FEDERAL IMPACTING RULINGS

— AND —

COURT DECISIONS

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FEDERAL IMPACTING RULINGS

— AND —

COURT DECISIONS

A. RETIREMENT FUNDS ENTITLED TO CREDITORS RULED

LERBAKKEN

v.

SIELOFF AND ASSOCIATES, PA

(U.S. Court of Appeals, Eighth Circuit)

(Docket No. 18-3415)

February 7, 2020

"HEADNOTE

"1. Bankruptcy estate property-exemptions-retirement funds -qualified domestic relations order.

"8th Cir. affirmed that Chap. 7 debtor wasn't entitled to bankruptcy estate exemption of his interests in ex-wife's Code Sec. 401(k) and IRA, which he was awarded in divorce decree but in respect to which he refused to submit QDRO in accord with divorce court's order: taxpayer failed to show that his interest in either account qualified as 'retirement funds' for bankruptcy purposes. Notably, as of bankruptcy filing, taxpayer, having not yet renamed IRA or transferred same to account under his name, held only conditional interest therein; and that conditional interest lacked most of legal characteristics of ordinary retirement funds in that, although taxpayer could make additional contributions, he was obligated by state law to withdraw his conditional interest and moreover, wasn't subject to rules for ordinary IRAs transferred incident to divorce, since IRA had not yet been transferred. And as to Code Sec. 401(k) plan, legal characteristics of ordinary retirement funds were similarly lacking. Notably, taxpayer as ex-spouse couldn't make additional contributions to Code Sec. 401(k) plan; was obligated by state law to use funds for legal services; and couldn't make withdrawal without QDRO.

"OPINION

"National Consumer Bankruptcy Rights Center; National Association of Consumer Bankruptcy Attorneys Amici on Behalf of Appellant(s)

"United States Court of Appeals For the Eighth Circuit,

"A state court awarded Brian A. Lerbakken part of his ex-wife's Individual Retirement Account and her 401(k) in a dissolution decree. Lerbakken filed for bankruptcy, claiming that his interests in the IRA and 401(k) are exempt as 'retirement funds.' Sieloff & Associates, P.A., a creditor, objected to the exemptions. The bankruptcy court disallowed them, ruling that Ler-

bakken's interests in the IRA and 401(k) are not retirement funds. In re Lerbakken, Order, BKY 18-50037 (Bankr. D. Minn. May 15, 2018). Lerbakken appealed to the Bankruptcy Appellate Panel, which affirmed. Lerbakken v. Sieloff & Assoc., P.A. (In re Lerbakken), 590 BR 895, 897-98 [122 AFTR 2d 2018-6359] (B.A.P. 8th Cir. 2018). Lerbakken appeals the BAP's judgment. Having jurisdiction under 28 U.S.C. §158(d)(1), this court affirms.

"I.

"Sieloff represented Lerbakken in his dissolution in Minnesota. The court's decree awarded Lerbakken all of his ex-wife's IRA and half of her 401(k). The court ordered Lerbakken to submit a Qualified Domestic Relations Order (QDRO). Lerbakken refused, which leaves him with only a domestic relations order.

"Two months after the decree, the court ordered an attorney's lien against Lerbakken for Sieloff's legal services. The court expressly permitted Sieloff to recover the unpaid fees from Lerbakken's interests in his ex-wife's IRA and 401(k). The unpaid fees exceed the total of Lerbakken's interests.

"Six months after the decree, Lerbakken filed for bankruptcy under Chapter 7, claiming that his interests in the IRA and 401(k) are exempt from the bankruptcy estate as 'retirement funds' under 11 U.S.C. §522(b)(3)(C). Sieloff, a scheduled creditor, objected to the exemptions.

"The bankruptcy court[1] disallowed the exemptions. It ruled that Lerbakken's interests in his ex-wife's IRA and 401(k) are not 'retirement funds.' The Bankruptcy Appellate Panel (BAP) affirmed.[2] It ruled, relying on Clark v. Rameker, 573 U.S. 122, 130 [113 AFTR 2d 2014-2308] (2014), that section 522(b)(3)(C) applied only to the person who created and contributed to the retirement account.

"On appeal, this court again reviews the bankruptcy court's decision, independently applying the same standard as the BAP. See Treadwell v. Glenstone Lodge, Inc. (In re Treadwell), 637 F.3d 855, 863 (8th Cir. 2011). This court reviews the bankruptcy court's findings of fact for clear error, and its conclusions of law de novo. Id.

"II.

"When a debtor files for bankruptcy, all of his or her property becomes property of a bankruptcy estate. Taylor v. Freeland & Kronz, 503 U.S. 638, 642 (1992). See also 11 U.S.C. §541 (describing the formation of a bankruptcy estate). A debtor may prevent the distribution of property claimed as exempt. Taylor, 503 U.S. at 642. One exemption is 'retirement funds to the extent those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code.' 11 U.S.C. §522(b)(3)(C). This exemption 'requires that funds satisfy not one but two provisions to be exempt: the funds must be `retirement funds,' and they must be held in a covered account.'Clark, 573 US at 131.

"The first issue is whether Lerbakken's interests in the IRA and 401(k) are 'retirement funds' and thus eligible for

exemption under 11 U.S.C. §522(b)(3)(C) when the accounts were created and maintained by his ex-wife and Lerbakken's interests resulted from a divorce decree.

"In Clark, the Court defined 'retirement funds' as 'sums of money set aside for the day an individual stops working.' Clark, 573 U.S. at 127. The Court focused on three significant legal characteristics of ordinary retirement funds. Id. at 125. Account holders of ordinary retirement funds (1) are able to make additional contributions to the funds, (2) are not obligated to withdraw the funds, and (3) must pay a penalty to withdraw the funds at any time, for any purpose, prior to the age of 59½. Id. at 128. Ultimately, 'retirement funds' are 'funds objectively set aside for one's retirement,' not 'a pot of money that can be freely used for current consumption.' Id. at 128-29.

"III.

"As for the IRA, Lerbakken's most cogent argument is that the Internal Revenue Code says that an IRA transferred incident to divorce is 'treated as an [IRA] of such [recipient] spouse, and not of such [donor] individual.' 26 U.S.C. §408(d)(6). Lerbakken then reasons that an IRA transferred incident to divorce necessarily satisfies the legal characteristics of an ordinary IRA. See Clark, 573 U.S. at 127. [pg. 2020-812]

"Unfortunately for Lerbakken, these tax provisions do not make his IRA interest 'retirement funds' under the Bankruptcy Code. The date of filing, January 23, 2018, determines the property of the bankruptcy estate. See 11 U.S.C. §§522(b)(3)(A), 541. 'A debtor's exemptions are determined as of the time of the filing of his [bankruptcy] petition.' In re Peterson, 897 F.2d 935, 937 (8th Cir. 1990). Exemptions are 'not of property which would or might be exempt if some condition not performed were performed, but of property to which there is... a present right of exemption' on the date when the petition is filed. Myers v. Manley, 318 U.S. 622, 626 (1943).

"When Lerbakken filed for bankruptcy on January 23, 2018, his interest in his ex-wife's IRA was subject to a condition not performed—it had not been renamed, or transferred into an account under his name. See I.R.S. Pub. No. 590-A, Cat. No. 66302J at 28 (Dec. 21, 2018) (https://www.irs.gov/pub/irs-pdf/p590a.pdf) (describing the 'two commonly used methods of transferring IRA assets to a ... former spouse').

"The issue then is whether Lerbakken's conditional interest in his ex-wife's IRA has the legal characteristics of ordinary retirement funds. As for the first characteristic, Lerbakken could make additional contributions, on January 23, 2018, to his ex-wife's IRA. See I.R.S. Pub. No. 504, Cat. No. 15006I at 18-19 (Feb. 5, 2019) (https://www.irs.gov/pub/irs-pdf/p504.pdf).

"Second, state law obligates Lerbakken to withdraw his conditional interest in the IRA. Lerbakken's interest is defined by state law. See Butner v. United States, 440 U.S. 48, 55 (1979) (holding that, absent a contrary federal interest, '[p]roperty in-

terests are created and defined by state law'). The governing state law—the dissolution decree and the court-ordered attorney's lien—define Lerbakken's interest as a debt owed to Sieloff. By the decree and lien, Lerbakken is supposed to effectuate a transfer or renaming of his ex-wife's IRA to pay a debt 'regardless of [his] proximity to retirement.' See Clark, 573 U.S. at 128. The purpose of the second characteristic is to preserve the account for retirement. Id. Because the dissolution of Lerbakken's ex-wife's IRA is obligatory, his interest does not satisfy the second characteristic.

