160 T.C. 399–470

UNITED STATES TAX COURT

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April 30, 2023

UNITED STATES TAX COURT

WASHINGTON, D.C.

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ALON FARHY, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 10647-21L. Filed April 3, 2023.

P failed to file Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, for his 2003–10 taxable years as required by I.R.C. § 6038(a). P's failure to file the information returns was willful and not due to reasonable cause. R assessed an initial penalty under I.R.C. § 6038(b)(1) and continuation penalties under I.R.C. § 6038(b)(2) against P for each of his 2003–10 taxable years. R proposed a levy to collect the unpaid penalties, and P timely requested an I.R.C. § 6330 hearing. After the hearing, R issued a notice of determination sustaining the proposed levy. P timely petitioned this Court. *Held*: R lacks statutory authority to assess penalties under I.R.C. § 6038(b)(1) or (2) against P. *Held, further*, R may not proceed with collection of these penalties from P via the proposed levy.

Edward M. Robbins, Jr., for petitioner.
Cassidy B. Collins, for respondent.

OPINION

MARVEL, *Judge*: This case is before the Court for disposition pursuant to Rule 122.[1] Petitioner seeks review of respondent's determination to proceed with a proposed levy to collect section 6038(b) penalties that respondent assessed against petitioner. After stipulations, the only issue remaining for decision is whether respondent has statutory authority to assess penalties provided by section 6038(b). For the reasons discussed herein, we decide this issue in favor of petitioner and hold that respondent may not proceed with collection via the proposed levy.

Background

The parties submitted this case fully stipulated under Rule 122. The stipulated facts and facts drawn from the stipulated Exhibits are incorporated herein by this reference. Petitioner resided in Israel when he petitioned the Court.[2]

During his 2003 through 2010 taxable years (years at issue), petitioner owned 100% of Katumba Capital, Inc., a foreign corporation incorporated in Belize. From 2005 (at the latest) through 2010 petitioner also owned 100% of Morningstar Ventures, Inc., a foreign corporation incorporated in Belize. During the years at issue, petitioner participated in an illegal scheme to reduce the amount of income tax that he owed, and on February 14, 2012, he signed an affidavit describing his role in that illegal scheme. He was granted immunity from prosecution in a nonprosecution agreement that he signed on September 20, 2012.

For the years at issue, petitioner had a reporting requirement under section 6038(a) to report his ownership interests in both Katumba Capital and Morningstar Ventures. For

[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code (Code), Title 26 U.S.C., in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] Unless otherwise agreed by the parties in writing, venue for an appeal would be the U.S. Court of Appeals for the District of Columbia Circuit. *See* § 7482(b)(1) (flush language).

each year at issue, petitioner was required to file Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, but he did not.

On February 9, 2016, the Internal Revenue Service (IRS) mailed petitioner notice of his failure to file the required Forms 5471 for the years at issue, but petitioner never filed them. For each year at issue, petitioner's failure to file the Form 5471 was willful and not due to reasonable cause.

On November 5, 2018, the IRS assessed an initial penalty under section 6038(b)(1) of $10,000 for each year at issue, and on November 12, 2018, the IRS assessed continuation penalties under section 6038(b)(2) totaling $50,000 for each year at issue. These assessments are reflected on copies of Form 4340, Certificate of Assessments, Payments, and Other Specified Matters, that the parties have submitted as stipulated exhibits. The IRS complied with the written supervisory approval requirements in section 6751(b) for the section 6038 penalties for the years at issue.

On January 30, 2019, the IRS issued to petitioner Letter 1058, Final Notice of Intent to Levy and Notice of Your Right to a Hearing (levy notice). The IRS, through the levy notice, sought to collect section 6038 penalties that the IRS had assessed because petitioner was required, but failed, to file Forms 5471 for the years at issue.

Petitioner timely requested a hearing pursuant to section 6330. On February 19, 2019, petitioner's counsel mailed the IRS a letter enclosing Form 12153, Request for a Collection Due Process or Equivalent Hearing. Among other issues, petitioner disputed whether the IRS has legal authority to assess section 6038 penalties.[3]

On June 4, 2021, respondent issued petitioner a Notice of Determination Concerning Collection Actions under IRC Sections 6320 or 6330 of the Internal Revenue Code (Notice of Determination), regarding petitioner's liabilities for unpaid civil penalties imposed pursuant to section 6038. The Notice of Determination sustained respondent's proposed collection

[3] An attachment to petitioner's Form 12153 refers to an earlier and related Form 12153 dated November 26, 2018, for the income tax liabilities for the years at issue. The parties resolved petitioner's income tax liabilities for the years at issue via a stipulated decision in a separate case in this Court. *See* Docket No. 11202-21L. However, the section 6330 hearings were conducted concurrently at the administrative level.

action. Petitioner timely filed a Petition with this Court for a review of the determination on June 9, 2021. The parties have stipulated that, except for the assessment authority issue in dispute,[4] the settlement officer conducting the section 6330 hearing obtained verification from the IRS that the requirements of any applicable law or administrative procedure have been met as required by section 6330(c)(1). The parties have also stipulated that the settlement officer considered any issues raised at the hearing and whether any proposed collection action balanced the need for the efficient collection of taxes with petitioner's legitimate concern that any collection action be no more intrusive than necessary. Finally, the parties stipulate that, except for the assessment authority issue in dispute, any error by the settlement officer was a harmless error and the settlement officer did not abuse his discretion in sustaining the levy proposed in the levy notice.

Discussion

A. *Jurisdiction and Standard of Review*

The Court has jurisdiction to review the IRS's determination concerning a levy action when the taxpayer timely petitions for review.[5] § 6330(d)(1). Petitioner has timely petitioned for review of the Notice of Determination, which concerns a proposed levy action. We therefore hold that we have jurisdiction to review the Notice of Determination.

Where the validity of the taxpayer's underlying liability is properly at issue, we review the underlying liability de novo. *See* § 6330(c)(2)(B); *Sego v. Commissioner*, 114 T.C. 604, 609–10 (2000). We review the IRS's determinations respecting any nonliability issues for abuse of discretion. *Goza v. Commissioner*, 114 T.C. 176, 181–82 (2000). The key facts are fully stipulated and are also described in the Notice of

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[4] The IRS's Taxpayer Advocate Service has alerted the IRS and Congress to the assessment authority issue that is presented in this case. *See* Taxpayer Advocate Service, *National Taxpayer Advocate Annual Report to Congress* 119–31 (2020).

[5] In *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493 (2022), the Supreme Court of the United States held that the timeliness requirement in section 6330(d)(1) (i.e., the requirement that a petition be filed with this Court within 30 days of a determination) is not jurisdictional. That requirement is not at issue here because petitioner timely filed his Petition.

Determination. "Where, as here, we are faced with a question of law . . . , our holding does not depend on the standard of review we apply. We must reject erroneous views of the law." *Manko v. Commissioner*, 126 T.C. 195, 199 (2006); *see Kendricks v. Commissioner*, 124 T.C. 69, 75 (2005); *McCorkle v. Commissioner*, 124 T.C. 56, 63 (2005); *see also Freije v. Commissioner*, 125 T.C. 14, 32–37 (2005) (setting aside a determination to proceed with collection because the appeals officer's verification that the requirements of applicable law were met was "incorrect" because of an "error as a matter of law," specifically an assessment that was "simply invalid," and holding that a taxpayer's ability to dispute his underlying tax liability pursuant to section 6330(c)(2)(B) does not cure an invalid assessment).

B. *Assessment Authority for Section 6038(b) Penalties*

Section 6038(b)(1) imposes a penalty of $10,000, with respect to each annual accounting period for which a failure exists, if any person fails timely to furnish certain required information with respect to any foreign business entity. Section 6038(b)(2) imposes a continuation penalty of $10,000 for each 30-day period (or fraction thereof) during which such failure continues with respect to any annual accounting period after an initial 90-day notice period, subject to a maximum of $50,000.[6] There is no statutory provision, in the Code or otherwise, specifically authorizing assessment of these penalties.

Section 6201(a) authorizes and requires the Secretary of the Treasury to make assessments of all taxes (including interest, additional amounts, additions to tax, and assessable penalties) imposed by the Code.[7] The Secretary of the Treasury has delegated these duties to the Commissioner of Internal Revenue, who has delegated them in turn to other IRS officials. *See* Treas. Reg. §§ 301.6201-1(a), 301.7601-1, 301.7701-9. Assessment is "the formal recording of a taxpayer's tax liability." *Baltic v. Commissioner*, 129 T.C. 178, 183

[6] Both types of penalties are subject to a reasonable cause exception. § 6038(c)(4)(B). That exception is not at issue in this case because the parties have stipulated there was no reasonable cause for petitioner's failure to meet the requirements of section 6038(a).

[7] A materially identical version of this portion of section 6201(a) has existed since 1954. *See* Internal Revenue Code of 1954, ch. 736, § 6201, 68A Stat. 3, 767.

(2007); *see* § 6203. When a tax (including for this purpose a deemed tax, such as an additional amount, addition to tax, assessable penalty, or interest, as explained below) is assessed, the IRS may take certain actions to collect the tax administratively. *See, e.g.*, § 6502(a) (permitting collection of a tax by levy, and generally providing a ten-year period of limitation for collection by a proceeding in court or by levy, when a tax has been assessed); § 6322 (providing that the lien imposed by section 6321 arises when an assessment is made); *see also Goldston v. United States* (*In re Goldston*), 104 F.3d 1198, 1200–01 (10th Cir. 1997) ("Abundant precedent exists for the proposition in a variety of tax contexts that liability for federal taxes does not hinge on whether the IRS has made a valid assessment. . . . While the absence of an assessment prevents the IRS from administratively collecting the tax, it may still file a civil action . . . ."). The IRS may immediately assess, inter alia, the tax determined by a taxpayer on his or her own return, § 6201(a)(1), as well as certain assessable penalties not subject to the Code's deficiency procedures, *see Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008). However, the term "assessable penalties" as used in section 6201(a) is left undefined, creating uncertainty about which penalties the IRS may assess and ultimately collect through administrative means.

"Agencies have only those powers given to them by Congress . . . ." *West Virginia v. EPA*, 142 S. Ct. 2587, 2609 (2022). Petitioner contends that the IRS lacks authority to assess the section 6038(b) penalties at issue. Petitioner argues that there is no law giving the IRS authority to assess penalties under section 6038(b) and that while the United States may be able to collect liabilities for these penalties through a civil action, *see* 28 U.S.C. § 2461(a), the IRS may not assess or administratively collect these penalties.

Petitioner contends that section 6038(b), unlike a bevy of other penalty sections in the Code (discussed below), contains no provision authorizing assessment of the penalty it provides for. Therefore, petitioner argues, a section 6038(b) penalty is not an assessable penalty, although it may be collected through a civil action.

Respondent contends that the term "assessable penalties" includes any penalties found in the Code that are not subject to the Code's deficiency procedures. Respondent points out

that neither section 6201 nor any other Code section limits the term “assessable penalties” to those found in subchapter B of chapter 68 of subtitle F of the Code (entitled “Assessable Penalties”). Respondent argues that reading that subchapter as the exclusive location for assessable penalties would contravene section 7806(b), which provides in relevant part that

> [n]o inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter relating to the contents of this title be given any legal effect.

Respondent also argues that in any case, the term “taxes” in section 6201 is broad enough to encompass section 6038 penalties. Respondent cites *Ruesch v. Commissioner*, 154 T.C. 289 (2020), *aff’d in part, vacated and remanded in part*, 25 F.4th 67 (2d Cir. 2022), for support for his statutory construction arguments. Finally, respondent argues that the legislative history surrounding the enactment of penalties in section 6038(b) provides support for his position.

We conclude that petitioner’s reading of the Code is the correct one. Congress has explicitly authorized assessment with respect to myriad penalty provisions in the Code, but not for section 6038(b) penalties. Section 6671(a) provides that the numerous penalties found in subchapter B of chapter 68 of subtitle F (i.e., in sections 6671–6725) “shall be assessed and collected in the same manner as taxes,” subjecting those penalties to the Secretary’s assessment authority under section 6201. Section 6665(a)(1) contains a similar statement that the additions to tax, additional amounts, and penalties provided in chapter 68 of subtitle F (i.e., in sections 6651–6751) “shall be assessed, collected, and paid in the same manner as taxes.” Code sections outside of chapter 68 of subtitle F whose violations the Code specifically penalizes commonly (1) contain their own express provision specifying the treatment of penalties or other amounts as a tax or an assessable penalty for purposes of assessment and collection, *see, e.g.*, §§ 527(j)(1), 856(g)(5)(C), 857(f)(2)(A), 4980H(d)(1), 5000A(g)(1), 5114(c)(3), 5684(b), 5761(e), 9707(f); (2) contain a cross-reference to a provision within chapter 68 of subtitle F providing a penalty for their violation, *see, e.g.*, §§ 1275(c)(4), 6033(o), 6043(d), 6046(f), 6046A(e), 6420(i)(2), 6421(j)(1), 6427(p)(1), 7501(b); or (3) are

expressly covered by a penalty provision within chapter 68 of subtitle F, *see, e.g.*, §§ 6652(c), 6674, 6675, 6677, 6679, 6685, 6686, 6688, 6689, 6690, 6692, 6693, 6695, 6698, 6699, 6704, 6705, 6706, 6707, 6707A, 6708, 6709(c), 6710, 6712, 6714, 6717, 6718, 6719, 6720. In contrast, section 6038 contains only a cross-reference to a criminal penalty provision, section 7203. § 6038(f)(1).

Furthermore, 28 U.S.C. § 2461(a) expressly provides that "[w]henever a civil fine, penalty or pecuniary forfeiture is prescribed for the violation of an Act of Congress without specifying the mode of recovery or enforcement thereof, it may be recovered in a civil action." Here, the section 6038(b) penalties at issue are prescribed for the violation of section 6038(a)(1) and (2), which was enacted by the Revenue Act of 1962, Pub. L. No. 87-834, § 20(a), 76 Stat. 960, 1059, and amended by other Acts of Congress since then. However, no mode of recovery or enforcement is specified for these penalties, unlike for myriad other penalties in the Code. We are loath to disturb this well-established statutory framework by inferring the power to administratively assess and collect the section 6038(b) penalties when Congress did not see fit to grant that power to the Secretary of the Treasury expressly as it did for other penalties in the Code.

Respondent's arguments are unavailing. We agree with respondent that the term "assessable penalties" as used in section 6201(a) is not limited to penalties found in subchapter B of chapter 68 of subtitle F (titled "Assessable Penalties"),[8] but the term "assessable penalties" used in section 6201 does not automatically apply to *all* penalties in the Code not subject to deficiency procedures. "Assessable penalties" is not a term used to distinguish between penalties subject to deficiency procedures and those that are not. "The label of 'assessable penalty[]' . . . does not automatically bar a taxpayer from using the deficiency procedures to challenge the liability. An assessable penalty, rather, must be paid upon notice and demand and assessed and collected in the same manner as taxes." *Smith v. Commissioner*, 133 T.C. 424, 428 (2009). While some provisions explicitly exempt certain assessable penalties

[8] As explained above, some Code sections outside chapter 68 of subtitle F contain their own express provision authorizing assessment of penalties provided therein.

from deficiency procedures, *see id.* at 428 & n.3, others do not specify whether those procedures apply. In those cases, we consider whether the assessable penalty at issue is "included in the statutory definition of 'deficiency[,]'" or whether the assessable penalty "depend[s] upon a deficiency" or, to the contrary, "may be assessed even if there is an overpayment of tax."[9] *Id.* at 429; *cf.* § 6665(b)(1) (applying deficiency procedures to the portion of the addition to tax under section 6651 "which is attributable to a deficiency in tax described in section 6211"); *Wilson v. Commissioner*, 118 T.C. 537, 540–41 (2002). However, if we were to consider whether section 6038(b) penalties are subject to deficiency procedures without first deciding whether the section 6038 penalties must be paid upon notice and demand and assessed and collected in the same manner as taxes, we would be putting the proverbial cart before the horse. That is because there is no provision in the first place providing that these penalties "must be paid upon notice and demand and assessed and collected in the same manner as taxes." *Smith*, 133 T.C. at 428. Simply put, while section 6038(b) provides for penalties, it does not provide for assessable penalties. Respondent's argument that section 6038(b) penalties are necessarily assessable penalties because they are not subject to deficiency procedures assumes a faulty premise and must be rejected.[10]

Respondent's argument that the term "taxes" in section 6201(a) encompasses the section 6038(b) penalties (even if they are not assessable penalties) fares no better. Precedent firmly establishes that taxes and penalties are distinct categories of exactions, at least in the absence of a provision treating them as the same. *See Grajales v. Commissioner*, 156

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[9] We note that respondent's own internal guidance has concluded that the section 6676 penalty, an assessable penalty, is subject to deficiency procedures on the basis of a similar line of reasoning. *See* I.R.S. Chief Couns. Adv. Mem. 201520005 (May 15, 2015).

[10] Neither party has argued that section 6038(b) penalties constitute "additional amounts" or "additions to the tax" for purposes of section 6201(a), and we note that our precedent forecloses that argument. *See Whistleblower 22716-13W v. Commissioner*, 146 T.C. 84, 92–96 (2016) (stating that "additional amounts" and "additions to the tax" are terms of art in the Code and holding that certain penalties were not "additional amounts" because they were neither enumerated in chapter 68 nor assessed, collected, or paid in the same manner as taxes).

