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This issue includes:

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LIFE-5115 7/23

US District Court denies stay of enforcement of order to repatriate foreign assets as security for payment of FBAR judgment, *United States v. Isac Schwarzbaum*

No. 9:18-cv-81147 (USDC, So. Fla), June 9, 2023.

Facts

In the May 2023 edition of *John Hancock Central Intelligence*, we reported on the latest developments in a long line of judgments involving a taxpayer that has been determined to have violated reporting requirements under the Foreign Bank Account Reporting (FBAR) provisions under 31 USC §5314. The Court granted an IRS motion to compel the Taxpayer to repatriate sufficient portions of the unreported foreign assets to secure payment of the judgment, including accrued interest and penalties. Enforcement of the motion was stayed pending Taxpayer's appeal, but as we reported, Taxpayer lost the appeal. Taxpayer has filed another appeal, and now moves to stay enforcement of the repatriation order further. Taxpayer asserts that a stay is appropriate because, if Taxpayer is forced to liquidate his foreign investment accounts, he will face significant and irreparable harm because he "would be required to pay the transaction costs and income tax associated with the liquidation and transfer of his assets into the United States." The IRS answers that none of the four "stay factors" (discussed below) weigh in Taxpayer's favor. It asserts that Taxpayer's proper recourse in these circumstances is to file a "supersedeas" bond (viz., post adequate resources regardless of source to secure payment of the judgment).

Holding

The Court begins by clarifying that to obtain a stay pending appeal, the movant bears the burden of showing that the circumstances justify the court's exercise of its discretion to provide that relief. Citing relevant federal case law, the Court asserts that the four relevant factors are: (1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies. The Court stresses that first two factors are the most critical and that the last two factors merge when the Government is the opposing party as is the case here. The Court holds that Taxpayer has failed to show that any of these factors favor the grant of Taxpayer's motion to stay the order of repatriation. As to the first factor, Taxpayer has raised only one issue that could result in reversal, but that argument is flawed and therefore unlikely to succeed on its merits. As to irreparable harm, Taxpayer has provided no authority for the proposition that the mere possibility of transaction costs and potential capital gain constitute irreparable harm. Rather, as the IRS points out, courts have recognized that potential monetary loss is insufficient to establish irreparable harm. Moreover, Taxpayer has neglected to supply any evidence in support of his factual assertions regarding costs he may incur. Normally, a failure to satisfy the first factor in a motion for stay pending appeal dooms the motion, but the Court goes on to dispose of the final two factors. First, it agreed with the IRS that without a bond, the US faces potentially total loss, citing that Taxpayer's foreign assets fell in value more than $12M while the appeals were considered. Finally, the Court holds that Taxpayer has provided no evidence or argument that the public interest favors a stay of enforcement. Taxpayer's motion for stay is denied.

Takeaway

As we reported in May, taxpayers who ignore the FBAR requirements — and feel secure because the unreported assets are apparently beyond the reach of the IRS and US courts — do so at their peril. We expect that this line of cases and the ruling on this motion will be cited often to support the reach to foreign assets to enforce FBAR requirements.

IRS allows surviving spouse, as personal representative of Decedent's estate, to roll over IRA despite lack of beneficiary designation

IRS Private Letter Ruling 202322014, June 2, 2023.