"Third, no transfer of the IRA had occurred by January 23, 2018, so Lerbakken was free from the rules that encourage leaving the funds untouched until retirement age. See 26 U.S.C. §§408(d)(6), 72(t)(1), (2)(C),(3)(A). See also Clark, 573 U.S. at 128-29. Lerbakken's IRA interest was not subject to the rules for ordinary IRAs transferred incident to divorce because it had not been transferred. See 26 U.S.C. §408(d)(6). Lerbakken's IRA interest is not 'treated as an individual retirement account' belonging to him. See id. Rather, Lerbakken's interest in the IRA was a sum of money in his ex-wife's IRA, not an account 'set aside for the day when an individual stops working.' Clark, 573 U.S. at 127.

"Lerbakken's interest in his ex-wife's IRA lacks most of the legal characteristics of ordinary 'retirement funds,' and is not exempted as 'retirement funds' under section 522(b)(3)(C).[3]

"IV.

"As for the 401(k),[4] Lerbakken did not have a QDRO on January 23, 2018. He cannot access his interest in the account without a QDRO. See 29 USC §1056 (d)(1), (3)(A). See also 26 USC §§72(t)(2)(C),414(p)(1)(A), 401(a)(13)(A)-(B).' The QDRO provisions of ERISA do not suggest that an alternate payee [what Lerbakken would be] has no interest in the plans until [he] obtains a QDRO, they merely prevent [him] from enforcing [his] interest until the QDRO is obtained.' See Nelson v. Ramette, 322 F.3d 541, 544 (8th Cir. 2003). In the absence of a QDRO, state law determines Lerbakken's property interest in the 401(k) on January 23, 2018. See Butner, 440 U.S. at 55. The governing state law-the dissolution decree and the court-ordered attorney's lien-define Lerbakken's interest in his ex-wife's 401(k) as a debt owed to Sieloff.

"By Clark's framework, Lerbakken's 401(k) interest is not a 'retirement fund.' As for the first legal characteristic of ordinary retirement funds, Lerbakken could not make additional contributions to his ex-wife's 401(k) on January 23, 2018, because contributions must be made by the employer or employee, not an ex-spouse. See 26 U.S.C. §§401 (a)(1), (13)(A)-(B). Second, Lerbakken is obligated by state law to withdraw the funds to pay Sieloff for legal services, not to use the funds for retirement. Third, without a QDRO, Lerbakken could not [pg. 2020-813] make a withdrawal on January 23, 2018. See 29 U.S.C. §1056(d)(1), (3)(A). See also 26 U.S.C. §§72(t)(2)(C), 414(p)(1)(A). See also Nelson, 322 F.3d at 544.

"Lerbakken's conditional interest in the 401(k) lacks the legal characteristics of ordinary 'retirement funds,' and is not exempted as 'retirement funds' under section 522(b)(3)(C).[5]

"V.

"Lerbakken advances four broad arguments. First, he says that the BAP and the bankruptcy court misapplied Clark by limiting the 'retirement funds' exemption 'to individuals who create and contribute funds into the retirement account.' In re Lerbakken, 590 B.R. at 897 (discussing the ordinary usage of retirement funds as excluding funds set aside for retirement by a different person). As Clark says, the key features of 'retirement funds' are the objective legal characteristics. Clark, 573 U.S. at 125, 128-29. As discussed, Lerbakken's interests in the IRA and 401(k) do not have the necessary legal characteristics.

"Second, Lerbakken argues that the similar tax treatment of transferred and surviving-spouse IRAs necessitates treating accounts transferred incident to divorce the same as accounts inherited by surviving spouses. 26 U.S.C. §§408(d)(3)(C)(ii), (d)(6). However, the Court suggests that even a surviving spouse-which Lerbakken is not--does not have 'retirement funds' when the surviving spouse does not roll over the IRA into his own IRA. See Clark, 573 U.S. at 125. Lerbakken failed to roll over the funds from his ex-wife's accounts into his own accounts by January 23, 2018, when exemptions are determined. 11 U.S.C. §§522(b)(2)(A), 541.

"Third, Lerbakken asserts that the funds in his ex-wife's IRA and 401(k) were intended to support both spouses in retirement. However, Clark explicitly prohibits a 'case-by-case, fact-intensive' examination of subjective purpose-which forbids examining Lerbakken's (or his ex-wife's) intent. Clark, 573 U.S. at 127. See also id. at 133 ('the possibility' that debtors may use funds for 'retirement purposes' does not mean an IRA meets the 'defining legal characteristics of retirement funds').

"Finally, Lerbakken advances other policy reasons for his exemptions. To the contrary, the exemption provisions of the Bankruptcy Code 'effectuate a careful balance between the interests of creditors and debtors.' Clark, 573 U.S. at 129. Indeed, permitting debtors to enjoy cash windfalls through exemption 'would convert the Bankruptcy Code's purposes of preserving debtors' ability to meet their basic needs and ensuring they have a 'fresh start' into a 'free pass.'' Id. at 130 (citations omitted). In Lerbakken's words, 'It was [his] strategy to use the determination in the bankruptcy that the accounts were exempt to prevent [Sieloff] from enforcing its lien against the accounts after the bankruptcy case in state court.'

"Because Lerbakken's interests in his ex-wife's IRA and 401(k) are not 'retirement funds' under 11 U.S.C. §522(b)(3)(C), the bankruptcy court and the BAP correctly disallowed the exemptions from the bankruptcy estate.

"The judgment is affirmed.

"1 The Honorable Robert J. Kressel, Judge, United States Bankruptcy Court for the District of Minnesota.

"2 The Honorable Anita L. Shodeen, Bankruptcy Judge, United States Bankruptcy Appellate Panel for the Eighth Circuit, writing for a unanimous panel.

"3 Because Lerbakken's conditional interest in the IRA is not 'retirement funds,' this court need not address the 'covered account' requirement. See Clark, 573 U.S. at 131. See also 11 USC §522(b)(3)(C).

"4 Although Lerbakken's interest in the 401(k) may be an ERISA-qualified plan and thus excluded from his bankruptcy estate by the anti-alienation language of 29 U.S.C. §1056(d)(1), Lerbakken has waived this issue, as he expressly says. See Patterson v. Shumate, 504 U.S. 753, 760 (1992) (holding that ERISA's anti-alienation provision 'constitutes an enforceable transfer restriction for purposes of 11 U.S.C. §541(c)(2)'s exclusion of property from the bankruptcy estate').

"5 Because Lerbakken's conditional interest in the 401(k) is not 'retirement funds,' this court need not address the 'covered account' requirement. See Clark, 573 U.S. at 131. See also 11 U.S.C. §522(b)(3)(C)." (Thomson Reuters, *Checkpoint*)

B. PREPARER'S ELECTRONIC 1040 FILING ERROR ANALYZED

HAYNES

v.

U.S.

(U.S. Court of Appeals Fifth Circuit)

(Docket No. 17-50816)

January 29, 2019

"HEADNOTE

"1. "District court's summary judgment decision that <u>married taxpayers weren't entitled to refund of failure to timely file returns penalty for year for which neither they nor their CPA, who believed he timely e-filed their return, were notified until more than 10 months later</u> that IRS had rejected same was vacated and remanded: court's underlying conclusion, that <u>taxpayers' reliance on CPA to timely e-file their return couldn't as matter of law constitute reasonable cause excusing Code Sec.6651(a) penalty</u>, was based on bright line rule in longstanding Supreme Court case that involved mailing of paper returns vs. e-filings and reliance on attorney who unquestionably acted negligently in failing to timely file clients' return; but here, in contrast, <u>whether CPA acted negligently in 1st place or whether his actions were sufficient to meet Code Sec. 6651(a)(1)'s reasonable cause standard raised material fact question for jury to decide</u>.

"OPINION

"IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT,

"Appeal from the United States District Court for the Western District of Texas USDC No. 3:16-CV-112

"The IRS assessed a penalty against Christopher and Priscilla Haynes (the Hayneses) for filing their 2010 tax return late. [They attempted] to recoup that penalty.

"Taxpayers are entitled to a refund on IRS penalties only if they can show reasonable cause and a lack of willful neglect for the late filing. 26 USC §6651(a)(1). In *United States v. Boyle*, the Supreme Court held that reliance on an attorney or an accountant to file a tax return cannot constitute reasonable cause under §6651(a)(1). 469 U.S. 241, 245 [55 AFTR 2d 85-1535] (1985). The district court held that *Boyle*, which was decided before electronic filing existed, should be extended to e-filing. It believed that this ruling ended the case as a matter of law in the Government's favor. This latter conclusion is incorrect. Even if *Boyle* should be extended to e-filing, another genuine dispute of material fact precludes summary judgment. Accordingly, we vacate and remand without deciding the *Boyle* question.

"I.

