



**THE STUDENT POWERPOINT VERSION INTENTIONALLY DOES NOT
COMPLETELY MATCH THE PRESENTATION**



FEDERAL TAX


2025 EXAM CYCLE
LIVE FROM LAS VEGAS
VIRTUALLY VIA LIVESTREAM

Text




Preparing to
Practice before the
US Tax Court

Federal Taxation
2025 Exam Cycle




May 2025 Handout (bound)



Preparing to
Practice before the
US Tax Court

May 2025 Handout
QUESTIONS
2025 Exam Cycle



May 2025 Handout (downloaded)

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Federal Taxation

TAX COURT EXAM ALLOCATION OF FEDERAL TAXATION EXAM QUESTIONS BY TOPIC NUMBER OF QUESTIONS AND TIME ALLOTTED EXAMS 2000-2023

TOPICS	2023		2021		2018		2016		2014		2012		TOTAL			
	#	% TIME	#	% TIME	#	% TIME	#	% TIME	#	% TIME	#	% TIME	#	% TIME		
DEFINITIONS/EXPLAIN/DESCRIBE	1	0.0%	0	15.6%	15	7	13.0%	19	11	21.2%	20	5	14.0%	14	6.2%	
GROSS INCOME	1	0.2%	0	10.4%	10	1	5.2%	5	1	3.4%	9	1	8.2%	0	0.0%	
CASH VS ACCRUAL DEFERRISSES	1	1.0%	1	4.2%	4	3	8.7%	8	2	4.2%	4	4	10.4%	10	3.1%	
REMOVING/AGREEMENT/CHANGE OF RESIDENCE	1	2.1%	2	0.0%	0.0%	0.0%	0.0%	0.0%	1	2.1%	2	1	1.0%	1	0.0%	
PERSONAL INJURY/DAMAGES AWARDS	0	0.0%	0	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
TRAVEL/ENTERTAINMENT/BUSINESS EXPENSE	10	22.0%	22	0.0%	0.0%	0.0%	0.0%	1	2.1%	2	0.0%	0	3.1%	2	0.0%	
DIVIDENDS & MARITAL/FAMILY STATUS	0	0.0%	0	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
CAPITAL GAINS/DIVIDENDS	0	0.0%	0	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	
REAL ESTATE	3	16.1%	27	4	25.0%	24	4	2.0%	4	2	10.4%	10	5	21.0%	21	4.1%
CORPORATIONS/LLC	3	14.0%	16	3	22.0%	22	2	8.7%	8	2	10.4%	10	1	3.1%	3	1.0%
PARTNERSHIPS	1	0.2%	0	1.2%	1	2	9.4%	9	0	0.0%	2	7.2%	7	1	7.2%	
ESTATE/EST/EST/EST/EST/EST	3	6.4%	0	2	3.1%	1	2	6.3%	16	4	9.4%	16	2	6.3%	0	3.1%
INTEREST/SPENDING/EST/EST/EST/EST	4	8.2%	0	4	11.0%	11	7	17.0%	17	4	10.4%	10	4	10.4%	0	0.0%
TOTAL	27	100.0%	90	22	100.0%	94	11	100.0%	74	38	100.0%	90	27	100.0%	1,150	1,150



Federal Taxation

40% of Exam – 96 minutes

2nd most difficult exam section once, but now students are passing Evidence and not passing Tax

Covers a lot of tax law, especially the gross income question series. In 2023 also tested a series on medical deductions and business expenses.



Federal Taxation

IRC (or portions) supposed to be available during exam

This is not a comprehensive look at IRC – geared towards exam, not your practice

We will have many topic-related webinars available for your 2025 Fed Tax studies – see student content area of taxcourtexam.com



Study Tips

Some repetition in exam questions - likely to see concepts tested over and over: gross income, real estate, cash vs accrual, corporations, and estates

We'll introduce you to some of these today:

- Introduction/new tax law
- Gross income + cash/accrual
- Corporations
- Partnerships
- LLCs and other entity issues
- Entity calculations
- Penalties and Interest



Court Cases May be Tested ...

HANDOUT PAGE 71

Court cases may be tested

It's not law school

No need (and no time) for IRAC analysis



Court Cases May be Tested ...

HANDOUT PAGE 73

Sample #1

From Parker Publishing/ustaxcourt.gov

155 TC 7 (9/9/20)

ROBIN J. FOWLER, PETITIONER v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT Docket No. 12810-18

P filed his 2013 tax return on October 15, 2014, which R's software reviewed and rejected for failure to include an Identity Protection Personal Identification Number (IP PIN). P refiled his 2013 tax return with an IP PIN on April 30, 2015; R's software reviewed and accepted the return. Thereafter, R sent P a notice of deficiency for the 2013 tax year on April 5, 2018.

R moved for partial summary judgment, and P cross-moved for summary judgment, on whether R issued a timely notice of deficiency. The parties dispute whether P's first submission triggered the I.R.C. sec. 6501(a) limitations period.

Held: P's first submission triggered the running of the I.R.C. sec. 6501(a) limitations period, notwithstanding P's omission of an IP PIN.

Held, further, R's motion for partial summary judgment will be denied, and P's cross-motion for summary judgment will be granted.



Court Cases May be Tested ...

HANDOUT PAGE 73

From 2021 Practice & Procedure Exam

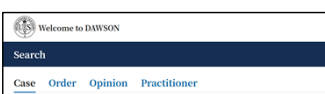
2021 S-19 (1 minute) TP e-filed TP's 2018 federal income tax return on October 15, 2019. The IRS computer software program reviewed and rejected the submitted return for failure to include an Identity Protection Personal Identification Number (IP PIN). TP re-filed the 2018 tax return with an IP PIN on April 30, 2020 and the IRS software reviewed and accepted the return. On April 5, 2023 the IRS sent TP a notice of deficiency for the 2018 tax year. The IRS notice of deficiency satisfied §6051. True or False?

SUGGESTED ANSWER: False. (2/2)



Court Cases May be Tested ... (P 71)

Easy to look them up at ustaxcourt.gov



Court Cases May be Tested ... (P 72)

Search by type of opinion, date, petitioner name, issue



Court Cases May be Tested ...

Generous offer by a fellow student (not in the handout) - Forum

Josh Youngblood

Star 15 in Welcome

Daily email with tax court opinions

I have an automation setup that, every day after the day's opinions are published, will download and email them to you. I have a couple of other people on it now. I use Readwise and have mine sent there so...

4 10

New comment 3 hours ago

josh Tax Court PDF (MOP 30412-12) - Caption: Mark P. Himmel & Deborah W. Himmel, Petitioners Docket Num: 30412-12 Filing Date: ... Apr 17



Court Cases May be Tested ...

I provide synopsis of court cases periodically

<p>General Info/Court Cases</p> <p>Access Content</p>	<p>Webinars/Videos</p> <p>Access Content</p>	<p>May 2025 Class</p> <p>Access Content</p>
<p>July 2025 Class</p> <p>Access Content</p>	<p>Review 2025 Class</p> <p>Access Content</p>	<p>All Assignments</p> <p>Access Content</p>

Available Content

- TC Opinion April-December 2024 and TC Memo for 2024
- TC Opinion January-March 2024
- Reading a Case



Court Cases May be Tested ...

Synopsis of court case

What if the date on the notice of deficiency gives more time that the statute allows to file a petition? In *Douglas Dodson and Rebecca Dodson* (162 TC 1 (1/3/24)) respondent mailed the first notice of deficiency on 10/7/21 giving a specified deadline to file the petition on 12/5/22, over one year from the date on which respondent mailed the first notice. One day later, on 10/8/21, respondent mailed a second notice of deficiency that purported to correct the deadline for filing a petition, giving a final filing date of 1/6/22 and providing a cover sheet that stated the previous notice was sent with an incorrect date.