Facts

Decedent was 78 years old and surviving Spouse was 74 years old at the time of Decedent's death. At his death, Decedent owned an Individual Retirement Account (IRA), maintained by Custodian. Decedent's Last Will and Testament (Will) names Spouse as Decedent's sole personal representative. Decedent's Will was admitted to probate and Spouse was appointed to be the sole personal representative of Decedent's estate with the sole authority to administer the estate. Notably, Decedent did not designate a beneficiary of IRA, and the IRA agreement provides that if no beneficiary is designated for IRA, the account balance in IRA remaining at Decedent's death is payable to Decedent's estate. Decedent's Will leaves Decedent's entire residual estate, which includes IRA, solely to Spouse. At all times after the death of Decedent, IRA has been maintained in the name of Decedent. At the time of passing, Decedent had received all distributions required under §401(a)(9). In Spouse's capacity as the sole personal representative of Decedent's estate, Spouse intends to (i) direct the payment of IRA to Spouse, and (ii) direct the payment to herself as sole residual beneficiary of Decedent's estate. Within 60 days of the date the proceeds are paid, Spouse then intends to roll them over into an IRA maintained in her name. Spouse represents that IRA has satisfied the requirements of §408 at all relevant times, and any rollover IRA set up by Spouse will satisfy the requirements of §408 at all relevant times. Spouse requests the following rulings from the IRS: (1) Spouse will be treated for the purposes of §§408(d)(1) and 408(d)(3) as the payee or distributee of the proceeds from IRA; (2) IRA will not be treated as an inherited IRA with respect to Spouse; (3) Spouse will be eligible to roll over the proceeds from IRA into an IRA set up and maintained in Spouse's name, as long as the rollover occurs no later than the 60th day after the date the proceeds are paid to Decedent's estate; and (4) Spouse will not be required to include in Spouse's gross income any portion of the IRA proceeds timely rolled over to an IRA set up and maintained in Spouse's name.

Holding

The IRS was able to provide Spouse with the requested rulings. First, IRC §408(d)(1) provides that, except as otherwise provided in §408(d), any amount distributed out of an IRA shall be included in gross income by the distributee under §72. However, this required treatment does not apply to any amount distributed to the beneficiary of the IRA if that amount is "rolled over" into another IRA or other eligible retirement plan for the benefit of the distributee within 60 days of the date of the distribution. Generally, if a decedent's IRA proceeds pass through a third party (for example, an estate) and then are distributed to the decedent's surviving spouse, the surviving spouse will be treated as having received the proceeds from the third party and not from the decedent's IRA. Thus, generally, a surviving spouse will not be eligible to roll over the IRA proceeds into the surviving spouse's own IRA. However, the general rule will not apply in a situation in which the decedent's estate is the beneficiary of a decedent's IRA proceeds, and the decedent's surviving spouse is the sole administrator of the estate and the sole beneficiary of the IRA proceeds that pass through the estate. Under these circumstances, no third party can prevent the surviving spouse from receiving the proceeds of the IRA and from rolling over the proceeds into the surviving spouse's own IRA. Under the facts presented, the IRA account balance remaining at Decedent's death is payable to Decedent's estate under the terms of Decedent's Will. Spouse, Decedent's surviving spouse,

is the sole personal representative of Decedent's estate and the sole residual beneficiary under Decedent's Will. As personal representative, Spouse can cause the IRA proceeds to be paid to Decedent's estate and then to Spouse as the residual beneficiary of Decedent's estate. Accordingly, for purposes of §408(d)(3)(A), Spouse is effectively the individual for whose benefit IRA is maintained. Thus, if Spouse receives the IRA proceeds, Spouse may roll over the proceeds into one or more IRAs set up and maintained in Spouse's name, provided that all other applicable rules of §408(d)(3) are satisfied.

Takeaway

Oliver Wendell Holmes, Jr. famously wrote that "The life of the law has not been logic; it has been experience." This ruling serves as a reminder that in some cases, it can be both. If no one can prevent a surviving spouse from receiving the full balance of a decedent's IRA, then there is no legal or equitable reason to treat the IRA any other way than as the surviving spouse being the named beneficiary on the IRA and, therefore, being able to roll the IRA balance over as the Spouse's own (non-inherited) IRA.

Tax Court excludes Taxpayer's discharge of indebtedness from gross income due to insolvency

Katrina E. White v. Commissioner, No. 15886-18, T.C. Memo. 2023-77, June 21, 2023.

