Current Federal Tax Developments

Week of October 26, 2020

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ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF OCTOBER 26, 2020
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Current Federal Tax Developments

Kaplan Financial Education

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SECTION: 165
DAILY FANTASY SPORTS FEE IS A WAGERING TRANSACTION, DEDUCTIONS LIMITED TO WINNINGS, PER CHIEF COUNSEL ADVICE

Citation: Chief Counsel Advice 202042015, 10/16/20

In CCA 202042015[1] the IRS decided that the amount a daily fantasy sports player pays to participate in a contest is a wagering expense subject to IRC §165(d)'s limitation on the deduction of gambling losses.

IRC §165(d) provides:

> (d) Wagering losses
>
> Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions. For purposes of the preceding sentence, in the case of taxable years beginning after December 31, 2017, and before January 1, 2026, the term "losses from wagering transactions" includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction.

The memorandum begins by describing a standard fantasy sports league:

> A traditional fantasy sports league is comprised of participants that select players from professional sports teams to create a "fantasy" team. The selection of professional players occurs during a "draft" held at the beginning of the season. Each professional player can only be selected once during the draft, but participants may drop, add, or trade players as they become available throughout the season. A schedule is created and each week fantasy teams compete head to head. The winner of the match up depends on the statistical performance of each professional player in their respective real-life sports games that week.[2]

The memorandum then goes on to describe how daily fantasy sports (DFS) differs from the traditional model:

> DFS modified the traditional fantasy sports model to offer more flexible and fast paced competitions. Under the DFS model, participants are given a salary cap with which to select their fantasy team. Multiple participants can select the same professional players so long as they do not exceed the salary cap. Instead of drafting professional players for an entire season, the fantasy team exists for a

[1] CCA 202042015, October 16, 2020, https://www.irs.gov/pub/irs-wd/202042015.pdf (retrieved October 17, 2020)

[2] CCA 202042015, pp. 1-2

> single day or a single week. Once participants have created their teams, they may select from a variety of competitions including head to head competitions, cash games, guaranteed prize pools, and 50/50 competitions:
>
> - Head to head competitions allow two players to challenge each other with the winner receiving the entire pool.
> - Cash games include transactions within a league that identifies winners based on the best performing teams.
> - Guaranteed prize pools are games that have a set entry fee to compete in a fixed prize pool, regardless of the number of entrants.
> - 50/50 competitions involve a transaction in which the top 50% of performers nearly double their returns on investment while the other half receive nothing.
>
> Each of these contests are structured as pay to play, with the participant submitting an entry fee for each contest, and the host website taking a commission from fees collected. Participants receive points based on the live performance of their selected players. The points for each player on the fantasy team are compiled for a final fantasy score that determines the winners of the match up.[3]

The memorandum looks to determine if the above describes a wagering transaction to which IRC §165(d) would apply. The analysis looks at what courts have determined to be wagers:

> In the absence of a statutory or regulatory definition, a term's "plain, obvious, and rational meaning" must be applied. See *Liddle v. Commissioner*, 103 T.C. 285 (1994); *Boyd v. United States*, 762 F.2d 1369 (9th Cir. 1985). In *Tschetschot v. Commissioner*, T.C. Memo 2007-38, for purposes of applying § 165(d), the Tax Court examined dictionary definitions of wager, including Random House College Dictionary's definition of "something risked or staked on an uncertain event; bet; the act of betting," in ultimately holding a poker tournament is a wagering activity. The Court also considered the following definition of wager from Black's Law Dictionary:
>
> > Money or other consideration risked on an uncertain event; a bet or gamble. 2. A promise to pay money or other consideration on the occurrence of an uncertain event.
>
> The Court stated that wagering, when used in the Internal Revenue Code (the Code), is synonymous with gambling. *Id.*

[3] CCA 202042015, p. 2

> State courts note the definition of wager requires two or more parties, having mutual rights in respect to the money wagered, having a chance to win or lose upon the outcome of an uncertain event. See *Las Vegas Hacienda, Inc. v. Gibson*, 77 Nev. 25, 27, (1961); see also *Robertson v. United States*, 343 U.S. 711(1952); *Toomey v. Penwell*, 76 Mont. 166 (1926). In this way, a wager is distinguishable from a prize. Unlike a wager, State courts have found that a prize or reward is compensation for an act done. See *Las Vegas Hacienda*, 77 Nev. at 27 (The court held an offer to pay $5,000 for shooting a hole in one to any golfer paying a small fee is a prize, not a wager); *Toomey v. Penwell*, 76 Mont. at 172-173 (Requiring owners to pay entry fees to enter their horses in a race does not constitute a wager, and the purse money awarded to the winner is a prize).[4]

The memorandum determines that the DFS transactions meet the definition of a wager:

> DFS transactions meet the definition of wager as interpreted by the Tax Court and State courts because there is an uncertain event (such as the live performance of individual players), winnings if the event resolves in participant's favor, and consideration is lost if the event does not resolve in participant's favor. Each DFS transaction is a pay to play competition with predetermined winnings for a certain number of participants. The outcome of the competition turns on the overall statistical performance of live professional players assembled into the fantasy team. The winning participant receives a return of his or her initial bet along with wagering gains, while the losing participant walks away empty handed. This is consistent with the courts' interpretation of the term "wager."[5]

The memorandum concludes that the activity is not a contest of skill, a category that would exempt the payment from being treated as a wager:

> It may be argued that DFS is not wagering because it is a contest of skill. As a general rule, a contest in which a prize is offered based on the mental or physical skill of the contestant is not considered gaming. The fact that each contestant is required to pay an entrance fee does not make the payment a bet or gaming transaction unless the entrance fees alone consist of the winnings to be won by the successful contestant. See Rev. Rul. 57-521, 1957-2 C.B. 779. Revenue Ruling 57-521 examined a puzzle contest in which contestants submitted solutions with a fee per submission to play and concluded that the puzzle game was not a wagering pool or lottery under the excise tax provisions of § 4421 because the outcome relied entirely on the contestant's skill in completing the puzzle. The Service later distinguished this type of contest as a game of skill from poker tournaments which are considered wagering. See *Tschetschot v. Commissioner*, T.C. Memo 2007-38; see also *Gustafson v. Alloyd Co.*, 513 U.S. 561, 570 (1995) (Generally, an Act of Congress should not be

