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IRS listed transaction activity

Listed transactions and transactions of interest are among the categories of transactions requiring IRS reporting if the taxpayer has engaged in such a transaction or a similar transaction. Listed transactions are tax-avoidance transactions the IRS has identified by notice, regulation or other forms of published guidance, or transactions expected to obtain the same or substantial tax consequences.

The IRS had a longstanding practice of issuing notices to identify listed transactions and transactions of interest. However, recent court decisions have held that the use of notices to identify these transactions does not comply with the notice and comment requirements of the Administrative Procedures Act (APA). On March 3, 2022, the Sixth Circuit Court of Appeals held that Notice 2007-83, which identified certain trust arrangements as listed transactions, violated the APA (see *Mann Construction*, CA-6, 2022-1 USTC ¶50,122, 27 F4th 1138, 1147 (2022)). Subsequently, the U.S. District Court for the Eastern District of Tennessee referred to the *Mann* decision in holding that Notice 2016-66, involving micro-captive transactions, also violated the APA (see *CIC Services*, LLC, DC-TN, 2017-2 USTC ¶50,402 (2022)). Efforts to restrict this view to the Sixth Circuit failed on Nov. 9, 2022, when the Tax Court, relying on *Mann*, held that Notice 2017-10, identifying certain syndicated conservation easements as listed transactions, also violated the APA (see *Green Valley Investors*, LLC, 159 TC No. 5, Dec. 62,122 (2022)).

The IRS has stated it will no longer take the position that transactions of interest do not need to comply with the APA. The IRS will continue to take the position that listed transactions can be identified by notice or other similar guidance based on the American Jobs Creation Act of 2002 exempting the identification of such transactions from the APA's notice and comment procedures. The IRS said it would continue to defend existing listed transaction notices in cases outside the Sixth Circuit.

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However, the IRS has also started to use proposed regulation procedures rather than notice procedures for listed transactions and transactions of interest. The IRS recently issued four such sets of proposed regulations.

Syndicated conservation easements

Although the IRS had several successful enforcement actions related to syndicated conservation easements prior to the Tax Court decision in *Green Valley*, the IRS has issued proposed regulations and a notice and comment period regarding syndicated conservation easements. The IRS states that if a transaction becomes a listed transaction or a transaction of interest, a taxpayer who participated in such a transaction and a material advisor on it must meet reporting requirements on Forms 8886 and 8918, respectively. The reporting obligation starts within 90 days of the transaction becoming a listed transaction or transaction of interest if the assessment limitations period remains open for any tax year in which the taxpayer participated in the transaction. A material advisor must report by the last day of the month that follows the end of the calendar quarter in which the advisor became a material advisor on the listed transaction or transaction of interest.

Micro-captive insurance arrangements

On April 10, 2023, the IRS obsoleted its Notice 2016-66 identifying micro-captive insurance arrangements as transactions of interest and issued proposed regulations to accomplish the same result. Certain micro-captive insurance transactions are also identified as listed transactions. The IRS said it was doing so to eliminate any confusion and continue its efforts to combat abusive tax shelters.

Malta personal retirement arrangements

On June 6, 2023, the IRS issued proposed regulations regarding a Malta personal retirement arrangement being classified as a listed transaction. The scheme involves a U.S. citizen or resident alien who (1) directly or indirectly transfers cash or other property to, or receives a distribution from, a personal retirement scheme established under the Malta Retirement Pension Act of 2011 and (2) states on a federal tax return that the income, gains or distributions are not taxable in the U.S. under the U.S./Malta tax treaty. The IRS said they may expand the scope of the listed transaction to include other foreign jurisdictions.

Monetized installment sales

On Aug. 4, 2023, proposed regulations identified monetized installment sales transactions as listed transactions. A monetized installment sale generally involves a taxpayer selling appreciated property to a buyer through an intermediary in exchange for an installment note. The seller receives only interest payments, with the principal paid at the end of the installment agreement. The structure is designed to let the seller receive the proceeds of the sale minus fees while delaying recognition of the gain until the balloon payment of principal.