"On October 17, 2011, the last day of a six-month filing extension, John Dunbar, a [CPA] and paid tax preparer, electronically transmitted the Hayneses' Form 1040 income tax return, which he had prepared, to Lacerte Software...for filing with the IRS. Later that day, Dunbar notified Mr.Haynes that the 2010 return had been timely filed. Ten months later, however, on August 20, 2012, the Hayneses received an overdue-return notice from the IRS for the 2010 tax year.

"In response to the Hayneses' resulting inquiry, Dunbar ultimately determined that, on October 17, 2011, Lacerte accepted the electronically submitted return and timely transmitted it to the IRS. Nevertheless, the IRS rejected the return because Ms. Haynes's [SSN] erroneously appeared on the line designated for an employment-identification number. For reasons unknown, the Hayneses did not receive a rejection notice from the IRS, [pg. 2019-571] Dunbar, or Lacerte prior to the August 2012 notice of nonpayment.

"To remedy the deficiency, the Hayneses filed a paper return. Once it was received, the IRS assessed a penalty, which the Hayneses paid.[...the Hayneses subsequently] filed a request for abatement of the penalty for reasonable cause. The IRS denied their request, and the Hayneses sued, seeking a refund under §6651(a)(1).

"After discovery, both parties moved for summary judgment. The district court denied the Hayneses' summary-judgment motion but granted the Government's. It concluded that, as a matter of law, the Hayneses' undisputed reliance on their CPA to timely electronically file their tax return could not constitute reasonable cause under §6651(a)(1). The Hayneses timely appealed.

"II.

"[1] We review de novo the district court's grant of summary judgment, using the same standard as the district court. *Windham v. Harris Cty.*, Tex., 875 F.3d 229, 234 (5th Cir. 2017). We are not limited to the district court's reasons for granting summary judgment, however, and may affirm 'on any ground raised below and supported by the record.'*Boyett v. Redland Ins. Co.*, 741 F.3d 604, 606-07 (5th Cir. 2014)(quotation omitted).

"Summary judgment is proper 'if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law.' Fed. R. Civ. P. 56(a). A genuine dispute of material fact exists 'if the evidence is such that a reasonable jury could return a verdict for the nonmoving party.' *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). We construe 'all facts and inferences in the light most favorable to the nonmoving party.' *Dillon v. Rogers*, 596 F.3d 260, 266 (5th Cir. 2010). But '[s]ummary judgment may not be thwarted by conclusional allegations, unsupported assertions, or presentation of only a [little] evidence.' *McFaul v. Valenzuela*, 684 F.3d 564, 571 (5th Cir. 2012).

"III.

"A.

"When taxpayers fail to timely file their tax returns, they are hit with a penalty that increases as time passes. 'To escape the penalty, the taxpayer bears the heavy burden of proving both (1) that the failure did not result from `willful neglect,' and (2) that the failure was `due to reasonable cause.'' *Boyle*, 469 U.S. at 245 (quoting 26 U.S.C. §6651(a)(1)). Under the relevant regulations, reasonable cause exists when the taxpayer 'demonstrate[s] that he exercised `ordinary business care and prudence' but nevertheless was `unable to file the return within the prescribed time.'' Id. at 246 (quoting 26 C.F.R. §301.6651(c)(1)). 'Whether the elements that constitute `reasonable cause' are present in a given situation is a question of fact, but what elements must be present to constitute `reasonable cause' is a question of law.' Id. at 249 n.8 (emphasis omitted).

"In *Boyle*, the Supreme Court laid down a bright-line rule regarding the reasonable-cause standard: reliance on an agent to file a tax return cannot, standing alone, constitute reasonable cause excusing a late filing. Id. at 252. *Boyle* dealt with placing a paper tax return in the mail. Id. at 243. The Hayneses now ask us to cabin *Boyle* to that specific context. They do so largely because they believe filing a tax return electronically—due to the special software needed—is fundamentally different than mailing a return. Unsurprisingly, the Government sees no problem with extending *Boyle's* bright-line rule to e-filing.

"While the e-filing issue is an interesting one, it is one that we need not decide today. Even if the Government is right that *Boyle* should apply to e-filing, another genuine dispute of material fact—laid out in the next section—still defeats summary judgment. Consequently, we take no position on whether a taxpayer's re-

liance on a CPA to e-file a tax return, by itself, constitutes reasonable cause.

"B.

"To understand the dispute of material fact, it is first necessary to recognize the fundamental agency rule working in the background of *Boyle*: an agent's authorized actions are imputed to its principal. See *Pioneer Inv. Servs. v. Brunswick Assocs. Ltd.* P'ship, 507 U.S. 380, 397 (1993) (holding that a principal is responsible for the acts and omissions of a 'freely selected agent' (quotation omitted)). In *Boyle*, no one disputed that the attorney negligently failed to mark the filing date on his calendar and did not file his client's tax return on time due to that slip. *Boyle*, 469 U.S. at 242-43. Thus, under the normal agency rule, the client would be responsible for that negligence. The client attempted to escape that normal rule by arguing that reliance on his attorney to timely file his return was enough, standing alone, to constitute reasonable cause under the tax code. Id. at 249-51. The *Boyle* court rejected that assertion. But the important point for our purposes is this: the client's strategic move was only needed because his attorney was clearly negligent. See *Pioneer Inv. Servs.*, 507 U.S. at 397 [pg. 2019-572] **(holding that the proposition that 'a client could be penalized for counsel's tardy filing of a tax return' animated *Boyle*).**

"In contrast to the attorney in *Boyle*, **it is not clear that Dunbar was negligent**. On the one hand, Dunbar electronically submitted the Hayneses' return to the IRS prior to the expiration of the October 17, 2011, filing deadline. Nevertheless, the Hayneses' return was rejected because it had the wrong employment-identification number. **Yet for reasons unknown, a rejection notice pointing out the error was never sent to Dunbar. Had it been, Dunbar could have easily cured the clerical error. On the other hand, while Dunbar did not receive a rejection notice, neither did he receive an acceptance notice, nor did he proactively ensure that the IRS had accepted the tax return**.

"**Whether it was reasonable for Dunbar to assume, based on the IRS's silence, that it had accepted the Hayneses' return or whether ordinary business care and prudence would demand that he personally contact the IRS to ensure acceptance is a genuine question of material fact for the jury to decide**. Because Dunbar is the Hayneses' agent, if a jury determines that his actions meet the reasonable-cause standard, it must find the same to be true for the Hayneses—barring any determination of independent negligence by them.[1] After all, principals are not only bound by their agents' failures, as in *Boyle*, but also by their diligence.[2]

"It is this question of matrial fact that makes it unnecessary for us to decide whether a broad e-filing exception to *Boyle* exists. That complex question need only be answered if Dunbar, in fact, acted negligently in filing the Hayneses' tax return. Only then would the Hayneses be relegated to relying solely on their reliance on Dunbar to meet the reasonable-cause standard, thereby teeing up the *Boyle* question.

"IV.

"Accordingly, **because there is a genuine dispute of material fact at this time over whether Dunbar's actions could meet the reasonable-cause standard, the district court erroneously granted summary judgment for the Government. The judgment of the district court is VACATED, and this case is REMANDED** for proceedings consistent with this opinion.

"* Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

"1 It is apparent from the record that after Dunbar timely electronically submitted the return, and provided verbal confirmation of filing to Mr. Haynes, on October 17, 2011, neither he nor the Hayneses took further action to confirm that the IRS had actually received the return from Lacerte or acknowledged its acceptance for processing. Additionally, though the **<u>Hayneses' return reflected an unpaid balance due in the amount of more than $40,000, they made no tax payment in October 2011, or at any time, by electronic withdrawal or otherwise, prior to August 2012. The Government argues that this nonpayment information was sufficient to impose a duty of inquiry on the Hayneses, relative to the status of their return, such that reasonable cause is necessarily legally absent</u>**. Likewise, the Government emphasizes the obligations of both Dunbar and Lacerte, as Authorized IRS e-file Providers, to check the IRS acknowledgement file to confirm the IRS's acceptance of a previously transmitted return and to inform the taxpayer of rejections.

"2 We note that this same factual issue also precludes summary judgment on the willful-neglect element." (Thomson Reuters, *Checkpoint*)

C. PREPARER'S FAILURE TO E-FILE EXTENSION FOR LATE FILING PENALTY ABATEMENT DENIED

Kristen Intress
and
Patrick Steffen

v.

Commissioner

(District Court, TN)
August 2, 2019

"A married couple's <u>late filing penalty refund claim was dismissed because the couple's reliance on a tax professional to e-file an extension to file their 2014 return was not reasonable cause to abate the penalty when the preparer's negligence resulted in the extension not being properly filed</u>.