T.C. 55, 61 (2021) (analyzing whether an exaction is a tax or penalty by reference to the label Congress chose to apply to it), *aff'd*, 47 F.4th 58 (2d Cir. 2022); *see also Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 546 (2012) ("The Code contains many provisions treating taxes and assessable penalties as distinct terms. . . . There would, for example, be no need for § 6671(a) to deem 'tax' to refer to certain assessable penalties if the Code already included all such penalties in the term 'tax.'"); *Chadwick v. Commissioner*, 154 T.C. 84, 93 (2020) (stating that sections 6665 and 6671 "do not characterize 'penalties' as something other than penalties" but instead simply specify the manner in which penalties within their scope are to be assessed and collected); *cf. Liberty Univ., Inc. v. Lew*, 733 F.3d 72, 87–89 (4th Cir. 2013) (holding that employer mandate exaction in section 4980H is not a tax for purposes of the Anti-Injunction Act in part because it is not included in subchapter B of chapter 68 and no other provision deems it a tax). Section 6665(a)(2) deems any reference in the Code to "'tax' . . . also to refer to the additions to the tax, additional amounts, and penalties provided by" chapter 68 of subtitle F, and a similar provision specifically applicable to the penalties in subchapter B of that chapter is found in section 6671(a). There would be no need for these provisions to deem "tax" to refer to certain penalties if the Code already included those penalties in the term "tax." The adjective "assessable" would also be unnecessary to modify the term "penalties" in section 6201 if section 6201 authorized the Commissioner to assess all penalties provided in the Code.[11]

The Code also contains some detailed provisions governing (1) the circumstances under which it deems certain amounts to be a "tax" for assessment and collection purposes and (2) the consequences of deeming a penalty to be assessable. For example, section 6665(b) includes specific provisions regarding the circumstances under which certain additions to tax (or portions thereof) are or are not deemed to be taxes for

[11] In comparison, the Code uses the term "any . . . penalty" in describing civil actions that require the authorization of the Secretary of the Treasury and the direction of the Attorney General to commence. *See* § 7401 (providing that no civil action for the collection or recovery of "taxes, or of any fine, penalty, or forfeiture," shall be commenced unless the Secretary of the Treasury authorizes or sanctions the proceedings and the Attorney General or his delegate directs that the action be commenced).

purposes of subchapter B of chapter 63 of subtitle F (relating to deficiency procedures for income, estate, gift, and certain excise taxes). *Cf. Smith*, 133 T.C. at 429 n.4 (listing penalties in subchapter B of chapter 68 containing specific exclusions from the application of deficiency procedures). Section 5761 expressly distinguishes between the circumstances under which a penalty under that section may be recovered by civil action or through administrative assessment and collection. *See* § 5761(a) (providing that a person who fails to comply with certain Code requirements shall "be liable to a penalty of $1,000, to be recovered, with costs of suit, in a civil action, except where a penalty under subsection (b) or (c) or under section 6651 or 6653 or part II of subchapter A of chapter 68 may be collected from such person by assessment"). Moreover, at least one Code provision, section 5000A(g)(2)(B), specifically restricts the collection actions that may be taken after the assessment of a penalty that is otherwise "assessed and collected in the same manner as an assessable penalty under subchapter B of chapter 68." § 5000A(g)(1). Given this detailed statutory framework, we decline to substitute the Commissioner's judgment for Congress' decision not to deem the section 6038(b) penalties "taxes" for assessment and collection purposes.

We recognize that when section 6201(a) states that the "taxes . . . imposed by this title" whose assessments the Secretary of the Treasury is authorized and required to make "includ[e] interest, additional amounts, additions to the tax, and assessable penalties," there is no indication that this list is necessarily exclusive. *See* § 7701(c). However, we reject the notion that the assessment authority provided by section 6201(a) covers all penalties, or virtually any exaction, imposed by the Code simply because it covers taxes and certain other exactions specifically included. All of the items specifically included in the term "taxes . . . imposed by this title" as used in section 6201(a) have a close connection to that term. "[A]ny reference" in the Code to "'tax' imposed by this title" is also deemed to refer to additional amounts, additions to tax, and penalties provided by chapter 68 (the latter of which, as we have explained, are assessable penalties by reason of section 6665(a)(1)). § 6665(a)(2); *see also* § 6671(a). Similarly, section 6601(e)(1) provides that "[a]ny reference in this title

(except subchapter B of chapter 63, relating to deficiency procedures) to any tax imposed by this title shall be deemed also to refer to interest imposed by this section on such tax." None of these limited inclusions in the term "taxes . . . imposed by this title" in section 6201 has any similarity to a fixed-dollar information reporting penalty that is nowhere deemed a tax or authorized or required to be assessed or collected in the same manner as a tax or assessable penalty. Moreover, when Congress has seen fit to add other items to a list that includes interest, additional amounts, additions to tax, and assessable penalties, it has done so expressly. *See* § 6321 (providing that the amount of the lien that arises after a person neglects or refuses to pay any tax after demand includes "any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto").

Our holding in no way contravenes section 7806(b) because we do not define the term "assessable penalties" as used in section 6201(a) by reference to the title of subchapter B of chapter 68 of subtitle F nor by reference to the grouping of similar provisions in that subchapter. Instead, we conclude that the term "assessable penalties" as used in section 6201(a) includes penalties that "must be paid upon notice and demand and assessed and collected in the same manner as taxes," *Smith*, 133 T.C. at 428, regardless of their location within the Code. Our conclusion recognizes that the term "assessable penalties" as used in section 6201(a) encompasses some exactions outside of subchapter B of chapter 68 of subtitle F in addition to the substantial number of penalties within that subchapter that are assessable by reason of section 6671(a).

We also reject respondent's reliance on our holding in *Ruesch* because *Ruesch* has no bearing on the issue before us.[12] In *Ruesch*, 154 T.C. at 290, the taxpayer did not pay

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[12] In a recent opinion, we observed that "the U.S. Court of Appeals for the Second Circuit vacated for mootness the portion of our order in *Ruesch* resolving the jurisdictional question" at issue in that case. *Adams v. Commissioner*, 160 T.C. 1, 10 (2023). We also observed that the view of "virtually all the courts of appeals is that when a judgment is vacated, the vacatur deprives the underlying opinion of any precedential effect." *Id.* Nonetheless, for two reasons, we do not rely on that ground here to reject respondent's reliance on *Ruesch*. First, in *Adams* we expressly "readopt[ed] our holding in *Ruesch*," noting that "the Second Circuit simply held that the question was moot in that particular case. Accordingly, although our opinion in

assessed section 6038(b) penalties upon notice and demand. The IRS certified the taxpayer's liability for those penalties to the Secretary of State as a "seriously delinquent tax debt" within the meaning of section 7345(b). *Ruesch*, 154 T.C. at 290–91. The taxpayer filed a petition challenging the correctness of the Commissioner's certification as well as the taxpayer's underlying liability for the section 6038(b) penalties. *Ruesch*, 154 T.C. at 291. The IRS subsequently discovered that the taxpayer had timely submitted a request for a collection due process or equivalent hearing with respect to the section 6038(b) penalties. *Ruesch*, 154 T.C. at 291. That request suspended collection of the taxpayer's tax debt so that it was no longer seriously delinquent within the meaning of section 7345(b)(2)(B)(i). *Ruesch*, 154 T.C. at 291. The IRS accordingly reversed its certification as erroneous and so notified the Secretary of State. *Id.* The IRS also filed motions with this Court, one of which sought to dismiss the challenge to the section 6038(b) penalties for lack of jurisdiction, which we granted. *Ruesch*, 154 T.C. at 291. We did not make any merits determination as to the taxpayer's challenge to the underlying liability. We noted specifically that the taxpayer might have a prepayment forum in this Court to consider the contention that the penalties were illegally assessed "upon . . . receipt of a notice of determination following completion of [the taxpayer's collection due process] proceeding," similar to the challenge that petitioner now brings. *Id.* at 297. We held that we had no jurisdiction either under section 7345 or pursuant to our deficiency jurisdiction to consider the taxpayer's underlying liability for the penalties in the absence of such a notice of determination. *Ruesch*, 154 T.C. at 297.

In so holding, we did acknowledge that section 6038 penalties are not subject to deficiency procedures. Specifically, we stated:

Ruesch was deprived of its precedential effect, it has not lost its persuasive value." *Id.* at 12. Second, we noted that the view of the D.C. Circuit, to which an appeal would lie in this case, *see supra* note 2, regarding the effect of vacatur "appears to be more nuanced" than that of its sister circuits, *Adams*, 160 T.C. at 11 n.7. It is therefore uncertain whether the jurisdictional holding of *Ruesch* ever lost its precedential effect for purposes of this case and others in which an appeal would lie to the D.C. Circuit. Nonetheless, we determine that our holding in *Ruesch* simply does not control the issue before us.

> After the IRS mails a taxpayer a timely notice of deficiency, this Court has jurisdiction to redetermine deficiencies in income, estate, and gift taxes 'imposed by subtitle A or B' and deficiencies in certain excise taxes imposed by 'chapter 41, 42, 43, or 44.' Secs. 6212(a), 6213(a). The section 6038 penalties assessed against [the taxpayer] are imposed by subtitle F, chapter 61, and thus lie outside our deficiency jurisdiction.[13]

Ruesch, 154 T.C. at 297. We also noted that the taxpayer did not allege receipt of a notice of deficiency with respect to these penalties. *Id.* None of these statements is inconsistent with this Opinion. As already explained, the mere fact that a penalty is not subject to deficiency procedures does not automatically give rise to the conclusion that it is an assessable penalty, such as where, as here, Congress has not given the Commissioner the authority to assess the penalty.

Finally, respondent relies on a passage in the legislative history surrounding the enactment of section 6038(b) penalties to support his arguments. A Senate Finance Committee report states that the existing sanction addressing violations of section 6038(a), now found in section 6038(c), "reducing creditable foreign taxes is of no use if the U.S. person required to report paid no foreign income taxes during the year in question." *See* S. Rep. No. 97-494 (Vol. 1), at 299 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 781, 1042. The report further states, referring to section 6038(c)(3): "Where both penalties are applied, the amount of the reduction in the foreign tax credit is reduced by the amount of the fixed-dollar penalty imposed. It is intended that the reduction in foreign tax credit penalty may be waived in some cases where the flat $1,000 penalty will be imposed." S. Rep. No. 97-494 (Vol. 1), at

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[13] In addition to our explanation in *Ruesch* of why deficiency procedures do not apply to section 6038(b) penalties, we note also here that section 6038(b) penalties do not depend on the existence of a deficiency. *See Smith*, 133 T.C. at 428–29. The penalties depend only on a failure to furnish information in a timely manner. While section 6662(a), (b)(7), and (j) imposes an accuracy-related penalty on an undisclosed foreign financial asset understatement, challenges to which we may review under our deficiency jurisdiction, section 6038(b) penalties are separate penalties. We cannot use the existence of the undisclosed foreign financial asset understatement penalty to find that the Commissioner may assess section 6038(b) penalties. Likewise, while a taxpayer's violation of section 6038 gives rise to the application of a tolling provision for the assessment of tax in section 6501(c)(8), that tolling provision does not itself provide any authority for finding that section 6038(b) penalties may be assessed by the Commissioner.

300, 1982 U.S.C.C.A.N. at 1043. These statements say nothing about the manner in which section 6038(b) penalties are to be collected. Our holding today does nothing to frustrate the operation of the provision found in section 6038(c)(3) for coordination of the two penalties. The United States may, of course, choose which penalty to pursue or to pursue both, in which case section 6038(c)(3) may apply to reduce the amount of the section 6038(c) penalty. Our holding concerns only the applicable manner of collection for section 6038(b) penalties.

Respondent also points to a statement in the report that the penalty found in section 6038(c) was not commonly imposed "because the penalty is complicated." S. Rep. No. 97-494 (Vol. 1), at 299, 1982 U.S.C.C.A.N. at 1042. Read in context, this statement is referring to the fact that a penalty imposing a foreign tax credit reduction has unpredictable effects because on the one hand, "a taxpayer could incur a substantial penalty for a minor failure," but on the other hand, "reducing creditable foreign taxes is of no use if the U.S. person required to report paid no foreign income taxes during the year in question." *Id.* It is not a statement referring to the manner of assessment or collection for penalties imposed under either provision.

Conclusion

Respondent assessed penalties under section 6038(b) against petitioner without statutory authority to do so. Accordingly, we hold that respondent may not proceed with the collection of these penalties from petitioner via the proposed levy.

We have considered all of the parties' arguments and, to the extent they are not discussed herein, find them to be irrelevant, moot, or without merit.

To reflect the foregoing,

An appropriate decision will be entered for petitioner.

SRBISLAV B. STANOJEVICH, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 4984-17L. Filed April 10, 2023.

P, in his capacity as the trustee of a grantor-type trust (T), filed frivolous income tax returns for T for 2009 through 2012. R assessed an I.R.C. § 6702(a) frivolous return penalty against P for each year and later filed a Notice of Federal Tax Lien (NFTL) as to the penalties. P challenges the lien filing in this collection due process case, asserting primarily that he is not liable for the penalties because they stem from the income tax returns of another taxpayer. *Held*: P is liable for the penalties because I.R.C. § 6702(a) imposes a penalty on a "person [who] files what purports to be a return of a tax imposed by this title," and P's filing of the frivolous returns on behalf of T falls within the meaning of that provision. *Held, further*, the NFTL filing is sustained.

Srbislav B. Stanojevich, pro se.
Alexander N. Martini and *John T. Arthur*, for respondent.

OPINION

KERRIGAN, *Chief Judge*: Respondent seeks summary adjudication in this collection due process (CDP) case commenced pursuant to sections 6320(c) and 6330(d)(1).[1] The relevant collection actions were initially a proposed levy for 2015 and the filing of a Notice of Federal Tax Lien (NFTL) for 2009–12 (subject years). This case became moot as to 2015 after the Internal Revenue Service (IRS) Office of Appeals[2] determined in a Supplemental Notice of Determination Concerning Collection Action(s) under Section 6320 and/or 6330 (supplemental notice) that no balance is due for 2015 and that a levy for

[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C. (Code), in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. All monetary amounts are rounded to the nearest dollar.

[2] On July 1, 2019, the IRS Office of Appeals was renamed the IRS Independent Office of Appeals. *See* Taxpayer First Act, Pub. L. No. 116-25, § 1001, 133 Stat. 981, 983 (2019). We will use the name in effect at the times relevant to this case, i.e., the Office of Appeals or Appeals.

that year would therefore be inappropriate.[3] Appeals determined in both the Notice of Determination Concerning Collection Action(s) Under Section 6320 and/or 6330 of the Internal Revenue Code (notice of determination) and the supplemental notice that the NFTL filing was proper as to the subject years.

The NFTL filing stems from respondent's determination that petitioner filed frivolous income tax returns for the subject years and is liable for $5,000 for each year in penalties imposed under section 6702(a). Petitioner filed those returns on behalf of a trust, the Source Financial Trust (SFT), in his capacity as the trustee.[4] Petitioner argues that he is not liable for the penalties because they relate to the income tax returns of another taxpayer, SFT. Petitioner further argues that Appeals should not have upheld the NFTL filing because Appeals has not met the verification requirement under sections 6320(c) and 6330(c)(1) and (3). We disagree with petitioner's arguments and sustain respondent's determination that the NFTL filing was proper as to the subject years.

Background

The following facts are based upon the parties' pleadings, Motion papers, Declarations, and attached Exhibits, which include the administrative record of the CDP proceeding. *See* Rule 121(b). These facts are stated solely for the purpose of ruling on respondent's Motion and not as findings of fact. *See Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994).

Petitioner resided in Florida when his Petition was timely filed. In January 2013, petitioner submitted a request to the IRS for an employer tax identification number (EIN) for SFT. Petitioner represented that SFT was a grantor-type trust and that he was SFT's trustee. The IRS assigned an EIN to SFT on January 15, 2013. Petitioner later filed with the IRS a Form 1041, U.S. Income Tax Return for Estates and Trusts, for each subject year. Petitioner filed those returns on behalf

[3] Given that 2015 and a proposed levy are no longer at issue, we hereinafter limit our discussion to the subject years and the NFTL filing.

[4] Respondent disputes that SFT should be characterized as a valid trust for Federal tax purposes but asks the Court to treat SFT as a valid trust for purpose of our deciding the motion at hand. We will do so.

of SFT. He reported on the returns that he was SFT's trustee and signed the returns as SFT's "Authorized Representative."

The respective returns for the subject years reported interest income (and SFT's total and taxable income) of $40,709, $48,096, $57,091, and $58,176. Each return also reported that SFT had federal income tax withheld in an amount equal to the amount of the interest/total taxable income reported on the return, that SFT's "[t]otal tax" for the year was zero, and that SFT was entitled to receive an overpayment equal to the amount of the withheld tax. The returns included as attachments various Forms 1099 that petitioner had prepared and that reported payments to and from SFT. Some of the Forms 1099 also reported the amounts of withheld federal income tax that the returns reported were withheld federal income tax.

The IRS determined that the Forms 1099 were false and that each income tax return was "frivolous" for purposes of section 6702(a). Eventually, pursuant to section 6702(a), respondent assessed against petitioner a penalty of $5,000 for each subject year. Forms 8278, Assessment and Abatement of Miscellaneous Civil Penalties, show that before the assessments, an "Originator" with the IRS had proposed the penalties and that the proposed penalties were approved by the supervisor.

