Current Federal Tax Developments

Week of August 2, 2021

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SECTION: PPP LOAN
SBA ISSUES NEW IFR CREATING SBA FORGIVENESS APPLICATION PLATFORM, OPTIONAL REVENUE REDUCTION CONFIRMATION AND DEFERMENT WHILE DECISIONS ARE UNDER APPEAL

Citation: Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, 7/28/21

The Small Business Administration (SBA) has issued a new Interim Final Rule (IFR) that provides an option for lenders to allow certain borrowers to apply for forgiveness directly through the SBA, creates an optional simplified method to document the required drop in revenue for Second Draw Paycheck Protection Program (PPP) loans for certain borrowers and provides a deferment of payments for those who timely file an appeal with the SBA.[1]

SBA Hosted Application for Forgiveness

The SBA is creating a direct borrower forgiveness portal where eligible borrowers will initiate the application process with the Small Business Administration at https://forgiveness.sba.gov.[2]

To be eligible to participate, a borrower must meet the following conditions:

- The borrower's lender must elect to participate in the SBA online application for forgiveness program and must direct the borrower to apply via the SBA program[3] and
- The loan must have been for $150,000 or less.[4]

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[1] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, https://www.sba.gov/sites/default/files/2021-07/FINAL%20IFR%20Forgiveness%207.23.21-508.pdf (retrieved July 29, 2021)

[2] Part IV.2.a. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8287)

[3] Part IV.2.a. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8287) and Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

[4] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

The SBA describes the process as follows:

> When a PPP lender opts-in to the direct borrower forgiveness process, the Platform will provide a single secure location for all of its borrowers with loans of $150,000 or less to apply for loan forgiveness through the Platform using the electronic equivalent of SBA Form 3508S. Upon receipt of notice that a borrower has applied for forgiveness through the Platform, lenders will review the loan forgiveness application in the Platform and issue a forgiveness decision to SBA inside the Platform. SBA believes that lenders that opt-in to using the direct borrower forgiveness process will benefit with reduced costs, increased efficiency, and more timely remittance of forgiveness payments from SBA, while borrowers will benefit from the ability to submit loan forgiveness applications directly through the Platform and reduce the wait time and uncertainty associated with submission through their lender.[5]

The SBA plans to release the following additional information on the program in the near future:

- The process for lenders to opt-in to the direct borrower forgiveness process,
- The process for borrowers with loans of $150,000 or less to access the Platform and submit their loan forgiveness applications directly through the Platform, and
- The process for lenders to access the forgiveness applications in the Platform to perform reviews of their borrowers' applications, issue forgiveness decisions to SBA, and request forgiveness payments from SBA[6]

The SBA notes that even after the platform is launched, borrowers will need to submit their forgiveness application through their lender in the following situations:

- The PPP lender does not opt-in to use the direct borrower forgiveness process;
- The borrower's PPP loan amount is greater than $150,000;
- The borrower does not agree with the data as provided by the SBA system of record, or cannot validate their identity in the Platform (for example, if there is an unreported change of ownership); or
- For any other reason where the Platform rejects the borrower's submission.[7]

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[5] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

[6] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

[7] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

The lender will be required to continue processing any applications already submitted before the lender opts-in, rather than being able to force borrowers to begin the process again under the SBA system:

> During the transition period after the launch of the direct borrower forgiveness process, lenders that opt-in will be expected to complete the processing of any loan forgiveness applications that have already been submitted by borrowers to the lender and should inform such borrowers not to submit a duplicate loan forgiveness application through the Platform.[8]

COVID Revenue Reduction Score

One of the requirements for a borrower to obtain a second draw PPP loan is that the borrower must have suffered a reduction in revenue of not less than 25% for one quarter in 2020 compared to the same quarter in 2019. Those who borrowed less than $150,000 were allowed to delay providing evidence to support this revenue reduction until they applied for loan forgiveness.[9]

The IFR Overview provides the following description of the original process for demonstrating that a borrower had met this criteria:

> The Second Draw PPP Loan IFR and the Loan Forgiveness and Loan Review IFR implementing the Economic Aid Act provide that if a borrower with a Second Draw PPP Loan of $150,000 or less did not produce documentation of revenue reduction at the time of application, the borrower must, on or before the date the borrower applies for loan forgiveness, submit to the lender documentation adequate to establish that the borrower experienced a revenue reduction of 25% or greater in 2020 relative to 2019, and such documentation may include relevant tax forms, including annual tax forms, or if relevant tax forms are not available, quarterly financial statements or bank statements. The rules also provide that where a borrower with a Second Draw PPP Loan of $150,000 or less does not provide documentation of revenue reduction with its loan application, the lender must perform a good faith review of the documents provided by the borrower at or before forgiveness, including the borrower's calculations and supporting documents.[10]

The SBA will establish, as an alternative to providing the information discussed above, a COVID Revenue Reduction Score based on information regarding the borrower's

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[8] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.2

