. Commissioner*, CA3, Case No. 22-1789, July 19, 2023
 - Outside the Third Circuit, the Tax Court will continue to rely on *Hallmark* (and it would appear, per the *Golsen* rule, might continue to do so in the Ninth Circuit even if the Tax Court were to accept the Third Circuit decision as persuasive)
 - Note - even though *Culp* can ask for equitable relief, it's not clear they will obtain such relief

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IRS to Be Required to Justify Suspense Account Method the Agency Uses for Certain Losses



Photo by [Annie Spratt](#) on [Unsplash](#)

- *Kanwal v. Commissioner*, Order, Docket Nos. 23766-18, 23769-1, 23776-18, and 23842-18, US Tax Court, July 18, 2023
 - Issue involved a taxpayer that deducted losses from an S corporation in excess of basis in a prior year
 - Prior year was closed for adjustment when the IRS uncovered the issue, so used what's referred to as the "suspense method" to deal with the issue, beginning in the first year available for adjustment

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/20/irs-required-to-justify-its-suspense-method-for-dealing-with-s-corporation-losses-claimed-in-closed-year-with-insufficient-basis>



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 - Under the suspense method, the loss that should not have been allowed is placed in a suspense account
 - No loss deductions or nontaxable distributions are allowed until income or shareholder additions to basis absorb the suspense account

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	S Corporation Income/Loss	Tax Return Income/Loss	Suspense Account	Basis Loss Carryover	Shareholder Basis
Beginning basis - Year 1					0
Loss from S Corporation Year 1 (loss deducted though no basis)	(100)	(100)			0
Basis - Year 2			0	0	0
Loss Year 2 (Did Not Deduct - put in loss carryover)	(100)	0	0	(100)	0
Basis - Year 3			0	(100)	0

IRS examines taxpayer and discovers problem in year 1 when Year 3 is the first year open for adjustment.

In Year 3 the corporation showed \$100 of income. The Form 1040 showed the \$100 of income reduced to zero by the loss carryover.

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Beginning basis - Year 1					0
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Basis - Year 2			0	0	0
Loss Year 2 (Did Not Deduct - put in loss carryover)	(100)	0	0	(100)	0
Basis - Year 3			0	(100)	0
Add Suspense Account in First Open Year			(100)	0	0
Income Year 3 - Not allowed to use the loss	100	100	100	0	0
Basis Entering Year 4			0	(100)	0

21

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- *Kanwal v. Commissioner*, Order, Docket Nos. 23766-18, 23769-1, 23776-18, and 23842-18, US Tax Court, July 18, 2023
 - IRS justifies this by reference to Reg. §1.1016-6(a) to eliminate a double deduction
 - First suggested in FSA 200230030, used in TAM 200619021 and part of training in SCO/P/53_05_01_03-06
 - Orders notes that “eliminate” is not a synonym for prevent, suggest IRS must wait for a double deduction or equivalent to offset

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 - Did not formally rule at this, but sent the IRS back to justify the matter and both parties to apply the concepts to the complex facts of the case rather than just the simple example

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Taxpayer Must Include IRA Distributions in Income Even Though Triggered by a Fraud



Photo by [Grant Durr](#) on [Unsplash](#)

- *Gomas v. United States*, US District Court for the Middle District of Florida, Case No. 8:22-CV-01271, July 17, 2023
 - Taxpayer inherited an online business from his brother
 - Discovered business manager was stealing inventory and mismanaging the business
 - Moved the business to where he lived and put his stepdaughter in charge (turns out retaining the original business manager would have been a better choice...)

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/20/despite-being-victim-of-fraud-that-led-taxpayer-to-believe-he-had-to-pay-cash-to-avoid-jail-was-still-subject-to-tax-on-funds-withdrawn-from-ira>



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- *Gomas v. United States*, US District Court for the Middle District of Florida, Case No. 8:22-CV-01271, July 17, 2023
 - Wanted to shut down business, but stepdaughter convinced him to let her continue to run the business
 - Moved business to her home, got \$20,000 to build a fence for the business which no one seems to have ever seen or confirmed got built - but this is still not the big problem

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- *Gomas v. United States*, US District Court for the Middle District of Florida, Case No. 8:22-CV-01271, July 17, 2023
 - Told her stepfather that the former manager and other employees had opened merchant service sub-accounts using his personal information
 - Now company (and he) were liable for missing funds
 - Convinced the couple they needed to hire an attorney to prevent stepfather from going to prison

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- *Gomas v. United States*, US District Court for the Middle District of Florida, Case No. 8:22-CV-01271, July 17, 2023
 - In reality none of this was true-put they sent her money to hire and make payments to an attorney she claimed to have hired.
 - Took funds from Mr. Gomas' retirement accounts to make these payments and pay tax on those large distributions
 - Ended up taking over \$1.1 million dollars from accounts, over \$700,000 to daughter

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 - Turns out daughter turned to friends and family for other frauds (\$200,000)-but they got suspicious and determined she was fraudulently requesting funds
 - Family informed parents two years after she took all of the funds to drain his retirement account

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- *Gomas v. United States*, US District Court for the Middle District of Florida, Case No. 8:22-CV-01271, July 17, 2023
 - Filed an amended return to remove the retirement plan distributions from income
 - IRS disallowed the refund claim, as did the District Court

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 - Taxpayer claimed did not obtain the benefit of the distribution
 - Problem was they transferred the funds to their checking account
 - Would have been different if daughter had forged documents to empty the account

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 - Taxpayer argued the payments to daughter were for a business expense
 - No actual legal fees were ever paid
 - He had no business to which any expenses could be attached - was a personal criminal and civil case (or would have been had any of it been real)
 - Was simply theft

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