Petitioners filed the petition for review on 3/3/22, using the 1st NOD but before that petition filing deadline, but after the petition filing deadline specified in the 2nd notice and after the 90-day period for filing a petition provided in the first sentence of §6213(a). In other words, they were after 1/5/22 but before 12/5/22, 147 days after respondent mailed the first notice and 146 days after respondent mailed the second notice.

The Tax Court ruled the petition was filed timely (pursuant to the last sentence of §6213(a)). That sentence reads: "Any petition filed with the Tax Court on or before the last date specified for filing such petition by the Secretary in the notice of deficiency shall be treated as timely filed."

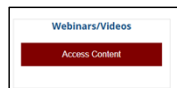
The first notice unambiguously determined a deficiency against petitioners and was valid.

NOTE: Consider this a likely exam topic.



Remember a webinar is in the student portal also

Available Content	
✓	§551 & §721 Exchange Overview - Recorded 2/8/25
✓	Reading A Case - Recorded 1/4/25
✓	A Look at the 2023 Exam - Recorded 12/7/24
✓	Getting Started - 2023 Exam Cycle - Recorded 11/1/24
✓	Learning Styles Webinar - Recorded 11/12/22
✓	Jurisdiction Webinar - Recorded 11/12/22
✓	Discovery thru Appeals Webinar - Recorded 2/12/23
✓	Penalties and Interest Webinar - Recorded 2/10/23



New Tax Law (p 2)

Federal Disaster Tax Relief Act of 2023... enacted December 2024

"Qualified disaster" casualty loss treatment for most disasters starting in 2020 through 2024

Qualified wildfire relief payment exclusion

East Palestine train derailment payment exclusion



New Tax Law (p 3)

SECURE 2.0... passed in December 2022

RMDs at age 73 instead of age 72

Missed RMD excise tax from 50% to 25%/10%

New SOL on RMD (3 yr)/excess contribution (6 yr) excise taxes; SOL starts even if TP not required to file return

529 plan amounts can be transferred to Roth IRAs



New Tax Law

SECURE 2.0... passed in December 2022

New 10% penalty exceptions for qualified disaster recovery distributions, emergency expense distributions, terminal illness distributions, and domestic abuse distributions

Additional access to Roth accounts in various retirement plans

Additional catch-up contributions for TPs >= age 50



New Tax Law

SECURE 2.0... passed in December 2022

No syndicated conservation easement deduction if deduction >2.5x the partnership basis unless held >3 years

Certain high income wage earners can only put in catch-up contributions as Roth contributions



New Tax Law (p 4)

INFLATION REDUCTION ACT of 2022... passed in August 2022

Individual & business tax credits for various "green" initiatives, including electric vehicles, solar energy, etc.
 \$80 billion+ for IRS modernization and enforcement
 New corporate AMT for corps income > \$1 billion
 New 1% stock buyback excise tax for publicly traded corps
 §461(l) excess business loss limitation extended to 2028



New Tax Law (p 3)

TAXPAYER FIRST ACT... passed in July 2019

Small taxpayers must receive access to the non-privileged case file no later than 10 days prior to the Appeals conference. A small TP is one with adjusted gross income of \$400,000 or less or gross receipts of \$5,000,000 or less.
 If the IRS denies Appeals review to a taxpayer who receives a NOD, TP can protest the decision to deny access to the IRS Appeals Office.



Cash vs Accrual Basis (p 5)

Cash basis is most common method – income is reported when actually or constructively received and expenses are deducted when paid.

Accrual matches income and expense related to the same year. Income is reportable when earned – TP's right to income is fixed, can be determined



Accrual Basis

Under the “all events test” expenses are deductible in year in which all events occur that fix the liability and the liability can be determined with reasonable accuracy

Deductions are allowed in the taxable year when all the events occur that establishes a liability giving rise to such deduction, and economic performance occurred.

- Expenses must be prorated between tax years if covers > 1 taxable year.



Cash Equivalent Doctrine

... income reported when the equivalent of cash is received in a taxable transaction.

Includes property, notes and marketable securities.



Constructive Receipt (p 6)

... when TP has unfettered access to income

No matter if TP chooses to receive then or later.

Physical possession does not determine taxability ... can't hold checks to make income includible in another year



Economic Performance

- ... fixes certain liabilities as provided by the IRC
- ... as services are provided
- ... as property is used



2014/S-1: Cash vs Accrual

2014/S-1 (4 minutes) X and Y are cash method, calendar year taxpayers. On December 15, Year 1, Y sold and delivered to X goods to be sold in X's business. The terms of the sale provided that payment was due within 30 days of delivery of the goods. The following are alternative situations.



2014/S-1: Cash vs Accrual

On December 31, Year 1, X offered to pay Y in cash for the goods, but Y refused and asked that X pay Y in January of Year 2. If X made payment in cash to Y on January 5, Year 2, when should Y report the gross income from the sale of the goods?

SUGGESTED ANSWER:



2014/S-1: Cash vs Accrual

On December 27, Year 1, Y received as payment from X a check made by X that was dated December 24, Year 1. If Y cashed the check on January 3, Year 2, and the check was honored by X's bank, when should Y report the gross income?

SUGGESTED ANSWER:



2014/S-1: Cash vs Accrual

On December 27, Year 1, Y's bookkeeper, a full-time employee of Y, received as payment a check from X that was dated December 24, Year 1, and which was payable to Y. The bookkeeper left on a holiday trip without depositing the check, and the bookkeeper did not return until January 4, Year 2, on which date the bookkeeper delivered the check to Y, who cashed the check at X's bank. When should Y report the gross income?

SUGGESTED ANSWER:



2014/S-1: Cash vs Accrual

On December 31, Year 1, Y received from X a promissory note of X in the amount of X's indebtedness to Y. The note was transferred to Y because X had no cash and was in severe financial difficulty. The note was nonnegotiable, bore no interest, and was due in 180 days. During December, January, February, and March, of Year 2, Y attempted to negotiate the promissory note, but no one would accept the note. On May 1, Year 2, X made full payment on the note. When should Y report the gross income?

SUGGESTED ANSWER:



2014/S-2: Cash vs Accrual

(3 minutes) TP is a corporation engaged in a trade or business. To enhance its profitability, TP enters into a management consulting services contract. The contract prescribes that X provide services to TP over the next three years. The contract requires the performance of 40% of the services in year 1, 30% of the services in year 2, and the remaining 30% of the services in year 3. The contract requires TP to pay \$100,000 over the term of the contract: 50% in year 1, 30% in year 2, and 20% in year 3. Discuss when TP will be permitted to deduct amounts paid to TP in year 1, 30% in year 2, and 20% in year 3. Discuss when TP will be permitted to deduct amounts paid to X if TP uses the accrual method of accounting.

SUGGESTED ANSWER:



Assignment of Income (p 7-8)

... one person transfers income earned by them to another person with intention that the assignee pays tax on the transferred income.

Generally assignment of income is not permitted under the IRC and the so-called 'assigned' income is taxable to the person who earns it.



Fleischer Case

TP signed agreements as an individual then reported it through S corp (no SE tax).

Petitioner should have reported the income earned under his financial consulting agreements.

Ryan Fleischer TC Memo 2016-238 (12/29/16)



TCJA Dependency Issues (p 8)

TCJA suspended the deduction for exemptions for tax years beginning after 12/31/2017 and before 1/1/2026; however, the dependent definitions still exist in the tax law. In lieu of the deduction, there is an expanded child tax credit (up to \$2,000 per qualifying child, refundable up to \$1,400) and a new family tax credit (up to \$500) for family members who do not qualify for the child tax credit.