[9] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[10] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

industry. If a borrower's COVID Revenue Reduction Score shows a 25% reduction in revenue, the lender will treat that as satisfying the documentation of a revenue reduction requirement.[11]

The purpose of the program is described as follows in the IFR's Overview:

> To streamline forgiveness of Second Draw PPP Loans of $150,000 or less where the borrower did not submit documentation of revenue reduction at the time of the loan application, SBA has determined that an alternative form of revenue reduction confirmation is warranted to document the borrower's revenue reduction.[12]

The IFR goes on to describe the source of the COVID Revenue Reduction Score:

> An independent third-party SBA contractor has developed a COVID Revenue Reduction Score (score) based on a variety of inputs including industry, geography, and business size. The score uses current data on economic recovery and return of businesses to operational status.[13]

The score will only be used for loans of $150,000 or less, and will be an optional basis for *lenders* to use to verify qualification:

> Each Second Draw PPP Loan of $150,000 or less will be assigned a score, which will be maintained in the Platform and will be visible to lenders to use on an optional basis as an alternative to document revenue reduction. Additionally, the score will be visible to those borrowers that submit their loan forgiveness applications through the Platform using the direct borrower forgiveness process.[14]

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[11] Part IV.6.a. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8293), Part IV.6.b. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8293), SBA Form 3508S subsection of Part V.2.a. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8296), Part IV.(g)(2)(v) of the Second Draw IFR (86 FR 3712, 3721), and Part IV.(j) of the Second Draw IFR (86 FR 3712, 3722)

[12] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[13] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[14] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

The use of the score to bypass the requirement for the borrower to document the revenue reduction to the lender is detailed by the SBA as follows:

> When the score meets or exceeds the value required for validation of the borrower's revenue reduction, use of the score will satisfy the requirement for the borrower to document revenue reduction.[15]

If the score does not show the 25% reduction being met, the borrower is not out of luck, but rather must now provide the detailed documentation to support a decrease in revenue that had previously been required for all borrowers.

> When the score does not meet the value required for validation of the borrower's revenue reduction, and if the borrower has not already provided documentation to the lender that validates the borrower's revenue reduction, the borrower must provide documentation either directly to the lender (for those lenders that do not opt-in to the direct borrower forgiveness process) or provide documentation to the lender by uploading it to the Platform.[16]

The IFR indicates that the SBA will shortly provide more information with regard to the score and its use.[17]

Deferment Extension for SBA Office of Hearings and Appeals (OHA) Appeals

While borrowers have a right to appeal the final loan review decisions of the SBA, current guidance requires the borrower to begin making payments on the loan before the appeal process is completed.

> Currently, the rule for appeals of final SBA loan review decisions on PPP loans provides that because a PPP borrower must begin making payments of principal and interest on the remaining balance of its PPP loan when SBA remits the loan forgiveness amount to the PPP lender (or notifies the lender that no loan forgiveness is allowed), an appeal by a PPP borrower of any final SBA loan review decision does not extend the deferment period of the PPP loan. [18]

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[15] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[16] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[17] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.A.1

[18] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.B

However, the SBA has now determined that the process could be unnecessarily administratively burdensome should the borrower be successful on appeal, and thus will revise the provisions to allow for deferment:

> SBA has determined that, in order to avoid the potential administrative burden of having to reverse implementation of the final SBA loan review decision, including the refund of borrower payments by the lender and the processing of forgiveness payments by SBA, a timely appeal by a PPP borrower of a final SBA loan review decision should extend the deferment period of the PPP loan. SBA believes that allowing for continued deferment is in the best interest of the borrower. For these reasons, SBA is conforming the applicable PPP rules to provide that a timely appeal by a PPP borrower of a final SBA loan review decision extends the deferment period of the PPP loan until OHA's decision becomes final under 13 CFR 134.1211.[19]

The new IFR allows the borrower to extend the deferment period to cover the period the final loan review decision is under appeal:[20]

> SBA is amending the appeals rule to, among other things, provide that a borrower's timely appeal of a final SBA loan review decision will extend the deferment period for the PPP loan until SBA's Office of Hearings and Appeals (OHA) issues a final decision on the appeal.[21]

However, the borrower will need to take action to inform the lender that the decision is under appeal at the OHA to take advantage of the deferment extension:

> The revised OHA rule will provide that the borrower should notify the lender of the appeal so that the lender can extend the deferment period. Under the revised OHA rule, an appeal petition must be filed with OHA within 30 calendar days after the appellant's receipt of the final SBA loan review decision.[22]

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[19] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.B

[20] Part IV.2.b. of the Consolidated Forgiveness and Loan Review IFR (86 FR 8283, 8288) and Part III.B.9. of the Consolidated Eligibility IFR (86 FR 3692, 3703)

[21] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.B

[22] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section III.B

Effective Date

These revisions take effect immediately upon release of the IFR.[23]

SECTION: 162
IN TAXPAYER'S SITUATION, COST OF AN MBA PROGRAM FOUND TO BE A DEDUCTIBLE BUSINESS EDUCATION EXPENSE

Citation: Zuo v. Commissioner, Tax Court Bench Opinion, Docket No. 5716-195, 7/26/21

The issue of when education expenses represent deductible business expenses involves an analysis of the specific facts for each taxpayer. Reg. §1.162-5 outlines the rules that apply in such cases.