"**Background.** Under Code Sec. 6651(a), the IRS can impose and collect a penalty from an individual who fails to timely file an income tax return. The penalty is 5% of the amount of tax required to be shown on the return if the failure is 1 month or less, with an additional 5% for each additional month, or fraction thereof,

during which such failure continues, not exceeding 25% in the aggregate. The IRS will abate the penalty if the taxpayer's failure to timely file is due to reasonable cause and not due to willful neglect. (Code Sec. 6651(a))

The Supreme Court has held that a taxpayer's reliance on a professional third party for tax filing is not reasonable cause for abatement of late penalties should the third party fail to timely file. Reasonable cause is defined as being 'unable to file the return within the prescribed time' notwithstanding the taxpayer's 'exercise of ordinary business care and prudence.' (*Boyle*, (S Ct. 1985) 55 AFTR 2d 85-1535) Thus, under *Boyle*, the taxpayer has the duty to timely file taxes, and reliance on an agent to fulfill that duty is unjustified when the agent does nothing the taxpayer could not do himself.

"There is a limited exception to *Boyle* for taxpayers who are disabled and must rely on an agent to prepare and transmit their returns to the IRS. (*Erickson*,(Bank DC MN 1994)...

"Rev Proc 2011-25 ... provides that a professional tax preparer is not required to e-file an individual income tax return if the preparer obtains a hand-signed statement from the taxpayer stating that the taxpayer chooses to file a paper return and the taxpayer, not the preparer, files the paper return with the IRS.

"A taxpayer may qualify for administrative relief from a late filed return penalty under the IRS's First Time Penalty Abatement program when the taxpayer: (1) didn't previously have to file a return or had no penalties for the 3 tax years prior to the penalty tax year; (2) filed all currently required returns or requested an extension of time to file; and (3) has paid or arranged to pay any tax due. (Internal Revenue Manual (IRM) at 20.1.1.3.3.2.1)

Facts. Married taxpayers, Kristen Intress and Patrick Steffen, employed a professional tax preparer to prepare and file an extension to file their 2014 income tax return. Their tax preparer prepared an electronic Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, and queued up the form through her e-file software. However, the preparer failed to hit send and, therefore, the IRS did not receive the couple's 2014 Form 4868 on or before the due date for the extension, which was April 15, 2015.

"The IRS imposed and collected a late filing penalty under Code Sec. 6651(a) from the couple because they failed to file a valid extension for their 2014 tax return and filed that return late.

"**Arguments.** The couple argued that their reliance on a third-party tax preparer to timely file their extension was reasonable cause under Code Sec. 6651 and that *Boyle* did not apply to e-filed tax returns because taxpayers have no control over the e-filing process.

"The couple also argued that they were entitled to a first-time abatement relief from the late filing penalty under the IRS's First Time Abatement program.

"The IRS argued that the couple's reliance on a tax

professional was not reasonable cause for not timely filing their extension under *Boyle*.

"**District court's holding.** The district court noted that the couple's argument that *Boyle* did not apply to e-filed tax returns was a novel legal question not previously addressed by the federal courts. However, the district court determined that, in this case, *Boyle* applied.

"The district court rejected the couple's argument that their reliance on a tax professional to file their extension was reasonable cause to abate the late filing penalty. The district court noted that taxpayers are not obligated to use a tax professional to e-file an extension of time to file or a return. In fact, individuals are not required to e-file their own returns.

"The obligation to e-file a return arises only if the taxpayer uses a professional tax return preparer who is required by the IRS to e-file returns. However, even then taxpayers can opt out of e-filing using the procedure in Rev Proc 2011-25. Thus, the couple had the option to prepare their own extension and mail it to the IRS because they were not required to use a tax professional to prepare or to e-file their extension.

"Since the decision to use a tax preparer was within the couple's control, and there was no evidence that the couple was not capable of preparing Form 4868 due to a disability, *Boyle* applied to their reasonable cause argument. But, the couple failed to show they exercised ordinary business care and prudence when filing their extension.

"The district court also concluded that the 'ordinary business care' standard in *Boyle* would continue to be the standard for reasonable cause, at least until e-filing becomes universally mandatory or paper filing so cumbersome that ordinary taxpayers could not file paper returns. But, the district court noted that the 'ordinary business care' reasonable cause standard in *Boyle* might need to be reassessed given the trend towards universal e-filing and the difficulty that could pose to *Boyle's* application going forward.

"The district court commented that the couple's argument that the burden of timely e-filing should be on the tax professional, not on the taxpayer, would be much more plausible if the IRS required all returns to be e-filed. At that point, the average taxpayer would be similarly situated to a taxpayer with disabilities in that reliance on an agent or intermediary for transmission of the electronic return would be required.

"The district court also rejected the couple's argument that they were entitled to a first time penalty relief under the IRM. As the IRS pointed out, the IRM is a policy guide to a governmental agency and does not entitle a taxpayer to judicial relief. (Laidlaw, TC Memo 2017-167)." (Thomson Reuters, *Checkpoint*, August 16, 2019)

D. EMPLOYEE VS. INDEPENDENT CONTRACTOR RULED

Vanderbilt
v.
Boat Bottom Express

(U.S. District Court
Southern District of Florida)

(July 24, 2019)

Synopsis

A woman sued her former employer on multiple grounds, including fraudulent filing of Form 1099-MISC by reporting her as an independent contractor [when] she was an employee and not an independent contractor. The federal court awarded her $5,000 in damages for the erroneous filing, $4,416 O.T. Pay, and $8,843.12 in legal costs and fees, totalling $18,259.12.

"Following prior default judgment and in accord with damages hearing, district court upheld taxpayer's damage claims under FLSA and Code Sec. 7434 against boat co. and its owner for which/whom taxpayer worked in various capacities. As to Code Sec. 7434 damages, court found that taxpayer's claims that co. issued false Form 1099-MISC reporting payment to her in stated amount as independent contractor rather than employee, even though she and co. had verbal contract to treat her as employee, was sufficient to support her claim for statutory damages.

"THIS CAUSE came before the Court upon the evidentiary hearing it held on the issue of damages on June 22, 2019 (D.E. 35).[1]

"[1] Plaintiff Valerie Vanderbilt filed this case against Boat Bottom Express Limited Liability Company ('BBE'), a business in Ramrod Key, Florida, and Jeffrey Peer, alleged owner of BBE, for unpaid overtime violations, fraudulent filing of a tax return, and breach of contract (D.E. 1). After both Defendants defaulted, the Court granted Plaintiff's Motion for Entry of Final Default Judgment as to liability, and set an evidentiary hearing to allow her to prove her unliquidated damages (D.E. 30). Defendants did not appear at the ... hearing. Plaintiff called two witnesses: (a) herself, and (b) her fiancé Gregory Knippel.

"Regarding Plaintiff's claim for unpaid overtime violations against both Defendants, the uncontroverted testimony shows that there was a verbal contract between Ms. Vanderbilt and Jeffrey Peer under which Defendants agreed to pay her $16 per hour to perform various tasks for the business. For a total of four weeks Ms. Vanderbilt opened and closed the business Monday through Saturday (working 8:30 a.m. to 5 p.m.) and worked nights taking calls from customers and handling other tasks for Jeffrey Peer individually and for BBE. She testified: 'Basically, I ran everything.' The Court finds based on Plaintiff's testimony that for those four weeks, Ms. Vanderbilt worked 63 hours per week, rather than 40 hours per week. Twenty-three hours of overtime over four weeks totals $2,208.00.[2] The Court also finds that Plaintiff is entitled to an equivalent amount of liquidated damages under the FLSA where Defendants' actions in failing to pay over-

time were intentional. Therefore, in total, Defendants jointly and severally owe $4,416.00 for unpaid overtime violations.

"As for Plaintiff's claim for breach of contract against BBE, based on the uncontradicted testimony, the Court determines there was in fact a second contract between Valerie Vanderbilt and BBE entered into about four weeks after the initial contract. Specifically, on an evening in mid-November 2017, Valerie Vanderbilt, Gregory Knippel, and Jeffrey Peer were all present at Ms. Vanderbilt and Mr. Knippel's residence in Big Pine Key, and had a conversation wherein Mr. Peer (acting on behalf of BBE) offered Ms. Vanderbilt a new contract of $1,000 per month plus 7% of BBE's yearly gross revenue (less the costs of labor and materials), and she verbally accepted the offer. According to testimony, 7% of gross revenue portion of the agreement was memorialized on a piece of paper signed by both Ms. Vanderiblt and Mr. Peer. They then proceeded to 'whiteboard' how they could grow the company following Hurricane Irma, which had hit the area in September 2017. The Court finds that Ms. Vanderbilt continued to perform under the second contract until she was terminated in mid-October 2018. Her termination consisted of a woman appearing at her office (who, Ms. Vanderbilt testified, she eventually realized she had seen with Mr. Peer as his friend or acquaintance) and demanding her files, laptop, and keys to the company car. The Court finds that the written contract entitling Ms. Vanderbilt to 7% of gross revenue (minus labor and materials) was confiscated along with Ms. Vanderbilt's other work materials. At the hearing, Ms. Vanderbilt testified that BBE's gross revenue for the year was 'right in the neighborhood of $650,000' (she testified that she 'did all the Quickbooks, every day'), but she was unable to proffer any evidence in support of the cost of labor and materials beyond her own salary of $1,000 per month for 2018. As the Court ruled at the hearing, this is simply insufficiently precise to sup[pg. 2019-5300] port [sic] a damages award for Plaintiff's breach of contract claim.