[4] CCA 202042015, pp. 2-3

[5] CCA 202042015, p. 3

> read as a series of unrelated and isolated provisions); *Atl. Cleaners & Dyers v. U.S.*, 286 U.S. 427, 433 (1932) (There is a presumption that identical words used in different parts of the same act are intended to have the same meaning; however, this is not absolute, and the same term may be interpreted differently when reasonably warranted). DFS transactions are similar to poker and other wagers in which a player's skill is a component of the game but it does not dictate the outcome. As such, the argument that DFS transactions are excluded from wagering as a game of skill are unpersuasive.[6]

The memorandum also concludes the fact that the player selects a team does not convert the payment into an entrance fee rather than a wagering transaction subject to §165(d)'s limits:

> It may also be argued that the DFS pay to play transactions are entrance fees for their team, comprised of players selected by the taxpayer based on knowledge and skill, to compete. However, the test is not whether there is an element of chance or skill, but which is the dominating element that determines the result of the game. See *People ex rel. Ellison v. Lavin*, 71 N.E. 753, 755 (N.Y. 1904). While skill may be involved in drafting the players of a team, the taxpayer's skill has no impact on the players' live performances. Further, DFS is not unlike pari-mutuel betting, long considered wagering, in which an individual uses knowledge and skill to choose which players or horses to select. See *Lakhani v. Commissioner*, 142 T.C. 151, 154 (2014) (pari-mutuel wagering is an event of chance). Although skill may be an element of the transaction, chance dominates the outcome of the transactions. See *Mayo v. Commissioner*, 136 T.C. 81, 91 (2011) (a wager is where a taxpayer stands to win or lose on the basis of chance); Rev. Rul. 83-130, 1983-2 C.B. 148 (a raffle ticket is a wager because it is the disposal by chance of a single prize among purchasers of single chances). Any argument a DFS transaction is not wagering because it is based on skill must fail because elements of chance beyond the participant's control ultimately determine the outcome of the transaction.[7]

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[6] CCA 202042015, pp. 3-4

[7] CCA 202042015, p. 4

SECTION: 165
REVENUE PROCEDURE 2009-20 PONZI SCHEME SAFE HARBOR DEDUCTION MUST BE CLAIMED IN YEAR PROVIDED IN THE REVENUE PROCEDURE

Citation: Giambrone et al v. Commissioner, TC Memo 2020-145, 10/19/20

In the case of *Giambrone et al v. Commissioner*, TC Memo 2020-145[8] the Tax Court ruled that a taxpayer must strictly follow an IRS revenue procedure granting a more favorable tax treatment than normally would be available if the taxpayer wishes to take advantage of the procedure.

The case involved what is often referred to as the "Madoff ruling" found at Revenue Procedure 2009-20. The revenue procedure grants taxpayers relief from the normal provisions for claiming a theft loss from criminally fraudulent investment arrangements, such as Ponzi schemes. The ruling was issued following the confession of Bernie Madoff to having run one of the largest Ponzi schemes ever.

The procedure allowed taxpayers to claim theft losses from such schemes under a simplified reporting method. If a taxpayer is not pursuing a potential third-party recovery, the taxpayer may claim as a loss 95% of the qualified investment. In this case, the key issue was when that deduction had to be claimed under the revenue procedure.

The loss is to be claimed in the *discovery year* as defined in the Revenue Procedure.[9] The *discovery year* is defined as:

> .04 Discovery year. A qualified investor's discovery year is the taxable year of the investor in which the indictment, information, or complaint described in section 4.02 of this revenue procedure is filed.[10]

The indictment, information or complaint relates to the lead figure(s) in the fraudulent scheme.[11] In this case the lead figure was Mr. Farkas, and the action against him was described as follows in the opinion:

> On June 15, 2010, a Federal grand jury returned an indictment against Mr. Farkas charging him with conspiracy and bank, wire, and securities fraud. According to the indictment Mr. Farkas had devised a scheme to misappropriate over $1 billion in funds from various financial institutions, including TBW, the FHLMC, the Government National Mortgage Association, and the Troubled Asset Relief Program. A jury

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[8] *Giambrone et al v. Commissioner*, TC Memo 2020-145, October 19, 2020, https://www.ustaxcourt.gov/UstcInOp2/OpinionViewer.aspx?ID=12344 (retrieved October 20, 2020)

[9] Revenue Procedure 2009-20, Section 5.01

[10] Revenue Procedure 2009-20, Section 4.04

[11] Revenue Procedure 2009-20, Section 4.02

> convicted Mr. Farkas on April 19, 2011, and he later was sentenced to 30 years in prison.[12]

The Giambrones were investors that were a victim of the fraudulent scheme. However, as the opinion notes, they did not claim a loss under Revenue Procedure 2009-20 until the filing of their 2012 income tax return, despite Mr. Farkas being indicted two years earlier:

> The Giambrones claimed theft loss deductions of 95% of the value of their investments in Platinum on their 2012 Federal income tax returns. The Giambrones premised their claimed deductions on Rev. Proc. 2009-20, sec. 1, 2009-14 I.R.B. at 749, which provides "an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent."[13]

The IRS challenged the deduction, noting that the Revenue Procedure was not available to be used on the 2012 return—if they were going to make use of that safe harbor, the taxpayers were required to do so on their 2010 return, as that was the year Mr. Farkas was indicted.

The taxpayers argued that limiting the discovery year to the single year the lead figure is indicted is not compatible with IRC §165(e) and Reg. §1.165-1(d)(3), and that their treatment of 2012 as that year is compatible with that broader rule.[14]

The Tax Court begins its analysis by noting that a Revenue Procedure is not binding on the Tax Court and, thus, "even if the Giambrones were to establish that the IRS had erred in its application of Rev. Proc. 2009-20, supra, we would not be required to conclude that they are entitled to the claimed theft loss deductions."[15]

The Court notes that the taxpayers concede they did not request safe harbor treatment on their 2010 income tax returns. The Court then notes that the taxpayers are in error when they assert the safe harbor must include the broader view of the discovery year found in the IRC and regulations:

> The Giambrones are laboring under a fundamental misconception: Rev. Proc. 2009-20, supra, is not required to comport with the terms of section 165 (or the accompanying regulation). It is an exercise of administrative discretion on the part of the IRS, offering beneficial treatment for categories of theft losses meeting certain well-defined conditions. The Giambrones cannot gain the benefit of it without adhering to its conditions the IRS imposed. See, e.g., *Beech Trucking Co. v. Commissioner*, 118 T.C. 428, 444 (2002)[16]