Reg. §1.162-5(a) allows a deduction for ordinary and necessary business education expenses, even if the education may lead to a degree, if the education

- Maintains or improves skills required by the individual in his employment or other trade or business, or
- Meets the express requirements of the individual's employer, or the requirements of applicable law or regulations, imposed as a condition to the retention by the individual of an established employment relationship, status, or rate of compensation.[24]

However, such expenses will not be allowed as a deduction, even though they otherwise meet one of the two prior conditions, if:

- The education meets the minimum education requirements for qualification in the trade or business,[25] or
- The education program being pursued will qualify a taxpayer for a new trade or business.[26]

The minimum education requirements rule is often fairly easy to identify—for instance, a CPA specializing in tax obtaining a degree from a law school will generally not be

[23] Interim Final Rule RIN 3245-AH79, Business Loan Program Temporary Changes; Paycheck Protection Program – COVID Revenue Reduction Score, Direct Borrower Forgiveness Process, and Appeals Deferment, July 28, 2021, Overview Section II

[24] Reg. §1.162-5(a)(1) and (2)

[25] Reg. §1.162-5(b)(2)

[26] Reg. §1.162-5(b)(3)

considered to have incurred a deductible expense, even if the student does not plan to sit for the Bar exam and plans to continue working in the CPA firm.[27]

But the qualification for a new trade or business clause tends to lead to more issues, especially in cases where training would lead to a Masters in Business Administration (MBA) degree. That was the key issue decided in the bench opinion in the case of *Zuo v. Commissioner*.[28]

Mr. Zuo's employment and business history before beginning his MBA program was detailed as follows in the opinion:

> After receiving his bachelor's degree, petitioner worked as an investment banking analyst at Goldman Sachs in San Francisco, California for two years. In September 2013, he left Goldman Sachs and began employment as an investment analyst at Solstein Capital, LLC (hereinafter Solstein Capital), a hedge fund located in San Francisco. While working full-time at Solstein Capital, petitioner simultaneously pursued two entrepreneurial technology ventures. In 2014, petitioner founded Wikispective, Inc. (hereinafter Wikispective), which petitioner describes as a project similar to Wikipedia. In 2015, petitioner co-founded 36Names LLC (hereinafter 36Names), a domain name leasing company. Petitioner filed articles of organization for 36Names with the Secretary of State of California on June 12, 2015. He actively worked to grow 36Names throughout 2016. The business registration for 36Names with the State of California was canceled on September 11, 2017. Petitioner's records indicate that he invested $21,905 of his own funds for startup costs for Wikispective and 36Names.[29]

The taxpayer's education program for 2016 was described as follows:

> In May of 2016, petitioner left his position at Solstein Capital to pursue a MBA degree from the Massachusetts Institute of Technology (hereinafter MIT). He continued to work on 36Names while traveling over the summer of 2016 and after enrolling at MIT in the fall of 2016. While studying at MIT, petitioner and some of his fellow MBA students organized a company called DeepBench LLC (hereinafter DeepBench). Petitioner served as the CEO of DeepBench starting in October of 2016. DeepBench is a company organized under the laws of the State of Delaware that helps connect its clients to expert advisors through its software platform. Petitioner left his position at DeepBench in October 2020 to found and serve as the managing

[27] Reg. §1.162-5(b)(3)(ii) Example 1

[28] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/tax-court-rules-against-irs-in-deductibility-of-mba-tuition/76xyk (retrieved July 26, 2021)

[29] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021

> partner for a company called Optionality Partners (a consultancy that advises entrepreneurs on starting businesses from scratch).[30]

Mr. Zuo claimed a $24,412 deduction for the expenses related to his MBA program on his 2016 income tax return. The IRS, after examining the taxpayer's return, disallowed the deduction in its entirety.

The IRS argued that the skills provided by the program were not required to be successful in his employment with Solstein Capital, apparently viewing the training as being aimed at allowing the taxpayer to pursue a new trade or business as an entrepreneur.

But the Tax Court determined that Mr. Zuo had been in the business of being an entrepreneur and already possessed the necessary qualifications before he began his MBA program. The opinion provided that:

> We are satisfied that petitioner was qualified in the trade or business of being an entrepreneur before enrolling in the MBA program at MIT on the basis of the time and money he had previously spent founding, organizing, and assuming the financial risks of his two entrepreneurial ventures, Wikispective and 36Names. Further, petitioner had likely developed significant business acumen that was useful in pursuing these ventures while obtaining an undergraduate degree in business administration and working as an investment analyst at Goldman Sachs and Solstein Capital. Petitioner continued to develop his entrepreneurial skillset when he helped found and served as the CEO of DeepBench starting in 2016.
>
> Although petitioner's business courses at the MIT MBA program may have honed his leadership, communication, organization, and other skills necessary to run a successful business, they did not "qualify" him for a new trade or business as an entrepreneur. Rather, they maintained and refined skills he was already using in his current business. See *Allemeier v. Commissioner*, slip op. at 13-14; *Sherman v. Commissioner*, 36 T.C.M. (CCH) at 1193-1194; sec. 1.162-5(b)(3), Income Tax Regs.[31]