Facts

Petitioner owned and operated LLC in Wisconsin. In 2015, Petitioner signed a promissory note to Bank for a small business loan of $15,000. Petitioner's business struggled and brought in little revenue. Between July 2015 and February 2016, Petitioner made five payments on the loan totaling $661, but made no further payments. In November 2016, Bank charged the loan off its books. Bank issued Petitioner a Form 1099-C, Cancellation of Debt, reporting discharge of debt totaling $14,433. In April 2015, Petitioner had entered into a three-year lease with Properties for office space for her business beginning June 2015 and terminating May 2018. The lease included an acceleration clause stating that, if rent was late for more than two months, the full amount on the remaining lease would be immediately due in full and had to be paid on the third month. Petitioner breached her lease with Properties in January 2016. In November 2015 Petitioner received an $8,000 loan from her family to help with her struggling business. Petitioner did not enter into a written loan agreement or set a repayment schedule, and the record is unclear as to whether any interest was charged. Petitioner had made two payments of $100 each toward the loan at the time her small business loan debt was discharged. Petitioner timely filed her 2016 federal income tax return. She reported as her only income for the year wage income of $29,140. She claimed a standard deduction of $9,300 and exemptions totaling $12,150 for a taxable income of $7,690. Petitioner did not report the discharge of indebtedness on her return. The IRS examined Petitioner's return and determined that the discharge of indebtedness represented gross income to Petitioner. The IRS issued a Notice of Deficiency, and Petitioner timely petitioned this Court for redetermination. Petitioner appeared pro se.

Holding

As our readers are accustomed to seeing, the Court begins by stating that the IRS determination set forth in a Notice of Deficiency is presumed correct and the taxpayer bears the burden of proof of showing that the determination is in error, such as (in the Seventh Circuit, anyway, as this case is) by showing that the assessment is arbitrary and excessive or lacks a rational foundation. Similarly, in cases involving unreported income (such as the present case), this showing is typically made when the IRS makes no evidentiary

showing at all but simply rests on the presumption of correctness or when its evidence completely fails to link the taxpayer to the alleged unreported income. Although IRC §61(a) defines gross income as "all income from whatever source derived," including income from discharge of indebtedness, §108(a) provides certain exceptions under which discharge-of-indebtedness income is excluded from income. For purposes of §108, "insolvent" means that the taxpayer's liabilities exceed the fair market value of her assets. The amount of the exclusion is limited to the amount by which the taxpayer is insolvent, i.e., the amount by which the taxpayer's liabilities exceed the fair market value of her assets. Citing Tax Court authority, the Court states that a taxpayer claiming the benefit of the insolvency exception must prove (1) with respect to any obligation claimed to be a liability, that, as of the calculation date, it is more probable than not that she will be called upon to pay that obligation in the amount claimed, and (2) that the total liabilities so proved exceed the fair market value of her assets. Petitioner does not dispute that the loan was discharged in 2016. Rather, she argues that the discharge of the debt should be excluded from income because she was insolvent at the time of discharge. Petitioner provided the IRS and the Court with an insolvency worksheet that Petitioner alleges shows her assets and liabilities at the time of the discharge of indebtedness, as well as supporting documentation of the listed items, including loan documents, the lease agreement and correspondence between Petitioner and her creditors. The Court finds that Petitioner's liabilities totaled $51,636, while the value of her assets totaled $32,060. As a result, Petitioner's discharge-of-indebtedness income is excluded from her gross income for federal income tax purposes.

Takeaway

In our industry, we are trained to reflexively consider most discharge of indebtedness as includible in gross income for federal income tax purposes, which is probably accurate in the vast majority of cases that we come across. However, not always. Petitioner reminds us that all accretions to wealth are taxable under the Internal Revenue Code unless another provision of the Code allows otherwise, such as IRC §108. Also, despite the favorable outcome for the Petitioner, readers should not conclude from this case that representing oneself is usually a good idea.

Taxpayer fraudulently fails to file returns and pay tax for at least seven years despite more than $3.5M in income

Claude Franklin Sanders v. Commissioner, No. 14986-19, T.C. Memo. 2023-71, June 2, 2023.

