Current Federal Tax Developments

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SECTION: 2010
AUTOMATIC LATE PORTABILITY ELECTION RELIEF PROCEDURE PUBLISHED BY IRS

Citation: Revenue Procedure 2017-34, 6/9/17

In Revenue Procedure 2017-34 the IRS published a simplified method to obtain permission for an extension of time under Reg. §301.9100-3 to file a Form 706 and elect portability *without* the need to apply for a private letter ruling and pay the associated fee.

Under IRC §2010 a surviving spouse may make an election to claim any lifetime transfer tax exclusion that was not used to reduce the estate tax on the deceased spouse. This amount, known as the deceased spouse unused exclusion amount (DSUE) can end up being equal to the entire maximum lifetime transfer amount ($5,490,000 for 2017), especially if the deceased spouse left his/her entire estate to his/her spouse.

However, under IRC §2010(c)(5)(A) the election is only effective if made by the due date of the estate tax return (including extensions received) for the deceased spouse. In Reg. §20.2010-2(a)(1) the IRS provided that for an estate that would not otherwise be required to file a return, that due date would be the date on which an estate tax return would have been due had one been required for the decedent. That same regulation provides that if an estate tax return was required for the decedent, no extension of time to file a portability election will be available under Reg. §301.9100-3.

Reg. §301.9100-3 provides for the method by which a taxpayer may request IRS permission to make an election after the date prescribed by regulation for an election to make. The provision cannot be used to obtain an extension of time to make an election if the date for the election is set by Congress in the Internal Revenue Code, as the IRS's view is that the agency lacks the authority to override the Code on this issue without specific authorization from Congress.

Shortly after the due dates passed for the first individuals to die that had estates eligible to elect portability, the IRS began receiving requests to grant relief to make the portability election on a "late" Form 706. As the IRS pointed out in Chief Counsel Email 201650017, such relief has been granted to estates where no Form 706 was otherwise required, but the agency's position was that it lacked the authority to grant relief if a Form 706 was otherwise required to be filed. While that offered relief to many estates, it still required filing a private letter request and paying the often substantial

fee for such a ruling, along often with fees to professionals to shepherd the request through the letter ruling process.

Despite the cost and complications of making such a request, the IRS has received a relatively large number of such requests. Rev. Proc. 2017-34 notes:

> Treasury and the Service have determined that the considerable number of ruling requests for an extension of time to elect portability received since December 31, 2014, indicates a need for continuing relief for the estates of decedents having no filing requirement under § 6018(a). Further, the considerable number of ruling requests received has placed a significant burden on the Service. Accordingly, this revenue procedure provides a simplified method to the estates of decedents having no filing requirement under § 6018(a) to obtain an extension of time under § 301.9100-3 to elect portability, provided that certain requirements (set forth in sections 3.01 and 4.01 of this revenue procedure) are met.

The IRS had received requests that an automatic procedure provide for an unlimited period to make a request, but the procedure notes that the IRS felt this was not appropriate. For this reason, Rev. Proc. 2017-34 limit its relief to estate having no requirement to file a Form 706 which requests the relief by the later of:

- January 2, 2018 *or*
- The second anniversary of the decedent's date of death.[1]

Section 3 of Rev. Proc. 2017-34 provides the scope of the relief. Relief is available if all the following requirements are satisfied:

- The decedent:
  - was survived by a spouse;
  - died after December 31, 2010; and
  - was a citizen or resident of the United States on the date of death.
- The executor is not required to file an estate tax return under § 6018(a) as determined based on the value of the gross estate and adjusted taxable gifts and without regard to the need to file for portability purposes;

[1] Rev. Proc. 2017-34, Section 2.02(6)

- The executor did not file an estate tax return within the time required by § 20.2010-2(a)(1) for filing an estate tax return; and
- The executor satisfies all requirements listed below to request relief.

Relief is not available if an estate tax return was timely filed by the executor. As the ruling notes "Such an executor either will have elected portability of the DSUE amount by timely filing that estate tax return or will have affirmatively opted out of portability in accordance with § 20.2010-2(a)(3)(i)."[2]

If an estate was eligible to make the election but fails to do so, all is not lost—the regular process of filing for a ruling under Reg. §301.9100-3 will be available to the estate, though it will require asking for a private letter ruling and paying the applicable fee.