The IRS sent petitioner a Letter 3172, Notice of Federal Tax Lien Filing and Your Right to a Hearing Under IRC 6320. In response petitioner completed a Form 12153, Request for a Collection Due Process or Equivalent Hearing. A settlement officer with Appeals held the requested CDP hearing with petitioner. Later, on January 26, 2017, Appeals issued to petitioner a notice of determination sustaining the NFTL filing.

Petitioner timely petitioned the Court as to the notice of determination. We remanded this case to Appeals for the purpose of clarifying the determinations with respect to verification requirements of section 6330(c)(1) for the section 6702 assessments. The same settlement officer held a second CDP hearing with petitioner and issued the supplemental notice upholding the NFTL filing. Before issuing the supplemental notice, the settlement officer reviewed IRS transcripts and other computer records showing as to the penalties that a notice and demand, an NFTL filing, and a notice of a right to a CDP hearing were issued to petitioner. She also verified

for each subject year that assessments of the penalties were properly made pursuant to sections 6201 and 6751(b)(1) and that the penalties had not been fully paid.

Discussion

I. *Summary Judgment Standard*

Summary adjudication is intended to expedite litigation and avoid costly, time-consuming, and unnecessary trials. *See Fla. Peach Corp. v. Commissioner*, 90 T.C. 678, 681 (1988). We may decide a case through summary adjudication when the record shows that there is no genuine dispute as to any material fact and that a decision may be rendered as a matter of law. *See* Rule 121(b); *Sundstrand Corp.*, 98 T.C. at 520. Summary adjudication requires that we construe factual materials and inferences drawn from them in the light most favorable to the nonmoving party. *See Sundstrand Corp*., 98 T.C. at 520. The nonmoving party may not rest upon mere allegations or denials in his pleadings, but must set forth specific facts demonstrating that a genuine dispute exists for trial. *See* Rule 121(d); *Sundstrand Corp.*, 98 T.C. at 520.

II. *Section 6320*

Section 6320 requires the Commissioner to notify a taxpayer of the filing of an NFTL. The notice must inform the taxpayer of his or her right to a CDP hearing on the propriety of the filing. *See* § 6320(a)(3)(B). In a section 6320 CDP hearing, taxpayers may raise any relevant issue or request the consideration of a collection alternative. *See* §§ 6320(c), 6330(c)(2)(A). An issue is not properly raised at the CDP hearing if the taxpayer fails to request consideration of that issue by the settlement officer or if the taxpayer requests consideration but fails to present any evidence after being given a reasonable opportunity to do so. *See* Treas. Reg. § 301.6320-1(f)(2), Q&A (F)(3). A taxpayer may challenge the existence or amount of the underlying tax liability only if he or she did not receive a notice of deficiency or otherwise have a previous opportunity to dispute the liability. *See* §§ 6320(c), 6330(c)(2)(B).

III. *Standard of Review*

Where the validity of a taxpayer's underlying liability is properly at issue, we review that liability de novo. *See Sego v. Commissioner*, 114 T.C. 604, 610 (2000); *Goza v. Commissioner*, 114 T.C. 176, 181–82 (2000). In all CDP cases, we review any other determination by Appeals for abuse of discretion. *See Goza*, 114 T.C. at 182. Abuse of discretion exists when a determination is arbitrary, capricious, or without sound basis in fact or law. *See Murphy v. Commissioner*, 125 T.C. 301, 320 (2005), *aff'd*, 469 F.3d 27 (1st Cir. 2006).

IV. *Analysis*

The parties dispute whether petitioner is liable for the section 6702(a) penalties that respondent determined with respect to the income tax returns petitioner filed for SFT for the subject years. This dispute addresses the existence or amount of the underlying liabilities. Petitioner neither received a notice of deficiency nor otherwise had a previous opportunity to challenge that liability; therefore, we decide that dispute on the basis of a de novo scope and standard of review.

Respondent argues that petitioner did not properly challenge his underlying liabilities at the CDP hearings. If true that would mean that we could decline to consider that issue in this proceeding. *See Giamelli v. Commissioner*, 129 T.C. 107, 113–15 (2007). But we disagree. The record establishes that during the CDP hearings petitioner made the same argument that we now consider: that he is not liable for the penalties because the returns to which they relate are not his personal returns.

Section 6702(a) provides that "[a] person shall pay a penalty of $5,000 if . . . such person files what purports to be a return of a tax imposed by this title" and the other requirements under section 6702(a)(1)(A) or (B) and section 6702(a)(2) (other requirements for a section 6702(a) penalty) are met.[5] Respondent bears the burden of proving that peti-

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[5] In full, section 6702(a) provides:

> (a) Civil penalty for frivolous tax returns.—A person shall pay a penalty of $5,000 if—
>
> > (1) such person files what purports to be a return of a tax imposed by this title but which—

tioner is liable for the determined section 6702(a) penalties. *See* § 6703(a). The burden, however, does not come into play to the extent that we decide an issue of law such as the meaning of the statute. *See Pei Fung Guo v. Commissioner*, 149 T.C. 334, 336 (2017).

Our analysis of the parties' dispute starts with the text of section 6702(a). *See Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 450 (2002). We interpret that text by giving each undefined word its plain, obvious, and rational meaning when construed in the light of the statute as a whole. *King v. St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991); *see Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, [a court] normally construe[s] it in accord with its ordinary or natural meaning."). Absent absurd, unreasonable, or futile results, there is "no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *United States v. Am. Trucking Ass'ns*, 310 U.S. 534, 543 (1940).

The parties do not challenge that the text of section 6702(a)(1) and (2), which sets forth the other requirements for a section 6702(a) penalty, may be applied exactly as it reads. Nor do we. We look to the face of the filed SFT income tax returns to decide whether those other requirements for a section 6702(a) penalty have been met. *See Callahan v. Commissioner*, 130 T.C. 44, 51 (2008). We find on our reading of SFT's filed returns that each return meets those requirements.

First, each return "does not contain information on which the substantial correctness of the self-assessment may be judged" and "contains information that on its face indicates that the self-assessment is substantially incorrect." *See* § 6702(a)(1). Each return reports that SFT is recognizing a significant amount of taxable interest income as SFT's only source of income and that the amount of the interest income

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(A) does not contain information on which the substantial correctness of the self-assessment may be judged, or

(B) contains information that on its face indicates that the self-assessment is substantially incorrect, and

(2) the conduct referred to in paragraph (1)—

(A) is based on a position which the Secretary has identified as frivolous under subsection (c), or

(B) reflects a desire to delay or impede the administration of Federal tax laws.

equals the amount of SFT's taxable income and withheld Federal income tax.

Each return claims that SFT is entitled to a refund of the full amount of the reported withheld tax (which, again, is the same amount as the amount of SFT's interest/taxable income) because, as the return reports, no tax is imposed on SFT's taxable income. We cannot comprehend from reading the SFT returns as filed how no tax could be self-assessed on SFT's reported taxable income and how SFT could be entitled to a refund equal to the amount of its reported taxable income. The information reported on the returns, as we understand it, also indicates that each self-assessment is "substantially incorrect" within the context of section 6702(a)(1)(B).

Second, we conclude from reading the returns that each return "is based on a position which the Secretary has identified as frivolous." *See* Notice 2010-33, § III(22), 2010-17 I.R.B. 609, 611 (identifying as "frivolous" for purpose of section 6702 a "claim on an income tax return or purported return an amount of withheld income tax . . . that is obviously false because it . . . is disproportionately high in comparison with the income reported on the return or information on supporting documents filed with the return").

In our view the filing of each return merely "reflects a desire to delay or impede the administration of Federal tax laws." Whether petitioner believes that SFT's returns as filed are correct is of no concern. We find that if a return reflects a position that the IRS has identified as "frivolous" for purpose of a section 6702(a) penalty, then the taxpayer's belief in the correctness of his position cannot serve as a defense to the penalty. *See Hudson v. United States*, 766 F.2d 1288, 1291 (9th Cir. 1985) (per curiam).

As to the remaining requirement, that the "person files what purports to be a return of a tax imposed by this title," we conclude that the meaning of that text is clear because the words are either unambiguously defined by Congress or unambiguous in and of themselves. *See* § 6702(a). Petitioner and SFT are each "person[s]" under the definition that Congress has given that word for purposes of interpreting a Code provision. That definition when applied here is "not otherwise distinctly expressed or manifestly incompatible with the intent thereof." *See* § 7701(a)(1) ("When used in this title, where not other-

wise distinctly expressed or manifestly incompatible with the intent thereof . . . [, t]he term 'person' shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation."); *cf.* § 7701(a)(14) (defining the word "taxpayer" more narrowly as "any person subject to any internal revenue tax").[6]

Each of SFT's returns, given in part that they were filed on Forms 1041, "purports to be a return of a tax imposed by this title." *See* § 6702(a)(1). To that end, the Code provides that income tax may be imposed on the income of a trust, *see* § 641 (setting forth rules on the imposition of income tax with respect to a trust), and requires that a trust such as SFT, through its fiduciary, file an annual return reporting its income and its corresponding self-assessed income tax, *see* § 6012(a)(4) ("Returns with respect to income taxes under subtitle A shall be made by . . . [e]very trust having for the taxable year any taxable income, or having gross income of $600 or over, regardless of the amount of taxable income . . . .").

The Treasury Regulations also require that a trustee use Form 1041 to make and file any income tax return for the trust. *See* Treas. Reg. § 1.6012-3(a)(1) (stating that a "fiduciary . . . must make a return of income on form 1041" if such a return is required to be filed).[7] We conclude that each SFT return was filed purporting to be a return of a tax imposed by this title. *See Alexander v. Commissioner*, T.C. Memo. 2012-75, slip op. at 7. "Because a taxpayer may not obtain a refund without first filing a return, 26 C.F.R. § 301.6402-3(a)(1), the form filed by * * * [the taxpayer] should be construed to be a 'purported' return" for purposes of section 6702(a). *See Alexander*, T.C. Memo. 2012-75, slip op. at 7–8 (quoting *Olson v. United States*, 760 F.2d 1003, 1005 (9th Cir. 1985)).

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[6] We do not read section 6671(b) to limit the term "person" in the case of a section 6702(a) penalty to certain officers or employees of a corporation, or to certain members or employees of a partnership. *See* § 7701(c) ("The terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined."); *see also Crites v. Commissioner*, T.C. Memo. 2012-267, at *7–8.

[7] In certain cases, a trustee is not required to file Form 1041 to meet the reporting requirements for the trust. *See* Treas. Reg. § 1.671-4. The record at hand does not establish that this is one of those cases.

We now need to determine whether a taxpayer may be assessed a section 6702(a) penalty for filing a frivolous return that is not his personal return. We read section 6702(a) to answer that question in the affirmative. We read nothing in section 6702 that conditions the applicability of section 6702(a) on a person's filing of his or her personal income tax return. In fact section 6012(b)(4) points to our contrary reading through its mandate that the return of a trust "shall be made by the fiduciary thereof," or in other words, by its trustee. *See also* § 7701(a)(6) (defining the term "fiduciary" as a "trustee . . . or any person acting in any fiduciary capacity for any person").

The fact that Congress has directly placed on a trustee the duties and responsibilities associated with the filing of the trust's income tax return supports our conclusion that Congress considered it appropriate also to impose section 6702(a) liability on a trustee who files a frivolous income tax return on behalf of the trust. Nor is such a conclusion absurd or unreasonable, and it does not produce a futile result either.[8]

We hold that petitioner, as the trustee/fiduciary of SFT, was responsible for the filing of SFT's income tax returns for the subject years. Given that he was in fact the one who actually did file those returns, he is also the one who may properly be subject to a penalty under section 6702(a). We sustain respondent's determination that petitioner is liable for the section 6702(a) penalties that respondent determined in the supplemental notice.

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[8]We also are mindful that unequivocal evidence of a clear legislative intent could arguably lead to a different result. *See Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *see also Blue Lake Rancheria Econ. Dev. Corp. v. Commissioner*, 152 T.C. 90, 105 (2019); *Chapman Glen, Ltd. v. Commissioner*, 140 T.C. 294, 322 (2013); *Halpern v. Commissioner*, 96 T.C. 895, 899 (1991); *Hirasuna v. Commissioner*, 89 T.C. 1216, 1224 (1987); *Huntsberry v. Commissioner*, 83 T.C. 742, 747–48 (1984). But any such arguable unequivocal bar is a high one to clear. *See GTE Sylvania, Inc.*, 447 U.S. at 108; *see also Chapman Glen, Ltd.*, 140 T.C. at 322 (and cases cited thereat). The parties have not proffered any "unequivocal evidence" that could lead to a contrary result, and we are not aware of any such evidence either.

V. *Abuse of Discretion*

Appeals is required to (1) properly verify that the requirements of applicable law and administrative procedure have been met, (2) consider any relevant issues that the taxpayer raised, and (3) consider "whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the [taxpayer] that any collection action be no more intrusive than necessary." §§ 6320(c), 6330(c)(3). The record establishes that the settlement officer completed all of her responsibilities under section 6320 (including her verification that assessments of the penalties were not in violation of section 6751(b)(1)).[9]

Petitioner does not contend that Appeals erred with respect to the "relevant issues" or balancing prongs. We conclude that petitioner has waived any argument on those points. *See 3K Inv. Partners v. Commissioner*, 133 T.C. 112, 121 n.9 (2009). Petitioner's argument is that the assessments are invalid under the verification prong because, he asserts, he never received a Form 23–C, Assessment Certificate-Summary Record of Assessments, showing that any of the penalties have actually been assessed.

The record reflects that the settlement officer reviewed the IRS's transcripts and other computer records for petitioner, as well as his administrative file. She concluded that the IRS had properly assessed section 6702(a) liabilities and had met all other applicable requirements. As we understand petitioner's argument, respondent must produce a Form 23–C to prove that an assessment was made properly. We have rejected this argument before as frivolous. *See Carothers v. Commissioner*, T.C. Memo. 2013-165, at *8 n.7.

We also have explained that a settlement officer does not abuse his or her discretion when, to obtain the requisite verification, he or she relies on an IRS transcript, rather than producing or relying upon a Form 23–C. *Id.* Section 6330(c)(1) does not require the settlement officer to rely upon a particular document (e.g., the summary record itself rather than transcripts of account) in order to satisfy this verification requirement. *Nestor v. Commissioner*, 118 T.C. 162, 166–67

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[9] Section 6751(b)(1) generally provides that "[n]o penalty under this title shall be assessed unless the initial determination of such assessment" receives proper written approval.

(2002). The settlement officer's verification that petitioner's liabilities were correctly assessed was proper under our jurisprudence. Petitioner has not comprehensibly alleged any irregularity in the IRS's assessment procedures that would call into question the validity of the assessments or the information in the transcripts. *Cf. Roberts v. Commissioner*, 118 T.C. 365, 370–71 (2002) (rejecting the notion that the IRS's use of a computer-generated report rather than a Form 23–C to make an assessment constitutes an irregularity in the IRS's assessment procedure), *aff'd*, 329 F.3d 1224 (11th Cir. 2003). We find no abuse of discretion in the settlement officer's disposition of the nonliability requirements.

We sustain the supplemental notice. We have considered all of petitioner's arguments, and to the extent not discussed above, we find them to be irrelevant, incomprehensible, or without merit.

To reflect the foregoing,

An appropriate order and decision will be entered.

DAVID W. TICE, PETITIONER *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 24983-15. Filed April 10, 2023.

P, a U.S. citizen, filed one income tax return for 2002 and one income tax return for 2003, each with the Virgin Islands Bureau of Internal Revenue (VIBIR) and each claiming residency in the U.S. Virgin Islands (USVI). R determined that P was not a bona fide USVI resident under I.R.C. § 932(c) but rather a U.S. citizen other than a bona fide USVI resident under I.R.C. § 932(a) and therefore was required to file income tax returns "with both the United States and the Virgin Islands." *See* I.R.C. § 932(a)(2). R determined deficiencies for P and in 2015 issued a notice of deficiency. P moves for summary judgment that the three-year period of limitations under I.R.C. § 6501(a) began to run upon his filing of returns with the VIBIR for 2002 and 2003 in 2003 and 2004, respectively, making the 2015 notice of deficiency untimely. For purposes of deciding whether to grant summary judgment, we assume that P was not a bona fide USVI resident under I.R.C. § 932(c) but rather a taxpayer other than a bona fide USVI resident under I.R.C. § 932(a).

Held: Taxpayers who filed a return only with the VIBIR for taxable years ending before December 31, 2006, do not trigger the statute of limitations under I.R.C. § 6501(a) unless they are bona fide residents of the USVI to whom I.R.C. § 932(c) applies. *See Cooper v. Commissioner*, T.C. Memo. 2015-72. *Held, further*, as a taxpayer "other than a bona fide resident of the Virgin Islands" to whom I.R.C. § 932(a) applies (for purposes of this Motion), P's filing of returns only with the VIBIR did not trigger the statute of limitations under I.R.C. § 6501(a) and therefore the notice of deficiency could be issued "at any time" under I.R.C. § 6501(c)(3). *Held, further*, P's Motion for Summary Judgment will be denied.

Joseph M. Erwin, for petitioner.

Matthew R. Delgado and *Jeffrey D. Heiderscheit*, for respondent.

