John Hancock

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This issue includes:

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INSURANCE PRODUCTS	MAY LOSE VALUE	NOT A DEPOSIT
NOT BANK GUARANTEED	NOT FDIC INSURED	
NOT INSURED BY ANY GOVERNMENT AGENCY		

LIFE-5115 8/24

DC Circuit finds "inventory gain" attributable to nonresident taxpayer's sale of partnership interest is not US-source income

Rawat v. Commissioner, 134 AFTR 2d 2024-5131 (D.C. Cir.)

Facts

Taxpayer is a nonresident alien who made several investments in a US-based company (Company), ultimately accumulating a 29.2% interest. Company is taxed as a partnership. In 2008, Taxpayer sold her shares back to Company in exchange for a note. The $438 million sale price included $6.5 million of gain on Company's inventory. Taxpayer recognized $6.5 million of ordinary income in 2008, but there was no agreement with the IRS regarding the situs of that income. The IRS contended it was US-source income, and that Taxpayer therefore owed about $2.3 million in taxes. Taxpayer eventually paid the tax (and penalties, interest, and other adjustments) and petitioned the Tax Court for a refund. The Tax Court agreed with the IRS, finding that §751(a) requires any gain attributable to the sale of inventory within a partnership to be taxed to the partner as a sale of the inventory, rather than of a partnership interest. Taxpayer appealed to the D.C. Circuit.

Holding

This case involves both partnership taxation and income taxation of nonresident aliens (NRAs). Under §741 of the Internal Revenue Code (Code), any gain or loss from the sale of a partnership interest is treated as a gain or loss of a capital asset. Section 741 applies "except as otherwise provided in section 751 (relating to unrealized receivables and inventory items)." Section 751(a) provides that gain from "unrealized receivables" or "inventory items" of a partnership is taxable as ordinary income rather than as a capital gain. Regarding income taxation of NRAs, they are taxed only on US-source income. While the 2017 Tax Cuts and Jobs Act (TCJA) provides that income from the sale of a United States partnership is US-source income, this case predates the TCJA. The Code provisions regarding the sale of personal property, therefore, govern this transaction. Those provisions generally treat income from an NRA's sale of personal property as foreign-source income but may consider income from an NRA's sale of inventory as US-source income, depending on the context. Both parties agree that if the inventory gain is treated as income from the sale of a partnership interest that it is foreign-source income and therefore not taxable to Taxpayer. The question is whether §751(a) deems inventory gain from the sale of a partnership interest to be gain from the sale of inventory (and therefore taxable, under these circumstances, as US-source income). To answer that question, the Court dives deeply into the statutory language. Because the statute mirrors the language used in the definition of "ordinary income," the Court concludes that if Congress wanted inventory gain to "be considered as an amount realized from the sale or exchange of" such property, rather than as ordinary income, it would have drafted the statute differently. To buttress this conclusion, the Court points to §751(b)(1), where Congress did use the phrase "such property." The Court finds the IRS's other arguments relating to legislative history unpersuasive and finds in favor of the taxpayer.

Takeaway

While the 2017 passage of the TCJA renders this particular issue moot, the decision itself is a comprehensive education in statutory interpretation.

District Court upholds IRS's jeopardy assessment

***Geiger v. U.S.,* 134 AFTR 2d 2024-5119 (DC FL).**

Facts

Decedent participated in the Offshore Voluntary Disclosure Program (OVDP), which the IRS introduced in 2012 to provide amnesty from certain financial penalties and prison to taxpayers willing to disclose income from foreign sources and pay the associated taxes. Under the OVDP, in 2012 Decedent disclosed foreign-source income from 2003 through 2010, including from Foreign Foundation. Decedent indicated in his filings that Foreign Foundation was a grantor trust and that his tax liability was just over $6 million. Decedent made an initial payment of about $2 million. In 2015, Decedent died. Decedent's son was the executor of his estate and Plaintiff in this action. Several months after Decedent's death, the IRS sent Plaintiff a letter asking him to "approve and conclude the 2012 OVDP" by essentially ratifying Decedent's actions. Plaintiff refused, and claimed that Decedent's Foreign Foundation was a non-grantor trust (which would receive more favorable tax treatment). The IRS requested additional information on Foreign Foundation, which Plaintiff provided in 2017. In 2020, Plaintiff filed a statement with the IRS again asserting that Foreign Foundation was a non-grantor trust, which the IRS disputed in its response several months later. The IRS again asked Plaintiff to approve and sign a document to conclude the OVDP, which would ratify the treatment of Foreign Foundation as a grantor trust. Plaintiff again refused, and in 2021 disclosed to the IRS that the Estate distributed a majority of the assets, leaving only $1 million to conclude the OVDP. Plaintiff also indicated that "the beneficiaries of the Estate are unable to pay the balance due with the current treatment [of Foreign Foundation as] a grantor trust." The IRS officially removed Decedent from the OVDP on January 6, 2023. Around 2015, shortly after receiving notice from the IRS regarding Decedent's tax liability, Plaintiff consulted with financial and legal professionals. He entered into a settlement agreement with his mother and, in July 2017, transferred the bulk of the estate to four irrevocable Wyoming trusts (Trusts). Trusts funded personal expenses of Plaintiff and his mother, including a personal residence and a lavish wedding featured in *Brides* magazine. Mother claimed she was receiving "tax free earnings," while Plaintiff had little income and $25,000 in monthly expenses. It is not clear how much was disbursed from Trusts to Plaintiff and his mother, but there were several years of disbursements before Plaintiff informed the IRS that neither the estate nor the beneficiaries could pay the tax liability. In December 2023, the IRS issued a notice of assessment against the Estate of about $15 million (significantly more than the liability under the OVDP) and also issued a notice of jeopardy assessment. The jeopardy assessment was based on Plaintiff's distribution of assets to himself and his refusal to pay the estate's tax liability. Plaintiff filed this action challenging the jeopardy assessment in May 2024.