The requirements referenced above for qualified estates to obtain relief are:

- A person permitted to make the election on behalf of the estate of a decedent--that is, an executor described in § 20.2010-2(a)(6)—must file a complete and properly prepared Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return, on or before the later of January 2, 2018, or the second annual anniversary of the decedent's date of death. The Form 706 will be considered complete and properly prepared if it is prepared in accordance with § 20.2010-2(a)(7).
- The executor filing the Form 706 on behalf of the decedent's estate must state at the top of the Form 706 that the return is "FILED PURSUANT TO REV. PROC. 2017-34 TO ELECT PORTABILITY UNDER § 2010(c)(5)(A)."[3]

If it is later determined that the estate was originally required to file an estate tax return, the election is deemed to be void—that is, there is no DSUE for the surviving spouse.[4]

A grant of relief under this procedure will not allow a surviving spouse to obtain a refund of overpaid gift or estate taxes due to the

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[2] Rev. Proc. 2017-34, Section 3.02
[3] Rev. Proc. 2017-34, Section 4.01
[4] Rev. Proc. 2017-34, Section 4.03

increase in DSUE if the statute of limitations for claiming a refund of that tax has expired prior to the grant of automatic relief. This will generally affect those filing under the special "January 2, 2018" relief date for decedents that passed away after the portability provisions came into the law, since normally the statute should still be open if relief is granted within two years of the decedent's date of death.[5]

However, the procedure does authorize the filing of protective claim for refund if the statute is still open in anticipation of filing a Form 706 under this procedure. So, if the statute of limitations period for claiming a refund on a gift or estate tax return will shortly expire, a protective claim would be filed under the provisions of Section 5.02 of Revenue Procedure 2017-34.

The IRS provides three of examples of how the claim for refund rules will work.

Example 1

(a) Predeceasing Spouse (S1) dies on January 1, 2014, survived by Surviving Spouse (S2). The assets includible in S1's gross estate consist of cash on deposit in bank accounts held jointly with S2 with rights of survivorship in the amount of $2,000,000. S1 made no taxable gifts during life. S1's executor is not required to file an estate tax return under § 6018(a), and does not file such a return.

(b) S2 dies on January 30, 2014. S2's taxable estate is $8,000,000 and S2 made no taxable gifts during life. S2's executor files a Form 706 on behalf of S2's estate on October 30, 2014, claiming an applicable exclusion amount of $5,340,000. S2's executor includes payment of the estate tax with the Form 706.

(c) Pursuant to this revenue procedure, S1's executor files a complete and properly prepared Form 706 on behalf of S1's estate on December 1, 2017, reporting a DSUE amount of $5,340,000. The executor includes at the top of the Form 706 the statement required by section 4.01(2) of this revenue procedure. The filing of the return satisfies the requirements for a grant of relief under this revenue procedure and S1's estate is deemed to have made a valid portability election. The Service accepts S1's return with no changes.

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[5] Rev. Proc. 2017-34, Section 5.01

(d) To recover the estate tax paid, S2's executor must file a claim for credit or refund of tax by October 30, 2017 (the end of the period of limitations prescribed in § 6511(a)), even though a Form 706 to elect portability has not been filed on behalf of S1's estate by that date. Such a claim filed on Form 843, Claim for Refund and Request for Abatement, in anticipation of the filing of the Form 706 by S1's executor will be considered a protective claim for credit or refund of tax. Accordingly, as long as the Form 843 is filed on or before October 30, 2017, the Service can consider and process that claim for credit or refund of tax once S1's estate is deemed to have made a valid portability election and S2's estate notifies the Service that the claim for credit or refund is ready for consideration.

Example 2

(a) The facts relating to S1 and S1's estate are the same as in Example 1. S2 makes a gift to Child of $6,000,000 on December 1, 2014. S2 has made no prior taxable gifts. On April 15, 2015, S2 files a Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, claiming an applicable exclusion amount of $5,340,000. S2 tenders payment of the gift tax with the Form 709.

(b) To recover the gift tax paid, S2 must file a claim for credit or refund of tax (protective or otherwise) within the time prescribed in § 6511(a) for filing a claim for credit or refund.

Example 3

(a) The facts are the same as in Example 2 except that S2's Form 709 claims an applicable exclusion amount of $10,680,000 including a DSUE amount of $5,340,000 from S1's estate. As a result, the Form 709 reports no tax due and S2 tenders no gift tax.

(b) Although the portability election, once made, makes S1's DSUE amount available to S2 retroactively to S1's date of death, that DSUE amount is not available until the election is made. Because S2 files the Form 709 before S1's estate makes the portability election, S2's claimed application of the DSUE amount will be denied and gift tax on the transfer will be assessed. To recover that gift tax once the portability election has been made by S1's estate, S2 must file a claim for credit or

refund of tax (protective or otherwise) within the time prescribed in § 6511(a) for filing a claim for credit or refund.