OPINION

PUGH, *Judge*: In this case we again consider the timeliness of a notice of deficiency issued to a U.S. citizen who claimed to be a resident of the U.S. Virgin Islands (USVI) for 2002 and 2003 (years in issue). Taxpayers like petitioner—those who claimed bona fide residency in the USVI and filed returns only with the Virgin Islands Bureau of Internal Revenue (VIBIR) for the years in issue—seek the repose offered by the statute of limitations in section 6501(a).[1] Petitioner therefore moves for summary judgment that a notice of deficiency issued in 2015 for the years in issue was untimely because the three-year period of limitations in section 6501(a) began to run upon his filing of returns with the VIBIR for the years in issue.[2] The Internal Revenue Service (IRS or respondent) maintains that, for these years, petitioner's filing of returns only with the VIBIR does not meet the section 6501(a) requirements for triggering the statute of limitations unless he was a bona fide resident of the USVI within the meaning of section 932.

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[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C. (Code), in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] Petitioner alternatively argues that Treasury Regulation § 1.932-1(c)(2)(ii) "should apply to the years here in issue [(2002 and 2003)]." We address this alternative argument below.

Background

The facts required to decide petitioner's Motion are straightforward; they are derived from the pleadings, the First Stipulation of Facts, and the parties' Motion papers. They are stated solely for the purposes of deciding petitioner's Motion for Summary Judgment and not as findings of fact in this case. *See Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994).

Petitioner, a U.S. citizen, filed one income tax return for 2002 in October 2003 and one income tax return for 2003 in December 2004, each with the VIBIR and each claiming residency in the USVI. The IRS determined that petitioner was not "a bona fide resident of the Virgin Islands" under section 932(c) but rather a U.S. citizen "other than a bona fide resident of the Virgin Islands" under section 932(a) and therefore was required to file income tax returns "with both the United States and the Virgin Islands," as mandated by that subsection. The IRS determined deficiencies, additions to tax, and a penalty for the years in issue and in 2015 issued a notice of deficiency. Petitioner resided in Texas when he timely filed his Petition.

Discussion

I. *Summary judgment*

The purpose of summary judgment is to expedite litigation and avoid costly, time-consuming, and unnecessary trials. *Fla. Peach Corp. v. Commissioner*, 90 T.C. 678, 681 (1988). The Court may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. Rule 121(a)(2). In deciding whether to grant summary judgment, we construe factual materials and inferences drawn from them in the light most favorable to respondent as the nonmoving party. *Sundstrand*, 98 T.C. at 520.

II. *Statutory framework*

A. *Section 6501(a): statute of limitations for assessment*

Section 6501(a) generally requires that income tax be assessed "within 3 years after the return was filed." It defines

"return" as "the return required to be filed by the taxpayer." Thus, in determining whether the three-year statute of limitations has been triggered, we consider both (1) whether the document submitted was the "return" required to be filed and (2) whether it was properly "filed by the taxpayer." *See Appleton v. Commissioner*, 140 T.C. 273, 284 (2013).

"[L]imitations statutes barring the collection of taxes otherwise due and unpaid are strictly construed in favor of the Government." *Badaracco v. Commissioner*, 464 U.S. 386, 392 (1984) (quoting *Lucia v. United States*, 474 F.2d 565, 570 (5th Cir. 1973)). "In effect, a period of limitations runs against the collection of taxes only because the Government, through Congressional action, has consented to such a defense. Absent Government consent, no limitations defense exists." *Lucia*, 474 F.2d at 570.

A taxpayer must show "meticulous compliance" with all filing requirements in the Code or regulations to begin the period of limitations. *Lucas v. Pilliod Lumber Co.*, 281 U.S. 245, 249 (1930); *see also Allnutt v. Commissioner*, 523 F.3d 406, 412 (4th Cir. 2008), *aff'g* T.C. Memo. 2002-311; *Winnett v. Commissioner*, 96 T.C. 802, 807–08 (1991). "[I]n order for returns to be considered 'filed' for purposes of setting the period of limitations in motion, the returns must be delivered, in the appropriate form, to the *specific* individual or individuals identified in the Code or Regulations." *Allnutt v. Commissioner*, 523 F.3d at 413. "In other words, a return does not trigger the running of the statute of limitations unless it is filed in the place required by the statute or regulations." *Commissioner v. Estate of Sanders*, 834 F.3d 1269, 1274 (11th Cir. 2016), *vacating and remanding* 144 T.C. 63 (2015).

If the filing requirement is not satisfied—i.e., "[i]n the case of failure *to file* a return"—the statute of limitations is not triggered and "the tax may be assessed . . . at any time." § 6501(c)(3) (emphasis added).

B. *Section 932(a)(2): filing requirement for U.S. citizens with USVI-source income who are not bona fide USVI residents*

The USVI is an insular area of the United States; it is classified as an unincorporated territory by 48 U.S.C. § 1541(a) (2006) and is not part of one of the 50 States or the District of Columbia. It generally is not a part of the United States for

tax purposes. *See* § 7701(a)(9). Congress established the "mirror tax system" as the tax law of the USVI in 1921. Act of July 12, 1921, ch. 44, § 1, 42 Stat. 122, 123 (codified as amended at 48 U.S.C. § 1397 (2006)); *see also United States v. Calhoun*, 566 F.2d 969, 975 (5th Cir. 1978) ("This statute effectively established separate and distinct taxing jurisdictions in the United States and the Virgin Islands . . . .").

Originally, U.S. citizens permanently residing in the USVI who had both U.S.-source and USVI-source income "were required to file returns and pay taxes to both jurisdictions." *Appleton*, 140 T.C. at 278. In 1954 Congress established an "inhabitant rule" that treated these individuals as having satisfied their U.S. tax obligation by paying tax directly to the USVI. *See id.* at 279; Revised Organic Act of the Virgin Islands, ch. 558, § 28, 68 Stat. 497, 508 (1954). In 1986 Congress repealed the "inhabitant rule" and enacted section 932 to coordinate the U.S. and USVI tax systems.[3] *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 1274(a), 100 Stat. 2085, 2596.

Under section 932, the filing requirement for a taxpayer with USVI-source income depends on the taxpayer's residency. Subsection (a), titled "Treatment of United States Residents," applies to an individual for the taxable year if the individual "is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands at the close of the taxable year)," § 932(a)(1)(A)(i), and "has income derived from sources within the Virgin Islands . . . for the taxable year," § 932(a)(1)(A)(ii). Subsection (c), titled "Treatment of Virgin Islands Residents," applies to an individual for the taxable year if the individual "is a bona fide resident of the Virgin Islands at the close of the taxable year." § 932(c)(1)(A).[4]

Section 932 then provides different filing requirements depending on which mutually exclusive subsection applies. "Each individual to whom" subsection (a) applies—i.e., a U.S.

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[3] Section 932 is not part of the mirror code and thus is not part of the USVI territorial tax system. Its purpose is to help ensure a unified tax split between the USVI and the U.S. Treasury for those U.S. citizens who have USVI-source income. *See Appleton*, 140 T.C. at 280 n.12.

[4] Effective October 22, 2004, section 932 was amended by striking "at the close of the taxable year" and inserting "during the entire taxable year" each place it appeared. American Jobs Creation Act of 2004, § 908(c)(2), Pub. L. No. 108-357, 118 Stat. 1418, 1656.

citizen or resident with USVI-source income who is not a USVI resident—"shall file his income tax return for the taxable year with *both* the United States *and* the Virgin Islands." § 932(a)(2) (emphasis added). By contrast, "[e]ach individual to whom" subsection (c) applies—i.e., a bona fide resident of the Virgin Islands—"shall file an income tax return for the taxable year with the Virgin Islands." § 932(c)(2).

In section 7654(e), Congress directed Treasury to "prescribe such regulations as may be necessary to carry out the provisions of . . . [section] 932, including regulations . . . prescribing the information which the individuals to whom [section 932 applies] shall furnish to [it]." Treasury did not, however, promulgate regulations applicable for tax years 2002 and 2003. In 2008 it promulgated Treasury Regulation § 1.932-1(c)(2)(ii), which provides that for purposes of the section 6501(a) statute of limitations, an income tax return filed with the USVI by an individual who takes the position that he or she is a bona fide USVI resident will be deemed a U.S. income tax return, provided that the United States and the USVI have entered into an agreement for the routine exchange of income tax information satisfying the requirements of the IRS.[5] The regulation applied prospectively to "taxable years ending after April 9, 2008." *Id.* para. (j). Taxpayers also could elect to apply it "to open taxable years ending on or after December 31, 2006" (i.e., back to the time when Notice 2007-31 became applicable). *Id.* Petitioner cannot elect to apply the rule in Treasury Regulation § 1.932-1(c)(2)(ii) because the tax years in issue ended before December 31, 2006.

For purposes of deciding whether to grant summary judgment, we assume that petitioner was not a bona fide USVI resident under section 932(c), but rather a U.S. citizen other than a bona fide USVI resident under section 932(a). Therefore, petitioner was required to file returns "with both the United States and the Virgin Islands" for 2002 and 2003. *See* § 932(a)(2). We also assume that the documents petitioner

[5] It also provides that the working arrangement announced in I.R.S. Notice 2007-31, 2007-1 C.B. 971, is a satisfactory agreement. Notice 2007-31 had adopted the same rule as the regulation—that a tax return filed with the VIBIR by a U.S. citizen claiming to be a bona fide USVI resident would commence the section 6501(a) period of limitations for federal tax purposes—for tax years ending on or after December 31, 2006.

submitted to the VIBIR constituted "returns" so that we may focus on the filing requirement.

III. *Analysis*

A. *Petitioner's filing requirement under section 932(a)(2)*

For the years in issue, petitioner was required by statute to file his income tax returns "with *both* the United States *and* the Virgin Islands," § 932(a)(2) (emphasis added), because he was a U.S. citizen with USVI-source income who was not a bona fide USVI resident. Because he was not a bona fide USVI resident, he was not subject to the "filing requirement" under paragraph (2) of subsection (c), which requires bona fide USVI residents to file solely "with the Virgin Islands."[6]

Filing with the VIBIR is not filing with the IRS. If a taxpayer were deemed to have filed "with both the United States and the Virgin Islands" by virtue of filing "with the Virgin Islands" then section 932(a)(2) would be meaningless. This construction of section 932(a)(2) ignores the phrase "with . . . the United States" and makes the filing requirements of subsections (a)(2) and (c)(2) redundant. It therefore would "run[] aground on the so-called surplusage canon—the presumption that each word Congress uses is there for a reason." *Advoc. Health Care Network v. Stapleton*, 581 U.S. 468, 477 (2017). "Our practice . . . is to 'give effect, if possible, to every clause and word of a statute.'" *Id.* at 478 (quoting *Williams v. Taylor*, 529 U.S. 362, 404 (2000)).

Therefore, taxpayers who file a return only with the VIBIR for the years in issue do not trigger the statute of limitations under section 6501(a) unless they are bona fide residents of the USVI to whom section 932(c) applies. As a taxpayer other than a bona fide USVI resident to whom section 932(a) applies, petitioner did not trigger the statute of limitations under section 6501(a) by filing returns only with the VIBIR; therefore, the notice of deficiency could be issued "at any time." § 6501(c)(3).

Petitioner's primary argument is essentially that, notwithstanding the statutory filing requirements described above

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[6] Petitioner acknowledges the structure and operation of section 932, stating that "[b]y filing his returns with VIBIR and not [r]espondent, it is an obvious inference that [petitioner] has taken the position that he was a bona fide resident of the Virgin Islands for his 2002 and 2003 tax years."

(which turn on the taxpayer's residency), whether he actually was a bona fide resident of the USVI for the years in issue is immaterial because he claimed to be one in his VIBIR returns, and merely claiming to be one is sufficient to qualify him for the section 932(c) single filing regime. We rejected this argument in a 2015 memorandum opinion, *Cooper v. Commissioner*, T.C. Memo. 2015-72, at *22–24, concluding that "the period of limitations will have expired only if [the taxpayers] can prove they were bona fide residents of the Virgin Islands at the close of 2002 and 2003" because "[s]ection 932(c) does not provide that a taxpayer's subjective belief that he/she is a bona fide resident of the Virgin Islands is sufficient to place him/her into that section's single filing regime. More is required."

Taxpayers raised the same argument before the U.S. Court of Appeals for the Eleventh Circuit in *Commissioner v. Estate of Sanders*, 834 F.3d at 1274 ("Appellees argue that if a taxpayer files a return with the VIBIR, but not the IRS, in the good faith belief that he is a USVI resident, the limitations period should start even if the taxpayer is not, in fact, a bona fide USVI resident."). The Eleventh Circuit also rejected it, and even cited *Cooper*, holding that "a taxpayer who files a return only with the VIBIR does not trigger the statute of limitations unless he is actually a bona fide resident of the USVI," *id.* at 1278–79, because "the language and structure of the statute [section 932] are clearly inconsistent with [the taxpayers'] invitation to us to imply a good faith exception to the requirement that the return be filed in the proper place," *id.* at 1276.

And taxpayers raised it before this Court in *Hulett v. Commissioner*, 150 T.C. 60, 71 (2018), *rev'd and remanded sub nom. Coffey v. Commissioner*, 987 F.3d 808 (8th Cir. 2021), arguing "that a subjective good faith belief that one is a *bona fide* resident is what matters for the statute of limitations." We issued lead, concurring, and dissenting opinions in *Hulett*. No opinion secured a majority vote. No opinion directly addressed whether the dual filing requirement under section 932(a)(2) was satisfied by a taxpayer's sole filing with VIBIR.

The lead opinion addressed whether VIBIR's subsequent transmissions of the taxpayers' USVI-filed returns to the IRS as part of a cover-over request, *see* § 7654(a), constituted

"returns" for purposes of section 6501(a) and (c)(3), and we concluded that they did under the four-part test set forth in *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986). As for the requirement that returns be properly "filed by the taxpayer," § 6501(a); *see Appleton*, 140 T.C. at 284, the lead opinion relied on a deemed concession by the IRS that a "taxpayer's subjective intent has no role to play" in determining whether a return has been properly "filed," *Hulett*, 150 T.C. at 80.[7] The lead opinion noted the taxpayers' argument that filing with the VIBIR triggers the statute of limitations regardless of residency but did not discuss it further because of our holding in *Cooper*. *Id.* at 71 n.9 (citing *Cooper*, T.C. Memo. 2015-72, at *22).

The dissent concluded that the statute of limitations was not triggered by the VIBIR's transmission to the IRS because "[f]iling a valid Federal income tax return with the IRS for purposes of section 6501(a) requires an intentional act by the taxpayer, and there was none here." *Id.* at 107 (Marvel, J., dissenting).

The concurrence in effect acknowledged that for purposes of the opinion the taxpayers were not bona fide USVI residents subject to section 932(c), and therefore section 932(a), including its filing requirement, applied, as urged by the Commissioner. *Id.* at 103 & n.3 (Thornton, J., concurring in the result). But, noting that a return can be "honest and genuine—though possibly erroneous," the concurrence thought it "unnecessary to decide whether the [taxpayers] were bona fide residents of the [USVI] . . . because the returns [the taxpayers] filed with the VIBIR under section 932(c)(2) started the section 6501(a) period of limitations for Federal income tax purposes." *Id.* at 98 (Thornton, J., concurring in the result).[8] In sum, the *Hulett* opinions focused either on the return requirement (lead and concurring opinions) or on the necessity of an intentional act by the taxpayer to meet the filing requirement and whether

[7] Petitioner reserves the argument that VIBIR's subsequent transmission of his USVI-filed returns to the IRS triggered the statute of limitations, and we therefore do not address it.

[8] Petitioner contends that we should adopt the concurring opinion in *Hulett*, 150 T.C. at 98–104 (Thornton, J., concurring in the result), which received a plurality of votes, but acknowledges that it did not receive a majority vote and therefore is not binding precedent.

subsequent actions by VIBIR could satisfy it (dissenting opinion).

On appeal, the U.S. Court of Appeals for the Eighth Circuit held that a USVI nonresident's sole filing with the VIBIR does not begin the running of the three-year period of limitations. *Coffey v. Commissioner*, 987 F.3d at 813–15.[9] The taxpayers, as USVI nonresidents (for purposes of the appeal), were subject to section 932(a)(2) and therefore required to file "with both the United States and the Virgin Islands." *Id.* at 812. They filed only with the VIBIR. Because they failed to file in a place required by the statute—with the IRS—the Eighth Circuit held that they "d[id] not create a 'filed' return under section 6501(a)." *Id.* at 814 (citing *Commissioner v. Estate of Sanders*, 834 F.3d at 1279).

Absent stipulation to the contrary, this case is appealable to the U.S. Court of Appeals for the Fifth Circuit. *See* § 7482(b)(1)(A). In the Fifth Circuit, unlike in the Eighth and Eleventh Circuits, there is no precedent squarely on point that we must follow. *See Golsen v. Commissioner*, 54 T.C. 742, 756–57 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

Our holding above gives effect to the statutory text and structure and is consistent with *Cooper*. We did not directly address whether the dual filing requirement under section 932(a)(2) was satisfied by a taxpayer's sole filing with VIBIR in *Estate of Sanders* or *Hulett*. On appeal of those cases, however, the Eleventh and Eighth Circuits did.[10] Although we are not bound by either *Estate of Sanders* or *Coffey*, as a court of national jurisdiction we take into account the reasoning of a reversing appellate court. *See Lawrence v. Commissioner*, 27

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[9] The Eighth Circuit also held that the statute of limitations under section 6501(a) was not triggered by the IRS's actual knowledge of the taxpayers' information because "[t]he IRS's actual knowledge is not a filing," and nor was it triggered when VIBIR sent documents to the IRS because the taxpayers "never authorized the VIBIR to file their documents with the IRS." *Coffey v. Commissioner*, 987 F.3d at 813 (concluding that for these reasons the taxpayers "did not meticulously comply with requirements to file with the IRS" and therefore "the statute of limitations never began"). This holding relates to petitioner's reserved argument. *See supra* note 7.