Summary

The IRS will likely continue using the proposed regulations with notice and comment procedures for future listed transactions and transactions of interest until the issue is clarified in the courts or through congressional action. The IRS may also, as it has done with syndicated conservation easements and micro-captives, issue proposed regulations for current listed transactions and transactions of interest that were put in place by notice procedures. ■

IRS issues proposed regulations on prevailing wage and apprenticeship requirements

The Inflation Reduction Act, enacted in 2022, added prevailing wage and apprenticeship requirements to receive enhanced credits or deductions for many new and enhanced clean energy tax breaks. The enhancement can be five times the amount otherwise available. The proposed regulations, issued on Aug. 29, 2023, expand on previous guidance issued in IR-2022-208 and Notice 2022-61.

The prevailing wage and apprenticeship requirements apply to the following:

- Code Sec. 30C Alternative Fuel Vehicle Refueling Property Credit
- Code Sec. 45 Production Tax Credit
- Code Sec. 45Q Carbon Oxide Sequestration Credit
- Code Sec. 45V Production of Clean Hydrogen Credit
- Code Sec. 45Y Electricity Production Tax Credit
- Code Sec. 45Z Clean Fuel Production Credit
- Code Sec. 48 Investment Tax Credit
- Code Sec. 48C Advanced Energy Project Credit
- Code Sec. 48E Clean Energy Investment Credit
- Code Sec. 170D Energy Efficient Commercial Building Deduction

Only the prevailing wage requirements apply to the following:

- Code Sec. 45L New Energy Efficient Home Credit
- Code Sec. 45U Zero-Emission Nuclear Power Production Credit

Prevailing wage requirement

The proposed regulations largely incorporate the Davis-Bacon Act, as administered by the Wage and Hours Division of the Department of Labor, to the extent that it is relevant and consistent with sound tax administration. The proposed regulations define several relevant terms:

- Applicable wage determination
- Laborer
- Mechanic
- Construction, alteration or repair
- Locality or geographic area
- Prevailing wage rate

The proposed regulations would require taxpayers to use the general wage determination in effect when the construction of the facility begins. They would not need to update the determination during construction unless the contract changed to extend the time period or include additional substantial construction, alteration or repair work. Ordinary maintenance would be excluded from construction, although the proposed regulations state that basic maintenance before construction may meet the requirements. The proposed regulations also address secondary construction sites.

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The IRS anticipates that taxpayers would generally be able to use general wage determinations issued by the Department of Labor. However, if a general wage determination does not exist for the geographic area for the type of labor or construction, the taxpayer must request a supplemental wage determination from the Wages and Hours Division. The request must include any applicable general wage determinations, a description of work to be undertaken, the geographic area, the construction start date, the labor classifications needed, the duties required, the proposed wage rate and any additional relevant information. Various time limits apply. Review and appeal procedures would be available under the Davis-Bacon Act.

The proposed regulations also address correction procedures and possible penalties, including procedures for workers who cannot be located and whether a taxpayer has intentionally disregarded the requirements.

Apprenticeship requirements

The proposed regulations divide the apprenticeship requirements into three:

- The labor hours requirement addresses the applicable percentage of total labor hours to be performed by qualified apprentices.
- The ratio requirement addresses satisfaction of the applicable apprenticeship-to-journey worker ratio daily.
- The participation requirement addresses satisfaction of the labor hours requirement by preventing hiring apprentices to perform only one type of work.

The proposed regulations also address efforts required to obtain apprentices, a good faith exception for inability to obtain apprentices, and failure to satisfy the apprenticeship requirements, including applicable penalties.

Record-keeping requirements

The proposed regulations require the taxpayer to document compliance with the prevailing wage and apprenticeship requirements when the related tax return is filed, including maintaining relevant payroll records. The record-keeping burden falls on the taxpayer regardless of whether there are contractors and subcontractors involved and whether the taxpayer has transferred the credit to another entity.

The taxpayer must provide, with the relevant tax return, information on the location and type of qualified property, applicable wage determinations, wages paid, number of workers who received correction payments, wages and work hours of qualified apprentices, total hours by any laborer, mechanic, contractor or subcontractor, and total credit claimed. ■

Individual liable for penalties for failure to e-file and pay

An individual was liable for penalty under Code Sec. 6651 for failure to file tax returns and pay tax. The bright line rule established by the Supreme Court in *United States v. Boyle*, 85-1 USTC ¶13,602, 469 US 241, 245 (1985) applied to e-filed returns. The taxpayer argued that his reliance on his CPA constituted reasonable cause for his failure to timely file. Under Boyle, reliance on an agent does not by itself constitute reasonable cause for failure to file a timely tax return. The taxpayer argued that *Boyle* did not apply because Form 8879, *IRS e-file Signature Authorization*, exempted e-filing from the rule in *Boyle*. However, the act of signing Form 8879 did not transmit the return to the IRS and therefore did not relieve the taxpayer of exercising ordinary business care and prudence. The taxpayer still had a duty to supervise the CPA's tax preparation and ensure his tax return had been submitted. The taxpayer's choice to trust his CPA was not a disability or circumstance outside his control that stripped the taxpayer of the ability to ensure that his agent filed his taxes.