Form 8332 (p 11)

- ... written declaration releasing TP's claim to a dependency exemption deduction, child tax credit and additional child credit ...
- It may apply to one year, specified years, or all future years.
- No longer releases dependency, but other child benefits



Form 8332

Even if divorce decree says who gets kids
Be aware of the requirements ...

- noncustodial parent's name and social security number;
- name of the child or children;
- applicable tax year(s);
- custodial parent's signature, social security number and date of the signature



Gross Income (p 31)

Covers a lot of tax law quickly
We'll review a few calculations here



2021/S-3(b): Gross Income

(½ minute) TP recovered \$5,000 in cash from the surface of a highway after TP saw the door of a Brinks cash delivery truck swing open and release cash from the truck. The amount that constitutes gross income to TP is

SUGGESTED ANSWER:



2021/S-3(l): Gross Income

(l) TP was a credit card customer at a retailer whose computer system was Hacked/compromised by unauthorized persons, thereby possibly making personal and credit information about TP available to unauthorized persons. The retailer provided in kind, for the period of 18 months after restoration of the security of the retailer's computer system, to TP (and all other similarly situated credit customers of the retailer) credit and identity protection services provided by a third party, the value of which for the current year was \$300. The amount that constitutes gross income to TP is

SUGGESTED ANSWER



2018/S-5(b): Gross Income

(1/2 minute) \$30,000 embezzled from a not-for-profit organization as to which TP served as the treasurer.

SUGGESTED ANSWER:



2016/S-4(b): Gross Income

(1/2 minute) \$1,000,000 cash received as the winner of the Einstein Prize in Physics awarded by the Einstein Institute. Immediately upon receipt of the payment, TP made a gift of the \$1,000,000 to TP's child.

SUGGESTED ANSWER:



2016/S-4(d): Gross Income

(1/2 minute) \$60,000 as a partial payment of the proceeds of a life insurance policy in the face amount of \$500,000 on TP's father who died during the year. Pursuant to the terms of the policy, TP (as beneficiary of the policy) elected to receive a \$60,000 payment in each year for TP's life. TP's life expectancy is 10 years when the payments commence in 2016.

SUGGESTED ANSWER:



2016/S-4(o): Gross Income

(1/2 minute) TP had worked as a firefighter for the city in which TP lived. During TP's work career, TP accrued vacation time and sick leave and (2) for a period of time, TP was on temporary disability leave (during which TP continued to accrue vacation time and sick leave). Upon TP's retirement during the current year, TP's unused vacation time and sick leave (with a value of \$3,000) was "cashed out" (converted into the sum of money of \$3,000 and paid to TP).

SUGGESTED ANSWER:



2014/S-5(b): Gross Income

(1/2 minute) Pursuant to TP's employer's Employee Discount Program, TP purchased property from employer at a discount. The retail price for the property was \$3,000, and TP paid \$1,200. For the relevant period (TP's employer's prior taxable year), employer's sales were \$4,000,000, and employer's cost of goods sold was \$2,000,000.

SUGGESTED ANSWER:



2014/S-5(p): Gross Income

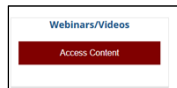
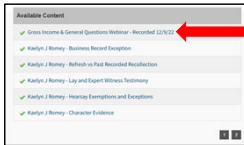
(1/2 minute) \$5,000 received from the American Red Cross as a victim of a hurricane to cover TP's unreimbursed medical, temporary housing, and transportation expenses incurred as a result of flooding from the hurricane.

SUGGESTED ANSWER:



QUESTIONS AND ANSWERS

View the gross income webinar for more review



CORPORATIONS

Text Page 76



Corporations (p 76)

Business entities created under state law

Unlimited life and survive the death of principals

Limited liability – subject to limitations



C vs S Corps

C corp is a separate taxable entity that pays tax on income at the corporate rate.

S corporation is a pass-through entity - under certain circumstances it may be taxed



Capital Contribution

generally not taxable to corp

Under §351: if 1 or more persons transfer money or property to a corporation solely in exchange for stock and immediately after exchange is in control of the corporation (80% total combined voting power and at least 80% of all outstanding shares of non-voting stock - attribution rules apply), there is no gain or loss recognized either to the transferor or the transferee.



Assumption of Liabilities

Under §357, in a §351 transfer generally doesn't cause recognized gain ... **UNLESS** the corp assumes liabilities > TP's adjusted basis in the property (then gain is recognized up to the amount of the difference) or there is no good business reason for the liability transfer.



Assumption of Liabilities Example

Ted and Sue form a corp. Sue contributes her computer with a FMV of \$3,000, basis of \$0 (\$179 was used when it was purchased by her sole proprietorship), and debt of \$2,000. Ted contributes \$3,000 in cash.

Sue recognizes \$2,000 worth of gain due to the debt relief exceeding her basis (\$2,000 – 0).



Loss on Capital Contribution

Loss not deductible IF the transferor owns (directly or indirectly) > 50% of the corporation's stock.

Even if TP does not have more than 80% control



Dividends (p 77)

E&P distributions are taxable dividends to S/H.

Distributions > E&P are considered a return of capital and not taxable up to the S/H's basis in the stock.

Distributions > stock basis are capital gain to the S/H.



Dividends

A corporation recognizes gain/loss when property is distributed to the S/H if the property's FMV > its adjusted basis.

The property is considered to be sold at its FMV to the S/H.



Basis Property Contributed (p 78)

If S/H contributes property, corp takes S/H's basis increased by any gain recognized on the exchange.

If the property is contributed by anyone other than S/H, basis is zero.



Basis Stock Received

Generally this is:

basis of property exchanged + any amount treated as a dividend + recognized gain on the exchange - cash or FMV of any property received - any loss recognized on the exchange + liability amount the corporation assumes (unless payment of the liability gives rise to a deduction when paid).



§351 Transactions – Tom's Easy Way (p 78-79)

1. Is §351 applicable?
Transfer of money and/or property for at least 80% control of the voting shares AND total shares of all other classes of stock.
2. Consequences to Transferor due to Exchange of Property
Gain is recognized only to the extent of boot received
If property is transferred subject to indebtedness, then gain is recognized only to the extent that debt relief exceeds basis
Character of gain is the same as if the property transferred was disposed of in a taxable transaction
Loss is not recognized
3. Basis of Stock Received by Transferor
Adjusted basis of property contributed
PLUS gain recognized by transferor upon transfer
FMV of boot received
LESS liabilities assumed by corporation (treated as cash payment for basis purposes)
4. Basis of Property Received by Corporation
Adjusted basis of property contributed
PLUS gain recognized by corporation upon transfer (allocated by FMV of the properties)

NOTE: Basis of built-in loss property cannot exceed the FMV of the property



Organization/Start Up Costs (p 79)

pre-open investigating the creation or acquisition of an active trade or business, surveys of potential customers, advertisements, salaries and wages for employees who are training and those being trained, travel and other expenses to secure distributors, suppliers or customers, and rent before the business opens.



Business Start Up Date

- the business acquires assets needed to conduct business,
- assets are put to productive use, or
- the business is ready to receive revenue.



What if No Business Results?

For TP:

- 1) those incurred before making a decision to acquire or begin a specific business are personal and nondeductible, including general search for, or a preliminary investigation of a business
- 2) those incurred in an attempt to acquire or begin a specific business are capital expenses and deductible as a capital loss



What if No Business Results?

For corp: all investigatory costs are deductible as a loss.