[10] In his Response to petitioner's Motion, respondent asserts that we should "disregard [p]etitioner's argument as irrelevant" because, in respondent's view, we are bound by *Coffey* outside the Eighth Circuit and must follow its holding "[n]otwithstanding whether the Fifth Circuit would reach the same conclusion." This assertion is incorrect under *Golsen*.

T.C. 713, 716–17 (1957), *rev'd on other grounds*, 258 F.2d 562 (9th Cir. 1958).[11] We find their reasoning, which focuses on the statutory text and structure, persuasive. And to follow their reasoning, we need not overturn any precedent because we have not previously directly addressed this issue. *Cf. Analog Devices, Inc. & Subs. v. Commissioner*, 147 T.C. 429, 443–45 (2016) (weighing the importance of reaching the correct result against the importance of following our precedent—i.e., stare decisis—when we had precedent directly on point). The filing requirement under subsection (a)(2) requires that the return referred to in that section be filed "with both the United States and the Virgin Islands"; therefore, the repose offered by section 6501(a) cannot apply to the returns petitioner filed with the USVI.

Petitioner states that adopting his position would "avoid[] the awkward and convoluted analysis of what is a tax return, what is 'filing,' and whether the taxpayer is a 'bona fide resident' of the territory 'at the close of the taxable year' for which he or she filed a return." But avoiding that analysis ignores the law in effect during the years in issue, which we will not do.

B. *Administrative Procedure Act and due process*

Alternatively petitioner argues that Treasury violated the Administrative Procedure Act and the Fifth Amendment to the U.S. Constitution by giving taxpayers the option to apply the otherwise prospectively effective rule in Treasury Regulation § 1.932-1(c)(2) for tax years ending on or after December 31, 2006, but not for the years in issue.

First, petitioner contends that the regulation is arbitrary and capricious and therefore we should set it aside. *See* 5 U.S.C. § 706(2)(A). He argues that by not giving taxpayers the option to apply the rule in Treasury Regulation § 1.932-1(c)(2) for tax years 2002 and 2003, Treasury "select[ed] [individual taxpayers who claimed to be bona fide residents of the USVI and filed their income tax returns with the VIBIR and not the IRS] for different treatment than other similarly situated taxpayers." But petitioner does not explain why we should consider taxpayers with different open tax years—i.e., those filing for

[11] Here we are not so much "reconsider[ing]" an issue, *Lawrence*, 27 T.C. at 716–17, as deciding it for the first time.

open tax years before December 31, 2006, and those filing for open tax years ending on or after December 31, 2006—as similarly situated. In addition, in providing that taxpayers filing on or after December 31, 2006, could choose to apply the rule in Treasury Regulation § 1.932-1(c)(2)(ii), Treasury articulated a satisfactory explanation for its action, *see Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), writing in the preamble to the final rule:

> This general rule applies as long as the IRS and U.S. Virgin Islands have in place an agreement for the automatic exchange of information satisfying the requirements of the Commissioner of the IRS. Because the working arrangement announced in Notice 2007-31 satisfies this condition, this general rule applies to years ending on or after December 31, 2006.

T.D. 9391, Preamble, 2008-1 C.B. 945, 951, 73 Fed. Reg. 19,350, 19,355–56 (Apr. 9, 2008).

And were we to find Treasury's election parameters arbitrary and capricious, the consequence would be to "hold [that part of the regulation] unlawful and set [it] aside," 5 U.S.C. § 706(2), not make it applicable for the years in issue. Although petitioner contends that the consequence of the regulation's invalidity is that "the [r]egulation applies to [p]etitioner's taxable years 2002 and 2003, thus making the [n]otice of [d]eficiency untimely," petitioner does not explain how invalidating a regulation not applicable for the years in issue could make it applicable for the years in issue. Nor could we identify any legal basis for in effect rewriting a regulation in this way.

Second, petitioner contends that Treasury violated the due process clause of the Fifth Amendment to the U.S. Constitution; his argument seems to be that Treasury Regulation § 1.932-1 failed to give fair warning of the conduct required. But the conduct required is found in the statute—i.e., section 932(a)(2)—not the regulations. *See Hulett*, 150 T.C. at 95 ("[T]he absence of regulations doesn't repeal section 932.").

Petitioner understandably wants the rule in Treasury Regulation § 1.932-1(c)(2)(ii) to apply for the years in issue. But it did not. *See, e.g.*, *Hulett*, 150 T.C. at 76 ("Had this regulation been in effect for the years at issue here, the [taxpayers] would easily have won this case. . . . But, as it is, the regulation didn't exist in 2003 and 2004 . . . ."); *Appleton*, 140 T.C. at 282 ("The Secretary did not, however, promulgate regulations

for [2002–04].”); *Cooper*, T.C. Memo. 2015-72, at *16 (same, for 2002 and 2003).

C. *Conclusion*

In sum, because filing with the VIBIR is not filing with the IRS, filing only with the VIBIR does not satisfy the dual filing requirement of section 932(a)(2). In the absence of a filing in the place required by statute (i.e., with the IRS), the period of limitations did not begin to run, and the notice of deficiency could be issued “at any time” under section 6501(c)(3). We therefore will deny petitioner’s Motion for Summary Judgment.

An appropriate order will be issued.

Reviewed by the Court.

KERRIGAN, FOLEY, GALE, PARIS, MORRISON, BUCH, NEGA, PUGH, ASHFORD, URDA, COPELAND, JONES, TORO, GREAVES, MARSHALL, and WEILER, *JJ.*, agree with this opinion of the Court.

GLADYS L. GERHARDT, ET AL.,[1] PETITIONERS *v.* COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket Nos. 11127-20, 11128-20, 11129-20, 11146-20. Filed April 20, 2023.

Ps contributed high-value, low-basis real estate and other property to charitable remainder annuity trusts (CRATs). The CRATs sold the contributed property and purchased five-year single premium immediate annuities (SPIAs) with most of the proceeds, naming Ps as recipients of the annuity payments. On their 2016 and 2017 tax returns, Ps took the position that the payments they received from the CRAT-funded SPIAs were not subject to tax, with the exception of small amounts Ps reported as interest. R examined Ps’ tax returns and determined deficiencies, taking the position that, under I.R.C. §§ 664 and 1245, the annuity payments Ps received were distributions

[1] Cases of the following petitioners are consolidated herewith: Alan A. Gerhardt and Audrey M. Gerhardt, Docket No. 11128-20; Jack R. Gerhardt and Shelley R. Gerhardt, Docket No. 11129-20; and Tim L. Gerhardt and Pamela J. Holck Gerhardt, Docket No. 11146-20.

from the CRATs and taxable to them as ordinary income. Two Ps, J and S, separately relinquished rental property and cash in exchange for other rental property in 2017. On their tax return for 2017, J and S took the position that gain from the disposition of the relinquished property should be deferred because the transaction qualified as a like-kind exchange under I.R.C. § 1031. R did not dispute that the transaction met the requirements of I.R.C. § 1031, but determined that I.R.C. § 1245 precluded deferral of the gain. J and S also sold certain property (MS) in 2017. They reported the net gain from the sale as ordinary income. R recomputed the amount of the gain and characterized it as long-term capital gain. For T and P, two other Ps, R determined an accuracy-related penalty under I.R.C. § 6662(a) for 2016. T and P claim the penalty should not apply because they acted with reasonable cause and in good faith reliance on their advisers. *Held*: The annuity payments Ps received from the CRAT-funded SPIAs in 2016 and 2017 were distributions from the CRATs and taxable to them as ordinary income under I.R.C. § 664. *Held, further*, Ps have not met their burden of showing that R erred in characterizing the payments as ordinary income on the basis of I.R.C. §§ 664(b) and 1245. *Held, further*, Ps' contrary arguments find no support in the Code, regulations, or caselaw. *Held, further*, J and S have not met their burden of showing that R erred in determining that I.R.C. § 1245 precluded deferral of the gain realized from the disposition of the relinquished property. *Held, further*, J and S offer no argument as to R's determinations concerning the sale of MS and have forfeited any objections on this point, so R's determinations with respect to the sale of MS stand. *Held, further*, T and P have not met their burden of showing that they acted with reasonable cause and in good faith reliance on their advisers.

Anita L. Steburg, for petitioners.
Stephen A. Haller, for respondent.

OPINION

TORO, *Judge*: In these consolidated cases, petitioners (collectively, Gerhardts) contributed high-value, low-basis properties to charitable remainder annuity trusts (CRATs). The CRATs promptly sold the properties, purchased immediate annuities with most of the proceeds, and designated the Gerhardts as the recipients of the payments under the annuity contracts. In 2016 and 2017, the Gerhardts received payments from the CRAT-funded annuity contracts. The principal issue before us (which affects all petitioners) is whether those annuity payments are taxable to the Gerhardts. We conclude they are.

The Gerhardts maintain, essentially, that selling the high-value, low-basis properties through the CRATs and having the CRATs buy immediate annuities for their benefit allowed them to have most of the sale proceeds returned to them tax free over time. That view finds no support in the law governing CRATs or elsewhere. Rejecting the Gerhardts' "too good to be true" arguments and consistent with our holding in *Furrer v. Commissioner*, T.C. Memo. 2022-100, we conclude that the annuity payments they received in 2016 and 2017 are distributions from the CRATs and taxable to them as ordinary income under section 664.[2]

Also before us are three additional issues each affecting only some petitioners: (1) whether Jack and Shelley Gerhardt should have recognized ordinary income under section 1245 when they disposed of depreciated property as part of a section 1031 like-kind exchange, (2) whether Jack and Shelley Gerhardt's gain from the sale of depreciated property is long-term capital gain, and (3) whether Tim and Pamela Gerhardt are liable for an accuracy-related penalty under section 6662(a). We find for the Commissioner on each issue.[3]

[2] Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C. (Code), in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure. We round all monetary amounts to the nearest dollar.

[3] The parties have filed Stipulations of Settled Issues in each case making concessions with respect to other issues, which we do not discuss further in this Opinion.

I. *Docket Nos. 11127-20, 11128-20, 11129-20, 11146-20 (CRAT Issue)*[4]

Background

A. *The Gerhardts' CRATs*

The Gerhardts apparently learned about using CRATs as a wealth-preservation strategy from John Eickhoff of Hoffman Associates, LLC, in 2015. Mr. Eickhoff referred the Gerhardts to Aric Schreiner of Columbia CPA Group, LLC, for tax advice. In 2015, Mr. Schreiner presented the Gerhardts with a "CRAT strategy." The record does not disclose the substance of Mr. Schreiner's presentation, but soon after that presentation, the Gerhardts formed CRATs with Mr. Schreiner's involvement.[5]

Although they are broadly similar, we describe the facts for each petitioner below. For clarity, we refer to individual petitioners by their first names.

B. *Gladys Gerhardt*[6]

The Albert and Gladys CRAT was created on November 2, 2015. Albert and Gladys were the CRAT's grantors and noncharitable beneficiaries. The CRAT instrument listed five organizations as charitable remaindermen. Gray, Lawrence & Jenkins, LLC, was the CRAT's trustee.

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[4] For ease of analysis and readability, our Opinion proceeds in four parts. Part I addresses the issue common to each of the consolidated cases. Part II addresses two issues related to Docket No. 11129-20. Part III addresses an issue related to Docket No. 11146-20. Part IV sets out our conclusion. Within each Part (other than Part IV), we first provide the relevant factual background and then discuss the applicable legal rules.

The parties submitted these cases fully stipulated under Rule 122. The facts set out in the background sections below are based on the pleadings and the parties' Stipulations of Facts as amended once, including the Exhibits attached thereto. The Stipulations of Facts (as amended) with accompanying Exhibits are incorporated herein by this reference.

Gladys, Alan, Audrey, Jack, and Shelley Gerhardt were residents of Minnesota when they timely filed their Petitions in these cases. Tim and Pamela Gerhardt were residents of Illinois.

[5] We note only for context that both Mr. Eickhoff and Mr. Schreiner also were involved in the formation of the CRATs in *Furrer*. *See* Stipulation of Facts ¶¶ 9(a), 10(a), 13(a), 14(a), 15(a), 16(a), 17(a), 18(a), 19(a), 22–25, *Furrer v. Commissioner*, T.C. Memo. 2022-100 (No. 7633-19).

[6] Gladys engaged in the transactions described here and filed joint federal income tax returns with her husband, Albert, who is now deceased.

Relevant here, the CRAT instrument required the trustee to pay to the beneficiaries for a five-year period an "Annuity Amount" "equal to the greater of: (1) ten percent of the initial net fair market value of all property transferred to [the CRAT] . . . or (2) the payments received . . . from one . . . or more Single Premium Immediate Annuities [(SPIAs)] purchased by the Trustee." Stipulation of Facts Ex. 13–J, at 23.

The CRAT instrument listed Albert and Gladys Gerhardt as the beneficiaries of the Annuity Amount. But the CRAT instrument also provided that "[n]either the Recipients nor the Recipients' Children shall have any right title, interest, or incident of ownership in or to any [SPIA] transferred to or purchased by the Trustee." *Id.* at 22. The CRAT instrument defined the term "Recipients" as those "entitled to receive the current annuity payment" and identified Albert and Gladys as the Recipients. *Id.* at 15.

Albert and Gladys contributed real estate to the Albert and Gladys CRAT on November 10, 2015. The Albert and Gladys CRAT filed Form 5227, Split-Interest Trust Information Return, for the 2015 tax year reporting the total fair market value of the contributed properties as $1,808,000. With Mr. Schreiner's assistance, Gladys filed Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, with her and Albert's 2015 income tax return, reporting total adjusted basis of $97,517 in the contributed properties. In December 2015 and March 2016, the trustee of the Albert and Gladys CRAT sold the properties for at least $1,658,000.[7]

Using the proceeds from the sales, the Albert and Gladys CRAT purchased a SPIA from Symetra Life Insurance Co. (Symetra) for $1,537,822 on March 7, 2016. The SPIA contract identified the Albert and Gladys CRAT as the "Owner" of the SPIA, but listed Albert as the annuitant and Gladys as the joint annuitant.[8] Under the SPIA contract, Symetra was

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[7] The parties' stipulations regarding the total sales price are inconsistent. One stipulation reflects total proceeds of $1,808,000, First Am. First Stipulation of Facts ¶ 32(e); another lists total proceeds of $1,658,000, *id.* ¶ 41. The discrepancy of $150,000 appears to be attributable to the fact that the Albert and Gladys CRAT owned only 50% of one of the properties it sold and thus received only 50% of the proceeds for that property. The discrepancy does not affect the result for the years before us.

[8] The SPIA contract defined the term "Annuitant" in relevant part as "the natural person intended to receive payments under this Contract." The

required to pay an annuity of $311,708 to Albert and Gladys beginning on April 6, 2016, and on each April 6 thereafter until five total payments were made.

Albert and Gladys received an annuity payment of $311,708 ($155,854 each) in each of 2016 and 2017. For 2016 and 2017, the Albert and Gladys CRAT reported these annuity payments as CRAT distributions to Albert and Gladys on Form 5227:

Recipient	*Distributions*	*2016*	*2017*
Albert Gerhardt	Ordinary Income	$2,026	$2,026
	Corpus	153,828	153,828
Gladys Gerhardt	Ordinary Income	2,026	2,026
	Corpus	153,828	153,828

The Albert and Gladys CRAT issued Schedules K–1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., to both Albert and Gladys for 2016 and 2017. For each year, the Schedules K–1 reported interest income of $2,026 paid to each of Albert and Gladys. The Schedules K–1 reported no other income.

Albert and Gladys jointly filed their federal income tax returns for the 2016 and 2017 tax years. Damon T. Eisma of Eisma & Eisma Attorneys at Law prepared the returns. On these returns, Albert and Gladys reported the interest income reported to them by the Albert and Gladys CRAT. They did not report the remaining payments from the CRAT-funded annuity on either the 2016 or the 2017 tax return.

On Forms 5227, the Albert and Gladys CRAT reported its assets at the end of 2015 to 2017 as follows:

SPIA contract also provided that "[t]here may be a joint Annuitant." Stipulation of Facts Ex. 38–J, at 3.

	2015	*2016*	*2017*
Trust Principal or Corpus	$1,774,271	$1,410,953	$1,103,298
Undistributed Income	–	–	–
Undistributed Capital Gains	–	–	–
Undistributed Nontaxable Income	–	–	–

The Commissioner examined Albert and Gladys's 2016 and 2017 tax returns as well as the Albert and Gladys CRAT trust accounting and reporting for those years. During the examination, the Commissioner determined that the Albert and Gladys CRAT trust accounting was inaccurate and adjusted it in relevant part as follows:

CRAT Trust Accounting According to IRS Examination

	2015	*2016*	*2017*
Prior Year Accumulated Ordinary Income	-0-	-0-	$1,159,807
Ordinary Income: Interest Income	-0-	$4,052	4,052
Capital Gain or Loss: Form 4797	-0-[9]	1,467,462[10]	-0-
Current Net Ordinary Income Before Distributions	-0-	1,471,514[11]	4,052
Total Distributable Income (Cumulative)	-0-	1,471,514	1,163,859
Distributions to Noncharitable Beneficiaries	-0-	311,707	311,707
Undistributed Ordinary Income	-0-	1,159,807	852,152

The Commissioner also determined that the income the Albert and Gladys CRAT realized on sales of the contributed properties was ordinary income under section 1245. Thus, according to the Commissioner, all the payments Albert and Gladys received in 2016 and 2017 from the CRAT-funded annuity were ordinary income to them under section 664(b).