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[12] *Giambrone et al v. Commissioner*, TC Memo 2020-145, p. 5

[13] *Giambrone et al v. Commissioner*, TC Memo 2020-145, pp. 5-6

[14] *Giambrone et al v. Commissioner*, TC Memo 2020-145, p. 11

[15] *Giambrone et al v. Commissioner*, TC Memo 2020-145, p. 10

[16] *Giambrone et al v. Commissioner*, TC Memo 2020-145, p. 12

In a footnote, the Court expands on the analysis. Since the IRS has granted a benefit not otherwise available under the IRC, the only issue for dispute is if the IRS fails to follow the terms of the relief itself:

> "We have recognized * * * that an abuse of discretion can occur where the Commissioner fails to observe self-imposed limits upon the exercise of his discretion, provided he has invited reliance upon such limitations." *Capitol Fed. Sav. & Loan Ass'n v. Commissioner,* 96 T.C. 204, 217 (1991). Here, the IRS stayed within the bounds set forth in Rev. Proc. 2009-20, *supra*, when disallowing the Giambrones' belated safe harbor requests.[17]

The taxpayers may avail themselves of the provisions of the law and regulations, presuming that 2012 would be a proper discovery year under those rules. But the taxpayers would also face other limitations on claiming a loss in those cases. As Revenue Procedure 2002-90 noted as a justification for its safe harbor when released:

> .03 The Service and Treasury Department recognize that whether and when investors meet the requirements for claiming a theft loss for an investment in a Ponzi scheme are highly factual determinations that often cannot be made by taxpayers with certainty in the year the loss is discovered.
>
> .04 In view of the number of investment arrangements recently discovered to be fraudulent and the extent of the potential losses, this revenue procedure provides an optional safe harbor under which qualified investors (as defined in § 4.03 of this revenue procedure) may treat a loss as a theft loss deduction when certain conditions are met. This treatment provides qualified investors with a uniform manner for determining their theft losses. In addition, this treatment avoids potentially difficult problems of proof in determining how much income reported in prior years was fictitious or a return of capital, and alleviates compliance and administrative burdens on both taxpayers and the Service.[18]

That is, the taxpayers could make use of the broader view of the discovery year in the law and regulations—but if they do so, they have to take on the burdens of dealing with all of the requirements of applying the law that the safe harbor mitigates.

In the view of the Court, the IRS is not forced to allow taxpayers to, effectively, use the parts of the safe harbor that are favorable to them and ignore those portions that present problems in their case—it's an all or nothing option to make use of the safe harbor.

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[17] *Giambrone et al v. Commissioner*, TC Memo 2020-145, p. 12, Footnote 7

[18] Revenue Procedure 2009-20, Section 2.03-2.04

SECTION: 408
DISTRIBUTION MADE TO A STATE UNCLAIMED PROPERTY FUND ADDED TO SELF-CERTIFICATION REASONS FOR LATE RETIREMENT PLAN ROLLOVER

Citation: Revenue Procedure 2020-46, 10/16/20

In 2016 the IRS released Revenue Procedure 2016-47,[19] providing the ability for an individual to self-certify specific reasons why they had not been able to roll over an IRA or qualified plan distribution within 60-days, qualifying for late rollover relief so long as the holder was able to document the self-certified reason if later required to by the IRS.

The IRS has now reissued the relief[20] to add a new self-certification reason:

> In response to requests from stakeholders, this revenue procedure modifies that list by adding a new reason: a distribution was made to a state unclaimed property fund.[21]

Aside from adding the new exception ("…the distribution was made to a state unclaimed property fund."),[22] no other changes were made to the prior ruling. However, Revenue Procedure 2020-46 includes the revised example certification, as well as the text of the other provisions in the original ruling.

Thus, the current list of reasons for a late rollover that the taxpayer may self-certify are:

- An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates;
- The distribution, having been made in the form of a check, was misplaced and never cashed;
- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
- The taxpayer's principal residence was severely damaged;
- A member of the taxpayer's family died;
- The taxpayer or a member of the taxpayer's family was seriously ill;

[19] The ruling was described in detail in the article "IRS Provides for Automatic Qualified Plan/IRA Late Rollover Relief" published on the Current Federal Tax Developments site on August 24, 2016. https://www.currentfederaltaxdevelopments.com/blog/2016/8/24/irs-provides-for-automatic-qualified-planira-late-rollover-relief (retrieved October 17, 2020)

[20] Revenue Procedure 2020-46, October 16, 2020, https://www.irs.gov/pub/irs-drop/rp-20-46.pdf (retrieved October 17, 2020)

[21] Revenue Procedure 2020-46, p. 1

[22] Revenue Procedure 2020-46, p. 3

- The taxpayer was incarcerated;
- Restrictions were imposed by a foreign country;
- A postal error occurred;
- The distribution was made on account of a levy under § 6331 and the proceeds of the levy have been returned to the taxpayer;
- The party making the distribution to which the rollover relates delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information; or
- The distribution was made to a state unclaimed property fund.[23]

SECTION: 3405
DISTRIBUTION OF EMPLOYER RETIREMENT PLAN BALANCE TO STATE UNCLAIMED PROPERTY FUND IS SUBJECT TO TAX WITHHOLDING AND INFORMATION REPORTING REQUIREMENTS

Citation: Revenue Ruling 2020-24, 10/16/20

Payments made to state unclaimed property funds of a participant's benefit from a retirement plan are subject to federal income tax withholding and information reporting, the IRS has ruled in Revenue Ruling 2020-24.[24]

The ruling is based on the following facts:

> Employer M is the plan administrator of Plan X, a qualified retirement plan under § 401(a) that does not include designated Roth accounts under § 402A, hold employer securities, or provide benefits described in § 104 (compensation for injuries or sickness) or § 105 (amounts received under accident and health plans). Individual C, a U.S. person under § 7701(a)(30)(A) with a calendar year taxable year, has an accrued benefit in Plan X with a value of $900, has not made a withholding election under § 3405 with respect to her benefit, and has no investment in the contract within the meaning of § 72 with respect to her benefit. In 2020, Individual C's accrued benefit (net of any applicable withholding) is paid to the State J unclaimed property fund, a fund under which a claim for property may be made by an owner.[25]

[23] Revenue Procedure 2020-46, p. 3

[24] Revenue Ruling 2020-24, October 16, 2020, https://www.irs.gov/pub/irs-drop/rr-20-24.pdf (retrieved October 17, 2020)