The taxpayer claimed that the e-filing burden fell on the CPA and that his CPA had a legal obligation to e-file the taxpayer's returns within three calendar days of receiving each Form 8879. The taxpayer argued that this legal obligation undermined *Boyle's* bright line rule. However, the taxpayer retained full control over the process and was not forced to work with his agent. Moreover, the IRS publication on which the taxpayer relied stated that an electronically filed return is not considered filed until the IRS acknowledges acceptance.

The taxpayer argued that *Boyle* did not preclude consideration of factors beyond the taxpayer's control when determining reasonable cause. The taxpayer claimed he exercised ordinary business care and should not be penalized solely because he hired a third-party tax preparer. However, the circumstances noted by the taxpayer were not beyond his control. Complex tax situations and tortuous e-filing procedures were not disabilities that deprived the taxpayer of the faculties needed for ordinary business care. Accordingly, the Supreme Court's authoritative construction of Code Sec. 6651(a)(1) in *Boyle* applied to e-filed returns as much as paper returns (see *W. Lee*, CA-11, affirming a DC Fla. decision, 2022-1 USTC ¶50,114). ■

Rules update mortality tables for defined benefit pension plans

Final regulations update mortality tables used by defined benefit pension plans to calculate present value for minimum funding requirements, effective for valuation dates on or after Jan. 1, 2024. The mortality tables reflect the ongoing impact of COVID-19 and the 0.78% annual cap on mortality improvement rates required by the SECURE 2.0 Act of 2022 (P.L. 117-328). In addition, the IRS separately proposed regulations modifying the rules for approving plan-specific substitute mortality tables, applying to plan years beginning on or after Jan. 1, 2025.

Final rule adopting mortality tables

In addition to calculating minimum funding contributions for single employer defined benefit plans, these tables are used to calculate single sum distributions and determine current liability for multi-employer plans and CSEC plans.

The final rule adopts base mortality tables from previously proposed regulations but alters mortality improvement rates for valuation dates on or after Jan. 1, 2024, to reflect the impact of COVID-19. The modification of the mortality improvement scale eliminates any mortality improvement during 2020, 2021, 2022 and 2023.

Also, as required under the SECURE 2.0 Act, the mortality improvement scale incorporates a 0.78% cap on mortality improvement rates for years after 2024. The final rule also eliminates the use of static mortality tables for all plans except small plans and provides reasonable approaches for plans to apply mortality tables to individuals who do not identify as male or female.

Proposed rules on substitute mortality tables

The IRS proposed regulations that would update the requirements for a single-employer defined benefit plan to use substitute mortality tables. Substitute mortality tables use actuarial data specific to the plan and replace generally applicable mortality tables when calculating present value for minimum funding purposes.

The IRS proposed updating the methodology for developing substitute mortality tables to reflect the impact of the COVID-19 pandemic. From 2020 to 2023, the mortality experience of participants in many pension plans was significantly higher than expected due to COVID-19. As a result, the IRS is concerned a plan-specific substitute mortality table using the actual mortality experience for the plan's population during those years might overstate the expected future mortality. To remedy this concern, the IRS proposed adjusting the mortality experience data for the years after 2019 and before 2024. The changes would apply for plan years beginning on or after Jan. 1, 2025 (see T.D. 9983, NPRM REG-103525-23).