The Commissioner issued Albert and Gladys a notice of deficiency for 2016 and 2017. Among other items not relevant here, the Commissioner increased Albert and Gladys's gross income by $307,656 for each of 2016 and 2017 to reflect the adjustments to their ordinary income from the CRAT-funded annuity payments.

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[9] The record reflects that the Albert and Gladys CRAT sold some of the contributed property in 2015 rather than 2016. So, it would appear that some of the gain and income included in the chart for 2016 should have been included for 2015 instead. But, because the CRAT made no distributions in 2015, this possible error does not affect its total distributable income (cumulative) for 2016 and 2017.

[10] The parties stipulate that the Commissioner determined that the Albert and Gladys CRAT sold the real estate contributed by Albert and Gladys for $1,658,000 and that it had a cumulative adjusted basis in the properties of $190,538. *See supra* note 7. In view of these amounts, the Albert and Gladys CRAT realized gain of $1,467,462 from the sale of the real estate. Relying on section 1245, the Commissioner further determined that the gain should be treated as ordinary income.

[11] The "Current Net Ordinary Income Before Distributions" amount consists of interest income of $4,052 and capital gain treated as ordinary income under section 1245 of $1,467,462.

C. *Alan and Audrey Gerhardt*

The Alan and Audrey CRAT was created on November 10, 2015. Alan and Audrey were the CRAT's grantors and non-charitable beneficiaries. The CRAT instrument listed one organization as a charitable remainderman. Gray, Lawrence & Jenkins, LLC, was the CRAT's trustee.

The terms of the Alan and Audrey CRAT instrument are similar to those discussed in the previous section, *see* Part I.B above, so we will not repeat them here.[12] The CRAT instrument identified Alan and Audrey as the beneficiaries and recipients of the Annuity Amount required to be paid out by the trustee.

Alan and Audrey contributed real estate to the Alan and Audrey CRAT on November 10, 2015. The Alan and Audrey CRAT filed Form 5227 for the 2015 tax year reporting the total fair market value of the contributed properties as $1,222,000. With Mr. Schreiner's assistance, Alan and Audrey filed Forms 709 with their 2015 income tax return, each reporting total adjusted basis of $42,079 in the contributed properties. In March 2016, the CRAT's trustee sold the properties for $1,222,000.

Using the proceeds from the sale of the properties, the Alan and Audrey CRAT purchased a SPIA from Symetra for $1,022,618 on March 22, 2016. The SPIA contract identified the Alan and Audrey CRAT as the "Owner" of the SPIA, but listed Alan as the annuitant and Audrey as the joint annuitant.[13] Under the SPIA contract, Symetra was required to pay an annuity of $207,232 to Alan and Audrey beginning on April 6, 2016, and on each April 6 thereafter until five total payments were made.

Alan and Audrey received an annuity payment of $207,232 ($103,616 each) in each of 2016 and 2017. For 2016 and 2017, the Alan and Audrey CRAT reported these annuity payments as CRAT distributions to Alan and Audrey on Form 5227:

[12] The same applies to the CRAT instruments for the remaining CRATs.

[13] The SPIA contract defined the term "annuitant" in the same way as the Albert and Gladys CRAT SPIA contract and also provided for the possibility of a joint annuitant. *See supra* note 8.

Recipient	*Distributions*	*2016*	*2017*
Alan Gerhardt	Ordinary Income	$1,347	$1,347
	Corpus	102,269	102,269
Audrey Gerhardt	Ordinary Income	1,347	1,347
	Corpus	102,269	102,269

The Alan and Audrey CRAT issued Schedules K–1 to both Alan and Audrey for 2016 and 2017. For each year, the Schedules K–1 reported interest income of $1,347 paid to each of Alan and Audrey. The Schedules K–1 reported no other income.

Alan and Audrey jointly filed their federal income tax returns for the 2016 and 2017 tax years. Damon T. Eisma of Eisma & Eisma Attorneys at Law prepared the returns. On these returns, Alan and Audrey reported the interest income reported to them by the Alan and Audrey CRAT. They did not report the remaining payments from the CRAT-funded annuity on either the 2016 or the 2017 tax return.

On Forms 5227, the Alan and Audrey CRAT reported its assets at the end of 2015 to 2017 as follows:

	2015	*2016*	*2017*
Trust Principal or Corpus	$1,200,685	$818,080	$613,542
Undistributed Income	–	–	–
Undistributed Capital Gains	–	–	–
Undistributed Nontaxable Income	–	–	–

The Commissioner examined Alan and Audrey's 2016 and 2017 tax returns as well as the Alan and Audrey CRAT trust accounting and reporting for those years. During the examination, the Commissioner determined that the Alan and Audrey CRAT trust accounting was inaccurate and adjusted it in relevant part as follows:

CRAT Trust Accounting According to IRS Examination

	2015	*2016*	*2017*
Prior Year Accumulated Ordinary Income	-0-	-0-	$904,201
Ordinary Income: Interest Income	-0-	$2,694	2,694
Capital Gain or Loss: Form 4797	-0-	1,108,739[14]	-0-
Current Net Ordinary Income Before Distributions	-0-	1,111,433[15]	2,694
Total Distributable Income (Cumulative)	-0-	1,111,433	906,895
Distributions to Noncharitable Beneficiaries	-0-	207,232	207,232
Undistributed Ordinary Income	-0-	904,201	699,663

The Commissioner also determined that the income the Alan and Audrey CRAT realized on sale of the contributed properties was ordinary income under section 1245. Thus, according to the Commissioner, all the payments Alan and Audrey received in 2016 and 2017 from the CRAT-funded annuity were ordinary income to them.

The Commissioner issued Alan and Audrey a notice of deficiency for 2016 and 2017. Among other items not relevant here, the Commissioner increased Alan and Audrey's gross income by $204,538 for each of 2016 and 2017 to reflect the adjustments to their ordinary income from the CRAT-funded annuity payments.

D. *Jack and Shelley Gerhardt*

Jack and Shelley created two CRATs, Jack and Shelley CRAT I and Jack and Shelley CRAT II, on November 10, 2015,

[14] The parties stipulate that the Commissioner determined that the Alan and Audrey CRAT sold the properties contributed by Alan and Audrey for $1,222,000 and that it had a cumulative basis in the properties of $113,261. In view of these amounts, the Alan and Audrey CRAT realized income of $1,108,739 from the sale of the properties.

[15] The "Current Net Ordinary Income Before Distributions" amount consists of interest income of $2,694 and capital gain treated as ordinary income under section 1245 of $1,108,739.

and February 17, 2016, respectively. Jack and Shelley were the grantors and noncharitable beneficiaries of the CRATs. The CRAT instruments also listed Jack and Shelley as the beneficiaries and recipients of the Annuity Amount required to be paid by trustee. The Jack and Shelley CRAT I instrument listed two organizations as charitable remaindermen, and the Jack and Shelley CRAT II instrument listed four organizations as charitable remaindermen. Gray, Lawrence & Jenkins, LLC, was the trustee of both CRATs.

Jack and Shelley contributed real estate to Jack and Shelley CRAT I in November 2015 and to Jack and Shelley CRAT II in May 2016. Each CRAT filed Form 5227 in the year of its creation, reporting the fair market values of the contributed properties at the time of contribution. Jack and Shelley CRAT I reported the total fair market value of the contributed properties it held as $1,530,000. Jack and Shelley CRAT II reported the fair market value of the contributed property it held as $440,550. With Mr. Schreiner's assistance, Jack and Shelley each filed Forms 709 with their 2015 and 2016 income tax returns reporting their contributions to Jack and Shelly CRAT I and Jack and Shelley CRAT II. Jack and Shelley each reported total adjusted basis of $62,548 in the properties contributed to Jack and Shelly CRAT I and adjusted basis of $72,359 in the property contributed to Jack and Shelley CRAT II.

In March 2016, Jack and Shelley CRAT I sold the contributed properties it held for $1,455,000. Later in 2016, Jack and Shelley CRAT II sold the contributed property it held for $440,550.

Both CRATs used proceeds from the sales of the contributed properties to purchase SPIAs from Symetra. Jack and Shelly CRAT I purchased a SPIA for $1,287,283. The SPIA contract identified the CRAT as "Owner" of the SPIA, but listed Jack as the annuitant and Shelley as the joint annuitant. *See supra* note 13. Under the SPIA contract, Symetra was required to pay an annuity to Jack and Shelley of $260,902, beginning on April 6, 2016, and each April 6 thereafter until five payments were made.

Jack and Shelley CRAT II purchased a SPIA for $367,302. The complete SPIA contract is not in the record, but the parties stipulated that Jack was listed as the annuitant of the

SPIA, and Shelley was the joint annuitant. Under the SPIA contract, Symetra was required to pay an annuity to Jack and Shelley of $73,678, beginning in July 2016 and each July[16] thereafter until five payments were made.

Jack and Shelley received an annuity payment of $260,902 ($130,451 each) from the SPIA purchased by Jack and Shelley CRAT I and an annuity payment of $73,678 ($36,839 each) from the SPIA purchased by Jack and Shelley CRAT II in 2016 and 2017. For each year, Jack and Shelley CRAT I reported the annuity payments as CRAT distributions to Jack and Shelley on Form 5227:

Recipient	*Distributions*	*2016*	*2017*
Jack Gerhardt	Ordinary Income	$1,696	$1,696
	Corpus	128,755	128,755
Shelley Gerhardt	Ordinary Income	1,696	1,696
	Corpus	128,755	128,755

Similarly, Jack and Shelley CRAT II filed Forms 5227 with the Commissioner reporting the annuity payments as CRAT distributions to Jack and Shelley as follows:

Recipient	*Distributions*	*2016*	*2017*
Jack Gerhardt	Ordinary Income	$111	$111
	Corpus	36,729	36,729
Shelley Gerhardt	Ordinary Income	110	110
	Corpus	36,728	36,728

In addition to filing the Forms 5227, each CRAT issued to Jack and Shelley Schedules K–1 for 2016 and 2017. The Schedules K–1 reported total interest income paid to Jack and Shelley equal to the total interest income listed on the Forms 5227. The Schedules K–1 reported no other income to Jack and Shelley.

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[16] The parties have stipulated that the annuity payments were to begin in June 2016 and continue in June of each following year until five payments were made. Our review of the record shows that the SPIA contract for Jack and Shelley CRAT II required Symetra to make the payments beginning in July 2016 and in July of each following year until five payments were made, and we so find. *See Cal-Maine Foods, Inc. v. Commissioner*, 93 T.C. 181, 195 (1989) (holding that we are not obliged to accept a stipulation between the parties when it is clearly contrary to facts disclosed by the record).

Jack and Shelley jointly filed federal income tax returns for the 2016 and 2017 tax years. Damon T. Eisma of Eisma & Eisma Attorneys at Law prepared the returns. On these returns, Jack and Shelley reported the interest income reported to them by the CRATs on the Schedules K–1. They did not report the remaining payments from the CRAT-funded annuities on the 2016 or the 2017 return.

On Forms 5227, Jack and Shelley CRAT I reported its assets at the end of 2015 to 2017 as follows:

	2015	*2016*	*2017*
Trust Principal or Corpus	$1,530,000	$1,182,759	$925,248
Undistributed Income	–	–	–
Undistributed Capital Gains	–	–	–
Undistributed Nontaxable Income	–	–	–

On Forms 5227, Jack and Shelley CRAT II reported its assets at the end of 2016 and 2017 as follows:

	2016	*2017*
Trust Principal or Corpus	$298,938	$220,388
Undistributed Income	–	–
Undistributed Capital Gains	–	–
Undistributed Nontaxable Income	–	–

The Commissioner examined Jack and Shelley's 2016 and 2017 tax returns as well as the CRATs' trust accounting and reporting for those years. During the examination, the Commissioner determined that the Jack and Shelley CRAT I trust accounting was inaccurate and adjusted it as follows:

CRAT Trust Accounting According to IRS Examination

	2015	*2016*	*2017*
Prior Year Accumulated Ordinary Income	-0-	-0-	$1,052,385
Ordinary Income: Interest Income	-0-	$3,392	3,392
Capital Gain or Loss: Form 4797	-0-	1,309,085[17]	-0-
Current Net Ordinary Income Before Distributions	-0-	1,312,477[18]	3,392
Total Distributable Income (Cumulative)	-0-	1,312,477	1,055,777
Distributions to Noncharitable Beneficiaries	-0-	260,902	260,092
Undistributed Ordinary Income	-0-	1,052,385	795,685

[17] The parties stipulate that the Commissioner determined that Jack and Shelley CRAT I sold the properties contributed by Jack and Shelley for $1,455,000 and that it had a cumulative basis in the properties of $145,915. In view of these amounts, Jack and Shelley CRAT I realized income of $1,309,085 from the sale of the properties.

[18] The "Current Net Ordinary Income Before Distributions" amount consists of interest income of $3,392 and capital gain treated as ordinary income under section 1245 of $1,309,085.

The Commissioner also adjusted the Jack and Shelley CRAT II accounting as follows:

CRAT Trust Accounting According to IRS Examination

	2016	*2017*
Prior Year Accumulated Ordinary Income	-0-	$366,872
Ordinary Income: Interest Income	-0-[19]	-0-
Capital Gain or Loss: Form 4797	$440,550[20]	-0-
Current Net Ordinary Income Before Distributions	440,550[21]	-0-
Total Distributable Income (Cumulative)	440,550	366,872
Distributions to Noncharitable Beneficiaries	73,678	73,678
Undistributed Ordinary Income	366,872	293,194

The Commissioner also determined that the income Jack and Shelley CRAT I and Jack and Shelley CRAT II realized on sales of the contributed properties was ordinary income under section 1245. Thus, according to the Commissioner, all the payments Jack and Shelley received in 2016 and 2017 from the CRAT-funded annuities were ordinary income to them.

The Commissioner issued Jack and Shelley a notice of deficiency for 2016 and 2017. Among other items, the Commissioner increased Jack and Shelley's gross income by $330,967 for each of 2016 and 2017 to reflect the adjustments to their ordinary income from the CRAT-funded annuity payments.

[19] We do not readily see why the Commissioner's trust accounting omits interest income of $221 reported by Jack and Shelley CRAT II on its Forms 5227 for 2016 and 2017. But this omission does not affect our analysis for the years before us.

[20] The parties stipulate that the Commissioner determined that Jack and Shelley CRAT II sold the property contributed by Jack and Shelley for $440,550 and that it did not have any basis in the property. In view of these amounts, Jack and Shelley CRAT II realized income of $440,550 from the sale of the property.

[21] The "Current Net Ordinary Income Before Distributions" consists solely of capital gain treated as ordinary income under section 1245 of $440,550.

E. *Tim and Pamela Gerhardt*

Tim and Pamela Gerhardt created two CRATs, Tim and Pamela CRAT I and Tim and Pamela CRAT II, on November 10, 2015, and January 21, 2016, respectively. Tim and Pamela were the grantors and noncharitable beneficiaries of the CRATs. The CRAT instruments also listed Tim and Pamela as the beneficiaries and recipients of Annuity Amount required to be paid by the trustee. The Tim and Pamela CRAT I instrument and the Tim and Pamela CRAT II instrument listed six organizations each as charitable remaindermen. Gray, Lawrence & Jenkins, LLC, was the trustee of both CRATs.

Tim and Pamela contributed real estate to Tim and Pamela CRAT I in November 2015 and to Tim and Pamela CRAT II in February 2016. Each CRAT filed Form 5227 in the year of its creation, reporting the fair market values of the contributed properties at the time of the respective contributions. Tim and Pamela CRAT I reported the fair market value of the contributed property it held as $310,000. Tim and Pamela CRAT II reported the fair market value of the contributed property it held as $549,450. With Mr. Schreiner's assistance, Tim and Pamela filed Forms 709 with the Commissioner reporting the contributions to Tim and Pamela CRAT I and Tim and Pamela CRAT II. Tim and Pamela reported no adjusted basis in the property contributed to Tim and Pamela CRAT I. They reported an adjusted basis of $90,245 in the property contributed to Tim and Pamela CRAT II.

In December 2015, Tim and Pamela CRAT I sold the contributed property it held for $310,000. In May 2016, Tim and Pamela CRAT II sold the contributed property it held for $549,450.

Both CRATs used proceeds from the sales of the contributed properties to purchase a SPIA from Symetra. Tim and Pamela CRAT I purchased a SPIA for $252,158. The SPIA contract identified the "Tim Leroy and Pamela Holck Gerhardt [CRAT]" as the SPIA's "Owner." Tim was listed as the annuitant and Pamela as the joint annuitant. *See supra* note 13. Under the SPIA contract, Symetra was required to pay an annuity to Tim and Pamela of $50,967, beginning on March 1, 2016, and on March 1 of each year thereafter until five payments were made.