[25] Revenue Ruling 2020-24, pp. 1-2

The ruling concludes that no exception exists from the requirement that a designated distribution rules under IRC §3405(e)(1)(B) exists for such a transfer, taxes must be withheld by the plan pursuant to IRC §3405(d).[26]

As well, because it is a designated distribution, reporting of any distribution in excess of $10 will be required on a Form 1099-R pursuant to IRC §6047(d).[27]

The ruling provides a warning in a footnote—the ruling should not be taken to indicate that such a distribution to a state unclaimed property fund would not violate other federal or state law:

> This revenue ruling does not address whether the payment to the State J unclaimed property fund otherwise complies with applicable law. For example, it does not address compliance with any search requirements applicable under state law and does not address matters arising under Title I of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 88 Stat. 829, as amended, for which the Department of Labor has subject matter jurisdiction under Reorganization Plan No. 4 of 1978, 5 U.S.C. App.[28]

SECTION: 6031
DRAFT 2020 FORM 1065 INSTRUCTIONS CONTAIN DETAILS OF TAX BASIS PARTNERS' CAPITAL ACCOUNT REPORTING REQUIREMENTS

Citation: 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, 10/21/20

The IRS has released a draft of the Form 1065 instructions for 2020 returns that contains the IRS's proposed requirement for reporting partners' capital on the K-1 on the tax basis.[29] The IRS issued a news release on the matter at the same time.[30]

News Release Summary

The news release indicates that the IRS has decided to require partnerships to use the transactional approach in computing partners' capital on the tax basis, and require tax basis capital reporting on the 2020 Schedules K-1, Form 1065. The release states:

> The revised instructions indicate that partnerships filing Form 1065 for tax year 2020 are to calculate partner capital accounts using the

[26] Revenue Ruling 2020-24, p. 3

[27] Revenue Ruling 2020-24, p. 4

[28] Revenue Ruling 2020-24, p. 2, Footnote 1

[29] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, https://www.irs.gov/pub/irs-dft/i1065--dft.pdf (retrieved October 22, 2020)

[30] IR-2020-240, October 22, 2020, https://www.irs.gov/newsroom/irs-releases-draft-form-1065-instructions-on-partner-tax-basis-capital-reporting (retrieved October 22, 202)

> transactional approach for the tax basis method. Under the tax basis method outlined in the instructions, partnerships report partner contributions, the partner's share of partnership net income or loss, withdrawals and distributions, and other increases or decreases using tax basis principles as opposed to reporting using other methods such as GAAP.
>
> According to IRS data, most partnerships already use the tax basis method although partnerships previously could report capital accounts determined under multiple methods.[31]

This means that partnerships that have always reported on the tax basis for partners' capital (which is what the IRS refers to as the transactional approach) will not need to use one of the methods proposed in Notice 2020-43 to determine partners' capital, either initially or on a continuing basis. That notice had proposed barring the use of the transactional approach[32] due to inconsistent use, but many commenters complained about the requirement to force partnerships that had always been reporting on something they felt was tax basis to go through one of the two alternative methods proposed in the Notice.

In the end, it appears the IRS not only relented and will allow continued use of the transactional approach, but has decided that is the only method to be allowed to be used following the computation of beginning partners tax basis capital for 2020 Schedules K-1.

The IRS defined the transactional approach as follows in Notice 2020-43:

> Commenters have indicated that many partnerships that currently possess partner tax capital information generally develop and maintain partner tax capital by applying the provisions and principles of subchapter K of chapter 1 of the Code (subchapter K), including those contained in §§ 705, 722, 733, and 742 of the Code, to relevant partnership and partner events. In such a situation, commenters have indicated that partnerships maintaining tax capital (i) increase a partner's tax capital account by the amount of money and the tax basis of property contributed by the partner to the partnership (less any liabilities assumed by the partnership or to which the property is subject) as well as allocations of income or gain made by the partnership to the partner, and (ii) decrease a partner's tax capital account by the amount of money and the tax basis of property distributed by the partnership to the partner (less any liabilities assumed by the partner or to which the property is subject) as well as allocations of loss or deduction made by the partnership to the partner (Transactional Approach).[33]

The IRS will reserve the two methods discussed in Notice 2020-43 solely for partnerships that have not been reporting partners' capital on the tax basis. They can

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[31] IR-2020-240, October 22, 2020

[32] Notice 2020-43, Section III (retrieved October 22, 2020)

[33] Notice 2020-43, Section III (retrieved October 22, 2020)

use these methods, among others, to compute their partners' beginning tax basis capital..

> Partnerships that did not prepare Schedules K-1 under the tax capital method for 2019 or otherwise maintain tax basis capital accounts in their books and records (for example, for purposes of reporting negative capital accounts) may determine each partner's beginning tax basis capital account balance for 2020 using one of the following methods: the Modified Outside Basis Method, the Modified Previously Taxed Capital Method, or the Section 704(b) Method, as described in the instructions, including special rules for publicly traded partnerships.[34]

The news release also indicates the IRS plans to publish a notice granting penalty relief for partnerships in this year of transition to tax basis capital account reporting:

> To promote compliance with using the tax basis method described in the revised instructions, the Treasury Department and the IRS intend to issue a notice providing additional penalty relief for the transition in tax year 2020. The notice will provide that solely for tax year 2020 (for partnership returns due in 2021), the IRS will not assess a partnership a penalty for any errors in reporting its partners' beginning capital account balances on Schedules K-1 if the partnership takes ordinary and prudent business care in following the form instructions to calculate and report the beginning capital account balances. This penalty relief will be in addition to the reasonable cause exception to penalties for any incorrect reporting of a beginning capital account balance.[35]

Likely the IRS has decided that the objections to date have primarily been related to the conversion of a minority of existing partnerships to the tax basis capital account reporting rather than the use of it on a continuing basis. So the agency has decided to be lenient in what will be allowed to compute the converted beginning tax basis capital account for partners, but then be strict regarding changes to those accounts being made only on the tax basis.