If an estate qualifies to use this procedure, this procedure will be the exclusive method to obtain an extension of time to file a portability election—the IRS will not consider a request for a traditional letter ruling under Reg. §301.9100-3. If an estate that is eligible to use this ruling had a request pending when this ruling was issued, the IRS will close the file and refund the user fee. The estate will need to comply with the procedures in this ruling to obtain relief.[6]

SECTION: 6109
IRS CAN REQUIRE PTINS FOR TAX PREPARERS, BUT CANNOT CHARGE USER FEES FOR ISSUANCE AND RENEWAL

Citation: Steele, et al v. United States, USDC DC, 119 AFTR 2d ¶2017-818, 6/2/17

The IRS has lost yet another battle in the United States District Court for the District of Columbia related to their attempts to expand regulation of tax preparers. In the case of *Steele, et al v. United States*, USDC DC,119 AFTR 2d ¶2017-818, while the Court the IRS was justified in establishing the requirement that tax preparers obtain a practitioner tax identification number (PTIN)—but that the agency had no authority to impose a fee for issuing that number.

The IRS had lost previous cases in this venue regarding their attempt to set up a preparer testing system (*Loving*, 113 AFTR 2d ¶2014-867) as well as the attempt to apply Circular 230 rules to tax preparation (*Ridgely*, 113 AFTR 2d ¶2014-5249).

Under regulations issued under IRC §6109, a tax preparer is required to obtain a PTIN before he/she may prepare returns for compensation (Treasury Reg. §1.6109-2(d)). The IRS also required the payment of a user fee to obtain a PTIN under authority claimed in Reg. §300.13. The plaintiffs in this case argued first that the IRS lacked the authority to require a preparer to obtain a PTIN and even if the Court found the agency had that authority, either it lacked the authority to impose a fee for the license or the fee that was imposed was excessive.

The Court first dealt with the question of whether the IRS could require PTINs for all preparers and found that the IRS was given a

[6] Rev. Proc. 2017-34, Section 6.02

direct grant of such authority in IRC §6109 and had not acted arbitrarily or capriciously in imposing the requirement. The opinion notes:

> The statute specifically says that the Secretary has the authority to specify the required identifying number to be used on prepared tax returns. 26 U.S.C. § 6109(d) ("The social security account number issued to an individual for purposes of section 205(c)(2)(A) of the Social Security Act shall, except as shall otherwise be specified under regulations of the Secretary, be used as the identifying number for such individual for purposes of this title." (emphasis added)). The Court must give effect to the unambiguous intent of Congress that the Secretary may require the use of such a number.
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> In addition, the decision to require the use of PTINs was not arbitrary or capricious. The agency offered several justifications for the regulation requiring the exclusive use of PTINs. First, the IRS explained the need to identify tax return preparers in order to maintain oversight, and stated that the use of a single identifying number was critical to such effective oversight. See Furnishing Identifying Number of Tax Return Preparer, 75 Fed. Reg. at 60310, 60313. The IRS stated that the use of a single number would "enable the IRS to accurately identify tax return preparers, match preparers with the tax returns and claims for refund they prepare, and better administer the tax laws with respect to tax return preparers and their clients." Id. at 60314. The IRS has articulated satisfactory explanations for its actions. See *State Farm*, 463 U.S. at 43. There is a rational connection between the regulations — requiring the use of PTINs — and the stated rationales — effective administration and oversight. See id. And, there is no indication that the IRS entirely failed to consider an important aspect of the problem, or that its rationales ran counter to the evidence before it, or that its reasoning is completely implausible. See id. In addition, this was not an unexplained change in policy. See *Encino Motorcars*, 136 S. Ct. at 2126. The aforementioned reasons for the change in policy were identified by the IRS.

But the Court found that the IRS had overstepped its authority in imposing a user fee for the PTIN. The IRS relied on the Independent Offices Appropriations Act (IOAA) of 1952 in

justifying the imposition of a user fee on those obtaining a PTIN. The Court explains the conditions under which the IOAA allows an agency to impose a user fee:

> The IOAA permits agencies to charge user fees for "a service or thing of value provided by the agency." 31 U.S.C. § 9701(b). The Supreme Court has read the language of the Act narrowly in order to distinguish between fees and taxes, the latter of which are the province of Congress. See N*at'l Cable Television Ass'n, Inc. v. United States,* 415 U.S. 336, 340–41 (1974). Fees are "incident to a voluntary act" and connote a benefit. Id. Agencies may impose fees for bestowing special benefits on individuals not shared by the general public. Id.; *Fed. Power Comm'n v. New England Power Co.,* 415 U.S. 345, 350–51 (1974); *Engine Mfrs. Ass'n v. E.P.A.*, 20 F.3d 1177, 1180 (D.C. Cir. 1994). There must be "a sufficient nexus between the agency service for which the fee is charged and the individuals who are assessed." *Seafarers Int'l Union of N. Am. v. U.S. Coast Guard*, 81 F.3d 179, 183 (D.C. Cir. 1996). Agencies must "make clear the basis for a fee it assesses under the IOAA." *Nat'l Cable Television Ass'n, Inc. v. F.C.C.*, 554 F.2d 1094, 1100 (D.C. Cir. 1976)