Tim and Pamela CRAT II purchased a SPIA for $456,410. The record does not include a copy of the SPIA contract for Tim and Pamela CRAT II, but the parties stipulated that Tim was the annuitant and Pamela was the joint annuitant. Under the SPIA contract, Symetra was required to pay an annuity to Tim and Pamela of $92,204, beginning on June 1, 2016, and on June 1 of each year thereafter until five payments were made.

Tim and Pamela received an annuity payment of $50,967 from Tim and Pamela CRAT I and an annuity payment of $92,205[22] from Tim and Pamela CRAT II in 2016 and 2017. For each year, Tim and Pamela CRAT I reported the annuity payments as CRAT distributions to Jack and Shelley on Form 5227:

Recipient	*Distributions*	*2016*	*2017*
Tim Gerhardt	Ordinary Income	$255	$255
	Corpus	25,229	25,229
Pamela Gerhardt	Ordinary Income	255	255
	Corpus	25,228	25,228

Similarly, Tim and Pamela CRAT II reported the annuity payments as CRAT distributions to Tim and Pamela on Form 5227:

Recipient	*Distributions*	*2016*	*2017*
Tim Gerhardt	Ordinary Income	$139	$139
	Corpus	45,964	45,964
Pamela Gerhardt	Ordinary Income	138	138
	Corpus[23]	45,964	45,964

[22] The Stipulation of Facts filed by the parties is inconsistent as to the annual amounts paid to Tim and Pamela by the Tim and Pamela CRAT I-funded annuity and the Tim and Pamela CRAT II-funded annuity. Based on our review of the record, we find that the correct number for the Tim and Pamela CRAT I-funded annuity is $50,967 and the correct number for the Tim and Pamela CRAT II-funded annuity is $92,205.

[23] The parties stipulated that the corpus distributions to Pamela were reported on Forms 5227 as $46,964 for both 2016 and 2017, due perhaps to what appears to be a scrivener's error in the 2016 Form 5227. Based on our review of the record, we find the correct amount is $45,964.

In addition to filing the Forms 5227, each CRAT issued to Tim and Pamela Schedules K–1 for 2016 and 2017. The Schedules K–1 reported total interest income paid to Tim and Pamela equal to the total interest income listed on the Forms 5227. The Schedules K–1 reported no other income to Tim and Pamela.

Tim and Pamela jointly filed federal income tax returns for the 2016 and 2017 tax years. Anthony J. Baldassano prepared the returns. Tim and Pamela reported the interest income reported to them by the CRATs on the Schedules K–1. They did not report the remaining payments from the CRAT-funded annuities on the 2016 or the 2017 return.

On Forms 5227, Tim and Pamela CRAT I reported its assets at the end of 2015 to 2017 as follows:

	2015	*2016*	*2017*
Trust Principal or Corpus	$288,685	$201,728	$151,271
Undistributed Income	–	–	–
Undistributed Capital Gains	–	–	–
Undistributed Nontaxable Income	–	–	–

On Forms 5227, Tim and Pamela CRAT II reported its assets at the end of 2016 and 2017 as follows:

	2016	*2017*
Trust Principal or Corpus	$372,652	$275,631
Undistributed Income	–	–
Undistributed Capital Gains	–	–
Undistributed Nontaxable Income	–	–

The Commissioner examined Tim and Pamela's 2016 and 2017 tax year returns as well as the CRATs' trust accounting and reporting for those years. During the examination, the Commissioner determined that the Tim and Pamela CRAT I trust accounting was inaccurate and adjusted it as follows:

CRAT Trust Accounting According to IRS Examination

	2015	*2016*	*2017*
Prior Year Accumulated Ordinary Income	-0-	-0-	$238,228
Ordinary Income: Interest Income	-0-	$510	510
Capital Gain or Loss: Form 4797	-0-	288,685[24]	-0-
Current Net Ordinary Income Before Distributions	-0-	289,195[25]	510
Total Distributable Income (Cumulative)	-0-	289,195	238,738
Distributions to Noncharitable Beneficiaries	-0-	50,967	50,967
Undistributed Ordinary Income	-0-	238,228	187,771

The Commissioner also adjusted the Tim and Pamela CRAT II accounting as follows:

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[24] The parties stipulate that the Commissioner determined that Tim and Pamela CRAT I sold the property contributed by Tim and Pamela for $310,000 and that it had a cumulative basis in the property of $21,315. In view of these amounts, Tim and Pamela CRAT I realized income of $288,685 from the sale of the property.

[25] The "Current Net Ordinary Income Before Distributions" amount consists of interest income of $510 and capital gain treated as ordinary income under section 1245 of $288,685.

CRAT Trust Accounting According to IRS Examination

	2016	*2017*
Prior Year Accumulated Ordinary Income	-0-	$457,246
Ordinary Income: Interest Income	-0-	-0-
Capital Gain or Loss: Form 4797	$549,450[26]	-0-
Current Net Ordinary Income Before Distributions	549,450[27]	-0-
Total Distributable Income (Cumulative)	549,450	457,246
Distributions to Noncharitable Beneficiaries[28]	92,204	92,204
Undistributed Ordinary Income	457,246	365,042

The Commissioner also determined that the income Tim and Pamela CRAT I and Tim and Pamela CRAT II realized on sales of the contributed properties was ordinary income under section 1245. Thus, according to the Commissioner, all the payments Tim and Pamela received in 2016 and 2017 from the CRAT-funded annuities were ordinary income to them.

The Commissioner issued Tim and Pamela a notice of deficiency for 2016 and 2017. Among other items, the Commissioner increased Tim and Pamela's gross income by $142,385 for each of 2016 and 2017 to reflect the adjustments to their ordinary income from the CRAT-funded annuity payments.

Discussion

F. *General Background*

A CRAT is a type of a charitable remainder trust. I.R.C. § 664. "[A] staple among estate planners," a charitable remainder trust is often a vehicle used by "individuals with sub-

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[26] The parties stipulate that the Commissioner determined that Tim and Pamela CRAT II sold the property contributed by Tim and Pamela for $549,450 and that it did not have any basis in the property. In view of these amounts, Tim and Pamela CRAT II realized income of $549,450 from the sale of the property.

[27] The "Current Net Ordinary Income Before Distributions" consists solely of capital gain treated as ordinary income under section 1245 of $549,450.

[28] As described above, we find that the amount of the annuity distributions was actually $92,205 for each year.

stantial appreciated capital gain property, a charitable intent, and a need for a stream of income during their lifetimes." Richard Fox, *Charitable Giving: Taxation, Planning, and Strategies* ¶ 25.01 (2023), Westlaw WGL-CHARGIV (footnotes omitted). "The basic concept of a [CRAT] involves a [grantor's] transfer of property to an irrevocable trust, the terms of which provide for the payment of a specified amount, at least annually, to the grantor or other designated noncharitable beneficiaries for life or another predetermined period of time up to twenty years." *Id.* (footnotes omitted); *see also* I.R.C. § 664(d). What remains in the trust after the expiration of that period (which cannot be less than "10 percent of the initial net fair market value of all property placed in the trust," I.R.C. § 664(d)(1)(D)), "must be transferred to one or more qualified charitable organizations or continue to be held in the trust for the benefit of such organizations." Fox, *supra*, ¶ 25.01. In short, unlike an immediate gift to charity, a contribution to a CRAT "blends the philanthropic intentions of a donor with his or her financial needs or the financial needs of others." *Id.*

As a rule, the grantor recognizes no gain when transferring appreciated property to a CRAT. *See Buehner v. Commissioner*, 65 T.C. 723, 740 (1976) ("A gift of appreciated property [to a CRAT] does not result in income to the donor . . . ." (quoting *Humacid Co. v. Commissioner*, 42 T.C. 894, 913 (1964))); *see also Furrer*, T.C. Memo. 2022-100, at *8–9 (discussing treatment of CRATs).[29] Moreover, because CRATs are exempt from income tax, a CRAT can sell appreciated property without itself paying tax on the sale. *See* I.R.C. § 664(c)(1); Treas. Reg. § 1.664-1(a)(1)(i); Fox, *supra*, ¶ 25.01.

But that does not mean that the grantor or other noncharitable CRAT beneficiaries do not have to pay tax with respect to distributions from the CRAT. "Although a [CRAT] is itself exempt from income tax and, therefore, pays no tax on any of its taxable income, the annuity . . . payments made to the noncharitable beneficiaries carry out taxable income that is subject to tax at the beneficiary level." Fox, *supra*, ¶ 25.50 (footnote omitted); *see also Alpha I, L.P. v. United*

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[29] In addition, the grantor may be entitled to a charitable contribution deduction equal to the present value of the remainder interest at the time of the transfer to the CRAT. *See* I.R.C. § 170(f)(2)(A); Treas. Reg. § 1.170A-6(b).

States, 682 F.3d 1009, 1015 (Fed. Cir. 2012) (stating the rule and citing section 664(b) and (c)(1)). This is so because when property is transferred to a CRAT, the basis of the property in the CRAT's hands generally is the same as it would be in the hands of the grantor. *See* I.R.C. § 1015(a) and (b); Treas. Reg. §§ 1.1015-1(a)(1), 1.1015-2(a)(1). And when the CRAT sells the property, it realizes gain to the extent the amount realized from the sale exceeds its adjusted basis. I.R.C. § 1001; *see also* Treas. Reg. § 1.664-1(d)(1)(i) (discussing the assignment of income to categories at the CRAT level). Although not taxable to the CRAT, that gain must be tracked and affects the treatment of distributions from the CRAT.[30] *See, e.g.*, Treas. Reg. § 1.664-1(d)(1)(viii) (providing examples illustrating the rules).

Congress has established specific ordering rules that govern the characterization and reporting of annuity amounts distributed by a CRAT to its income beneficiaries. *See* I.R.C. § 664(b). Under this regime, distributions from a CRAT to income beneficiaries are deemed to have the following character and to be distributed in the following order:

(1) as ordinary income, to the extent of the CRAT's current and previously undistributed ordinary income;
(2) as capital gain, to the extent of the CRAT's current and previously undistributed capital gain;
(3) as other income, to the extent of the CRAT's current and previously undistributed other income; and
(4) as a nontaxable distribution of trust corpus.

I.R.C. § 664(b)(1)–(4); Fox, *supra*, ¶ 25.50.[31]

CRATs are subject to strict reporting requirements to ensure compliance with the statutory ordering rules. *See* I.R.C.

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[30] The tax treatment set out in the text sometimes leads commentators describing the benefits of a CRAT to say that "[a]ppreciated assets held by an individual can be disposed of on a tax-free basis." Fox, *supra*, ¶ 25.02. But, as we have explained, and as the same commentators recognize, that is not quite right: "Although assets may be sold on a tax-free basis by a [CRAT], because distributions from the trust to noncharitable beneficiaries are subject to tax, a more accurate statement might be that a [CRAT] defers the payment of income tax [until noncharitable beneficiaries receive distributions from the CRAT]." *Id.* n.24.

[31] *See also Miller v. Commissioner*, T.C. Memo. 2009-182, 2009 WL 2432375.

§ 4947(a); Treas. Reg. § 1.664-1(a)(1)(ii). A CRAT must file an annual information return on Form 5227 reflecting its income, deductions, accumulations, and distributions for the year. *See* I.R.C. § 6011(a); Treas. Reg. § 53.6011-1(d). And it must issue to each income beneficiary a Schedule K–1 properly describing the tax character of all distributions. *See* I.R.C. § 6034A(a); Treas. Reg. § 1.6034-1(a).

G. *Burden of Proof*

The Commissioner's determinations in a notice of deficiency are generally presumed correct, and the taxpayer bears the burden of proving those determinations erroneous. *See* Rule 142(a)(1); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). The parties have stipulated that the Gerhardts received the payments from the CRAT-funded annuities at issue, and the Gerhardts do not otherwise argue that the burden is on the Commissioner to connect the Gerhardts with the income. *See Pittman v. Commissioner*, 100 F.3d 1308, 1313 (7th Cir. 1996), *aff'g* T.C. Memo. 1995-243; *Page v. Commissioner*, 58 F.3d 1342, 1347 (8th Cir. 1995), *aff'g* T.C. Memo. 1993-398; *Day v. Commissioner*, 975 F.2d 534, 537 (8th Cir. 1992), *aff'g in part, rev'g in part on other grounds, and remanding* T.C. Memo. 1991-140. Instead, the issue before us is whether those payments are taxable to the Gerhardts. As to the annuity payments, the Gerhardts have not alleged, and the evidence does not establish, that the burden of proof as to any factual issues before us has shifted to the Commissioner under section 7491(a). Accordingly, the burden remains with the Gerhardts to prove the Commissioner's determinations are erroneous.

H. *Application to the Gerhardts*

As we have already discussed, distributions from a CRAT typically are taxable in the hands of noncharitable beneficiaries to the extent of the CRAT's income. *See* I.R.C. § 664(b). Each of the CRATs here received appreciated property from the Gerhardts. The Gerhardts did not recognize gain on the transfers to the CRATs, and the CRATs have the same bases in the properties as the Gerhardts did before the contribu-

tions.[32] *See* I.R.C. § 1015(a) and (b); *Veterans Found. v. Commissioner*, 38 T.C. 66, 72 (1962), *aff'd*, 317 F.2d 456 (10th Cir. 1963); Treas. Reg. §§ 1.1015-1(a)(1), 1.1015-2(a)(1).[33] After receiving the properties, the CRATs sold them and used the proceeds to purchase SPIAs. The Gerhardts then received annual distributions from the CRATs in the form of annuities paid by the CRAT-funded SPIAs.

The CRATs realized gains on the sales of the contributed properties. *See* I.R.C. § 1001(a). Although the CRATs did not have to pay tax on those gains because of section 664(c), under section 664(b), the income they earned was relevant for determining the character of the distributions the Gerhardts received. *See* Treas. Reg. § 1.664-1(d)(1)(ii)(*a*); *see also Alpha I, L.P.*, 682 F.3d at 1015 ("[T]he income of a CRUT is taxable to its income beneficiaries upon distribution."); Fox, *supra*, ¶ 25.50.[34]

As we have already discussed, the character of CRAT distributions to noncharitable beneficiaries follows the character of the income to the CRAT. *See* I.R.C. § 664(b). The distributions are characterized in the following order: (1) ordinary income, (2) capital gains, (3) other income, and (4) trust corpus. *Id.* Here, the Commissioner determined that the income the CRATs earned was ordinary income because the properties the CRATs sold were subject to the rules of section 1245—a point not disputed by the Gerhardts.[35] On the ba-

[32] The Gerhardts have made no argument that the adjusted bases in the properties increased by reason of section 1015(d)(1) (adjustment to basis for gift tax paid). They have therefore forfeited any argument on that front. We note further that the record does not show that they actually paid gift tax on the contributions to the CRATs.

The Gerhardts also concede on brief that, if they had sold the properties instead of contributing them to the CRATs, they would have taxable gains in the amounts determined by the Commissioner. *See* Pet'rs' Reply to Resp't's Opening Br. 3–9.

[33] *See also Magness v. Commissioner*, T.C. Memo. 1965-260, 1965 Tax Ct. Memo LEXIS 70, *8–9, *9 n.3 (stating the rule and providing background on its adoption).

[34] *See also Miller v. Commissioner*, 2009 WL 2432375, at *2.

[35] The Gerhardts state in their answering brief that the Commissioner's characterization of the gains from the CRATs' sales of the contributed properties was "of little or no consequence." Pet'rs' Reply to Resp't's Opening Br. 20. They are mistaken. This characterization is indeed consequential. But the Gerhardts do not argue that the gains should be characterized in any other way (for example, as capital gains). Therefore, they have forfeited

sis of this determination and well-established law, *see* I.R.C. §§ 64, 1245(a), the Gerhardts had ordinary income from the CRATs as follows:

Ordinary Income from CRATs, Including Interest Income Already Reported by the Gerhardts

Petitioner	*CRAT*	*2016*	*2017*
Gladys	Albert and Gladys CRAT	$311,708	$311,708
Alan and Audrey	Alan and Audrey CRAT	207,232	207,232
Jack and Shelley	Jack and Shelley CRAT I	260,902	260,902
	Jack and Shelley CRAT II	73,678	73,678
Tim and Pamela	Tim and Pamela CRAT I	50,967	50,967
	Tim and Pamela CRAT II	92,205	92,205

The Gerhardts resist the straightforward analysis set out above. In their telling, the Code does a lot more than exempt the CRATs from paying tax on built-in gains realized when contributed property is sold. According to the Gerhardts, the Code also relieves them from paying tax on the distributions that were made possible by the CRATs' realization of the built-in gains. As they put it, "all taxable gains (on the sale of the asset[s contributed to the CRATs]) *disappear* and the full amount of the proceeds [is] converted to principal to be invested by the CRAT." Pet'rs' Opening Br. 6–7 (emphasis added). In the Gerhardts' view, "[i]t becomes obvious that Congress intended [this treatment] to promote charitable giving while offering large tax benefits as incentives." *Id.* at 7. The gain disappearing act the Gerhardts attribute to the CRATs is worthy of a Penn and Teller magic show. But it finds no support in the Code, regulations, or caselaw.

In *Furrer*, we considered facts and arguments nearly identical to those before us now and reached the same conclusion. We invited the Gerhardts to distinguish *Furrer* and even extended the briefing schedule to allow them to do so. But, tellingly, their briefs fail to mention the case at all.[36] Their

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the argument. *See, e.g.*, *Smith v. Commissioner*, 159 T.C. 33, 73 (2022); *see also Hackett v. City of S. Bend*, 956 F.3d 504, 509 (7th Cir. 2020); *Jenkins v. Winter*, 540 F.3d 742, 751 (8th Cir. 2008) ("Claims not raised in an opening brief are deemed waived.").