Any costs for assets acquired during this unsuccessful attempt are part of the basis in the assets, and are recovered when the asset when disposition occurs.



Accumulated Earnings Tax (p 80)

may apply for not distributing earnings beyond its reasonable business needs under §351 - 20% tax is on accumulated taxable income. Corp may retain E&P profits to meet reasonable business needs including:

- expansion of the business
- replacement of plant or equipment
- retirement of debt

Corps permitted generally to accumulate \$250,000 (\$150,000 if PSC)



Personal Service Corporation

C corp, substantially all of whose activities involve the performance of services in one or more of the 8 fields (health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting) described in §448(d)(2)(A).

May use the cash method of accounting regardless of gross income if the function and ownership tests are met.

Now same 21% rate as all over corporations



PSC Ownership/Function Tests

Ownership test is met if substantially (95% or more) of the stock is owned directly or indirectly by employees performing covered services.

Function test is met if substantially all (95% or more) the corp's activities are covered services.



Stock Redemption (p 81)

Corp buys stock back from a S/H using corporate funds. Redemption can be used to buy out an existing S/H - unlike a complete liquidation, corp continues to exist after a stock redemption.

A stock redemption is classified as a fully taxable dividend if certain factors are present - a stock redemption is treated as a sale of stock by the S/H with gains eligible for the favorable capital gain tax rates.



Stock Redemption

The types of transactions that qualify as stock redemptions and capital gains treatment at the S/H level include:

- The distribution is not essentially equivalent to a dividend: the transaction creates a meaningful reduction in the S/H's interest in the corporation.
- Substantially disproportionate redemption of stock: The S/H must (after the distribution) hold < 50% of voting stock and < 80% of the interest S/H held before the redemption.



Stock Redemption (p 82)

The types of transactions that qualify as stock redemptions and capital gains treatment at the S/H level include:

- Termination of a S/H's interest: complete termination of the interest is treated as a stock redemption.
- Partial liquidation: if the distribution is in redemption of stock held by a noncorporate S/H and in partial liquidation of the distributing corporation. The distribution is generally pursuant to a plan of liquidation.



Corporate Liquidation

C and S liquidations governed by §331 and §336.

Each entity has taxable income on the difference between the FMV and Basis of assets at liquidations:



Corporate Liquidation

under §331 the amounts received by S/H in complete liquidation of a corp are treated as in-full payment in exchange for the stock. If property is distributed its FMV is used to determine gain or loss on the transaction

If the stock basis is > the total distribution (cash and property), the S/H recognizes a loss.

If the distribution is > stock basis, S/H recognizes a gain.



Corporate Liquidation

under §336 a gain or loss will be recognized to a liquidating C or S corp on the distribution of property in complete liquidation as if the property were sold to the distributee at its FMV.



S Corporations (p 83)

tax issue - some pass-through advantages of a partnership with liability protection - conduit and not a tax paying entity, except:

- tax may be due on any recognized BIG. If previously a C corp, it pays tax on excess of value of the S corp's assets at the beginning of the first year for which the S election is in effect over the adjusted basis of the assets – during first 10 years if S election before 2009, 7 years for 2009 and 2010, and 5 years now



S Corporations

- if the S corp has E&P from when it was a C corp, and its passive income > 25% of gross receipts, it must pay corp tax on the 'excess net passive income.'

If the situation continues for 3 years, the S election is revoked.



S Corp Passthrough to S/H

items of income, deduction or credit that might affect a S/H are separated stated and each S/H takes a prorata share of the item.

remaining non-separately computed income is taken into account by S/H on a prorata basis.

The item's character before the pass-through is retained at S/H level.



S/H Basis

S/H must have basis to deduct losses.

Basis is the original capital contribution:

- + corp income taxable to S/H, and
- - nontaxable distributions and by items of loss and deductions allocated to S/H.



S/H Basis

If items reduce basis to zero S/H can continue to deduct items and reduce basis for any debts owed by the corp to S/H.

If S/H does this and later corporate income increases the stock basis, the basis of debt is increased back to the original level.



S/H Basis/Loan

S/H guarantee of a loan does not give additional basis to deduct corp losses until

S/H actually makes payment on guarantee.

Then payment is treated as a direct loan to the corp.



S Corp Requirements (p 84)

S/H must elect S status within the statutory period (generally on or before the 15th day of the 3rd mo of tax year in which the S election is desired) AND

- no more than 100 S/H allowed (individuals, estates or qualified trusts) – S/H must consent,
- family members can elect to be treated as 1 S/H,
- only 1 class of stock is permitted,
- no NRA permitted, and
- a calendar tax filing year is required.



S Corp Distribution Rules

Example: Seashore Shells is an S corp with no E&P. It distributes \$75,000 to its only S/H, Sue. Sue's adjusted basis in the stock is \$55K.

The amount of the distribution > her basis (\$20K) is taxable as a gain from the sale or exchange of property.



S Corp Distribution Rules

Under the S corp distribution ordering rules: most distributions tax-free except:

- if > basis, treated as a capital gain.
- if the S corp has E&P from when it was a C corp, may be taxable as dividends, and
- dividends in excess of AAA (accumulated adjustments account) are taxed as dividends to the extent of E&P



S Corp Distribution Rules

Example: Raggedy Reef is a C corp that converts to an S corp on 1/1/A6. It has E&P of \$50,000 on that date. In 20A6 the corporation has ordinary income of \$10,000 and distributes \$50,000 to its S/Hs.

	AAA	E&P
Balance at 1/1/A6	\$ 0	\$50,000
Ordinary income	10,000	0
Distribution	(10,000)	(40,000)
Ending balance	\$ 0	\$ 10,000

The \$40K distribution is taxable as a dividend.



2021/S-11: Corporations

In 2000, Corporation was created with a capitalization of 1,000 shares of voting common stock, 1,000 shares of nonvoting common, and 1,000 shares of voting preferred. Each share of stock has equal value and each share of voting stock has an equal voting right. The preferred stock was issued at the time of creation of Corporation, and the preferred stock is not §306 stock. The stock has been owned since the 2000 creation of Corporation as described in the attached table. In 2020, Corporation redeems all of the shares owned by B. Assume that at all times after the redemption, B serves as an officer of Corporation. A is unrelated to B and C. C is B's mother.



2021/S-11: Corporations

Attachment:

Shareholder	Voting Common	Nonvoting Common	Voting Preferred
A	200	600	700
B	300	100	300
C	500	300	0
Total	1000	1000	1000



2021/S-11: Corporations

(a)(3 minutes) Explain whether the redemption of all of B's shares qualifies for exchange treatment under §302(b)(3).

SUGGESTED ANSWER:



2021/S-11: Corporations

(b) (4 minutes) Explain whether the redemption of all of B's shares qualifies for exchange treatment under §302(b)(2).



2021/S-11: Corporations

SUGGESTED ANSWER:



2018/S-17: Corporations

(5 minutes) Briefly describe the circumstances under which a transfer or transfers to a corporation in exchange for stock of such corporation will be entitled to nonrecognition treatment. Also describe relevant adjusted basis rules.



2018/S-17: Corporations

SUGGESTED ANSWER:



2012/S-19: Corporations

2012/S-19 (11 minutes as allocated below) On January 1, 2012, A, B, and C organize AB: C Corporation (which is not and will not be an "investment company" under §351(e)). The following transfers were made to the corporation:

Transferor	Property	Fair Market Value	Adjusted Basis
A	Cash	\$200,000	\$200,000
B	Equipment	\$300,000	\$300,000
C	Unimproved real property	\$520,000	\$100,000



2012/S-19: Corporations

B's equipment had been purchased in 2010 for use in B's trade or business at a cost of \$400,000, and because of depreciation, the adjusted basis had been reduced to \$300,000 on January 1, 2012. The unimproved real property had been held by C as an investment since C's acquisition of the property in 2000.