The Court found that, following the striking down of the registered return preparer requirement in the *Loving* case, there was no longer a "service or thing of value" begin granted with the PTIN, since any individual may obtain such a number. The Court held:

> First, the argument that the registered tax return preparer regulations regarding testing and eligibility requirements and the PTIN regulations are completely separate and distinct is a stretch at best. While it is true that they were issued separately and at different times, they are clearly interrelated. The RTRP regulations specifically mention the PTIN requirements and state that PTINs are part of the eligibility requirements for becoming a registered tax return preparer. See Regulations Governing Practice Before the Internal Revenue Service, 76 Fed. Reg. at 32287–89; 26 C.F.R. § 1.6109-2(d) ("[T]o obtain a [PTIN] or other prescribed identifying number, a tax return preparer must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer authorized to practice before the Internal Revenue Service under 31 U.S.C. 330 and the regulations thereunder."). Furthermore, the overarching

> objectives named in the PTIN regulations indicate a connection to the RTRP regulations. They were 1) "to provide some assurance to taxpayers that a tax return was prepared by an individual who has passed a minimum competency examination to practice before the IRS as a tax return preparer, has undergone certain suitability checks, and is subject to enforceable rules of practice;" and 2) "to further the interests of tax administration by improving the accuracy of tax returns and claims for refund and by increasing overall tax compliance." Furnishing Identifying Number of Tax Return Preparer, 75 Fed. Reg. at 60310. The first objective clearly relates to the RTRP regulations regarding eligibility requirements for tax return preparers. The second objective is less explicit, but it does not stretch common sense to conclude that the accuracy of tax returns would be improved by requiring tax return preparers to meet certain education requirements.
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> Having concluded the inter-connectedness of the regulations, the government's argument begins to break down. The *Loving* court concluded that the IRS does not have the authority to regulate tax return preparers. *Loving*, 742 F.3d at 1015. It cannot impose a licensing regime with eligibility requirements on such people as it tried to do in the regulations at issue. Although the IRS may require the use of PTINs, it may not charge fees for PTINs because this would be equivalent to imposing a regulatory licensing scheme and the IRS does not have such regulatory authority. Granting the ability to prepare tax return for others for compensation — the IRS's proposed special benefit — is functionally equivalent to granting the ability to practice before the IRS.

The District Court goes on to note that D.C. Circuit, relying on the Supreme Court's holding in *Nat'l Cable Television Ass'n*, 415 US 336, has generally held that fees are permissible under IOAA for valid regulatory schemes—but here the regulatory scheme (the RTRP program) was struck down.

The opinion goes on:

> …[T]he Court notes that after *Loving*, anyone can obtain a PTIN. They need not meet any type of eligibility criteria. Thus, it is no longer the case that only a subset of the general public may obtain a PTIN and prepare tax returns for others

> for compensation. Hypothetically, every member of the public could obtain a PTIN, which means that every member of the public would also get the supposed "benefit" of being able to prepare tax returns for others for compensation. There is therefore no special benefit for certain individuals not available to the general public. It seems that if a benefit exists, it inures to the IRS, who, through the use of PTINs, may better identify and keep track of tax return preparers and the returns that they have prepared.

This particular issue had been previously addressed in other courts, with the IRS prevailing on both issues in the *Brennan, III, PC*, (DC GA) 109 AFTR 2d ¶2012-2439, *affd* (CA 11 2012) 109 AFTR 2d ¶2012-2442 and later in the case of *Buckley*, (DC GA) 112 AFTR 2d ¶2013-7255. The District Court recognized this issue and dealt with it as follows:

> The Court acknowledges that courts in the Eleventh Circuit have found that the PTIN fees are permissible under the IOAA. See Brannen, 682 F.3d at 1319; Brannen, 2011 WL 8245026, at *5–6; Buckley, 2013 WL 7121182, at *2. But, the Brannen decisions were made prior to D.C. Circuit's Loving decision, i.e., prior to the finding that the IRS lacks the authority to regulate tax return preparers and the striking down of the regulations attempting to do so. In addition, the Court disagrees with the Buckley court's finding that Loving (at the time the district court opinion) is entirely inapplicable because although the PTIN scheme was authorized by a different statutory authority, it is, as explained above, interrelated with the RTRP scheme.

In response to the *Steele* decision the IRS has shut down, for now, the PTIN registration and renewal program. In a statement issued June 6, the IRS stated:

> On June 1, 2017, the United States District court for the District of Columbia upheld the Internal Revenue Service's authority to require the use of a Preparer Tax Identification Number (PTIN), but enjoined the IRS from charging a user fee for the issuance and renewal of PTINs. In accordance with this order, PTIN registration and renewal is currently suspended.