[36] This is particularly notable given that the Gerhardts' counsel in these cases also represented the Furrers. Moreover, neither the Gerhardts' Opening Brief nor their Reply to Respondent's Opening Brief cites a single case

silence confirms our view that the reasoning in *Furrer* applies with equal force here.

As best we can tell, the Gerhardts maintain that the bases of assets donated to a CRAT are equal to their fair market values. *See* Pet'rs' Reply to Resp't's Opening Br. 10–11 ("Utilizing CRATs, the assets are donated to a CRAT and book at the fair market value of the asset at that time. The donor's basis is a moot point as the controlling fair market value is the price at the time the asset is donated to the CRAT."); *id.* at 13 ("The trustee of the CRAT has no way to know the cost basis of any asset donated to it, nor is it required to obtain such information since that is not required by the Internal Revenue Code."). Section 1015 flatly contradicts their position. Section 1015(a) governs transfers by gift, and section 1015(b) governs transfers in trust (other than transfers in trust by gift). Under either provision, the basis in the property "shall be the same as it would be in the hands of the donor" under section 1015(a) or "in the hands of the grantor" under section 1015(b).[37] And the Gerhardts' claim that section 1015 does not govern transfers to CRATs because it does not specifically mention them is meritless. Nothing in the text of the provision excludes CRATs from its scope.

The Gerhardts also seek shelter in the rules governing the taxation of annuities in section 72. But, if one respects the form of the transactions the Gerhardts chose, the Gerhardts did not buy any annuities from Symetra. The CRATs did so and directed how payments under the annuities were to be made.[38]

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in support of their position. As we have already explained, no such support exists.

[37] The position the Gerhardts advance has not been the law for more than a century. As Treasury Regulation § 1.1015-3(a) provides: "In the case of property acquired by gift or transfer in trust *before January 1, 1921*, the basis of such property is the fair market value thereof at the time of the gift or at the time of the transfer in trust." (Emphasis added.) For property transferred after December 31, 1920, "the basis of the property for the purpose of determining gain is the same as it would be in the hands of the donor." Treas. Reg. § 1.1015-1(a)(1) (governing "property acquired by gift . . . (whether by transfer in trust or otherwise)"); *see also* Treas. Reg. § 1.1015-2(a)(1) (setting out the same rule for "property acquired . . . by transfer in trust (other than by a transfer in trust by gift, bequest, or device)").

[38] As we have already noted, under the SPIA contracts, the Gerhardts did not have "any right title, interest, or incident of ownership in or to any

Thus, any amounts paid by Symetra as directed by the CRATs constitute amounts distributed by the CRATs for purposes of section 664(b). Contrary to the Gerhardts' view, nothing in section 72 overrides their obligation to comply with the rules of section 664(b) with respect to those amounts.

In light of the foregoing, it is plain that the Gerhardts have not shown that the determinations in the notices of deficiency on this issue were incorrect. Therefore, they must be upheld.

II. *Docket No. 11129-20 (Additional Issues Relating to Jack and Shelley Gerhardt's Returns)*

(1) *Section 1031 Like-Kind Exchange Issue*

Next we consider whether, for the 2017 tax year, Jack and Shelley Gerhardt properly excluded gain from the disposition of other property (Armstrong Site) from gross income under section 1031 or whether that gain must be recognized under section 1245. The Commissioner does not dispute that the transaction at issue met the requirements of section 1031. Instead, the Commissioner argues that, despite section 1031, the gain must be recognized as ordinary income because the property was depreciated "section 1245 property." *See* I.R.C. § 1245. After finding the facts that follow, for the reasons set out below, we decide this issue in the Commissioner's favor.

Background

Located in Armstrong, Iowa, the Armstrong Site was held by Jack and Shelley as rental property for the production of income. It comprised hog buildings and equipment as well as raw land. On January 19, 2017, Jack and Shelley relinquished the Armstrong Site to Andrew Gerhardt intending that it be exchanged for like-kind property. On February 28, 2017, a new property, the Cape Coral property, was identified

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[SPIA] transferred to or purchased by the Trustee." Stipulation of Facts Ex. 13–J, at 22. Symetra appears to have followed this contractual provision by issuing Forms 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., reflecting each year's annuity payments to the CRATs, not the Gerhardts. And the Gerhardts have stipulated that the CRATs reflected the annuity payments as distributions on their Forms 5227, Schedule A, Part II-A, Current Distributions Schedule, for each relevant year.

as the exchange property. On March 17, 2019, Jack and Shelley received the Cape Coral property from Andrew Gerhardt.

Jack and Shelley treated this exchange as a section 1031 like-kind exchange on their 2017 tax return. They reported a fair market value of $390,000 for the Cape Coral property. They also reported $104,338 as "[a]djusted basis of like-kind property [they] gave up, net amounts paid to other party, plus any exchange expenses" not used elsewhere on their return.[39] Stipulation of Facts Ex. 10–J, at 17. Consistent with these amounts, Jack and Shelley reported deferred gain of $285,662 on the exchange of the Armstrong Site.

As already noted, the Commissioner examined Jack and Shelley's 2017 return. The revenue agent conducting the audit accepted the fair market value of the Cape Coral property and agreed that Jack and Shelley paid for the property with the Armstrong Site (valued at $300,000) and $90,000 in cash. But the agent made adjustments to Jack and Shelley's reported exchange expenses, as well as their reported basis in the Armstrong Site. And he determined that the gain from the Armstrong Site was subject to the rules of section 1245 and that the gain should not be deferred but should be treated as ordinary income. Consistent with these determinations, the Commissioner increased Jack and Shelley's income for 2017 by $284,746.[40]

Discussion

A. *Recognition Under Section 1245*

Typically, under section 1031, no gain or loss is recognized on a like-kind exchange of property if all requirements of section 1031 are met. But, if "section 1245 property" is disposed of in a section 1031 like-kind exchange, then gain from the

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[39] The basis amount of $104,338 reported on Jack and Shelley's return consisted of reported basis of $14,338 in the Armstrong Site and exchange expenses, plus $90,000 in cash.

[40] This amount was equal to 100% of the gain from the exchange of the Armstrong Site as determined by the Commissioner. The Commissioner calculated the amount by subtracting selling costs and the adjusted basis of the land, buildings, and equipment, all as determined by the Commissioner, from the $300,000 sale price. The amount was slightly less than the amount Jack and Shelley reported as deferred gain because the Commissioner made certain favorable adjustments to Jack and Shelley's basis in the property.

disposition of that property may be recognized as ordinary income.[41] *See* I.R.C. § 1245(a)(1) (flush language), (b)(4); Treas. Reg. § 1.1245-6(b). If both section 1245 property and non-section 1245 property are disposed of in the same transaction, then gain is allocated between the section 1245 property and the non-section 1245 property in proportion to their respective fair market values. Treas. Reg. § 1.1245-1(a)(5). Section 1245 property includes "property which is or has been property of a character subject to the allowance for depreciation provided in section 167" that, as relevant here, is either (1) personal property or (2) a single-purpose agricultural or horticultural structure. I.R.C. § 1245(a)(3)(A), (D).

B. *Application to Jack and Shelley*

The Commissioner determined that the hog buildings and equipment on the Armstrong Site were section 1245 property and therefore that Jack and Shelley's gain from disposing of the property was ordinary income to them for 2017. Jack and Shelley dispute that the gain should be recognized as ordinary income. They argue that the gain should be deferred because they exchanged the Armstrong Site for the Cape Coral property in a properly executed section 1031 transaction. Essentially, they say that section 1031 trumps section 1245, at least as to the timing of gain recognition.

There is no dispute that Jack and Shelley followed the formalities of section 1031. But Jack and Shelley's argument ignores that gain may still be recognized under section 1245 if the property disposed of is "section 1245 property." *See* I.R.C. § 1245(a)(1) (flush language) ("[G]ain [from the disposition of section 1245 property] shall be recognized notwithstanding any other provision of this subtitle."); *see also* I.R.C. § 1245(b)(4) (providing rules for gain recognition in the context of a section 1031 transaction). Besides their broad assertion that "[t]he buildings on the [Armstrong Site] are incidental to the property and part of the property," Pet'rs' Opening Br. 20, Jack and Shelley offer no arguments with respect to

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[41] As relevant here, the amount recognized generally is limited to the amount by which the lesser of (1) the depreciation deductions claimed with respect to the property and (2) the amount realized in the transaction exceeds the taxpayer's adjusted basis in the property. *See* I.R.C. § 1245(a) and (b).

the Commissioner's determination that the Armstrong Site was depreciated section 1245 property. Nor do they contend that the limitations in section 1245(b)(4) assist them.

So far as Jack and Shelley may be arguing that their gain from the Armstrong Site is allocable primarily to non-section 1245 property, they have not set forth any facts supporting that view. The record does not show how much (if any) of the gain from the Armstrong Site could be allocable to non-section 1245 property.[42]

In short, Jack and Shelley have not met their burden to demonstrate that the Commissioner's determination is incorrect, and we find for the Commissioner on this issue.

(2) *Sale of Mosloski Site Issue*

We turn next to the Commissioner's determination that Jack and Shelley did not properly report gains from the sale of an additional property, which the parties refer to as the Mosloski Site.

Background

Jack and Shelley purchased the Mosloski Site in 1995. The Mosloski Site consisted of land, a hog-finishing barn, and hog equipment. On November 10, 2015, Jack and Shelley donated a partial interest in the Mosloski Site to their CRAT. Then on November 17, 2016, they sold their remaining interest in the Mosloski Site for $75,000. Jack received a Form 1099–S, Proceeds from Real Estate Transactions, that same day reporting the sales proceeds.

On their Form 1040, U.S. Individual Income Tax Return, for the 2016 tax year, Jack and Shelley reported total gain of $66,070 from the sale of the Mosloski Site as ordinary income. Along with their 2016 return, Jack and Shelley attached Form 4797, Sales of Business Property. On Form 4797, they reported a loss of $1,009 from the sale of the Mosloski Site land and gain of $67,079 from the sale of the Mosloski Site hog-finishing barn and hog equipment.

[42] We note in this regard that, according to the revenue agent's workpapers, when Jack and Shelley purchased the Armstrong Site they allocated approximately 1.6% of the purchase price to land (the non-section 1245 property) and the remaining 98.4% to buildings and equipment (the section 1245 property) for depreciation purposes.

In the notice of deficiency issued to Jack and Shelley, the Commissioner determined that the sale of the Mosloski Site was subject to depreciation recapture under section 1245. And because "the recapture amounts [from the Mosloski Site] under [section 1245] and land basis amounts are included in the charitable remainder annuity trust amounts," the Commissioner determined that the gain reported on Form 4797 was zero and that the entire $75,000 of sale proceeds was long-term capital gain to Jack and Shelley for 2016.

Discussion

Jack and Shelley offer no argument as to this adjustment in either of their briefs. Therefore, they have forfeited any objection as to this adjustment, and the Commissioner's determination stands. *See Smith*, 159 T.C. at 73; *see also Muhich v. Commissioner*, 238 F.3d 860, 864 n.10 (7th Cir. 2001), *aff'g* T.C. Memo. 1999-192; *Schneider v. Kissinger*, 412 F.3d 190, 200 n.1 (D.C. Cir. 2005) ("[A] litigant has an obligation to spell out its arguments squarely and distinctly, or else forever hold its peace." (quoting *United States v. Zannino*, 895 F.2d 1, 17 (1st Cir. 1990))).

III. *Docket No. 11146-20 (Tim and Pamela Gerhardt Section 6662(a) Penalty Issue)*

Finally, we consider whether Tim and Pamela are liable for an accuracy-related penalty under section 6662(a) and (b)(2) for a substantial understatement of income tax for 2016.

Background

Tim and Pamela reported total tax of $4,836 on their 2016 income tax return. The Commissioner determined that they had a tax deficiency of $39,448 for that year. During the examination of the 2016 return, IRS Revenue Agent Michael Lumpp proposed the imposition of an accuracy-related penalty under section 6662(a). Supervisory Revenue Agent Emily McDowell, Revenue Agent Lumpp's immediate supervisor, personally approved the assertion of the penalty in writing on July 22, 2019. Revenue Agent Lumpp had not communicated the penalty determination to Tim and Pamela or their representative before obtaining written supervisory approval.

In the notice of deficiency, mailed to Tim and Pamela on March 10, 2020, the Commissioner determined an accuracy-related penalty of $7,890 under section 6662(a) and (b)(2) for an underpayment due to a substantial understatement of income tax.

Discussion

A. *The Commissioner's Burden of Production*

Section 6662(a) imposes an accuracy-related penalty equal to 20% of the portion of an underpayment of tax required to be shown on a return that is attributable to any substantial understatement of income tax. *See* I.R.C. § 6662(a), (b)(2). An understatement of income tax is "substantial" if it exceeds the greater of "10 percent of the tax required to be shown on the return for the taxable year" or "$5,000." *Id.* subsec. (d)(1)(A).

Under section 7491(c) the Commissioner bears the burden of production with respect to the liability of an individual for any penalty. *See Higbee v. Commissioner*, 116 T.C. 438, 446 (2001). The record shows that Tim and Pamela's understatement of income tax for 2016 exceeded the threshold amount under section 6662(d)(1)(A), so the Commissioner has met his burden to show the penalty under section 6662(a) was proper when the notice of deficiency was issued.

The Commissioner must also show compliance with the procedural requirements of section 6751(b)(1). *See* I.R.C. § 7491(c); *Graev v. Commissioner*, 149 T.C. 485, 493 (2017), *supplementing and overruling in part* 147 T.C. 460 (2016). Section 6751(b)(1) provides that no penalty shall be assessed unless "the initial determination" of the assessment was "personally approved (in writing) by the immediate supervisor of the individual making such determination." The parties' stipulations show that the section 6662 penalty was properly approved.

B. *Reasonable Cause*

No penalty is imposed under section 6662 with respect to any portion of an underpayment "if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to [it]." I.R.C. § 6664(c)(1). Tim and Pamela have the burden to establish that they are

excused from the penalty for reasonable cause. *See United States v. Boyle*, 469 U.S. 241, 245 (1985); *Sugarloaf Fund, LLC v. Commissioner*, 911 F.3d 854, 861 (7th Cir. 2018), *aff'g Kenna Trading, LLC v. Commissioner*, 143 T.C. 322 (2014); *Neonatology Assocs., P.A. v. Commissioner*, 115 T.C. 43, 98 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

"The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances." Treas. Reg. § 1.6664-4(b)(1). Generally, "the most important factor is the extent of the taxpayer's effort to assess [his] proper tax liability." *Id.* Circumstances that may indicate reasonable cause and good faith include "an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer." *Id.*

Tim and Pamela argue that they have reasonable cause for the underpayment of tax for 2016 because they lacked relevant legal training and relied on tax advisers both in pursuing the CRAT transactions discussed above and in preparing their 2016 return. To show that their reliance on tax advisers constitutes reasonable cause, Tim and Pamela must show that their reliance was reasonable. *Boyle*, 469 U.S. at 250–51; Treas. Reg. § 1.6664-4(b)(1) ("[A taxpayer's reliance on] professional advice . . . constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith.").

Our Court applies a three-prong test to determine whether a taxpayer reasonably relied on professional advice. Specifically, we analyze whether "(1) [t]he adviser was a competent professional who had sufficient expertise to justify reliance, (2) the taxpayer provided necessary and accurate information to the adviser, and (3) the taxpayer actually relied in good faith on the adviser's judgment." *Neonatology Assocs., P.A.*, 115 T.C. at 99. Reasonable reliance on a professional "is a fact-specific determination with many variables, but the question 'turns on "the quality and objectivity of the professional advice obtained."'" *Am. Boat Co. v. United States*, 583 F.3d 471, 481 (7th Cir. 2009) (quoting *Klamath Strategic Inv. Fund, LLC v. United States*, 472 F. Supp. 2d 885, 904 (E.D. Tex. 2007), *aff'd sub nom. Klamath Strategic Inv. Fund*

ex rel. St. Croix Ventures v. United States, 568 F.3d 537 (5th Cir. 2009)). "Reliance may be unreasonable when it is placed upon insiders, promoters, or their offering materials, or when the person relied upon has an inherent conflict of interest that the taxpayer knew or should have known about." *Neonatology Assocs., P.A.*, 115 T.C. at 98.

C. *Application to Tim and Pamela*

Based on the record before us, we are unable to determine that Tim and Pamela reasonably relied on tax advisers in preparing the return or pursuing the positions reflected in the return. The record does not demonstrate the qualifications of the advisers, the nature of Tim and Pamela's communications with them, or the quality or objectivity of the advice Tim and Pamela received. These facts are necessary to our analysis, and it was Tim and Pamela's burden to provide them. This they did not do.[43] Accordingly, we sustain the determination of the section 6662(a) penalty.

IV. *Conclusion*

For the reasons stated above, we find for the Commissioner on all issues.

We have considered all of the parties' arguments and, to the extent not discussed above, conclude they are irrelevant, moot, or without merit.

To reflect the foregoing and the concessions of the parties,

Decisions will be entered under Rule 155.

[43] Statements made in the Gerhardts' brief without any citations of the record are not facts on which we may rely.