Instructions for Tax Basis Capital Accounts

The draft instructions begin by reminding taxpayers that the use of the tax basis is mandatory for 2020 partnership tax returns:

> **Tax basis method**. Figure each partner's capital account for the partnership's tax year using the transactional approach, discussed below, for the tax basis method. If you reported the partner's capital

[34] IR-2020-240, October 22, 2020

[35] IR-2020-240, October 22, 2020

> account last year using any other method (for example, GAAP, section 704(b), or other), you must use the tax basis method this year.[36]

Basic Transactional Method Approach

The IRS begins by describing a standard rule taxpayers should use to report partnership events or transactions:

> If you are uncertain how to report a partnership event or transaction, you should account for the event or transaction in a manner generally consistent with figuring the partner's adjusted tax basis in its partnership interest (without regard to partnership liabilities), taking into account the rules and principles of sections 705, 722, 733, and 742 and by reporting the amount on the line for other increase (decrease). *The partner's ending capital account as reported using the tax basis method in item L might not equal the partner's adjusted tax basis in its partnership interest. (emphasis added)* Generally, this is because a partner's adjusted tax basis in its partnership interest includes the partner's share of partnership liabilities, as well as partner specific adjustments. Each partner is responsible for maintaining a record of the adjusted tax basis in its partnership interest.[37]

Beginning Capital Account for Partnerships Previously Reporting on the Tax Basis

The IRS gives some information first for the majority of partnerships already purporting to report partners' capital on the tax basis about the beginning capital account reporting for 2020. The IRS starts by noting that taxpayers should, in this case, report the beginning capital account as the same number reported as the ending capital account on the prior year's Form 1065:

> If you figured the partner's capital account for last year using the tax basis method, enter the partner's ending capital account as determined for last year on the line for beginning capital account.[38]

Some taxpayers, now understanding that the IRS is looking to focus on negative capital accounts, may decide to recalculate their tax basis capital accounts. The IRS indicates that if they do so, some additional information will be necessary for partners whose capital account was negative on the prior return, but now shows a positive beginning balance:

> If you reported a negative ending capital account to a partner last year and a different amount is figured for the partner's beginning capital

[36] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 30

[37] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 30

[38] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 30

> account using the tax basis method this year, provide an explanation for the difference.[39]

As well, the IRS provides guidance for dealing with partners who did not hold a partnership interest in the prior year:

> If a partner joined the partnership through a contribution to the partnership this year, enter zero as the partner's beginning capital account. If a new partner acquired its interest in the partnership from another partner in a purchase, exchange, gift, inheritance, or as the result of death this year, enter an amount for beginning capital account that is equal to the transferor partner's ending capital account with respect to the interest transferred immediately before the transfer figured using the tax basis method.[40]

Contributions of Capital

The IRS gives the following instructions for properly reporting contributions of capital for tax basis capital account reporting:

> On the line for capital contributed during the year, enter the amount of cash plus the adjusted tax basis of all property contributed by the partner to the partnership during the year. The amount you enter on this line should be reduced by any liabilities assumed by the partnership in connection with, or liabilities to which the property is subject immediately before, the contribution. This amount might be negative.[41]

Note that final sentence—if a taxpayer's capital contribution included liabilities in excess of the basis of the property contributed, the capital contribution *should be a negative number*.

Current Year Net Income (Loss)

The income or loss line should be filled in as follows per the instructions:

> On the line for current year net income (loss), enter the partner's distributive share of partnership income and gain (including tax-exempt income) as figured for tax purposes for the year, minus the partner's distributive share of partnership loss and deductions

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[39] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 30

[40] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, pp. 30-31

[41] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

> (including nondeductible, noncapital expenditures) as figured for tax purposes for the year.[42]

Other Increases (Decreases)

The IRS goes on to describe the items that would be found in the other increases (decreases) box, with certain specific examples:

> On the line for other increase (decrease), enter the sum of all other increases or decreases that affected the partner's capital account for tax purposes during the year and attach a statement explaining each adjustment. For example, include increases for the following.
>
> - The partner's distributive share of the excess of the tax deductions for depletion (other than oil and gas depletion) over the adjusted tax basis of the property subject to depletion.
>
> - The partner's share of any increase to the adjusted tax basis of partnership property under section 734(b).
>
> Include decreases for the following.
>
> - The partner's distributive share of tax deductions for depletion of any partnership oil and gas property, but not exceeding the partner's share of the adjusted tax basis of that property.
>
> - The partner's share of any decreases to the adjusted tax basis of partnership property under section 734(b).

While §734 adjustments do affect partners tax basis capital accounts under the IRS system, the other adjustment triggered by an election under §754 does *not* affect partners tax basis capital accounts. §734 adjustments are internal to the partnership and affect all partners, while the §743 adjustment only affects the partner acquiring an interest. The IRS not only warns about this, but requires partnerships that have recorded a §743 adjustment in a manner that causes it to be included in a partner's purported tax basis capital account to remove that net adjustment on the 2020 return:

> **Note**: Section 743(b) basis adjustments are not taken into account in calculating a partner's capital account under the tax basis method. If section 743(b) adjustments are included in a partner's beginning capital account balance (because they were included in last year's ending capital account), those section 743(b) adjustments, whether positive or negative adjustments, should be removed from the partner's capital

[42] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

> account in the 2020 tax year and reported as a 2020 tax year other increase(decrease) item.[43]

Withdrawals and Distributions

The box that contains withdrawals and distributions should be computed for tax basis capital accounts as follows per the IRS instructions:

> On the line for withdrawals and distributions, enter the amount of cash plus the adjusted tax basis of all property distributed by the partnership to the partner during the year. The amount you enter on this line should be reduced by any liabilities assumed by the partner in connection with, or liabilities to which the property is subject immediately before, the distribution. This amount might be negative.[44]

Note that, as was true for capital contributions, distributions with liabilities in excess of basis may cause this number to properly be negative.

Ending Capital Account

Finally, the instructions discuss the ending capital account on the tax basis—and, not surprisingly, the IRS insists the column must add down to come up with the ending capital line:

> The sum of the amounts shown on the lines in item L above the line for ending capital account must equal the amount reported on the line for ending capital account. A partner's ending capital account determined under the tax basis method may be negative if the sum of a partner's losses and distributions exceeds the sum of the partner's contributions and share of income.[45]

Reconciliation with Schedule L (Balance Sheet) Partners' Capital Accounts

So must the capital accounts on the Schedule K-1s in total agree with the partners' capital accounts reported on Schedule L (Balance Sheet)? The answer is no, but only if Schedule L is not prepared on the tax basis.