Facts

Taxpayer resided in Tennessee at all times relevant to this case and was self-employed as a gold and silver broker and a writer from 1980 through at least 2016. Taxpayer began conducting these businesses in Arkansas but fled the state after an adverse state sales tax decision for failure to withhold sales tax on his brokerage transactions. Taxpayer moved his business to Tennessee, where he again faced state sales tax litigation. In 1998 Taxpayer sold his business to Buyer and thereafter provided consulting services to Buyer. In this role Taxpayer managed Buyer's website, drafted Buyer's monthly newsletter and provided office management services between 2009 and 2016. During these years Taxpayer submitted invoices to Buyer for his consulting services. Most of the invoices were for services valued in excess of $10,000, and he instructed Buyer to split the payments into installments of less than $10,000. Buyer paid the invoices in checks made out to "cash." In addition to these payments for services, Buyer would pay Taxpayer bonuses based

on business performance. Despite receiving this income, Taxpayer did not file income tax returns for tax years 2008 through 2018. Likewise, Taxpayer did not make estimated tax payments. The IRS conducted an examination for Taxpayer's tax years at issue. Throughout the examination, Taxpayer failed to communicate with the IRS's agent and did not attend the initial meeting. Taxpayer also failed to comply with document requests for his business records, allegedly because he had no records. Respondent prepared "substitutes for return" for the years at issue, showing no estimated taxes paid. On May 14, 2019, the IRS issued Taxpayer a Notice of Deficiency for the years at issue, determining unreported income in the amount of $3,492,526 and the deficiency, plus penalties, to be approximately $2,927,000.

Holding

Prepare yourself for some light summer fiction. Taxpayer argues that the payments he received from Buyer are not taxable because he is not an "individual" subject to tax. Specifically, Petitioner contends that he is a "citizen," not an "individual." Petitioner relies on IRC §7701(a)(1), defining "person" as an "individual." Petitioner then argues that because "citizen" and "person" are listed together in various Code sections, the two are mutually exclusive and thus so are "citizen" and "individual." Unfortunately for Taxpayer, his theory that citizens do not need to pay federal income tax has been consistently and for many, many decades rejected as frivolous by the Tax Court. The regulations under IRC §1 define an individual subject to tax as any "individual who is a citizen or resident of the United States." See Treas. Reg. § 1.1-1(a). A citizen is defined as "[e]very person born or naturalized in the United States and subject to its jurisdiction." See id. para. (c). Taxpayer is a citizen and, therefore, an individual and is a resident of the United States. Therefore IRC §1 imposes a tax on his income which, for the periods under examination, was $3,492,526. The Court then completes the analysis by establishing the jurisdiction, burden and standard faced by the IRS to establish separate penalties for failure to timely file and failure to pay timely the tax due — and the fraudulent intent necessary for each.

Takeaway

This case is noteworthy primarily because of the audacity of the taxpayer and the sheer numbers. After trouble with the state departments of revenue of Arkansas and Tennessee, and with the IRS and federal courts, Taxpayer appears unbowed and unbroken, but taxed nonetheless.

Wellness indemnity payments under employer-provided cafeteria plan are includible in employee gross income and subject to employment taxes

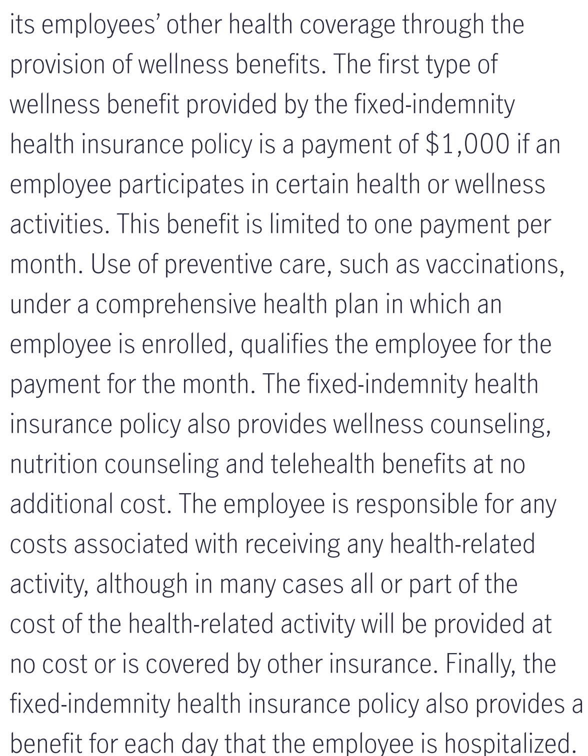
Internal Revenue Service Legal Memorandum (ILM) 202323006, May 9, 2023.