Proposed rules related to IDR process under No Surprises Act

The IRS, Department of Labor and Department of Health and Human Services jointly issued proposed regulations related to the federal independent dispute resolution (IDR) process established under the No Surprises Act (P.L. 116-260) (see, NPRM REG-122319-22). The proposed rules would:

- Impose new disclosure requirements that group health plans and health insurance issuers must include with the initial payment or notice of denial of payment for certain items and services subject to surprise billing protections
- Require plans and issuers to use claim adjustment reason codes and remittance advice remark codes when providing paper or electronic remittance advice to an entity that does not have a contractual relationship with the plan or issuer
- Amend requirements related to the open negotiation period preceding the federal IDR process, the initiation of the IDR process, the IDR dispute eligibility review, and the payment and collection of administrative fees and certified IDR entity fees
- Define bundled payment arrangements, amend requirements for batched items and services, and amend the rules for time extensions due to extenuating circumstances
- Require plans and issuers to register in the federal IDR portal

Individual penalized for not conducting activity in businesslike manner

An individual did not conduct his entity's activity in a businesslike manner and was not entitled to deductions under Code Sec. 183(b) for his reported Schedule C expenses. The taxpayer did not engage in the entity's activity with the requisite profit objective during the tax years at issue.

The court analyzed factors for checking profitability of business activities under Treas. Reg. §1.183-2(b). One was the taxpayer's indifference to the entity's mounting losses and lack of revenue, which failed to show a good faith expectation of profit. Another showed that the losses from the entity's activity generated substantial tax benefits for the taxpayer (see *W.F. Kraske*, TC Memo. 2023-128, Dec. 62,292(M) and *W.F. Kraske*, 161 TC —, No. 7, Dec. 62,291).

Home office deduction

The taxpayer was denied a home office deduction under Schedule A or C. He failed to satisfy the exclusivity requirement of Code Sec. 280A(c)(1). The court, referencing *Commissioner v. Groetzinger*, 480 U.S. at 35, ruled that since the entity's activity lacked a profit motive, it was not a trade or business.

Accuracy-related penalties

The taxpayer was liable for accuracy-related penalties under Code Sec. 6662(d)(1)(A) for substantially understating income tax for those years. The court, referencing *Laidlaw's Harley Davidson Sales, Inc.*, 29 F.4th at 1071, ruled that a tax compliance officer's immediate supervisor retained discretion to approve or withhold approval of the penalties. The taxpayer's request for consideration was not received until three days after written supervisory approval was given. ■

Taxpayer denied deductions for failing to substantiate expenses

An appeals court affirmed the denial of deductions for car and other expenses because the taxpayer failed strict substantiation requirements of Code Sec. 274(d). The taxpayer did not prove locations visited in connection with his Schedule C1 or Schedule C2 businesses. The taxpayer's calendar entries were not contemporaneous with the alleged travel.

The taxpayer could have incurred travel expenses through his consulting business. However, the Tax Court was not authorized to estimate expenses under the Cohan rule for deductions.

Most of the other expenses reported were allegedly for construction materials and tools. The taxpayer failed to prove that he purchased listed items. These items were not purchased for the taxpayer's Schedule C2 home improvement business (see *N. Eze*, CA-4, unpublished opinion, affirming, *per curiam*, a Tax Court opinion, 124 TCM 64, Dec. 62,093(M), T.C. Memo. 2022-83). ■

IRS continues to target large corporations for tax compliance

The IRS announced new initiatives to help ensure the wealthiest corporations properly pay the taxes they owe. The agency will send compliance alerts to about 150 U.S. subsidiaries of foreign corporations to encourage self-compliance with appropriate tax laws.

The agency will expand its large corporate compliance program to include companies with more than $24 billion in assets and about $526 million per year in taxable income for audit. The agency will hire accountants to enable audits on 60 more of the largest corporate taxpayers.

The agency also noted its continued prioritization of high-income individuals who have failed to either file their taxes or pay their tax debt. The efforts focus on those with more than $1 million income and $250,000 in recognized debt. ■

Art owned by exempt organization excluded from minimum investment return

Artwork acquired by an exempt organization through donations or purchases constituted assets used directly in carrying out the organization's exempt purposes and could be excluded from the organization's minimum investment return under Code Sec. 4942(e)(1)(A) and Treas. Reg. § 53.4942(a)-2(c)(3). The organization had a history of furthering its exempt educational and charitable purposes by supporting art museums and educational institutions through cash grants and by loaning publications about art and art history. Acquiring additional art for public exhibition, not private use, furthered the organization's exempt purposes. Consequently, these expenditures constituted qualifying distributions within the meaning of Code Sec. 4942(g)(1) (see *IRS Letter Ruling* 202342009). ■

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