"Regarding Plaintiff's claim for fraudulent filing of tax return pursuant to 26 U.S.C. §7434 against both Defendants, Ms. Vanderbilt testified that, after consulting a personal acquaintance who is a 'CPA,' she told Mr. Peer twice in the same week that she should be classified as an employee and not an independent contractor. She testified that in 2019, she nevertheless received through U.S. Mail an IRS Form 1099-MISC for the 2018 fiscal year. Plaintiff submitted this document as Exhibit 3, and it indeed lists that Boat Bottom Express LLC paid Valerie Vanderbilt 'nonemployee compensation' of $48,684.63 for 2018. Plaintiff argues that this evidences Defendants unlawfully giving false information to the IRS indicating that she was an independent contractor, when in fact she was an employee pursuant to the $1,000 per month verbal contract discussed above. Ms. Vanderbilt testified that she was not involved in the furnishing of the Form 1099 at issue, and did not send it to the IRS, as she was no longer working for BBE at that point. The Court finds that Defendant

BBE (listed on the form as 'PAYER') furnished the document at issue to the IRS, and as such, Defendant BBE is liable to Plaintiff for $5,000.00 in statutory damages pursuant to 26 U.S.C. §7434.

"Therefore, based on the uncontradicted, defaulted testimony, the damages in this case are $4,416.00 against both Defendants jointly and severally, and $5,000.00 against Defendant Boat Bottom Express Limited Liability Company.

"The Court further finds that the fees and costs requested by Plaintiff and supported by the declarations of counsel in Exhibit 4, totaling $7,550.25 in attorney's fees and $593.12 in taxable costs, are reasonable. At the hearing Plaintiff's counsel Jordan Richards requested an additional two billable hours at [$350 per hour rate] for his argument that day. The Court found this reasonable [and awarded plaintiff a total of $8,843.35 in fees and costs.]

"DONE and ORDERED in chambers at the James Lawrence King Federal Justice Building and United States Courthouse, Miami, Florida, this 24th day of July, 2019.

"[1] This Order memorializes findings of fact and conclusions of law that the Court articulated at the June 22, 2019 hearing.

[2] (23 hours)*($24/hour)*(4 weeks)." (Thomson Reuters, *Checkpoint*)

E. TAX HOME NOT ALWAYS WHERE TAXPAYER RESIDES NOTED

BROWN v. COMM.

(CA11)

March 30, 2020

Tax Year(s) 2012 & 2013

Synopsis

"HEADNOTE

"[1] Tax Court properly determined that CPA/GA resident's tax home was NJ, and thus that he and wife weren't entitled to business deductions for his travel between GA and NJ, while working pursuant to multi-year consulting contract for 1 client's NJ office as part of his 'concierge CFO business.' Tax home finding was supported by overall record, showing that husband's engagement with NJ client was indefinite and that such was his principal place of employment. Notably, while he claimed to have worked in other locations for other clients, those claims were unsupported and contradicted by evidence he spent at least 4 days per week in NJ and more time there than in GA or anywhere else. Moreover, it appeared that there was no business purpose for his trips from NJ to GA or benefit to NJ client or his other businesses, and instead that those trips were motivated by personal desire to spend time with family.

"2. Accuracy-related negligence penalties--burden of proof and production; written

approval of assessment--basis for penalties--defenses. Tax Court properly upheld accuracy-related negligence penalties against CPA/'concierge CFO business' owner/husband and wife for years for which they improperly claimed business deductions for husband's expenses of travel/commuting between site of his consulting job and residence. Taxpayers didn't raise any defense other than husband's self-serving claim that he didn't owe underlying liabilities.

"OPINION

"Petitioners-Appellants.

Michael E. Brown and Miriam Mercado-Brown (together, the 'Browns') appeal from the decision of the United States Tax Court, which held that taxpayer Brown's travel expenses in 2012 and 2013 were not deductible under the Internal Revenue Code ('IRC'), leading to deficiencies in the Browns' federal income tax for those years of $3,669 and $17,905, respectively, and that they were liable for negligence penalties for those years of $734 and $3,581, respectively. On appeal, the petitioners argue that the Tax Court erred in declining to consider uncontroverted factual evidence presented at trial, which established that Brown's travel expenses were deductible because his 'tax home' was Atlanta, Georgia, rather than Pennsauken, New Jersey. After thorough review, we affirm.

"This case turns on Brown's work with American Furniture Rental, Inc. ('AFR'), which is based in Pennsauken, and whether, while he was working for AFR, Brown's 'tax home' was Pennsauken or Atlanta. Brown, who has been a [CPA] for about 30 years, operates what he characterizes as a 'concierge CFO' business called 'Project Next,' in which he contracts with companies to manage their finances and to lead and mentor their finance personnel. In September 2012, Brown signed a consulting agreement with AFR, agreeing to provide services beginning in October 2012 for a term of three years, which could be extended. <u>AFR agreed to pay Brown $150,000 for the first year, $175,000 for the second year, and $200,000 for the third year</u>.

"Under their contract, AFR required Brown to work Monday through Thursday each week. In the beginning of Brown's engagement, AFR required him to spend those workweeks at its headquarters in Pennsauken. However, the evidence concerning the second half of 2013 is conflicted - while Brown testified that during that period, he negotiated with AFR to work two weeks in Atlanta and two weeks in Pennsauken in order to offset travel costs, in other testimony he said he 'was in a hotel room for 17 months every week' from October 2012 to February 2014.

"Around this same time, Brown worked for two other companies: Park Mobile (April 2011 to April 2012) and Pango (2012 to 2014). But Brown did not indicate where he worked for Park Mobile or how much time he spent on that work; as for Pango's work, Brown said he did it either in Atlanta, at AFR's offices in Pennsauken, or in a hotel room, but he did not provide the amount of time he spent on that work either. Brown also testified that he did administrative work for Project Next, his concierge CFO business, in Atlanta and

marketed his business 'from anywhere,' including Atlanta, since he typically marketed his business online, but again, he did not detail how much time he spent on these administrative and marketing tasks.

"In Brown's 2012 tax returns, he deducted $10,065 in expenses based on his travel between Atlanta and Pennsauken; in his 2013 returns, he deducted $52,617 in expenses based on this travel. The IRS disallowed the travel expense deductions for both years, resulting in income tax deficiencies of $3,669 for 2012 and $17,905 for 2013, and imposed a negligence penalty of $733 for 2012 and $3,581 for 2013.

"The Browns then petitioned the Tax Court for review of the IRS's decision. They argued that the IRS erred in disallowing Brown's travel expense deductions because his travel from his tax home in Atlanta to AFR in Pennsauken was for business purposes and, therefore, deductible. The Tax Court disagreed. The court found that Brown's tax home became Pennsauken when he began working for AFR. In support of its finding, the court noted that Brown's engagement with AFR was indefinite and that, in light of the three-year term of the consulting agreement, Brown could not have expected the engagement to be temporary. The court refused to credit Brown's testimony, in the absence of any travel records and receipts, that he began to work alternate two-week periods in Pennsauken and Atlanta in mid-2013, and observed that Brown's testimony about his work for other companies was vague. As for Brown's claim that his tax home had to be Atlanta because he had no principal place of business from 1998 through 2013, the Tax Court found no authority for expanding the scope of inquiry beyond the years at issue. Thus, the court concluded that Brown's trips from his tax home in Pennsauken to Atlanta were not for business purposes and, accordingly, the associated expenses were not deductible. The court also affirmed the IRS's imposition of penalties for both years, since Brown relied only on the absence of deficiencies as a defense. This timely appeal followed. [pg. 2020-1488]

"We review the Tax Court's factual findings for clear error, and its legal conclusions de novo. Bone v. Comm'r, 324 F.3d 1289, 1293 [91 AFTR 2d 2003-1364] (11th Cir. 2003). Whether certain travel expenses are deductible under the IRC 'is purely a question of fact in most instances.' Comm'r v. Flowers, 326 U.S. 465, 470 [34 AFTR 301] (1946); see also Michel v. Comm'r, 629 F.2d 1071, 1073 [46 AFTR 2d 80-6039] (5th Cir. 1980).[1] We also review for clear error whether a taxpayer acted with reasonable cause and in good faith when making a tax underpayment. Gustashaw v. Comm'r, 696 F.3d 1124, 1134 [110 AFTR 2d 2012-6169] (11th Cir. 2012).