Facts

An Employer provides comprehensive health coverage for its employees through a group health insurance policy. The comprehensive health coverage provides preventive care benefits, such as reimbursements for the cost of flu shots and other vaccinations, without any cost sharing for covered individuals. The coverage constitutes accident or health coverage for purposes of the exclusion for employer-provided accident or health coverage under IRC §106(a).

In addition to the health coverage, the Employer provides all employees, regardless of enrollment in other comprehensive health coverage, with the ability to enroll in coverage under a fixed-indemnity health insurance policy that would qualify as an accident and health plan under §106. Employees pay monthly $1,200 premiums for the fixed-indemnity health insurance policy by salary reduction through a §125 cafeteria plan. The only payments that the insurance company receives with respect to the insurance provided to the employees are the premium payments. In other words, the Employer has no liability for any costs incurred by the insurance company that may exceed the premiums paid by its employees.

The Employer's fixed-indemnity health insurance policy is a voluntary program primarily intended to supplement



its employees' other health coverage through the provision of wellness benefits. The first type of wellness benefit provided by the fixed-indemnity health insurance policy is a payment of $1,000 if an employee participates in certain health or wellness activities. This benefit is limited to one payment per month. Use of preventive care, such as vaccinations, under a comprehensive health plan in which an employee is enrolled, qualifies the employee for the payment for the month. The fixed-indemnity health insurance policy also provides wellness counseling, nutrition counseling and telehealth benefits at no additional cost. The employee is responsible for any costs associated with receiving any health-related activity, although in many cases all or part of the cost of the health-related activity will be provided at no cost or is covered by other insurance. Finally, the fixed-indemnity health insurance policy also provides a benefit for each day that the employee is hospitalized.

Under the fixed-indemnity health insurance policy, the wellness benefits are paid from the insurance company to the Employer, which then pays out the wellness benefit to employees via the Employer's payroll system.

Holding

In this chief counsel advice, the IRS considered what portions of payments under the plan described would be taxable to the employees. To begin with, in general, IRC §106(a) provides that gross income of an employee does not include employer-provided coverage under an accident or health plan, such as premiums for accident or health insurance coverage that are paid by an employer. On the other hand, §105(a) provides that, generally, amounts received by an employee through accident and health insurance for personal injuries or sickness are included in gross income to the extent the amounts (1) are attributable to contributions by the employer which are not includible in the gross income of the employee or (2) are paid by the employer. Section 105(b) provides that gross income does not include amounts paid by an employer to reimburse an employee for expenses incurred by the employee for medical care as defined in §213(d). The exclusion under §105(b) is limited to amounts paid solely to reimburse expenses actually incurred for medical care and does not apply to amounts that the taxpayer would be entitled to receive irrespective of whether expenses for medical care are incurred.

Under §125, an employer may establish a cafeteria plan that permits an employee to choose among two or more benefits, consisting of cash (generally, salary) and qualified benefits, including accident or health coverage. Under §125, the amount of an employee's salary reduction through a cafeteria plan applied to purchase health coverage is not included in gross income, even though it was available to the employee and the employee could have chosen to receive cash instead. If an employee elects salary reduction pursuant to §125 to pay for health coverage, the coverage is excludable from gross income under §106 as employer-provided accident or health coverage.