> The IRS, working with the Department of Justice, is considering how to proceed. As additional information becomes available, it will be posted at www.irs.gov/taxpros.
>
> For your customers with PTINs, there is no change to what you are doing. CE records should continue to be transmitted to the IRS.
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> For customers who need PTINs, please hold their CE records until the PTIN system reopens and they are able to obtain a PTIN. These preparers will be given the appropriate credit when reported.

For the moment, the biggest problem is that individuals who do not already have a PTIN cannot obtain one. The notice suggests that the PTIN system will eventually be reopened but does not give a time frame for this to happen. The notice only deals with those who must report their continuing education to the IRS (EAs), but doesn't explain what those people or anyone else lacking a PTIN is supposed to do about the identification number if preparing a return for compensation.

Current regulations require the use of a PTIN to file a return, but the IRS isn't issuing them at this point. The IRS has not yet indicated what a preparer with that dilemma is supposed to do at this point. Similarly, those with PTINs aren't out of woods if the IRS drags its feet on resolving this issue—under Reg. §1.6109-2(e) the IRS is authorized to set an expiration date on PTINs, and all PTINs currently issued have an expiration date of December 31, 2017.

The IRS could have continued to issue and process renewals for PTINs as the court found the agency had the right to impose this requirement—but, apparently, the IRS does not want to incur the costs of processing the applications. In News Release IR-2015-123 indicated that the agency incurs a $17 fee per application that is paid to an outside contractor that handles the application/renewal process.

One "solution" would be for the IRS to remove the regulations mandating the use of PTIN. That would have the advantage to the agency of eliminating the cost of running the PTIN program now that fees will no longer be paid—but it would also result in preparers needing to revert to using social security numbers as identifying numbers on returns under the default provisions of IRC §6109(a). While that number would only be required to be shown on the IRS copy of the return (with would be only in the electronically filed return for e-services), preparers might be wary of the use of the

number, especially in cases where a return must be filed in paper form (and thus the number "exposed" to the client).

SECTION: 6231
PARTNERSHIP INTEREST HELD IN A SINGLE MEMBER LLC PRECLUDES QUALIFICATION AS A SMALL PARTNERSHIP UNDER TEFRA PROVISIONS

Citation: Seaview Trading, LLC, et al v. Commissioner, (CA9 2017), Case No. 15-71330, 6/7/17

In Revenue Ruling 2004-88 the IRS held that if a single partner of a partnership is a disregarded entity (such as a single member LLC or a grantor trust), that partnership cannot qualify for an exemption from the TEFRA consolidated partnership audit rules under the provisions of IRC §6231(a)(1)(B)(i). In the case of *Seaview Trading, LLC, et al v. Commissioner*, (CA9 2017), Case No. 15-71330 the Ninth Circuit Court of Appeals agreed with the IRS's view expressed in that Revenue Ruling.

Robert Kotick and his father Charles Kotick formed Seaview Trading, LLC, which was taxed as a partnership. Each of the Koticks held their interest in Seaview through a single member LLC that was treated as a disregarded entity.

Under the TEFRA consolidated partnership examination provisions, a partnership exam generally takes place at the partnership level for items of income, deduction, and credits as well as for any other partnership items. The statute of limitations for the IRS to assess tax against the partners is the later of the expiration of the statute on the individual partner's return or the expiration of the statute for the partnership under the TEFRA audit provisions.

Although generally partnerships are subject to the consolidated partnership audit rules, IRC Section 6231(a)(1)(B)(i) provides for an exemption for certain small partnerships. These small partnerships are not subject to the TEFRA provisions unless the partnership affirmatively elects into the TEFRA regime by filing Form 8893 with its tax return for the year in question.

A partnership is exempt from the TEFRA consolidated audit provisions under the small partnership exception if:

- The partnership has 10 or fewer partners and
- Each of those partners is:
    - An individual (other than a nonresident alien)

- A C corporation or
- An estate of a deceased partner

If the partnership is exempt, the exam takes place at the individual partner level and the only statute of limitation for the IRS to assess tax is the standard statute on the partner's return. There is no partnership level statute in that case.

In this case Robert Kotick's 2001 income tax return was examined by the IRS. The IRS noticed that Robert had claimed a loss flowing to him from Seaview in 2001. While the IRS made various adjustments to Robert's return, they did not modify the flow through loss from Seaview. Rather the IRS opened an examination of Seaview in 2005 and finally issued a final partnership administrative adjustment (FPAA) under the TEFRA rules in 2010. In the meantime, the statute of limitations on Robert's individual return had otherwise expired in 2005.