"The Internal Revenue Code allows a deduction for travel expenses incurred 'while away from home in the pursuit of a trade or business.' 26 U.S.C. §162(a)(2). A taxpayer only may deduct travel expenses directly attributable to the conduct of the taxpayer's business. 26 C.F.R. §1.162-2(a). According to the Supreme Court, a deduction under 26

U.S.C. §162(a)(2) is only warranted if: (1) the expense is reasonable and necessary; (2) the expense is incurred while away from home; and (3) the expense is incurred in pursuit of business. Flowers, 326 U.S. at 470. The taxpayer bears the burden of proving the entitlement to a deduction. United States v. Gen. Dynamics Corp., 481 U.S. 239, 245 [59 AFTR 2d 87-899] (1987).

"Under our case law, '[a] taxpayer's home, for purposes of section 162(a)(2), means the vicinity of his principal place of employment and not where his personal residence is located, if such residence is located in a different place from his principal place of employment.' Michel, 629 F. 2d at 1073; see also Jones v. Comm'r, 444 F.2d 508, 509-10 [27 AFTR 2d 71-1563] (5th Cir. 1971); Curtis v. Comm'r, 449 F.2d 225, 227 [28 AFTR 2d 71-5693] (5th Cir. 1971); Masline v. Comm'r, 30 T.C.M. (CCH) 850 [¶71,204 PH Memo TC] (1971), aff'd, 462 F.2d 1328 [30 AFTR 2d 72-5057] (5th Cir. 1972). A taxpayer is 'away from home' if the taxpayer is required to travel away from his principal place of business for temporary work. Michel, 629 F.2d at 1073; see Peurifoy v. Comm'r, 358 U.S. 59, 60-61 [2 AFTR 2d 6055] (1958); Groover v. Comm'r, 714 F.2d 1103, 1104-05 [52 AFTR 2d 83-6017] (11th Cir. 1983). 'A taxpayer who accepts permanent or indefinite employment in a location different from that of his residence ... is considered to have moved his tax home to the new location, and is therefore no longer considered away from home.' Michel, 629 F.2d at 1073.

"On the record before us, the Tax Court did not clearly err in finding that Pennsauken was Brown's principal place of business from October 2012 through December 2013. For starters, Brown does not challenge on appeal the Tax Court's finding that his engagement with AFR was indefinite and not temporary; as the record reflects, Brown's consulting agreement with AFR had a term of three years, with the possibility of an extension. Further, we cannot say that the Tax Court clearly erred in finding that Brown spent more time working in Pennsauken than Atlanta or anywhere else. Brown admits that he 'worked mostly from Pennsauken' at the beginning of his work for AFR, but says that he negotiated, in mid-2013, to begin working alternate two-week periods in Pennsauken and Atlanta. However, Brown also testified that he 'was in a hotel room for 17 months every week' upon starting work with AFR (i.e., from October 2012 through February 2014). In addition, he gave an earlier statement to the IRS examining agent that, as of August 2014, he was still traveling between Pennsauken and Atlanta 'every week.' While Brown says that his use of the phrase 'every week' was mere slip of the tongue, nothing in the record supports this interpretation. As the Tax Court observed, Brown could have, but did not, support his contrary testimony with travel records, which warranted an inference against him on this issue. See Mammoth Oil Co. v. United States, 275 U.S. 13, 52 (1927) (where a party fails to produce evidence that is uniquely in its possession, the natural conclusion is that the evidence would be unfavorable to the party). On this record, the Tax Court did not clearly err

in finding that Brown worked four days every week in Pennsauken through December 2013. See Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 575 (1985) (observing that a factfinder may reasonably refuse to credit internally inconsistent testimony).

"As for Brown's claim that he did other work in other locations during this period, it is too vague. He said he did administrative work for Project Next, his concierge CFO business, in Atlanta; his online marketing work 'anywhere'; and his work for Pango either in Atlanta, at AFR in Pennsauken, or in a hotel room. But he offered no evidence as to the amount of time he spent on these activities, making it unclear whether he spent more time on them than he did on his work for AFR (i.e., four days per week) in Pennsauken. Further, Brown did not claim a home office expense deduction for the business use of his Atlanta [pg. 2020-1489] home for either 2012 or 2013, reasoning that he did not do so because the benefit would have been insignificant, but this explanation only bolsters the notion that he did not primarily work from Atlanta. What's more, between October 2012 and December 2013, AFR was Brown's sole source of business income.[2] Accordingly, Brown's claim that he did non-AFR work from Atlanta during this period is unsupported by the record and irrelevant, since we are unable to compare the amount of time he spent in each place.

"The Tax Court also correctly rejected the argument that, because Brown had worked for various clients in various locations since 1998, he should be deemed to have no regular place of business and therefore his permanent residence in Atlanta should be considered his tax home. The Tax Court has recognized that, if a taxpayer has no regular principal place of business during the period in question, the taxpayer's permanent residence is deemed to be his tax home. See Zbylut v. Comm'r, 95 T.C.M. (CCH) 1172[2008 RIA TC Memo ¶2008-044] [2008 RIA TC Memo ¶2008-044] (2008) (merchant sailor's permanent residence in the United States was tax home because he spent tax year aboard cargo ship docking at various ports); Johnson v. Comm'r, 115 T.C. 210, 212-14, 223 (2000)(same). As for whether, as Brown argues, the court should consider a taxpayer's travels outside the period under examination, the Tax Court solely has done so to evaluate the taxpayer's reasonable expectation concerning the duration of the employment at issue for the period under examination, or for background purposes. See, e.g., Michel,629 F.2d at 1074-75. However, Brown offers no authority, nor any persuasive reason for taking into account his travels and employment in years other than the years at issue in order to determine whether he had a principal place of business for the year in question. In short, the Tax Court did not clearly err in finding that Pennsauken was Brown's principal place of business between October 2012 and December 2013.

"Nor, moreover, did the Tax Court clearly err in finding that there was no business purpose to Brown's trips from his tax home in Pennsauken to his residence in Atlanta. While the IRC generally prohibits deductions for 'personal, living, or family expens-

es,' 26 U.S.C. §262(a), there is an exception for the deduction of otherwise nondeductible personal living expenses if they are incurred 'while away from home in the pursuit of a trade or business.' Id. §162(a)(2). Notably,'[t]he exigencies of business rather than the personal conveniences and necessities of the traveler must be the motivating factors.' Flowers, 326 U.S. at 474. A taxpayer may not deduct travel expenses necessitated by his decision to maintain a residence distant from his employment, where that decision is irrelevant to his employer or business. See id. at 473-74; Groover, 714 F.2d at 1104. Here, Brown could be 'anywhere' when doing his administrative work for Project Next, and he gave no reason for having to be in Atlanta to do his work for Pango or for any other aspect of his business. Rather, Brown's trips to Atlanta and decision to maintain a home in Atlanta appear to have been motivated by a personal desire to spend time with his family that did not benefit either AFR or his other business, especially since his contract with AFR required him to be in Pennsauken four days per week. Therefore, the Tax Court did not clearly err in finding that Brown's travel expenses were not incurred 'in the pursuit of a trade or business' and were nondeductible personal expenses. See 26 U.S.C. §§162 (a)(2), 262(a); Flowers, 326 U.S. at 470, 473-74.

"Finally, the Tax Court did not err in upholding the IRS's twenty-percent penalties against the Browns under 26 U.S.C. §6662. This provision defines 'negligence' as any failure to make a reasonable attempt to comply with the IRC and to exercise ordinary and reasonable care in the preparation of a tax return. 26 U.S.C. §6662(c); 26 C.F.R. §1.6662-3(b)(1). As we've noted, Brown's background was as a CPA and finance professional, and his sole defense against the penalties, in the Tax Court and on appeal, is that he does not owe the tax deficiencies. He has waived any other argument about the penalties, including the existence of reasonable cause. See Access Now, Inc. v. Sw. Airlines Co., 385 F.3d 1324, 1330 (11th Cir. 2004). Thus, because the Browns are liable for the deficiencies, they are liable for the penalties as well.

"AFFIRMED.

"[1] In Bonner v. City of Prichard, 661 F.2d 1206, 1209 (11th Cir.1981) (en banc), we adopted as binding precedent all Fifth Circuit decisions issued before October 1, 1981.