The instructions to Schedule M-2 indicate that it the reconciliation of partners capital accounts is always prepared on the tax basis.[46]

> Show what caused the changes during the tax year in the partners' capital accounts as reflected on the *partnership's books and records used in*

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[43] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[44] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[45] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[46] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 55

> *figuring the partnership's net income or loss for tax purposes*, the amount of any contributions and distributions of money or property made by the partnership to its partners, and any other increases or decreases to the partners' capital accounts *determined in a manner generally consistent with calculating the partners' adjusted tax bases in their partnership interests* (without regard to partnership liabilities), taking into account the rules and principles of sections 705, 722, 733, and 742.[47]

But the instructions note that while you must reconcile Schedule L capital to the totals on partner's K-1 capital account balances if the Schedule L balance sheet is presented on the tax basis, the reconciliation is not required if the Schedule L balance sheet is not reported on the tax basis:

> The balance at the beginning of the year should equal the total of the amounts reported as the partners' beginning tax basis capital accounts in item L of all the partners' Schedules K-1. If not, the partnership should attach an explanation of the difference. Generally, the balance at the beginning of the year should equal the adjusted tax basis of the partnership's assets at the beginning of the year reduced by the partnership's liabilities at the beginning of the year. If the partnership's balance sheet (Schedule L) is reported on the tax basis and if the aggregate of the partners' beginning and ending capital accounts differ from the amounts reported on Schedule L, attach a statement reconciling any differences. *No such reconciliation is required if Schedule L is not reported on the tax basis.*[48]

But Schedule M-2 will remain on the tax basis, as is clear in the instructions related to the balance at the end of the year section for Schedule M-2.

> The balance at the end of the year should equal the total of the amounts reported as the partners' ending capital accounts in item L of all the partners' Schedules K-1.

Partnerships Previously Reporting on a Method Other than Tax Basis for Partners' Capital

Those partnerships that, in prior years, used a method other than tax basis to report partners capital are given special instructions for this year. As was noted earlier, these partners will have to report partners' capital on Schedule K-1 on the tax basis this year per the draft Form 1065 instructions.

Last year partnerships that reported on a basis other than tax basis for partner's capital accounts did have to report negative tax basis capital accounts for any partners with such accounts. Thus, such partnerships may already have complete schedules of

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[47] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 55

[48] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 55

partners tax basis capital accounts calculated in which case those numbers should be used:

> If you reported partners' capital accounts using a method other than the tax basis method last year, but also maintained capital accounts in your books and records using the tax basis method (for example, for purposes of meeting the requirement to report partner negative tax capital accounts), you must report each partner's beginning capital account using the tax basis method.[49]

If the partnership did not maintain such tax basis records the IRS provides that such partnerships may refigure each partner's *beginning* capital account using one of the following methods, with the same method being used for each partner:

- Tax basis method;
- Modified outside basis method;
- Modified previously taxed capital method; or
- §704(b) method.[50]

The partnership must use the standard tax basis methods described previously to report all other items on Schedule L aside from the beginning partners' capital balances, so this represents a one-time only calculation to obtain a starting point for a partner's tax basis capital account.[51]

The following disclosures must also be made to each partner in this case as a statement attached to Schedule K-1:

> You must also attach a statement to the partners' Schedules K-1 indicating the method used to determine each partner's beginning capital account.[52]

The three methods aside from reconstructing the transaction tax basis capital accounts are described in the following sections.

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[49] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[50] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[51] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[52] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

Modified Outside Basis Method

The first method for computing the partners' beginning tax basis capital accounts for the transition is the modified outside basis method. This method looks at the outside basis of each partner's capital account as a starting point.

The instructions describe the method as follows:

> The amount to report as a partner's beginning capital account under the modified outside basis method is equal to the partner's adjusted tax basis in its partnership interest as determined under the principles and provisions of subchapter K including, for example, sections 705, 722, 733, and 742; and subtracting from that basis (1) the partner's share of partnership liabilities under section 752 and (2) the sum of partner's section 743(b) adjustments (that is, net section 743(b) adjustments). For purposes of establishing a partner's beginning capital account, you may rely on the adjusted tax basis information provided by your partners.[53]

Assuming each partner can provide the partnership with this information, or the partnership has maintained such information for each partner, this provides a relatively simple method to make the conversion.

However, this method will in many cases not result in total partners' tax basis capital that will reconcile to net tax basis capital for a balance sheet prepared on the tax basis. Thus, the method may require, as a practical matter, that the Schedule L balance sheet continue to be reported on a basis other than tax basis.

Modified Previously Taxed Capital Method

The second method looks to make use of the method found in the regulations under §743 to compute "previously taxed capital" for use in computing a §743(b) adjustment for a partner. The method looks to start with the cash each partner would receive if all partnership assets were sold, and and then adjust that number to take into account the gains and losses that would be reported by each partner related to that sale. Thus, the calculation is meant to determine each partners' share of the inside net tax basis of partnership property.

The instructions describe this method as follows:

> The amount to report as a partner's beginning capital account under the modified previously taxed capital method is equal to the following.
>
> - The amount of cash the partner would receive if you liquidated after selling all of your assets in a fully taxable transaction for cash equal to the fair market value of the assets; increased by

[53] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

> - The amount of tax loss determined without taking into account any section 743(b) basis adjustments (including any remedial allocations under Regulations section 1.704-3(d)) that would be allocated to the partner following such a liquidation (treating all liabilities as nonrecourse); and decreased by
>
> - The amount of tax gain determined without taking into account any section 743(b) basis adjustments (including any remedial allocations under Regulations section 1.704-3(d)) that would be allocated to the partner following such a liquidation (treating all liabilities as nonrecourse).
>
> Instead of using the assets' fair market value, you may determine the partnership's net liquidity value, and gain or loss, by using such assets' bases as determined under section 704(b), as determined for financial accounting purposes, or on the basis set forth in the partnership agreement for purposes of determining what each partner would receive if the partnership were to liquidate, as determined by partnership management.[54]

If this method is used, the following additional information must be provided to the partner:

> If the modified previously taxed capital method is used, the statement must also include the method used to determine the partnership's net liquidity value (fair market value, section 704(b) book value, etc.). The method used to determine the partnership's net liquidity value must be adopted for all partners in the partnership.[55]

§704(b) Method

While the prior two methods were described by the IRS in Notice 2020-43, the draft instructions add a brand new method based on §704(b) capital accounts, referred to in the §704 regulations as "book capital" accounts.