Robert contended that the IRS was too late in assessing tax, since Seaview qualified under the small partnership provisions noted above. As the partnership had only 2 partners it clearly met the first requirement of having less than 10 partners.

But the IRS contended that because both partners held their interests in single member LLCs, the second requirement was not met as the partnership had a member that was not an individual, a C corporation, or the estate of a deceased partner. Robert countered that the single member LLC was, under the regulations for IRC Section 7701, disregarded and thus the "owner" should be viewed as an individual.

Under Reg. §301.6231(a)(1)-1(a)(2) a partnership does not qualify for the small partnership exception if any partner is a pass-thru partner as defined at IRC §6231(a)(9). That provision defines a pass-thru partner as any "partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership." The IRS contended that an SMLLC is just such a pass-thru partner.

The Ninth Circuit references Revenue Ruling 2004-88, cited above, noting:

> The IRS directly addressed the question of whether a disregarded entity may constitute a pass-thru partner in Revenue Ruling 2004-88, 2004-2 C.B. 165.1 We have previously applied *Skidmore* deference to revenue rulings. See

> *Omohundro v. United States*, 300 F.3d 1065, 1068 (9th Cir. 2002) (per curiam). Under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944), and the Supreme Court's decision in *United States v. Mead Corp.*, 533 U.S. 218 (2001), an agency's ruling "is eligible to claim respect according to its persuasiveness." 533 U.S. at 221 (citing generally *Skidmore*, 323 U.S. 134). We consider multiple factors when exercising *Skidmore* review of agency action, including "the thoroughness and validity of the agency's reasoning, the consistency of the agency's interpretation, the formality of the agency's action, and all those factors that give it the power to persuade, if lacking the power to control." *Tualatin Valley Builders Supply, Inc. v. United States*, 522 F.3d 937, 942 (9th Cir. 2008); see also *Tablada v. Thomas,* 533 F.3d 800, 806–08 (9th Cir. 2008) (finding Skidmore deference warranted in light of the "rational validity" and consistent application of an agency's position, despite the existence of reasonable alternative interpretations).

The Ninth Circuit then looks at the details of the ruling to see if it should be granted deference under the above standard. While noting the ruling does not "contain extensive discussion of its analysis" it still found the logic persuasive.

> Ruling 2004-88 starts by emphasizing that the definition of a "pass-thru" partner contained in § 6231(a)(9) includes "partnership[s], estate[s], trust[s], S corporation[s], nominee[s] or [an]other similar person through whom other persons hold an interest in the partnership." Rev. Rul. 2004-88 (quoting § 6231(a)(9)). In other words, the definition expressly contemplates its application beyond the specific enumerated forms. Single-member LLCs are indisputably entities "through whom other persons hold an interest in [a] partnership." The question, therefore, is whether a single-member LLC constitutes a "similar person" in respect to the enumerated entities. Ruling 2004-88 holds that the requisite similarity exists when "legal title to a partnership interest is held in the name of a person other than the ultimate owner." Id. In support of this holding, Ruling 2004-88 cites *White v. Commissioner*, 62 T.C.M. (CCH) 1181 (1991), in which the custodian for minor children was not a pass-thru partner because it did not hold legal title to the children's partnership interests. Ruling 2004-88 contrasts that result with the

> outcome in *Primco Management Co. v. Commissioner*, 74 T.C.M. (CCH) 177 (1997), in which a grantor trust holding legal title to an interest in an S corporation constituted a pass-thru shareholder. Ruling 2004-88 then goes on to state that,
>
> > although LLC is a disregarded entity for federal tax purposes, LLC is a partner of P under the law of the state in which P is organized. Similarly, although A, LLC's owner, is a partner of P for purposes of the TEFRA partnership provisions under section 6231(a)(2)(B) because A's income tax liability is determined by taking into account indirectly the partnership items of P, A is not a partner of P under state law. *Because A holds an interest in P through LLC, A is an indirect partner and LLC, the disregarded entity, is a pass-thru partner under the TEFRA partnership provisions.* Consequently, the small partnership exception does not apply to P because P has a partner that is a pass-thru partner.
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> Rev. Rul. 2004-88 (emphasis added).

The panel rejected the argument that such a view was contrary to Reg. §301.7701-1(a)(1). But the panel found that the issue was not whether the IRS had to follow a state law structure in its federal tax law treatment. Rather, the ruling held:

> But the issue here is not whether the IRS may use state-law entity classifications to determine federal taxes. Rather, the question is whether an LLC's federal classification for federal tax purposes negates the factual circumstance in which the owner of a partnership holds title through a separate entity. In other words, state law is relevant to Ruling 2004-88's analysis only insofar as state law determines whether an entity bears the requisite similarity to the entities expressly enumerated in § 6231(a)(9) — that is, whether an entity holds legal title to a partnership interest such that title is not held by the interest's owner.