The fact that a taxpayer is not currently working is not fatal to the deduction, so long as he was in the trade or business prior to the program:

> A taxpayer may be engaged in a trade or business, although not working, if he was previously involved in and actively sought to continue in that trade or business while pursuing a defined degree program related to his or her line of work. *Ford v. Commissioner*, 56 T.C. 1300, 1304 (1971), *aff'd*, 487 F.2d 1025 (9th Cir. 1973); *Hitt v. Commissioner*, T.C. Memo. 1978-66, 37 T.C.M. (CCH) 333, 334-335 (1978). The taxpayer must clearly intend to seek employment in the same trade or business. *Goldenberg v. Commissioner*, T.C. Memo. 1993-

[30] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021

[31] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021

> 150, 1993 WL 101367, at *4; see *Corbett v. Commissioner*, 55 T.C. 884, 887-888 (1971).[32]

The taxpayer's situation therefore allowed for this deduction:

> Beginning in May of 2016 petitioner was not working for an employer in the fields of finance or business. He testified, however, that he continued to work on 36Names throughout the summer and fall of 2016. Although he also testified that he was traveling during the summer of 2016, petitioner clearly intended to continue his professional career as an entrepreneur. See *Corbett v. Commissioner*, 55 T.C. at 887-888; *Goldenberg v. Commissioner*, 1993 WL 101367, at *4. We are satisfied that the period from May 2016, when petitioner left his position at Solstein Capital, through October 2016, when petitioner founded DeepBench, was a transition period during which he actively sought to continue in the trade or business of entrepreneurship while pursuing a defined graduate degree program. We conclude that petitioner may be considered to have been carrying on his trade or business during this time. See *Ford v. Commissioner*, 56 T.C. at 1304; *Hitt v. Commissioner*, 37 T.C.M. (CCH) at 334-335.[33]

SECTION: 3131
IRS REVISES FAQ TO EXPAND PAID LEAVE CREDIT TO INCLUDE VACCINE-RELATED LEAVE FOR RELATED INDIVIDUALS

Citation: Tax Credits for Paid Leave Under the American Rescue Plan Act of 2021: Determining the Amount of the Tax Credit for Qualified Sick Leave Wages, Question 27a, IRS website, 7/29/21

The IRS updated its FAQ on "Tax Credits for Paid Leave Under the American Rescue Plan Act of 2021," adding Question 27a that creates a "substantially similar condition" under the Families First Coronavirus Relief Act (FFCRA) Section 5102(a)(6) that allows a credit for leave time paid to employees who take leave to:

- Accompany an individual with a qualifying relationship to the employee or self-employed person who is obtaining a vaccination or
- Care for an individual with a qualifying relationship to the employee or self-employed person who is recovering from a vaccination.[34]

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[32] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021

[33] *Zuo v. Commissioner*, Tax Court Bench Opinion, Docket No. 5716-195, July 26, 2021

[34] Tax Credits for Paid Leave Under the American Rescue Plan Act of 2021: Determining the Amount of the Tax Credit for Qualified Sick Leave Wages, Question 27a, IRS website, July 29, 2021,

In IRS News Release 2021-160, released at the same time as the additional question and answer were posted to the IRS website, the IRS describes the credit for paid leave as follows:

> The paid sick and family leave tax credits under the ARP are similar to those put in place by the Families First Coronavirus Response Act (FFCRA), as amended and extended by the COVID-related Tax Relief Act of 2020 (Tax Relief Act), under which certain employers could receive tax credits for providing paid sick or family leave that met the requirements of the Emergency Paid Sick Leave Act and the Emergency Family and Medical Leave Expansion Act (as added by FFCRA). The tax credits under the FFCRA, as amended and extended by the Tax Relief Act, covered leave taken beginning April 1, 2020, through March 31, 2021. The ARP amends and extends these credits to leave taken beginning April 1, 2021, through Sept. 30, 2021.[35]

Question 27a provides:

> **27a. Do "qualified sick leave wages" include wages paid for leave taken to accompany an individual who is obtaining a vaccination or to care for an individual who is recovering from vaccination? (added July 29, 2021)**
>
> Yes. Under section 5102(a)(6) of the FFCRA, an Eligible Employer may pay qualified sick leave wages to an employee who is experiencing any other "substantially similar condition," as specified by the Secretary of HHS, in consultation with the Secretary of the Treasury and the Secretary of Labor, to a condition for which the Eligible Employer may otherwise pay qualified sick leave wages. The Secretary of HHS has specified, in consultation with the Secretaries of Treasury and Labor, that an employee who takes leave to accompany an individual to obtain immunization related to COVID-19, or to care for an individual who is recovering from any injury, disability, illness, or condition related to the immunization, is experiencing a "substantially similar condition" under section 5102(a)(6) for which the Eligible Employer may pay qualified sick leave wages.
>
> The HHS Secretary further specified that, for this purpose, "individual" has the same meaning as was assigned to that term in 29 CFR 826.20(a)(5) for purposes of the FFCRA. Thus, "individual" means an immediate family member, someone who regularly resides in the employee's home, or a similar person with whom the employee has a relationship that creates an expectation that the employee would care