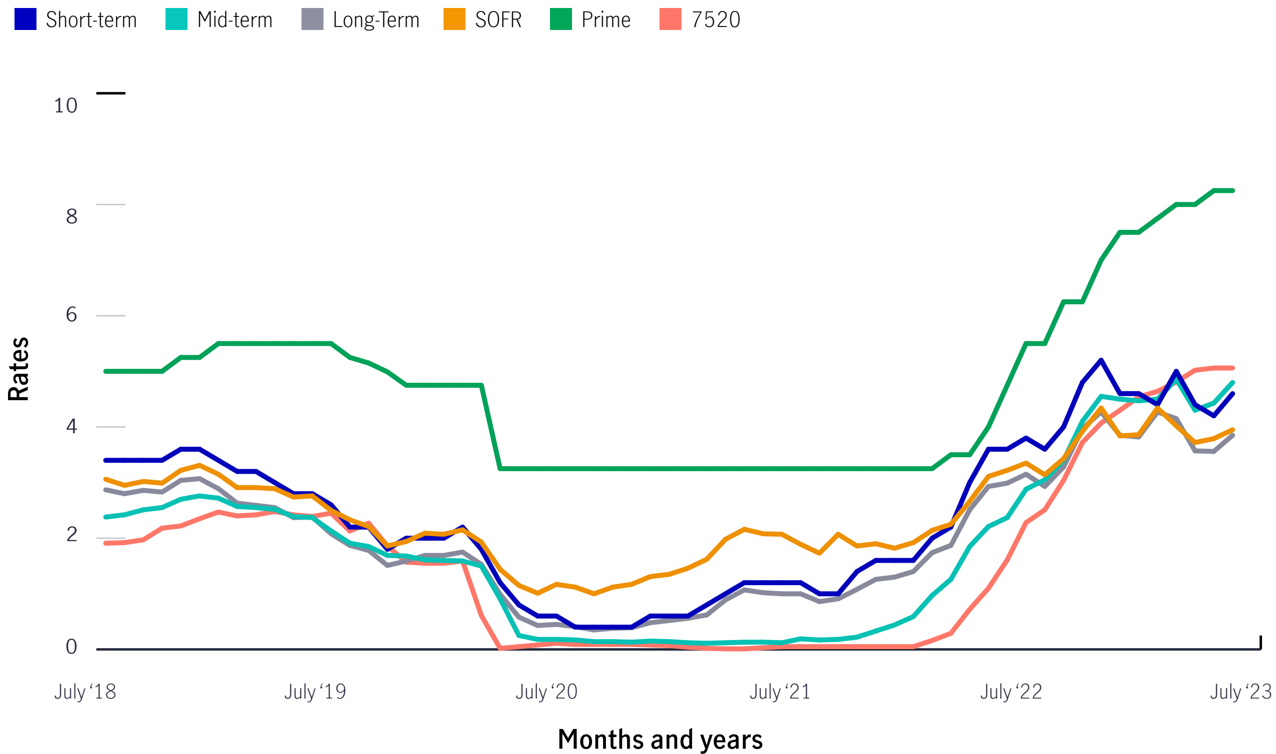
A fixed-indemnity health insurance policy is an insurance policy that pays covered individuals a specified amount of cash for the occurrence of certain health-related events, such as office visits or days in the hospital. Similarly, a critical disease or specific disease policy pays a specific amount for the diagnosis of a particular disease. The amount paid is not related to the amount of any medical expense incurred or coordinated with other health coverage. For these reasons, amounts paid to an employee that are attributable to contributions made by the employer that were not includible in the gross income of the employee are taxable to the employee and subject to employment taxes (such as Social Security and Medicare taxes).

Takeaway

Some employee benefits are taxable and some enjoy at least partial exclusion, but it isn't always obvious at first glance which are which. Guidance by competent tax and legal counsel should be sought when considering employee benefits to determine the full tax consequences of the contemplated plan alternatives.

The following are historical graphs of various rates that are commonly used by the Advanced Markets group

Short, Mid, Long Term Applicable Federal Rate (AFR), 7520, SOFR, Prime Rates from July 2018 – July 2023



Take a look at how rates compare this month to last month*

	Short-term AFR	Mid-term AFR	Long-term AFR	7520	SOFR	Prime
July 2023	4.80%	3.85%	3.98%	4.60%	5.06%	8.25%
June 2023	4.43%	3.56%	3.79%	4.20%	5.06%	8.25%

*For more information on these rates please visit https://www.irs.gov/applicable-federal-rates

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