The IRS describes this method as follows:

> The amount to report as a partner's beginning capital account under the section 704(b) method is equal to the partner's section 704(b) capital account, minus the partner's share of section 704(c) built-in gain in the partnership's assets, plus the partner's share of section 704(c) built-in loss in the partnership's assets. Property contributed to a partnership is section 704(c) property if, at the time of the contribution, its fair market value differs from its adjusted tax basis. Section 704(c) property also includes property with differences resulting from revaluations (reverse section 704(c) allocations). For

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[54] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

[55] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

> more information see sections 704(b) and 704(c) and Regulations sections 1.704-1 through 1.704-3.

Most partnership agreements drafted by legal counsel will require the maintenance of capital accounts under the §704(b) regulations or, in the case of target capital accounts, will provide what is essentially a yearly computation of that account that is used to determine income/loss allocations. The §704(b) capital accounts are important for a partnership to be able to defend any special allocations in the partnership agreement against an IRS challenge.

Again, this beginning "tax basis" capital account will often result in the total of the individual partner capital accounts not agreeing with the total of net tax basis capital on a balance sheet prepared on the income tax basis. So, again, this would be most appropriate in cases where the partnership plans to continue to report its Schedule L balance sheet on other than the tax basis.

Special Beginning Tax Basis Capital Account Method for Publicly Traded Partnerships

Finally, the instructions conclude with the following special method for computing the partners' beginning capital account for a publicly traded partnership:

> In the case of a sale or exchange of an interest in a publicly traded partnership, you may determine a transferee partner's beginning capital account by adjusting the partner's beginning capital account to reflect the transferee partner's purchase price of the interest rather than entering the transferor partner's ending capital account. In making the adjustments, you may use information required to be reported to you under Regulations section 1.6031(c)-1T, and publicly available trading price information. If you are a publicly traded partnership and adopt the modified previously taxed capital method, you may apply Regulations section 1.743-1(j)(4)(i)(B)(2) in figuring a partner's beginning capital account.[56]

[56] 2020 Instructions for Form 1065 (Draft), U.S. Partnership Return of Income, Draft as of October 21, 2020, p. 31

SECTION: 6651
CPA FIRM'S POTENTIAL LIABILITY TO CLIENT NOT SUBJECT TO REDUCTION DUE TO LAW FIRM FAILING TO PURSUE ALL POTENTIAL ROUTES TO REDUCE FAILURE TO FILE PENALTY

Citation: Goei, et al v. CBIZ, Inc. et al, USDC RI, C.A. No. 18-263-JJM-PAS, 9/29/20

In the case of *Goei, et al v. CBIZ, Inc. et al*[57] a U.S. District Court ruled that a CPA firm could not rely on alleged poor representation by the client's attorneys to reduce damages the firm might owe due to the taxpayers being subjected to failure to file penalties. While the ruling is based on specific Rhode Island law issues, it outlines the risks CPA firms face when dealing with filing issues.

The taxpayer in question lived in Switzerland but had U.S. filing responsibilities. He had engaged an individual CPA in 2007 to advise him on U.S. tax issues and handle tax filings. The CPA joined the CPA firm in 2008, bringing Mr. Goei along with him.

The preparation of Mr. Goei's 2014 income tax return was proving to be an involved situation with not all information immediately available as the October 15, 2015 extended due date approached. The opinion explains the situation as follows:

> As the October 15, 2015 filing deadline was approaching, Mr. Willey had not completed Plaintiffs' 2014 tax returns. Mr. Willey told Mr. Goei that he was "struggling with" the "presentation" of Mr. Goei's foreign entities on the tax returns.
>
> On October 9, 2015, Mr. Goei emailed Mr. Willey information that allowed him to figure out Plaintiffs' 2014 taxable income and gross U.S. tax. Mr. Willey still did not complete Plaintiffs' 2014 tax returns.
>
> Plaintiffs' Swiss tax returns were not complete as of the U.S. deadline of October 15, 2015, and Mr. Willey informed Mr. Goei that as of late October Plaintiffs would owe six or seven hundred thousand dollars in penalties. The Swiss returns were not completed until mid-December and not provided to Mr. Willey until after December 15. At that point, because more than two months had passed since Plaintiffs' U.S. filing deadline, Plaintiffs had incurred three months' worth of penalties.
>
> Plaintiffs were entirely unaware that the IRS would assess them millions of dollars in penalties and interest as the October 15th deadline passed without a filing. Mr. Willey did not tell Plaintiffs that the IRS would assess them Failure to File Penalties in addition to

[57] *Goei, et al v. CBIZ, Inc. et al, USDC RI*, C.A. No. 18-263-JJM-PAS, September 29, 2020, https://law.justia.com/cases/federal/district-courts/rhode-island/ridce/1:2018cv00263/44384/70/ (retrieved October 19, 2020)

> penalties for failure to make timely tax payments. He also failed to advise them of their right to seek a further filing extension until December 15, 2015, of the ability to file a tax return using estimates of data, or other actions that could have avoided or reduced penalties and interest. Having failed to file a return by October 15th, or to request a further extension to December 15th,[58] Plaintiffs' fate was sealed; the IRS would assess them a monthly Failure to File Penalty that would continue to run until the return was filed.[59]

When the taxpayers received the Deficiency Notice asserting the now rather significant amount of failure to file penalties, the taxpayers engaged the law firm of Mayer Brown to represent them in an appeal before the IRS Office of Appeals.

The opinion describes the actions the law firm took in representing the taxpayer in working to get the penalties abated in full or in part:

> Mayer Brown initially submitted a letter to the IRS arguing that Plaintiffs were entitled to a full abatement of penalties because Plaintiffs' complicated international tax situation meant that there were "unique, unforeseen complexities in determining [Plaintiffs'] 2014 tax year U.S. tax liabilities" and that as a result, "to avoid filing an inaccurate return, filing was unavoidably delayed." Mayer Brown then argued that Plaintiffs were entitled to a full abatement of penalties because they had relied on incorrect advice from Mr. Willey and CBIZ. Mayer Brown alternatively argued that Plaintiffs were entitled to an abatement of all but one month's worth of penalties because they had paid their tax liability in full on November 2, 2015. ECF No. 63 at ¶137. IRS Publication 54 allows taxpayers abroad to request an additional two-month extension of their filing date. If Plaintiffs had requested this extension, they would not have begun to incur penalties until December 15, 2015, instead of October 15, 2015. During the IRS appeal, the IRS asked whether Mayer Brown intended to seek this extension retroactively. Mayer Brown, however, conceded to the IRS that the extension had not been sought in a timely manner, and chose not to make a written request for what would effectively be a retroactive extension.
>
> After the presentation, the IRS agreed to reduce the penalty.[60]

While reduced, there was still a penalty the taxpayers had paid and they brought a claim against the CPA firm looking to be reimbursed for that portion of the penalty.