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https://www.irs.gov/newsroom/tax-credits-for-paid-leave-under-the-american-rescue-plan-act-of-2021-determining-the-amount-of-the-tax-credit-for-qualified-sick-leave-wages (retrieved July 29, 2021)

[35] Paid leave credit available for providing leave to employees caring for individuals obtaining or recovering from a COVID-19 immunization, IRS News Release IR-2021-160, July 29, 2021, https://www.irs.gov/newsroom/paid-leave-credit-available-for-providing-leave-to-employees-caring-for-individuals-obtaining-or-recovering-from-a-covid-19-immunization (retrieved July 29, 2021)

> for the person. For this purpose, "individual" does not include persons with whom the employee has no personal relationship.[36]

A conforming change was made to Question 31, adding these conditions to the paragraph describing "other substantially similar conditions."[37]

The new revision also applies to the similar credit for the self-employed.[38]

The "substantially similar condition" provision in FFCRA §5102(a)(6) is a type of leave that is an amount that is up to:

- Two-thirds of the employee's regular compensation for the time in question (but no less than minimum wages) but
- Not more than $200 per day.[39]

As was true before this change, an employee who is given paid leave for time to obtain a vaccination for him/herself or given paid time off to recover from the effects of the vaccination would entitle the employer to a credit for up to 100% (rather than two-thirds) of the employee's regular rate of pay, capped at $511 per day (rather than $200).[40]

SECTION: 6226
IN BBA AUDIT, ITEM INCLUDED IN IMPUTED ADJUSTMENT EVEN IF NO PARTNER WOULD HAVE PAID TAX ON THE ITEM HAD IT BEEN REPORTED ON THE ORIGINAL RETURN

Citation: Chief Counsel Email 202129012, 7/23/21

IRS emailed advice is always tricky to interpret, since we are seeing only one side of a conversation in these cases—only the IRS attorney's response is provided. And, unlike more formal advice from the Chief Counsel's office, these emails do not follow a formal structure where the facts under consideration are outlined in the attorney's response.

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[36] Tax Credits for Paid Leave Under the American Rescue Plan Act of 2021: Determining the Amount of the Tax Credit for Qualified Sick Leave Wages, Question 27a, IRS website, July 29, 2021

[37] Tax Credits for Paid Leave Under the American Rescue Plan Act of 2021: Determining the Amount of the Tax Credit for Qualified Sick Leave Wages, Question 31, IRS website, July 29, 2021

[38] Paid leave credit available for providing leave to employees caring for individuals obtaining or recovering from a COVID-19 immunization, IRS News Release IR-2021-160, July 29, 2021

[39] IRC §3131(b)(1)

[40] IRC §3131(b)(1)

But Chief Counsel Email 202129012[41] contains one side of a discussion that outlines an issue that arises with partnership examinations under the BBA centralized partnership audit regime, discussing if it matters that the partnership can show that if an item of adjustment had been properly reported by the partners no additional income tax would have resulted. The partnership would want to have this amount excluded from the imputed adjustment (IU) under the regime, which is generally subjected to tax at the highest marginal tax rate when paid by the partnership.

If the item is includable in income generally under Chapter 1 of Subtitle A of the IRC (normal taxes for federal income taxes), the email concludes that it does not matter if, due to other factors, these particular partners would not have paid any tax in the year in question if the amount had been properly reported:

> All adjustments to partnership-related items (PRIs) go into the computation of the imputed underpayment (IU) regardless of whether they would result in additional income tax if properly reported by the partners. The issue of whether there is a chapter 1 impact doesn't go into consideration of whether an adjustment goes into the IU computation but rather goes into the analysis of whether the item is a PRI or not. We are treating like 14 as a PRI (* * *).[42]

A simple example of how this could happen would relate to cancellation of indebtedness.

EXAMPLE

Mary and Twila are equal partners in the MT Partnership, a partnership subject to the BBA 2015 audit regime. The IRS examines the partnership's income tax return and it is determined that the partnership failed to report $25,000 of cancellation of indebtedness income. Under IRC §61(a)(11) cancellation of indebtedness is counted as income under IRC §61(a)(11) and thus is part of the imputed adjustment (IU).

Both Mary and Twila were insolvent at the date the debt was cancelled and had no attributes to be reduced under IRC §108(b) at the end of that year. Under IRC §108(a)(1)(B) cancellation of indebtedness of income is excluded from income when the taxpayer is insolvent at the time the debt is cancelled. However, per IRC §108(d)(6), the partnership itself does not qualify to apply this relief—rather, each partner must demonstrate their personal insolvency to qualify for the exclusion.