"[2] Brown reported income from AFR for $37,500 in 2012 and $184,759 in 2013. While he reported income from Park Mobile for 2012, his engagement with Park Mobile ended in April 2012, before he began working for AFR (and began incurring travel expenses between Pensauken and Atlanta) in October 2012. He reported no income from Pango during this time and did not even submit into evidence the Form 1099 from Pango he claimed he had received. We are unpersuaded by Brown's suggestion that he, a CPA of about 30 years, simply neglected to report his income from Pango." (Thomson Reuters, *Checkpoint*)

F. CHARITABLE WRITE-OFF LACKING SUBSTANTIATION DENIED

PRESLEY v. COMM.

(CA10)

October 25, 2019

"HEADNOTE

"1. Charitable contribution deductions-property donations and land improvement expenses-property owner; time for deduction; rendition of services; contemporaneous written acknowledgment.

"Tax Court properly determined that wife and husband/optometrist/vision care S corp. owner, who served as pastor for and pres. of his and wife's nonprofit religious corp., weren't entitled to charitable contribution deduction for purported donation to religious corp. of land improvement costs that husband's single member LLC/farm corp. paid before year at issue: Code Sec. 170(a)(1) and Reg §1.170A-1(a) only allowed deduction for expenses incurred in year claimed.

"2. Charitable contribution deductions-property donations-substantiation-reasonable cause.

"Tax Court properly determined that wife and husband/ optometrist/vision care S corp. owner, who served as pastor for and pres. of his and wife's nonprofit religious corp., weren't entitled to charitable contribution deductions for purported donations to religious corp. of tractor/ mower and residence in which they still lived. With respect to mower, <u>deduction failed because taxpayers admittedly failed to include requisite description of same on Form 8283 and failed to prove reasonable cause/reliance on CPA, who they neglected to ask about missing information</u>. And with respect to residence, deduction failed because supposed qualified appraisal and appraisal summary didn't comply with Reg §1.170A-13(c). While taxpayers argued that they substantially complied with same, that argument failed in face of fact that regardless of whether appraisal summary substantially complied, **<u>appraisal itself wasn't made before return was due as required under Reg §1.170A-13 (c)(3). ... their attempt to claim reliance on return preparer was unavailing</u>**.

"3. Accuracy-related substantial understatement or negligence penalties-burden of proof and production-written approval of assessment-reasonable cause; good faith-reliance on professional.

<u>Tax Court properly upheld accuracy-related substantial understatement or negligence penalties against wife and husband / optometrist / vision care S corp. owner, who served as pastor for and pres. of his and wife's nonprofit religious corp., for years for which they claimed improper charitable contribution deductions for purported donations of land improvement costs, tractor/mower and residence in which they still lived. Although taxpayers claimed reasonable and good faith reliance on their attorney and return preparers, those claims failed in face of facts that they didn't follow attorney's advice as to providing proper substantiation for deduction or ask preparers why stated information was missing from returns</u>.

"OPINION

"UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT,

"Richard and Martine Presley ('Presleys') appeal the decision of the United States Tax Court sustaining the Commissioner of Internal Revenue's Notice of Deficiency for tax years 2010 and 2012, including penalties, related to charitable deductions the Presleys claimed. Exercising jurisdiction under 26 U.S.C. §7482(a)(1), we affirm.

"I. Background

"Prior to 1997, the Presleys hosted Bible studies at their residence in Tulsa, Oklahoma. In 1997, they formed Presley Family Ministries, Inc.('PFM') as a nonprofit corporation under Oklahoma law. The Presleys' residence was named as PFM's location and principal office. Dr. Presley, who is an optometrist and operated several vision-care businesses, was named its principal agent. The Presleys have always served as PFM's corporate officers and on its four-member board of directors.

"PFM's primary purposes include promoting Christianity and providing optometry services to people in low-income areas of other countries through annual mission trips. Dr. Presley served as PFM's lead pastor and spiritual leader. After forming PFM, the Presleys continued to use their residence for meetings, Bible studies, and other activities in pursuit of PFM's charitable purpose. They funded all of PFM's activities and never received a salary, housing allowance, or other benefit from PFM. Since at least 2004, the IRS has recognized PFM as a tax-exempt organization under §501(c)(3) of[pg. 2019-6472]the Internal Revenue Code ('IRC' or 'Code'), 26 USC §501(c)(3).

"In 2008, Dr. Presley organized PFM Farms, LLC, and he owned 100% of it. Although PFM Farms was a for-profit entity, its purpose was to develop a blueberry farm and donate to PFM all profits from the sale of fruit to support PFM's charitable work. PFM Farms was set up as a pass-through entity, meaning income and loss would be reported on the Presleys' individual tax return (they were married and filed jointly for the years in question).

"In 2008, PFM and PFM Farms entered into a 10-year crop and farming lease under which PFM Farms leased two acres from PFM to establish the blueberry farm. In 2008 and 2009, PFM Farms paid $119,182.36 for construction and reconfiguration of existing water ponds on PFM's property but outside of the acreage covered by the lease (the 'land-improvement expenses'). In 2010, PFM Farms donated to PFM a Toro tractor-mower and the land-improvement expenses. At a board meeting in October 2010, PFM's board of directors approved receipt of those donations.[1]

"The Presleys' 2010 individual income tax return was prepared by Robert Johnson, a ... ('CPA'). Mr. Johnson was an employee of the Presleys and had unfettered access to, and familiarity with, all of the financial affairs and records of the Presleys and their entities. On the 2010 return, <u>the Presleys included a charitable deduction of $107,364.00 for the land-</u>

improvement expenses PFM Farms had donated to PFM.[2] They also included a $3,000 charitable deduction for the Toro mower. The Presleys did not separately list or disclose any information about these deductions on their return; the amounts were simply incorporated into larger claimed deductions on Schedule A, as they stipulated at trial.

"According to the minutes of a PFM board meeting held on April 20, 2012, PFM accepted the Presleys' donation of their residence, and a deed of transfer in fee simple was recorded in the county clerk's office in July 2012. Minutes from a May 25, 2012 PFM board meeting indicate that PFM's board of trustees approved the Presleys' request to use the residence as a parsonage, rent-free, after the transfer. Consistent with that indication, the Presleys continued to live in the residence rent-free (but paying the utility bills) through at least the time of trial in this case. The Presley's 2012 tax return was prepared by Kathy Burch, who is both an attorney and a CPA. The return was timely filed on October 15, 2013, after an extension. On that return, the Presleys claimed a charitable deduction of $235,422 for the donation of their residence to PFM. The Presleys included only the second page of the form used to report Noncash Charitable Deductions, Form 8283, where they listed the value of the deduction, but the form's 'Declaration of Appraiser' section was left entirely blank and unsigned, and the 'Donee Acknowledgment' portion of the form identified PFM as the donee but was unsigned. See Aplt. App.,Vol. 3 at 3223. In an appraisal report signed and dated December 5, 2013, a certified appraiser, Ronald Scott, concluded the fair market value of the residence as of May 10, 2012, was $236,000.[3]

"In 2016, after an audit, the Commissioner issued the Presleys a Notice of Deficiency for the 2010 and 2012 tax years. See id., Vol. 4 at 329-52. As relevant to this case, the Commissioner disallowed their charitable contributions of $107,346 for the land-improvement expenses, $3,000 for the Toro mower, and $235,422 for their residence.[4] The Commissioner also imposed [20%] accuracy-related penalties for both years ($7,853.80 for 2010, and $10,889.00 for 2012) based on I.R.C. §6662.

"The Presleys filed a petition for redetermination of the deficiencies in the United States Tax Court. After a trial, the court upheld the notice and the assessed penalties.The Presleys appeal[ed]." (Thomson Reuters, *Checkpoint*)

ATS Note: The remainder of the court case has been intentionaly omitted.

G. SHAREHOLDER'S PERSONAL EXPENSES RULED CONSTRUCTIVE DIVIDEND

Moacir Santos

v.

Commissioner

TC Memo 2019-148

October 31, 2019

Synopsis

The Commissioner assessed Mr. Santos for personal expenses paid from his SESP C corporation totalling $156,469 and classified such expense as a "constructive dividend."

"HEADNOTE

"1. Tax Court--who has burden of proof--new matter-amended and supplemental pleadings-surprise and prejudice.

"In deficiency case involving former bull rider/engineering corp. owner who didn't file returns, burden of proving question of whether he received constructive dividends in stated year shifted to IRS because this was new matter that IRS raised only after taxpayer amended his petition and IRS conceded that underlying unreported income was income of corp. However, taxpayer's belated argument that he was unfairly surprised or prejudiced by constructive dividend issue, which was tried by parties' implied consent, was meritless.

"2. Unreported income-constructive dividends-wholly owned corps.-benefit to shareholder; personal expenses-E&P.