The panel also found that Robert did have standing to challenge the IRS by filing a petition on Seaview's behalf, since the actual partner was not Robert but the SMLLC. As the ruling noted:

> Seaview does not dispute the tax court's factual findings that AGK held the largest interest in Seaview, that AGK filed its own petition for relief, or that Kotick filed his petition within

> the 90-day period during which only the tax matters partner may file such a petition. Seaview additionally presents no argument as to why the tax court erred in its analysis, beyond Seaview's general assertion that as a disregarded entity, AGK could not be tax matters partner. As we discuss supra, an entity's disregarded status does not preclude its treatment as a separate, pass-thru partner for the purposes of applying TEFRA's procedures.

SECTION: 7525
PRIVILEGE DID NOT ALLOW TAX PREPARER TO AVOID ANSWERING QUESTIONS REGARDING CLIENT UNDER IRS SCRUTINY

Citation: United States v. Radchik, USDC NJ, Case No. 2:17-cv-01187, 6/1/17

The IRS was investigating tax preparer Isana Radchik's clients for tax related matters, including a potential failure to file foreign financial bank account reports and whether the proper amounts of federal tax liabilities. In the case of *United States v. Radchik*, USDC NJ, Case No. 2:17-cv-01187, the question before the Court was whether the preparer could be required to respond to an IRS summons for information related to her work.

The taxpayer claimed two reasons why should not be required to respond to the IRS's summons:

- Under §7525 the information in question was protected by the tax practitioner privilege and
- She asserted her own fifth amendment right against self-incrimination.

IRC §7525 provides for a limited privilege available to "federally authorized tax practitioner" (FATP). An FATP is any individual authorized to practice before the IRS under the provisions found in Circular 230—generally attorneys, CPAs and EAs. If the individual is an FATP, the privilege is defined at §7525(a) as:

> (a) Uniform application to taxpayer communications with federally authorized practitioners
>
> > (1) General rule
> >
> > With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a

> taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.
>
> (2) Limitations
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> Paragraph (1) may only be asserted in--
>
> > (A) any noncriminal tax matter before the Internal Revenue Service; and
> >
> > (B) any noncriminal tax proceeding in Federal court brought by or against the United States.

A key factor to note is that the privilege is restricted to "tax advice" and is also no broader than what would exist for an attorney. Information obtained in the preparation of a tax return is generally not protected. As the opinion notes:

> The Section 7525 privilege "is no broader than the attorney-client privilege." *Trenk*, 2009 WL 485375, at *4. As a result, several district courts, including the District of New Jersey, have found that "[t]he privilege does not protect communications between a tax practitioner and a client simply for the preparation of a tax return." *Trenk*, 2009 WL 485375, at *4; *United States v. KPMG LLP*, 316 F. Supp. 2d 30, 35 (D.D.C. 2004); *Chao v. Koresko*, 2005 WL 2521886 (3d Cir. Oct. 12, 2005); see also *United States v. Arthur Andersen, L.L.P.*, 273 F. Supp. 2d 955, 957-58 (N.D. Ill. 2003), amended on reconsideration sub nom. *United States v. Arthur Andersen,* LLP, No. 02-6790, 2003 WL 21956404 (N.D. Ill. Aug. 15, 2003) (stating "[c]onfidentiality in the tax context may be waived when the communications with the tax adviser ultimately are used to prepare the client's tax returns, a non-confidential document.")

The tax adviser needs to establish that there was communication for the purpose of obtaining tax advice for any communications alleged to be protected. As the opinion continues:

> Courts analyze this burden applying the same framework as in the attorney-client privilege context: "a client seeking tax advice must obtain that advice from a tax professional acting as such, and in a manner indicating that those communications will be kept in confidence." *Arthur Anderson, L.L.P.,* 273 F. Supp. 2d, at 957-58; see also *Valero*

> *Energy Corp. v. United States,* No. 06-6730, 2008 WL 4104368, at *4 (N.D. Ill. Aug. 26, 2008), aff'd, 569 F.3d 626 (7th Cir. 2009) (protected "communication[s] must be made for the purpose of obtaining tax advice from a federally authorized tax practitioner.") Tax advice is defined within the statute as "advice given by an individual with respect to a matter which is within the scope of the individual's authority to practice." 26 U.S.C.A. § 7525; see also *Wells Fargo & Co. v. United States*, No. 09-2764, 2014 WL 2855417, at *6 (D. Minn. June 16, 2014). This does not include "[c]ommunications made primarily to assist in implementing a business transaction," but it may include a discussion of "legal tax strategy consequences," "interpretation of a partnership agreement," a "draft valuation" of a company, or "tax planning advice". *United States v. Microsoft Corp.*, No. 15-102, 2017 WL 1788411, at *3 (W.D. Wash. May 5, 2017); *Pasadena Ref. Sys. Inc. v. United States*, No. 10-0785, 2011 WL 1938133, at *3 (N.D. Tex. Apr. 26, 2011), report and recommendation adopted, No. 10-785, 2011 WL 1960555 (N.D. Tex. May 19, 2011); *United States v. BDO Seidman, LLP*, No. 02-4822, 2003 WL 932365, at *2 (N.D. Ill. Feb. 5, 2003), aff'd sub nom. *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003).