In this case, had the $25,000 of cancellation of indebtedness income been properly reported by the partnership on its original return, neither Mary nor Twila would have paid any additional tax, since they each would have qualified under IRC §108(a)(1)(B) to exclude the amount from income. However, in computing the imputed adjustment (IU) that would be used to compute the payment the partnership would make for the exam, the entire $25,000

[41] CCE 202129012, July 23, 2021, https://www.taxnotes.com/research/federal/irs-private-rulings/e-mail-chief-counsel-advice/no-excluding-partnership-related-items-from-imputed-underpayment/76x8b (retrieved July 25, 2021)

[42] CCE 202129012, July 23, 2021

would be treated as subject to tax at the highest marginal individual rates for the year in question.

In this scenario, to avoid the imposition of a tax, the partnership would either need to elect to use the option under IRC §6226 to push out the adjustment to the partners (who then would compute a net zero addition to tax for the item) or have the partners voluntarily amend the prior year returns under the provisions of IRC §6225(c)(2) to avoid tax being paid by any party on these items.

Note, though, that in the case of an administrative adjustment request (AAR) under §6227, the amended return option to remove the partners' share of the IU is not available.[43] Partnerships subject to the BBA regime cannot simply amend the original partnership return, but rather must make use of the AAR procedures under §6227 to voluntarily fix issues found in prior years. In that situation, only a push-out election under IRC §6226 would avoid paying tax on this item of income under the position taken in this emailed advice.

Of course, if a partnership is eligible to opt-out of the application of the BBA via the election under IRC §6221(b) and its related regulations, it could avoid this problem by opting out of the BBA regime by checking the appropriate box on Schedule B of Form 1065 and filing a properly completed Schedule B-2 with the return. In that case, the traditional amended return procedures are available to the partnership, which would have the tax impact computed on amended returns of the individual partners.

SECTION: 6677
SECOND CIRCUIT REVERSES TRIAL COURT, FINDS OWNER/BENEFICIARY OF FOREIGN TRUST LIABLE FOR 35% PENALTY FOR FAILURE TO REPORT A DISTRIBUTION

Citation: Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, 7/28/21

In November of 2019, we wrote[44] about the case of *Wilson, et. al. v. United States*, Case No. 2:19-cv-05037, US District Court, Eastern District of New York where a taxpayer prevailed in a case where he was the sole owner and beneficiary of a foreign trust. The owner/beneficiary was found to be liable for only the smaller 5% penalty under §6677(b) as the owner of a foreign trust that fails to file a report under IRC §6048. He was able to escape the 35% penalty imposed on a beneficiary for failing to report the receipt of a distribution from that trust as required by the same section.

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[43] IRC §6227(b)(1) which bars the use of IRC §6226(c)(2) provisions to reduce the IU

[44] Edward K. Zollars, CPA, "Taxpayer Who Was Both Beneficiary and Owner of Foreign Trust Only Liable for Owner Penalty for Failure to File Form 3520," *Current Federal Tax Developments* website, November 22, 2019, https://www.currentfederaltaxdevelopments.com/blog/2019/11/22/taxpayer-who-was-both-benfeciary-and-owner-of-foreign-trust-only-liable-for-owner-penalty-for-failure-to-file-form-3520 (retrived July 28, 2021)

However, the Second Circuit Court of Appeals has now reversed the District Court after the IRS appealed the decision,[45] finding that the 35% penalty the IRS had originally imposed was due in this case, noting:

> We vacate the court's judgment and hold that when an individual is both the sole owner and beneficiary of a foreign trust and fails to timely report distributions she received from the trust, the government has the authority under the IRC to impose a 35% penalty.[46]

The appellate panel described IRC §6048's reporting provisions as follows:

> Section 6048 of the IRC imposes disclosure requirements related to foreign trusts. Subsection (c) instructs "any United States person [who] receives . . . during any taxable year . . . any distribution from a foreign trust" to "make a return with respect to such trust for such year" that includes, inter alia, "the aggregate amount of the distributions so received from such trust." 26 U.S.C. § 6048(c). In other words, § 6048(c) requires beneficiaries of a foreign trust—such as Wilson—to disclose distributions they received from the trust in an annual filing. Subsection (b) orders U.S. owners "of any portion of a foreign trust" to "ensure that . . . such trust makes a return for such [taxable] year which sets forth a full and complete accounting of all trust activities and operations for the year" and "other information as the Secretary [of the Treasury] may prescribe." Id. § 6048(b).[47]

In this case, the owner/beneficiary failed to timely file Form 3520 and Form 3520-A for 2007.