2012/S-19: Corporations

In exchange for the contributions of A, B, and C, the corporation issues its common stock, 200 shares to A, 300 to B, and 500 shares to C. The fair market value of the stock is \$1,000 per share; the common stock is the only class of stock authorized and outstanding. In addition to the 500 shares of stock, C receives from ABC Corporation \$5,000 of cash and a 1-year note of ABC Corporation in the amount of \$15,000 at 6% interest. The ABC note has a fair market value equal to the face amount of the note.



2012/S-19: Corporations

(a)(4 minutes) Determine C's gain realized, C's gain recognized, and the character of any gain recognized by C.

SUGGESTED ANSWER:



2012/S-19: Corporations

(b) (3 minutes) Determine C's adjusted basis in the ABC Corporation stock received.

SUGGESTED ANSWER:



2012/S-19: Corporations

(c) (2 minutes) Determine the amount of gain recognized by ABC Corporation.

SUGGESTED ANSWER:



2012/S-19: Corporations

(d) (2 minutes) Determine the adjusted basis of ABC Corporation in the real property received from C.

SUGGESTED ANSWER:



2016/S-29: Corporations

(12 minutes, as allocated below) The taxable year is 2016, during which Tippet Corporation, a calendar year taxpayer, has \$316 current earnings and profits from operations of \$150,000. As of December 31, 2015, Tippet Corporation had \$316 accumulated earnings and profits of \$500,000. The stock of Tippet Corporation is owned equally by A, Inc. ("A"), a corporation, and TP, an individual. TP's adjusted basis in TP's 2,000 shares of stock of Tippet Corporation is \$300,000. A's adjusted basis in its 2,000 shares of stock of Tippet Corporation is \$600,000.



2016/S-29: Corporations

On December 31, 2016, Tippet Corporation makes the following nonliquidating distributions that are characterized as dividends for state law purposes:

Distributee Shareholder	Property Received	Fair Market Value	Adjusted Basis to Tippet Corporation
TP	Cash	\$500,000	\$500,000
TP	Grizzly Corporation stock*	\$300,000	\$50,000
A	Cash	\$500,000	\$500,000
A	Inventory	\$300,000	\$350,000



2016/S-29: Corporations

(4 minutes) Discuss and quantify the gain and loss recognition consequences to Tippet Corporation that result from the 2016 distributions.

SUGGESTED ANSWER:



2016/S-29: Corporations

(4 minutes) Determine the §301 consequences to TP of the 2016 distributions from Tippet Corporation, and determine TP's adjusted basis in the stock of Grizzly Corporation.



2016/S-29: Corporations

SUGGESTED ANSWER:



2016/S-29: Corporations

(4 minutes) Determine the §301 consequences to A, Inc., of the 2016 distributions from Tippet Corporation, and determine A's adjusted basis in the inventory.

SUGGESTED ANSWER



QUESTIONS AND ANSWERS

- **PARTNERSHIPS**
- Text Page 88



Partnership (p 87)

Relationship between ≥ 2 who join together to carry on a trade or business

Conduit – partners liable as individuals for taxes due

- Just sharing expenses is not a partnership
- Just co-ownership of property maintained, leased or rented is not a partnership unless owners provide services to tenants.



Partnership

Under the “check the box” regulations a noncorporate entity (MMLLC, with 2 or more owners) is automatically deemed to be a partnership unless the entity makes the election to be an association taxable as a corp – we’ll include info about LLCs here also



Limited Partnership

Offer limited liability to the LPs. They are often used for ownership of passive activities like real estate ownership.

A general partner is liable for the activities of the partnership and makes the appropriate business decisions.



Contributed Property (p 87)

a contribution of money or other property into a partnership in exchange for an interest in the partnership usually does not result in a gain or loss



Except ...

- transfers into an investment company, as defined in §351, are not tax-free, and
- disguised sales transactions are not tax-free. A disguised sale is deemed to occur if a TP transfers appreciated property into a partnership or LLC and within a short period of time, usually 2 years or less, receives a distribution of money or other property. Facts and circumstances determine if the transaction is a disguised sale rather than a tax-free contribution of property.



Encumbered Property

As with a corporation, transfers of encumbered property to a partnership or LLC results in recognized gain on the difference between the TP's basis and the amount of debt relief



§721 – Tom's The Easy Way (p 88)

Is §721 applicable?

Transfer of property or money in exchange for a partnership interest.

2. Consequences to Partner

Gain or loss is not recognized
Capital account, in general, is FMV (book) or adjusted basis (tax) of contribution property

3. Basis of Partnership Interest

Adjusted basis of property
PLUS money contributed
LESS cash received (including indebtedness assumed by partners with transfer of property)
PLUS share of partnership liabilities

3. Consequences to Partnership

Gain or loss is not recognized
Basis of contributed property is the partner's adjusted basis

4. Built-In Gain Property



Partnership Tax Year (p 90)

Generally determined by reference to its partners' tax years under §706. If one or more partners having the same tax year own a majority interest in partnership profits and capital

(>50%) the partnership must use the tax year of those partners. If there is no majority interest tax year, the partnership must use the tax year of all its principal partners (one with 5% or greater profits or capital interest)



Disallowed for Partnerships

- §151 personal exemptions,
- §164(a) deduction for §901 taxes paid to foreign countries and U.S. possessions,
- §170 charitable contributions,
- §172 net operating loss deduction,
- §§211-216 additional itemized deductions allowed for individuals, and
- §611 oil and gas depletion deduction.



Partnership Elections (p 92)

Affect partnership income calculation, including accounting methods, depreciation methods, accounting for specific items such as installment sales, and amortization of certain organization fees and business start-up costs of the partnerships.



Partner Elections

Any §108(b)(5) or §108(c)(3) relating to income from discharge of indebtedness,

- §617 relating to deduction and recapture of mining exploration expenditures, and
- §901 relating to taxes of foreign countries and U.S. possessions.



Organization/Syndication Fees

neither partnership nor partner can currently deduct any amounts paid or incurred to organize a partnership, or to promote the sale of, or to sell, any interest in the partnership.



Partnership Distributive Share

Reported on 1040 even if no actual distribution. The partner's distributive share of losses may be limited by the partner's adjusted basis.



Partner Distributive Share (p 93)

Usually partnership agreement determines.

May disregard if the partner allocations do not have substantial economic effect.

If a distributive share of a partnership item cannot be determined under the partnership agreement, it is determined by the interest in the partnership, including the partner's contributions, the interest of all partners in economic profits and losses, and the rights of the partners to capital distributions upon liquidation.



Partner/Partnership Consistency

The partner must treat partnership items on their tax returns in the same manner as the partnership tax return treats them. A partner using an inconsistent treatment can be assessed penalties and interest unless files Form 8082, *Notice of Inconsistent Treatment or Amended Return*, with the tax return.



Substantial Economic Effect

If there is reasonable possibility that the allocation will substantially affect the dollar amount of the partners' share of partnership income or loss independently of tax consequences,

and

the partner to whom the allocation is made actually receives the economic benefit or bears the economic burden corresponding to that allocation.



Guaranteed Payments

Guaranteed without regard to the partnership's income are deductible to the partnership for purposes of determining gross income and deductible business expenses.

For other tax purposes treated as a partner's distributive share of ordinary income - not subject to income tax withholding.

Health insurance premium treated as guaranteed payment.