While the Court noted that the IRS was in error when it claimed that the taxpayers had to affirmatively assert the privilege before it could be invoked, the Court found that the preparer had failed to show that what was being asked for fell within such privileged communications with her client.

Many of the questions she objected had no obvious connection to tax advice, nor had she ever shown that she had been requested to provide tax advice as distinct from return preparation. The opinion notes:

> The difficulty is Ms. Radchik has made no showing that she performed any work for the Bernshteyns beyond tax preparation. To date she has asserted that she prepared the Bernshteyns taxes, but not mentioned any tax advice she gave or circumstances surrounding advice she may have given. Absent Ms. Radchik giving tax advice and the government calling on her to divulge the advice, Ms. Radchik cannot assert the tax practitioner privilege.

Now the Court moved on to the second issue—that of a claim of fifth amendment protection against having to provide this information to the IRS. Note that the fact that information might subject her clients to criminal prosecution is not sufficient to invoke the privilege. The Court notes:

> Only the person to whom the privilege applies can claim the privilege. For example, it is not sufficient for Ms. Radchik to claim that she would be incriminating her clients' because the "privilege was never intended to permit (a person) to plead the fact that some third person might be incriminated by his testimony." *Matter of Grand Jury Empanelled*, 603 F.2d at 472 (internal citations omitted).

As well, a mere vague, unsubstantiated belief that the information might lead to criminal prosecution is not sufficient. The Court continues:

> Additionally, the person invoking the privilege "must provide more than mere speculative, generalized allegations of possible tax-related prosecution," there must be "substantial and real hazards of self-incrimination." Id. at 705; see also *United States v. Marra*, No. 05-2509, 2005 WL 2474873, at *8 (D.N.J. Oct. 5, 2005)

The IRS argued that she could have no such reasonable fear of prosecution because even if she had committed some criminal offense, the statute for charging her with the crime had expired and there was no ongoing investigation of the preparer:

> It is the Government's position that to assert the privilege against self-incrimination, Ms. Radchik must make a showing of a real and substantial hazard that might result by disclosing the information. (Tr. at 3.) According to the Government, no such threat exists because it is time barred from indicting Ms. Radchik and there is no current investigation of Ms. Radchik. The Government is "not delaying recommendation for a criminal investigation in order to gather more information," rather there is simply "no DOJ referral" according to Government attorney Nelson Wagner. (Tr. at 4.)

The Court found that, again, the preparer had failed to show evidence the privilege should apply:

> At this point there is no indication that criminal charges will be brought against Ms. Radchick. The investigation is being

> conducted by an IRS Agent for the purpose of assessing penalties for unpaid taxes. Ms. Radchick needs to point to some concrete evidence that she has a "real and substantial" concern regarding criminal prosecution. Stating her fear alone is not sufficient. The Court needs more than her "say-so" to appropriately apply fifth amendment protections. There must be a showing that Ms. Radchik's answers to the Government's questions would furnish the necessary link to prosecute Ms. Radchick under one of the statutes she mentions. Nothing in Respondent's Opposition to the Order to Show Cause, supplemental brief, or in-camera testimony substantiates her alleged fear of prosecution. Without more, this Court cannot afford Ms. Radchick protection under the fifth amendment.

In this case the Court was dealing with her assertion that she could avoid answering any IRS questions based on either or both privileges. The Court did note that if a specific inquiry the IRS made raised issues regarding either privilege she could raise that issue (and presumably end back up in Court)—but she had to subject herself to an IRS interview.

It is important to understand just how limited the practitioner privilege is—the vast majority of communications most readers are involved in will not be protected simply because it most often was obtained in the process of preparing a return. And even when it does relate to advice, the privilege still fails if the matter rises to a criminal level or the matter is not a tax matter before the federal courts.

Similarly, it's important to remember that the fifth amendment won't allow a preparer to keep from disclosing information just because it could incriminate a client.

Most non-attorney advisers have not had any serious training regarding how privilege works and how it may be destroyed—and given the porous nature of what privilege is created by IRC §7525 (no criminal matters and no protection for non-tax litigation) if it appears information is about to be revealed that needs to be privileged, competent legal counsel should be sought *before* the adviser gets the details that might have to later be revealed.