The CPA sought to argue that the law firm had not adequately raised and pursued positions that could have resulted in the full abatement or at least a larger reduction in the penalty. The Court did find that, under Rhode Island law, it is possible for

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[58] The IRS will consider providing an additional two months extension for taxpayers out of the country following the expiration of the automatic extension. See IRS Publication 54 (2019), p. 4, https://www.irs.gov/pub/irs-pdf/p54.pdf (retrieved October 19, 2020)

[59] *Goei, et al v. CBIZ, Inc. et al, USDC RI*, pp. 3-4

[60] *Goei, et al v. CBIZ, Inc. et al, USDC RI*, pp. 4-5

negligence of the client's attorney in a legal proceeding to be used by the firm to reduce or eliminate the firm's liability for any negligence. But, the Court noted, the firm's client has a low burden to meet to eliminate any such reduction—and, in this case, the client met that burden.

The opinion notes:

> "With respect to mitigation, the plaintiff need only make reasonable efforts to mitigate damages; the burden is not 'onerous and does not require him to be successful in mitigation.'" *Shoucair v. Brown University*, No. Civ.A.·PC·96·2896, 2004 WL 2075159 at *12 (RI. Super. Sept. 9, 2004); see also *Tomaino v. Concord Oil of Newport*, 709 A.2cl 1016, 1026 (RI. 1998).
>
> Defendants contend that Mayer Brown's decision to not pursue a retroactive extension for the late filing of Mr. Goei's tax returns constitutes a "failure to mitigate" any damages incurred because of Mr. Willey's conduct. However, the fact that a plaintiff does not need to be successful in mitigating damages suggests that we need not parse the strategy or decision making of Mayer Brown in its failure to ask the IRS for a retroactive extension for Plaintiffs and its subsequent decision to not pursue this argument after being appraised of its availability to them. Mayer Brown did enough during the appeal to obtain a reduction in the penalty for Plaintiffs. ECF No. 48 at ¶ 54. This is sufficient on its own to meet the low bar set for overcoming a "failure to mitigate" defense in Rhode Island.[61]

In this case it's not clear why the firm did not pursue the request for the additional two month extension to December 15. The most reasonable explanation would appear to be that the CPA was not aware of this option. The alternative would seem to be a case of this "slipping through the cracks" which seems unlikely since the firm was aware this return was at great risk of not being completed by October 15.

We also do not know the CPA's decision making process in not advising the client to prepare and file a timely return based on the currently available, even if somewhat imperfect, information on hand. Note that the Form 1040 jurat only provides that the taxpayer indicates that, to the best of the taxpayer's knowledge and belief, the returns are true, correct and complete and the preparer's declaration is based on all information the preparer has knowledge of. Certainly preparing a return with full disclosure of how reasonable estimates were made regarding unavailable information would seem to allow signing and filing the return.

We aren't told if the taxpayer offered to let the firm pursue relief first, but it is not unreasonable for the taxpayer who feels he/she has not received proper guidance to engage a different professional to attempt to resolve the matter. In this case the law firm had been involved with the taxpayer prior to this incident by giving tax advice.

The court ultimately decided that the law firm had improved the situation (reduced the penalty) and was not going to second guess their decision not to pursue a late grant of

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[61] *Goei, et al v. CBIZ, Inc. et al, USDC RI*, pp. 15-16

an extension. The extension would not have eliminated the penalty, since the return wasn't prepared until well after December 15, and there was no assurance the IRS would grant such relief. Thus, it seems reasonable to conclude that pursuing that avenue had a significant risk of incurring additional representation costs without achieving any additional reduction in penalty beyond what the law firm was able to achieve for the client.

Note that the court did not yet rule on whether, in fact, the CPA or the firm had actually been negligent in providing services to the client. The ruling here was merely on the issue of whether any such potential liability, if found, could be reduced due to the actions of the other adviser not pursuing every possible defense.

SECTION: FBAR REPORTING

DUE TO MISLEADING INFORMATION BEING POSTED TO BSA E-FILING WEBSITE, FINCEN GRANTS FBAR FILING EXTENSION TO OCTOBER 31, 2020

Citation: FinCEN Clarifies FBAR Extensions, FinCEN website, 10/16/20

Individuals who woke up the morning of October 16 realizing that, although they should have filed a Report of Foreign Bank and Financial Accounts (FBAR) by October 15, they had forgotten to do so, will be happy to learn they have been granted a short reprieve to get the report filed by the Financial Crimes Enforcement Network (FinCEN).[62]

The relief is granted due to a mistake made by FinCEN on October 14 when the agency posted a statement on the Bank Secrecy Act (BSA) e-filing website that was meant to remind filers of relief granted to victims of recent natural disasters who were given until December 31, 2020 to file the FinCEN form via a Notice issued on October 6.[63] However, the posting on the BSA site failed to include the information that the relief was limited to those impacted by the disasters, implying that all filers were to be given until the end of the year to file the form.

On October 16 FinCEN posted a clarification on the FinCEN website that provided the following temporary extension through Halloween to file the form to all taxpayers, along with reminding filers impacted by the disasters noted in the October 6 notice that they (and only they) have until December 31 to file the FBAR form electronically:

> FinCEN apologizes for the error and any confusion this has caused, and has coordinated with the IRS to address the concerns of filers

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[62] FinCEN Clarifies FBAR Extensions, FinCEN website, October 16, 2020, https://www.fincen.gov/fincen-clarifies-fbar-extensions (retrieved October 19, 2020)

[63] FinCEN Provides FBAR Relief to Victims of Recent Natura Disasters; Filers Have Until December 31, 2020 to File, FinCEN Notice, October 6, 2020 https://www.fincen.gov/sites/default/files/shared/Notice-Extend%20FBAR%20Due%20Date%20for%202020%20Disaster%20Victims-Final%2020201005.pdf (retrieved October 19, 2020)

who may have missed their filing deadline due to the October 14, 2020 message.

Filers who file their 2019 calendar year FBAR by October 31, 2020 will be deemed to have timely filed. As set out in the October 6 notice, FBAR filers impacted by recent natural disasters continue to have until December 31, 2020 to file their FBARs.[64]

[64] FinCEN Clarifies FBAR Extensions, FinCEN website, October 16, 2020