> As a result, he did not timely disclose the $9.2 million distribution he received or report other information about his trust. The IRS assessed a late penalty of $3,221,183, 35% of the $9.2 million distribution. This penalty derives from § 6677(a) of the IRC, which provides "if any notice or return required to be filed by [§] 6048" is not filed on time or is incomplete, "the person required to file such notice or return shall pay a penalty equal to . . . 35 percent of the gross reportable amount." 26 U.S.C. § 6677(a).[48]

The panel notes the trial court's original holding in this matter:

> Plaintiffs moved for partial summary judgment on their 5% penalty argument, which the district court granted, concluding that "[t]he IRS

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[45] *Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America*, Case 20-603, CA2, July 28, 2021, https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/foreign-trust-owner-beneficiary-faces-higher-reporting-penalty/76y5y (retrieved July 28, 2021)

[46] *Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America*, Case 20-603, CA2, July 28, 2021

[47] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

[48] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

> can . . . assess only the 5% penalty under . . . § 6677 – not both or either the 5% and/or 35% penalty – for Wilson's untimely filing of his 2007 Form 3520." *Wilson v. United States*, No. 19-CV-5037 (BMC), 2019 WL 6118013, at *8 (E.D.N.Y. Nov. 18, 2019).[49]

The panel found that the trial court had misread the plain meaning of IRC §§6048 and 6077:

> The plain language of the IRC's disclosure and penalty provisions, §§ 6048 and 6677, unambiguously demonstrates that when an owner of a foreign trust fails to timely disclose a distribution she received as a beneficiary of that trust, she violates § 6048(c) and thereby triggers the 35% penalty under § 6677(a). Section 6048(c) states in relevant part:
>
> > If any United States person receives (directly or indirectly) during any taxable year of such person any distribution from a foreign trust, such person shall make a return with respect to such trust for such year which includes . . . (B) the aggregate amount of the distributions so received from such trust during such taxable year.
>
> 26 U.S.C. § 6048(c)(1). Normally understood, "any United States person," *id.*, includes everyone, U.S. owners and beneficiaries of foreign trusts alike. The statute makes no exception for a beneficiary who is also the owner of a foreign trust. Wilson was therefore required under § 6048(c) to timely report the distribution he received from his trust.[50]

The panel goes on to describe the penalty provisions:

> Under § 6677(a), "if any notice or return required to be filed by [§] 6048 . . . is not filed on . . . time . . . the person required to file such notice or return shall pay a penalty equal to . . . 35 percent of the gross reportable amount." Id. § 6677(a). "[I]n the case of a failure relating to [§] 6048(c)," the "gross reportable amount" is "the gross amount of the distributions." Id. § 6677(c). Because Wilson failed to timely report under § 6048(c), the IRS assessed—in accordance with § 6677(a) and (c)—a penalty of 35% of Wilson's $9.2 million distribution.
>
> Nothing in other parts of §§ 6048 and 6677 diminishes or eliminates the applicability of the 35% penalty to Wilson as a beneficiary of the trust. However, the district court relied on § 6677(b) to conclude that the 35% penalty cannot apply. See Wilson, 2019 WL 6118013, at *6. Section 6677(b) "substitut[es] '5 percent' for '35 percent' [of the gross reportable amount]" as the applicable penalty for the failure to timely file "a return required under [§] 6048(b)," which is the reporting

[49] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

[50] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

> requirement for owners of foreign trusts. 26 U.S.C. § 6677(b). According to the court, because Wilson violated § 6048(b) by failing to timely file as an owner, § 6677(b)'s "mandate[] that the 5% replace the 35%" applies. Wilson, 2019 WL 6118013, at *6 (emphasis omitted). [51]

The panel then deals with the specific flaw it identifies with the original reasoning that found that only the 5% penalty applies:

> The problem with the district court's analysis is that § 6677(b) leaves untouched the 35% penalty that applies to *all other* reporting requirements under § 6048, including to a return disclosing distributions required by § 6048(c). The district court and Plaintiffs do not identify any text in the statute that elides the requirement to disclose distributions received as a beneficiary under § 6048(c) when the beneficiary is also the owner of a foreign trust. Nor is there any textual support for the court and Plaintiffs' view that when the owner and beneficiary are one, a failure to timely report the distribution received violates only § 6048(b) and not § 6048(c). Even if the information the owner must report under § 6048(b) covers the trust's distributions, nothing in the statute indicates that as a result, § 6048(b) displaces or merges with the separate requirement to report distributions under § 6048(c). See id. at *6–7. Because Wilson's failure to timely report the distribution he received violates § 6048(c) even if that same failure also violates his reporting requirements as an owner under § 6048(b), the 5% penalty under § 6677(b) does not supplant the 35% penalty.[52]

The panel also disagrees with the trial court finding that the provision in IRC §6677(a) that provides a penalty should not "exceed the gross reportable amount," and "a taxpayer should not be liable for any two penalties if their combined assessment would add up to more than the gross reportable amount for any one violation" as support its ruling. The district court found that the gross reportable amount for an owner's untimely filing is the gross value of assets held at the end of the tax year, which was $0 at the end of 2007. Thus the government was limited to 5% of zero in this case.