At Risk Rules

limit the amount of deductible loss to the amounts for which the partner is at risk, including:

- money and adjusted basis of any property contributed to the activity,
- the partner's share of net income retained by the partnership, and
- certain partnership debt if the partner is personally liable for the repayment, or the amounts are secured by the partner's property (other than property used in the activity).



Passive Activity Rules (p 94)

determined at the partner level and limit the amount a partner can deduct for passive activity losses and credits.

The partnership must separately report income, loss and credits for each activity.



Partnership Distribution (p 97)

no recognized gain or loss because of partner distributions.

The partner's adjusted basis is decreased, but not below \$0, by money and the adjusted basis of property distributed to the partner.



Partnership Distribution

includes current or prior years' earnings, a withdrawal by the partner in anticipation of the current year's earnings, a complete or partial liquidation of a partnership's interest, and a distribution to all partners in a complete partnership liquidation.



Partner's Gain

recognized on a distribution to extent that any money included in the distribution > partner's adjusted basis in the partnership.

Gain recognized is treated as capital from sale of the partnership interest on the distribution date. If property, other than marketable securities treated as money, is distributed to a partner he or she generally does not recognize any gain until that property is sold or disposed of.



Partner's Gain Example

Example: Ron's adjusted basis in his partnership interest is \$15K. He receives a distribution of \$10K in cash and land with an adjusted basis of \$2K and a fair market value of \$4K.

Ron does not recognize any gain on the transaction because the cash received is less than his adjusted basis in the partnership. Gain on the land is recognized when he sells or otherwise disposes of it. The distribution reduces the adjusted basis in Ron's partnership interest to \$3K ($\$15K - (\$10K + \$2K)$).



Partner's Gain

- Marketable securities generally treated as money in determining whether gain or loss is recognized on the distribution, unless that partner contributed the securities to the partnership.
- Unless partner's interest is completely liquidated, the basis of property distributed to the partner is same adjusted basis as for partnership. The basis of property to the partner cannot be more than the adjusted basis of his or her interest in the partnership, reduced by any money received in the same transaction.



Partner's Gain Example

Example: Ron, from the other example, takes the land with a \$2K basis, the same as it had in the partnership before the distribution.

Example: Amy, who has an adjusted basis of \$10K for her partnership interest, receives a distribution of \$4K cash and property with an adjusted basis to the partnership of \$8K. The basis of the distributed property is limited to \$6K (\$10K adjusted basis – \$4K cash received).



Basis Received in Complete Liquidation

... is the adjusted basis of the partner's interest in the partnership reduced by any money distributed in the same transaction.

The holding period for distributed property includes the partnership's holding period. If a partner contributed the property, the partner's holding period is also included.



Partner's Loss (p 98)

A partner does not recognize loss on a partnership distribution unless:

- the partner's adjusted basis in the partnership interest > the distribution,
- the partner's entire interest in the partnership is liquidated, and
- the distribution is in money, unrealized receivables or inventory items.



Partnership & Specified Person

no loss allowed from an exchange or sale of property, other than an interest in a partnership, that occurs directly or indirectly between a partnership and a person who has a direct or indirect interest in the capital profits or profits interest* of the partnership of more than 50%.

* Capital interest gives share of proceeds if the partnership assets are sold. Profits interest is any other interest



Partnership & Specified Person

No loss deduction allowed if the sale or exchange is between 2 partnerships in which the same persons directly/indirectly own > 50% interest of the capital or profits of each partnership. The basis of each partner's interest in the partnership is decreased (not below \$0) by share of the disallowed loss. If the purchaser later sells the property, only the gain realized greater than the disallowed loss is taxable. For any gain not recognized because of this rule, the basis of each partner's interest in the partnership is increased by the partner's share of that gain.



Partnership & Specified Person

For purposes of determining if there is > 50% ownership these rules apply:

RULE 1: An interest owned by or for a partnership, corporation, estate or trust is considered to be owned proportionately by its S/Hs, partners or beneficiaries.

RULE 2: An individual is considered to own the interest owned by or for the individual's family, including brothers, sisters, half-brothers, half-sisters, spouses, ancestors and lineal descendants.



Gain

Gains are treated as ordinary, not capital, if they occur between a person and a partnership, or between two partnerships if:

- > 50% of the partnership capital or profits interest is directly or indirectly owned by the same person, and
- the property in the hands of the transferee immediately after the transfer is not a capital asset, including accounts receivable, inventory, stock-in-trade, and depreciable or real property used in a trade or business.





Hot Assets (p 99)

Under §751 these give rise to ordinary income, not capital gains, when a partnership interest is sold. Hot assets are inventory and unrealized receivables.

The ordinary income treatment does not apply to a distribution of property to the contributing partner, or to certain payments made to a retiring partner or successor in interest of a deceased partner.



Sale of Partnership Interest

usually results in a capital gain or loss, except as noted for so-called hot assets, which are ordinary income.

Gain or loss is the difference between the amount realized and the adjusted basis of the partner's interest. If the selling partner is relieved of any partnership liabilities, she or he includes liability relief as part of amount realized for the interest.



Distributive Share Disposition Year (p 100)

A partner includes his or her distributive share of partnership items in income for the tax year in which the partner disposes of his or her entire partnership interest.

The partnership's tax year is considered closed on the date the partner disposed of the interest.



2008/S-22: Partnerships

(3 minutes) Briefly describe the federal income tax consequences associated with a transfer of partnership property (the fair market value of which exceeds the partnership's adjusted basis in the property) to a partner in satisfaction of the partner's §707(c) "guaranteed payment" right.

SUGGESTED ANSWER:



2006/S-24: Partnerships

(3 minutes) TP is a partner in the AB General Partnership, a cash method partnership that owns (1) zero-basis accounts receivable from trade creditors and (2) inventory property (within the meaning of Section 1221(1)) the fair market value of which is in excess of the partnership's adjusted basis in the inventory. TP sells TP's interest in the partnership to an unrelated person. Describe how §741 and 751 apply to TP with respect to the sale of the partnership interest.

SUGGESTED ANSWER:



2014/S-23: Partnerships

(5 minutes) Describe the federal income tax consequences to a partner (not the partnership) of a non-liquidating distribution of cash or property by a partnership to its partners.



2014/S-23: Partnerships

SUGGESTED ANSWER:



2021/S-14: Partnerships

Individuals TP1, TP2, and TP3 form a general partnership (which would not be treated as an investment company under §351 if incorporated). Under the terms of the partnership agreement, the partners are to receive a 30%, 30%, and 40% interest, respectively, in partnership capital; profits and losses are to be shared in the same proportion. The partners made the contributions in 2020 in exchange for their partnership interests in the manner described in the attached table.



2021/S-14: Partnerships

Attachment:

Partner	Contribution	Adjusted Basis	Fair Market Value
TP1	Unimproved real property	\$50,000	\$70,000*
TP2	Cash	\$30,000	\$30,000
TP3	Securities**	\$35,000	\$40,000



2021/S-14: Partnerships

*The real property has a total fair market value of \$70,000, but the property is encumbered by a \$40,000 mortgage indebtedness. TP1 purchased the real property in 2010 as an investment. The partnership receives the property subject to the \$40,000 mortgage indebtedness.

**TP3 purchased the securities as an investment in 2015.



2021/S-14: Partnerships

(a)(3 minutes) Discuss, quantify, and characterize any gain or loss recognized by TP1, TP2, and TP3 upon formation of the partnership.

SUGGESTED ANSWER:



2021/S-14: Partnerships

(b) (4 minutes) Discuss and quantify each partner's adjusted basis in his or her partnership interest upon formation.