IRS's determination that former professional bull rider /engineering corp. owner had unreported constructive dividend income from corp. was upheld. IRS, which had burden of proof on this matter, met same with evidence that taxpayer received distributions from corp. in form of bank account deposits and transfers, as well as via corp.'s payment of his personal expenses for such things as groceries, gym membership, residential rent, nanny, and other items. While taxpayer argued that corp. paid legitimate business expenses, that argument was undercut by above and fact that supposed business expenses weren't substantiated by anything other than bogus receipts that, although purportedly from different vendors, appeared to be from same receipt book, were out of order, and had other inconsistencies. Taxpayer's alternate arguments that expenses for rent and nanny were really for home office and nanny's cleaning of home office were similarly unavailing. Also, corp. had sufficient E&P in stated year to support constructive dividend treatment of entire amount at issue.

"3. Filing status-unmarried vs. married filing jointly-proof.

"IRS properly determined that non-filer/former professional bull rider/engineering corp. owner's filing status for stated year was unmarried, not married filing jointly: taxpayer admitted that he didn't marry until after start of year after year at issue.

"4. Failure to timely file and to pay tax shown due on returns penalties-burden of proof and production-substitute returns-reasonable cause. Failure to timely file and to pay tax shown due on returns penalties were upheld against former professional bull rider /engineering corp. owner for year for which he admittedly failed to file timely return and stipulated that IRS prepared return substitute [pg. 1166] which comported with Code Sec. 6020(b): IRS met its burden of production on penalties' applicability with proof

of above plus fact that although taxpayer did finally submit return years later, such was unsigned and didn't affect above; and he failed to show reasonable cause for his delinquencies in that, although claiming multiple reasons for why he couldn't file or pay tax, including because he was in process of purchasing house, that business revenue declined and he couldn't collect on outstanding debts, and that he was defending several lawsuits, record showed that he purchased house month before return was due and had time and resources to meet his tax obligations. Alternate claim that even if he was liable for penalties, they should be based on only portion of amount required to be shown due on return, was also unavailing.

"MEMORANDUM FINDINGS OF FACT AND OPINION

"Petitioner Moacir Santos operated an engineering and paving company through his wholly owned C corporation, Santos Engineering Santos Pavers, Inc. ('SESP'). Throughout 2010 Mr. Santos used SESP's bank account to make cash withdrawals, electronic transfers to his personal bank account, and payments of his personal expenses. Mr. Santos did not file his 2010 [*2] Federal income tax return. Pursuant to section 6212(a)[1] the ... ('IRS') issued to Mr. Santos a statutory notice of deficiency ('SNOD') on January 30, 2015, which determined the following deficiencies in his Federal income tax and additions to tax for tax years 2010, 2011, and 2012:

[··· Chart omitted]

"Mr. Santos filed a timely petition under section 6213(a) for redetermination of the deficiencies and additions to tax. After concessions by the parties,2 the issues for decision are:

"[*3] (1) whether Mr. Santos had constructive dividend income of $156,469 in 2010 as a result of cash withdrawals, electronic transfers to his personal account, and payments of personal and meal expenses, from SESP's bank account (we hold that he did);

"(2) whether Mr. Santos's filing status was unmarried, married filing separately, or married filing jointly for the 2010 tax year (we hold that his filing status was unmarried);

"(3) whether Mr. Santos is liable for the addition to tax under section 6651(a)(1) for failure to timely file for the 2010 tax year (we hold that he is); and

"(4) whether Mr. Santos is liable for the addition to tax under section 6651(a)(2) for failure to timely pay for the 2010 tax year (we hold that he is).

"FINDINGS OF FACT

"At the time Mr. Santos filed his petition, he resided in California.

"Mr. Santos

"Mr. Santos is the owner and operator of SESP, which he started after a broken shoulder ended his career as a professional bull rider. In October 2010 Mr. Santos's son was born, and he married his son's [pg. 1167] mother in 2011. Throughout 2010 Mr.

Santos maintained a Wells Fargo business checking account in his name [*4] and another Wells Fargo business checking account in the name of SESP. Mr. Santos purchased a house in March 2011.

"Mr. Santos never filed his Federal tax returns for the 2010,2011, and 2012 tax years.

"**SESP**

"In 2007 Mr. Santos incorporated SESP in the State of California as Santos Construction, Inc. During the entire 2010 tax year, Mr. Santos was its sole shareholder. At some point California's Franchise Tax Board suspended SESP's corporate status for failure to meet tax requirements.

"SESP had gross receipts for the taxable year 2010 in the amount of $443,028.This amount represents the aggregate amount of deposits into Mr. Santos's personal and corporate bank accounts. SESP did not keep books and records, so there was no way to distinguish between Mr. Santos's personal finances and the corporation's.

"In 2010 Mr. Santos expended SESP funds for his own use. He made cash withdrawals from SESP's bank account totaling $113,846 for his own use and not for corporate expenses. Also for Mr. Santos's personal use, SESP transferred $560 from its corporate account to his personal bank account. In 2010 Mr. Santos paid the cost of meals for himself totaling $13,146 by using SESP's corporate [*5] debit card. SESP paid $28,917 worth of Mr. Santos's other personal expenses in 2010 (including: rent, travel, and childcare). The amounts SESP expended for Mr. Santos personally totaled as follows:

Cash withdrawals	$113,846
Electronic transfer	560
Meals	13,146
Other personal expenses	28,917
Total	$156,469

"(The 'Meals' amount given above reflects adjustments that correct for meal expenses that the Commissioner had initially categorized instead as undifferentiated 'personal expenses'.)

"SESP's earnings and profits were at least $165,445 in 2010. Notice of deficiency [t]he IRS computed Mr. Santos's income for 2010 by reference to bank deposits and cash payments, plus personal and other nondeductible expenditures. On the basis of the results of that analysis, the IRS prepared for Mr. Santos a substitute for return for the year 2010 (pursuant to section 6020(b)) and issued to him the SNOD dated January 30, 2015. That SNOD determined, among other things, that Mr. Santos received unreported business income of $487,344 in 2010, which resulted in a deficiency of $166,635, and that he was liable for additions to [*6] tax under sections 6651 (a)(1) and (2) and 6654 for the 2010 tax year. Mr. Santos timely mailed his petition to this Court on April 30, 2015.

"**Tax Court proceedings**

"Mr. Santos's timely filed petition does not contest the amount of unreported gross income stated in the SNOD but argues that he is entitled to additional deductions therefrom and that his filing

status was 'married filing jointly'. This case was first set for trial in April 2016 but was continued generally. The case was then set for trial in September 2016, but Mr. Santos did not provide to the Commissioner the documents he intended to offer into evidence until two business days before his trial date; and on the day of trial, he asked for another continuance, which the Court granted.

"Trial was recalendared for March 2017, and in the interim Mr. Santos had an accountant prepare his tax returns. He submitted to the Commissioner copies of Forms 1040, 'U.S. Individual Income Tax Return', for the 2010, 2011, and 2012 tax years that were dated October 18, 2016, but neither he nor anyone purporting to be his agent signed them. Each of Mr. San [pg. 1168] tos's Forms 1040 included a Schedule C, 'Profit or Loss From Business', reporting SESP's income.

"[*7] SESP's gross receipts and constructive distributions

"At the beginning of trial on March 28, 2017, almost two years after first filing his petition, Mr. Santos moved to amend his petition to treat the gross receipts as attributable to SESP rather than to himself personally. The Court granted Mr. Santos's unopposed motion. The parties stipulated that the amount of gross receipts SESP received in 2010 was $443,028. Mr. Santos also provided to the Commissioner a statement titled 'SESP Profit and Loss Detail' for 2010, which provided line item entries for income and expenses and stated that SESP's net income was $121,381.

"As for Ms. Santos's 2010 income, the Commissioner then proceeded under the theory that in 2010 Mr. Santos had received constructive dividends from SESP. The Commissioner posits that during 2010 Mr. Santos 'drew no distinction between the funds of his business and his personal funds'. The Commissioner identified various categories of expenditures in SESP's bank statements that he argues were distributions to Mr. Santos-cash withdrawals, electronic transfers, personal expenses, and meal expenses-and at trial he put on evidence of those expenditures.

"[*8] Character of the distributions received by Mr. Santos

"To determine the character of the constructive distributions, the Commissioner calculated SESP's earnings and profits for 2010. The Commissioner posits that after adjustments to SESP's financial statement and Mr. Santos's Schedule C for stipulated amounts, disallowed deductions, and statutorily required adjustments are made, SESP's earnings and profits were at least $165,445 in 2010.Therefore, he argues that all of the constructive distributions Mr. Santos received from SESP in 2010 are dividends." (Thomson Reuters, *Checkpoint*)

<u>ATS Note</u>: The remainder of the court case has been omitted.

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N.B.: Underlining, bolding, and some use of the subhead "Synopsis" are those of ATS.