However, the panel criticized this reading, stating:

> The court's reasoning misses the fact that "gross reportable amount" has more than one meaning under § 6677(c). The definition of "gross reportable amount" varies depending on the subsection of § 6048 an individual violated. For example, "*in the case of a failure relating to [§] 6048(b)(1)*" (the owner's filing requirement), the gross reportable amount is "the gross value of the portion of the trust's assets at the close of the year." 26 U.S.C. § 6677(c)(2) (emphasis added). By contrast, "*in the case of a failure relating to [§] 6048(c)*" (the beneficiary's filing requirement), the gross reportable amount is "the gross amount

[51] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

[52] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

> of the distributions." Id. § 6677(c)(3) (emphasis added). As a result, the prohibition against applying a penalty that "exceed[s] the gross reportable amount," id. § 6677(a), refers not to a single, common amount but instead is based on the specific violation. A 35% penalty of the "gross amount of the distributions," here $3.2 million, does not exceed the "gross reportable amount" of the $9.2 million Wilson received as the beneficiary.[53]

The panel also found that the law did not limit the IRS to assessing only a single penalty:

> Equally unavailing is Plaintiffs' contention that the government may only assess one penalty because § 6677(a) states that a "person required to file . . . [a] return [under § 6048] shall pay a penalty equal to . . . 35 percent." See id. § 6677(a) (emphasis added); Appellees' Br. at 31. "[A] penalty" does not mean the government may impose only a single penalty even if the taxpayer violates multiple filing requirements under § 6048. This is made clear by the fact that the same sentence upon which Plaintiffs rely states, in full, that "the person . . . shall pay a penalty equal to . . . 35 percent of the gross reportable amount," 26 U.S.C. § 6677(a) (emphasis added), and as discussed above "gross reportable amount" has different meanings, permitting more than one penalty depending on the nature of the untimely filing. The structure and text of § 6677 reflect that if an individual fails to timely file "*any* . . . return required to be filed by [§] 6048," *id.* (emphasis added), she is subject to a 35% penalty based on each return she fails to file as required under § 6048. Construed in its statutory context, "a penalty" cannot carry the weight with which Plaintiffs burden it.[54]

The panel also dismisses the trial court's analysis that looked at Forms 3520 and 3520-A, along with their instructions, as support for a one penalty only reading of the statute. The panel summarized the trial court's position in this area as follows:

> According to the court, because a trust owner who received a distribution and reported it in the trust's Form 3520-A "is not required to otherwise report the distribution on Form 3520," "Form 3520 disregards the beneficiary status of the trust owner in favor of his owner status, at least for the limited purpose of tracking distributions to the owner." *Id.*[55]

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[54] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

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But the panel notes two issues with this view. First, the panel points out that the law looks at the information that must be disclosed, penalizing each failure, not basing a penalty on how many forms are required to make these disclosures:

> First, even if Wilson needed to file "a single Form 3520," id. at *6, § 6048 is concerned with the actual disclosure requirements, not the form on which the required disclosures are made. Filing a Form 3520 without providing all of the required information, such as the distributions, still violates § 6048.[56]

As well, the law requires a beneficiary to report any distributions he/she received, regardless of which form he/she is filing:

> Second, the court overlooks the fact that regardless of whether the person files Form 3520, Form 3520-A, or both, she must disclose any distributions she received from a foreign trust even if she is the sole owner and sole beneficiary. The option to disclose the distributions that an owner received from the trust in Form 3520-A does not "favor" the owner status. Indeed, as the government articulated, "[t]he instructions simply provide that, if the foreign trust at issue filed a Form 3520-A that properly reported all distributions as part of the trust's annual reporting (which did not occur here), the trust owner can simply direct the IRS to the [Form] 3520-A already filed (by checking the appropriate box on Part II of Form 3520 and attaching his ownership statement) and need not report that information again on Part III of the Form 3520." Appellant's Br. at 47–48.[57]

Finally, the panel rejects the argument that the forms and their instructions create ambiguity on the reporting obligation, finding the unambiguous law controls regardless of what the forms may or may not imply:

> Relatedly, Plaintiffs argue that Form 3520-A (the annual return for the trust), which includes separate subsections to report distributions to owners and beneficiaries, and the instructions for the form "evidence that the [IRS] did not view a distribution to the trust owner to be reported as a distribution to a trust beneficiary." Appellees' Br. at 22. Plaintiffs see this as "further evidence that the [IRS] did not view a distribution made to a trust owner as falling within the reporting requirements [of §] 6048(c) for beneficiaries." Id. Form 3520-A and its instructions carry no such implications. The separate reporting for owners and beneficiaries does not erase the owner's concurrent beneficiary status for the purpose of § 6048(c). Moreover, even if we were to find that the forms generate some ambiguity, "[t]he only role [extratextual] materials can properly play is to help 'clear up . . . not

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[56] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

[57] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021

create' ambiguity about a statute's original meaning." *McGirt v. Oklahoma*, 140 S. Ct. 2452, 2469 (2020) (citation omitted).[58]

[58] Emily Wilson, as Executrix of the Estate of Joseph A. Wilson v. United States of America, Case 20-603, CA2, July 28, 2021