SUGGESTED ANSWER:



2023/S-18: Partnerships

(8 minutes). In 2021, individuals TP1 and TP2 formed a general partnership (which would not have been treated as an investment company under § 351 if incorporated). Under the partnership agreement, TP1 and TP2 share everything (interest in partner capital, profits, and losses) equally. To form the partnership, TP1 contributed unimproved land. The gross fair market value of the land was \$200,000. The land was encumbered by a mortgage debt of \$100,000. The partnership received the land subject to the \$100,000 mortgage debt and the partnership became personally liable for the debt. TP1 purchased the land in 2012 as an investment. TP1's adjusted basis in the land was \$30,000. TP2 contributed \$100,000 cash.



2023/S-18: Partnerships

- a. Discuss, quantify, and characterize any gain or loss recognized by TP1 upon formation of the partnership.

SUGGESTED ANSWER:



2023/S-18: Partnerships

- b. Discuss, quantify, and characterize any gain or loss recognized by TP2 upon formation of the partnership.

SUGGESTED ANSWER:

- c. Discuss and quantify TP1's adjusted basis in TP1's partnership interest upon formation of the partnership.

SUGGESTED ANSWER:



2023/S-18: Partnerships

- d. Discuss and quantify TP2's adjusted basis in TP2's partnership interest upon formation of the partnership.

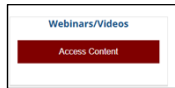
SUGGESTED ANSWER:



QUESTIONS AND ANSWERS

View the webinar for more review

Available Content	
✓	S351 & S721 Exchange Overview - Recorded 2/6/25
✓	Reading A Case - Recorded 1/4/25
✓	A Look at the 2023 Exam - Recorded 12/7/24
✓	Getting Started - 2025 Exam Cycle - Recorded 11/1/24
✓	Learning Styles Webinar - Recorded 11/12/22
✓	Jurisdiction Webinar - Recorded 11/13/22
✓	Discovery thru Appeals Webinar - Recorded 2/11/23
✓	Penalties and Interest Webinar - Recorded 2/10/23



LLC AND OTHER ENTITY ISSUES

Text Page 100



LLC (p 100-101)

Combines many of the advantages of corporate ownership with the advantages of partnership ownership, while avoiding the limitations on ownership applicable to S corp.

No limits to the numbers of members in an LLC but new members cannot be accepted without the agreement of existing members.



LLC Members

Like a general partnership, LLC members are usually active participants, but members can choose one or more to act as managers.

If there are no designated managers, all members are treated as managers.

A manager is defined as the person(s) with the continuing exclusive authority to make the necessary management decisions to operate the business for which the LLC was formed.



LLC Limited Liability

Members still can be held liable for unpaid payroll trust funds, unpaid sales and use taxes, failure to maintain the formalities of an LLC, commingling LLC funds and personal funds and operating as if a sole proprietorship, and for personally guaranteed loans and leases.

Like a corporation, the LLC does not protect a member from liability for own acts of negligence or malpractice.



Check Box, Domestic Entity (p 101)

LLC can be classified as either disregarded (sole proprietorship using Form 1040), a partnership (Form 1065) or a corporation (Form 1120) for federal income tax purposes.

Most MMLLCs are taxed following partnership rules.



Form 8832

Entity Classification Election, is used to elect out of a default classification or to change a prior election.

Copy is attached to the entity's Federal tax return filed for the year election is made.



EXAM ALERT!

The same exam question can be asked using the terms LLC, "check the box" or "domestic entity classification"



QUESTIONS AND ANSWERS

PENALTIES AND INTEREST

Text page 148

(also appears in Practice & Procedure)



Penalties & Interest (p 148)Often tested – more often tested in Federal Tax, but
also tested in Practice & Procedure

Penalties can be abated for reasonable cause

Interest is rarely abated



InterestInterest on an underpayment is generally paid from
the last day prescribed for payment through the
payment dateTP can make a deposit under §6603 to suspend
interest accruals

Interest

Interest rates on underpayments...

Federal short-term rate plus 3%

Federal short-term rate plus 5% if corp and >\$100K

Interest is compounded daily



Interest

The IRS must pay interest on delayed tax overpayments...

The rate is federal short-term rate plus 3%, but 2% for corporations (0.5% for corporate refund >\$10K), compounded daily

IRS generally has 45 days from unextended due date or claim filing date, whichever is later, to issue payment...



Interest

Suspended after 18 months if IRS doesn't send NOD within 18 months of the later of

- Original due date of the return OR
- Date taxpayer timely files return

Interest resumes 21 days after IRS sends notice & demand for payment



Penalties (p 149)

Civil penalties for violation of the tax law... used to encourage compliance

A TP can generally be relieved of a penalty if they show reasonable cause for the noncompliance and a good faith attempt to comply with the tax law...



Not All Penalties = TC Jurisdiction

If not subject to deficiency provisions, they are not jurisdictional

May come in as CDP hearing



Penalties Can be Abated

Reasonable cause can include...

Death or serious illness

Acts of war, casualty, disaster

Reliance on a tax advisor – **frequently tested**



Penalties

Reliance on a tax professional as reasonable cause (*Neonatology Assoc.*, 111 TC 42, (2000)):

1. The advisor was competent, with sufficient expertise to justify reliance.
2. The taxpayer provided necessary and accurate information to the advisor.
3. The taxpayer actually relied in good faith on the advisor's judgment.

This is frequently tested! Know this test!



MEMORY TOOL

Reasonable reliance on a tax professional for penalty relief:

C – **Competent** professional

A – **All** information (accurate and relevant) provided

R – **Relied** in good faith on adviser's judgment

CAR



Penalties

Reliance on a tax professional...

§6662 – for positions taken on a tax return

§6651(a)(1) – for failure to file?

- *Boyle* – TP has nondelegable duty to file tax returns or extensions
- What if a tax pro gave advice as to a filing requirement or the timing of a filing requirement?



Penalties

Frequently encountered penalties on the exam...

§6651(a)(1)	§6662(c) – negligence
§6651(a)(2)	§6662(d) – substantial understatement
§6654	§6662(h) – valuation
§6663	§6702
§§6694, 6695	
§6672	



Penalties(p 152)

§6651(a)(1) – failure to file...

5% tax due on return per month (or part) up to 25%

§6651(a)(1) – failure to pay...

0.5% tax due on return per month (or part) up to 25%; goes up to 1% if IRS issues notice of intent to levy; goes down to 0.25% if TP is in an installment agreement



Penalties

§6654 – individual failure to pay estimated tax payments...

Determine required pre-payment amounts based on prior year or current year tax, then

Calculate the amount of pre-payment amounts not made, then

Impute interest from the required payment date to the unextended due date of the return



Penalties (p 153)

§6662(c) – negligence...

Failure to maintain books and records; disregard of rules and regulations

A position with a reasonable basis and is adequately disclosed is generally not due to negligence



Penalties

§6662(d) – substantial understatement of tax...

Substantial understatement is one that exceeds the greater of 10% (5% if §199A deduction on return) of tax required to be shown on the return, or \$5,000 for individuals

Penalty does not apply to an item for which there was substantial authority or a reasonable basis with adequate disclosure



Substantial Authority (p 154)

Substantial basis... weight of the authorities supporting the treatment is substantial in relation to the weight of the authorities supporting contrary positions under the appropriate facts and circumstances

Reasonable basis... reliance on one of the authorities

Adequate disclosure... Form 8275/8275-R or use annual revenue procedure



Authorities for Reliance

IRC, regs, Rev Rul, Rev Proc, treaties, official explanations, court cases, congressional intent, PLR, TAM, GCM, IRS info on press releases, notices, etc published in IRB.

Google & Facebook are not authoritative!!
(even Tom isn't substantial authority!)



Penalties (p 154-155)

§6662(h) – substantial valuation misstatement...

Claimed value is 150% or more of the actual value (20%)

Claimed value is 200% or more of the actual value (40%)



Penalties (p 155)

§6663 – fraud...

75% of tax understatement
 Clear and convincing evidence
 Intent to evade tax

Tax Court weighs “badges of fraud” ... two sets of books, TP obstruction, pattern of behavior, false entries or statements... etc.

Also §6651(f) for fraudulent failure to file at 75%



Penalties (p 157)

§6694/6695 – preparer penalties...

§6694: understated tax liability due to unreasonable positions

§6695: failure by preparer to sign return, give a copy of return, retain a copy of the return, etc.



Penalties

§6672 – trust fund recovery penalty

100% of the total trust fund taxes (a component of payroll taxes) not paid over

TP must have been required to pay over the tax and willfully failed to do so



§6751(b)(p 158)

§6751(b) – supervisory approval of penalties...

No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.



§6751(b)

§6751(b) does not apply to...

§6651

§6654

§6655

Any penalty calculated through electronic means



§6751(b)

§6751(b) is an evolving area of law since *Chai* and then *Graev* back in 2018...

The Tax Court has laid out its position over many TC Opinion cases... and some circuits have disagreed with interpretation

The IRS recently issued final regulations to standardize §6751(b) implementation nationwide...



§6751(b)

Here is the current Tax Court jurisprudence on §6751(b):

Written supervisory approval must be obtained before the first formal communication to the taxpayers of the initial determination to assess penalties...

Automatically calculated through electronic means means the penalty was issued without human input or review...



§6751(b)

Here is the Tax Court process for §6751(b)...

The IRS bears the initial burden of production under §7491 to offer evidence of compliance with §6751(b)(1)...

Once respondent satisfies the initial burden of production under §7491(c), petitioner must come forward with contradictory evidence suggesting that respondent did not comply with §6751(b)(1)...



Penalties (p 159)

From 5471 penalty – 5471 is an information return imposed under §6038(a)(1) on any US person who controls a foreign corporation

Penalty for failure to file a complete/timely 5471 is \$10,000 per annual accounting period + additional penalties once TP is notified of the requirement

The IRS does not have statutory authority to assess penalties provided by §6038(b) (*Alon Farhy*, 160 TC 6 (4/3/23))



2021/S-17: Penalties

(3 minutes) Describe in general terms the holdings of the Tax Court decisions interpreting the "reasonable cause" exceptions found in §6651(a) (1) and §6664(c)(1) with respect to taxpayer reliance on the advice of a tax professional.

SUGGESTED ANSWER:



2021/S-18: Penalties

(3 minutes) Describe the nature of the analysis likely to be undertaken by the Tax Court to determine if a taxpayer is subject to the §6663 fraud penalty.

SUGGESTED ANSWER:



2021/S-20: Penalties

(3 minutes) The IRS examiner determined that TP was liable for a 40% gross valuation misstatement penalty under § 6662(h), and the examiner determined in the alternative that TP was liable for a 20% accuracy-related penalty under § 6662(a). The examiner obtained written approval from the examiner's immediate supervisor, who signed an IRS Civil Penalty Approval Form, for the 40% gross valuation misstatement penalty. The § 6212 notice of deficiency issued to TP was based on the IRS Appeals officer's closing memorandum, for which the Appeals officer obtained written approval from the officer's immediate supervisor. The § 6212 notice of deficiency included the 20% § 6662(a) accuracy-related penalty but omitted the 40% § 6662(h) penalty. TP filed a Tax Court petition. In its TCR 30 answer pleading, the IRS asserted the 40% § 6662(h) penalty. The answer pleading was signed by the IRS trial counsel and the trial counsel's immediate supervisor. TP asserts that imposition of the 40% penalty is impermissible because the IRS failed to comply with § 6751(b)(1). Discuss how the court should rule on the issue of IRS compliance with § 6751(b)(1).



2021/S-20: Penalties

SUGGESTED ANSWER:



2018/S-30: Penalties

(2 minutes) TP is not a resident of the U.S. for federal income tax purposes. Because TP engaged in a transaction that possibly had U.S. income tax consequences, TP retained X to prepare the relevant U.S. federal income tax return. X has a bachelor of arts degree from Columbia College, a master of business administration degree from Columbia University Graduate School of Business, and a juris doctorate from St John's University School of Law. X is a certified public accountant licensed in the State of New York. X did not specialize in international tax law, and X had no advanced degree specializing in taxation. At the time TP hired X, X had been preparing U.S. income tax returns for 40 years. X spent 30% to 40% of X's time preparing income tax returns. Both TP and X believed that X was qualified to prepare the tax return of TP. Discuss whether TP can avoid liability for a penalty under §6662 on the basis of TP's reliance on the advice of X.



2018/S-30: Penalties

SUGGESTED ANSWER:



2018/P-4: Penalties

(2 minutes) Explain whether an individual Court petitioner may successfully challenge under §6751(b), in a pre-assessment deficiency proceeding, a §6662 penalty.

SUGGESTED ANSWER:



2023/S-22: Penalties

(3 minutes). In each of the following situations, the IRS issued a notice to the TP, the notice determined a penalty (not a penalty automatically calculated through electronic means), TP filed a petition with the Court in which TP challenged the penalty, and the case was tried and briefed. In each of the situations, state whether the IRS would bear, as part of its initial burden of production, the burden to show that the immediate supervisor (or higher level official) of the IRS individual who made the initial penalty determination personally approved that determination in writing. State 'yes' or 'no' to each subpart.



2023/S-22: Penalties

a. TP was an individual, the notice issued by the IRS was a notice of deficiency, and the penalty determined by the notice was a delinquency penalty for late filing of a required tax return.

SUGGESTED ANSWER:

b. TP was an individual, the notice issued by the IRS was a notice of deficiency, and the penalty determined by the notice was a § 6662 penalty.

SUGGESTED ANSWER:

c. TP was a partnership, the notice issued by the IRS was a notice of final partnership administrative adjustment, and the penalty determined by the notice was a § 6662 penalty.

SUGGESTED ANSWER:



2023/S-23: Penalties

(1 minute). The notice of deficiency issued to the TP (1) disallowed two deductions claimed on TP's return, (2) determined that TP had failed to report taxable income from TP's business, and (3) asserted the § 6663 penalty as to the entire deficiency. TP's petition conceded that he had fraudulently underreported his business income but maintained that his overstatement of his deductions was negligent, not fraudulent. State which party (TP or the IRS) will bear the burden of proof as to applicability of the § 6663 penalty to the portion of the deficiency attributable to the overstated deductions.

SUGGESTED ANSWER:



2021/S-16: Interest

(2 minutes) Briefly describe the interest payable with respect to a) an unpaid federal income tax liability, b) An addition to tax imposed by §6651.

SUGGESTED ANSWER:



2018/S-26: Interest

(3 minutes) Describe the interest that is imposed on unpaid assessable penalties, additional amounts, or additions to tax.

SUGGESTED ANSWER:



QUESTIONS AND ANSWERS

Remember a webinar is in the student portal also

Available Content	
✓ \$101 & §721 Exchange Overview - Recorded 2/8/25	
✓ Reading A Case - Recorded 1/4/25	
✓ A Look at the 2023 Exam - Recorded 12/7/24	
✓ Getting Started - 2025 Exam Cycle - Recorded 11/1/24	
✓ Learning Styles Webinar - Recorded 11/22/22	
✓ Jurisdiction Webinar - Recorded 11/22/22	
✓ Discovery thru Appeals Webinar - Recorded 2/11/23	
✓ Penalties and Interest Webinar - Recorded 2/10/23	