Holding

The Court begins with a review of the typical tax controversy procedure: a taxpayer litigates a tax dispute in tax court and, if the result is a decision in favor of the government, the IRS begins collecting the tax due, along with any penalties and interest. If, however, a taxpayer disputes a tax and the IRS is concerned that litigation would impair its ability to collect a tax because of the time involved, the IRS may initiate a "jeopardy assessment" under IRC §6861, prior to the resolution of the Tax Court proceedings. Section 7429 of the Code then provides the taxpayer with an expedited review of the jeopardy assessment. Courts consider two questions when reviewing a jeopardy assessment: was the assessment reasonable, and if so, was the amount assessed appropriate? The IRS bears the burden of proving that a jeopardy assessment was reasonable, based on the circumstances. The burden then shifts to the taxpayer to show that the amount assessed was not appropriate. Evidentiary

standards are more permissive in this inquiry. IRS Regulations provide three examples of when a jeopardy assessment is reasonable: the taxpayer i) appears to be either leaving the US or concealing themselves; ii) appears to be placing their property beyond the reach of the Government (by concealing, dissipating or transferring it); or iii) may be or become financially insolvent. These circumstances are not exclusive, however, and other courts have considered additional factors, such as evidence of criminal activity, sufficiency of assets to satisfy the tax, dissipation of assets through attorney's fees or forfeiture, and whether the taxpayer has made it difficult to locate the assets. Here, the IRS asserts that the jeopardy assessment is reasonable because 1) Plaintiff transferred almost all of the assets out of the estate without informing the IRS; 2) by transferring assets to Trusts, Plaintiff impaired the IRS's ability to collect the assets; 3) Trusts invested in illiquid assets, further hampering the IRS's collection efforts; 4) Plaintiff was aware of the estate's tax liability when he transferred assets to himself and his mother; and 5) Plaintiff and his mother do not have other sources of income to pay their expenses (or this tax liability) and rely on the Estate assets. The Court is unmoved by Plaintiff's contentions that the IRS was slow to act after learning of the depletion of the Estate's assets, that he provided the requested information to the IRS, and that the Trusts can pay the tax liability once it is finally determined. The Court finds in favor of the IRS, noting first that §7429 is "'most notable for its silence' and lack of specific requirements." There is no requirement that the IRS act with any particular speed — the question before the Court is just whether the jeopardy assessment was reasonable. With respect both to the IRS's speed (or lack thereof) and motivations behind the jeopardy assessment, the Court finds the IRS acted reasonably. The Court also notes that the specific facts of this case, including the transfer of funds out of the estate and personal use of the funds, as well as the past criminal conduct of Decedent (as admitted in his OVDP filings) and Plaintiff's apparent continuation of some of Decedent's tactics (including transferring assets offshore) support finding that the assessment is reasonable. With respect to the amount of the assessment, the Court finds that Plaintiff failed to prove that the method of computing the assessment was "fatally defective, irrational, arbitrary, or unsupported." The final taxable amount will be determined in the Tax Court proceeding, but the Court finds the amount of the jeopardy assessment appropriate.

Takeaway

Speed is relative. While the Plaintiff was found to be "quickly" dissipating assets over the pendency of this dispute, and thus jeopardizing the IRS's ability to collect, the Court did not consider the years between the IRS's communications with Plaintiff unreasonable.

Eighth Circuit affirms that Indian tribe members are subject to self-employment taxes

***Bibeau v. Commissioner,* U.S. Tax Court No. 23-2923 (2024).**

Facts

Taxpayer is an enrolled member of the Minnesota Chippewa Tribe. He lives and practices law on a Reservation in Minnesota. For tax years 2016 and 2017, Taxpayer reported self-employment income from his legal practice. He also reported a large net operating loss carryforward, which offset his income tax liability for those years; it did not, however, negate his self-employment tax liability. In 2019, Taxpayer requested a Collection Due Process (CDP) hearing, where he argued that his income was exempt from self-employment tax. His argument was unsuccessful, and he was issued a notice of determination, upholding the tax. Taxpayer petitioned the Tax

Court, arguing that Indians are generally exempt from federal taxes (including self-employment tax) or, in the alternative, that specific treaties between the government and his tribe exempted his income from federal taxes. Taxpayer based this argument on his understanding that Congress must expressly authorize federal taxation of Indians, which neither the Indian Citizenship Act of 1924 (1924 Act) nor the 1837 Treaty between the United States and the Minnesota Chippewa Tribe (1837 Treaty) do. The Tax Court disagreed, sustaining the notice of determination, and Taxpayer appealed.

Holding

The Court dispenses with Taxpayer's first argument quickly. Citing longstanding precedent and the Internal Revenue Code, the Court explains that, as US citizens, Indians are generally subject to taxation. With respect to Taxpayer's assertion that federal taxation requires express authorization by Congress, the Court cites a litany of cases that hold otherwise: Indians are "subject to federal income tax unless specifically exempted by treaty or statute." In determining whether there is such an exemption, the treaty or statute must have language "which can reasonably be construed to confer income exemptions." While any ambiguity should be interpreted in favor of the tribe, the treaty or statute cannot confer an exemption by implication. Taxpayer contends that the 1924 Act's provision that "the granting of such citizenship shall not in any manner impair or otherwise affect the right of any Indian to tribal or other property" exempts Indians from federal income tax. The Court disagrees, explaining that Congress's intent behind that provision was to "place individual Indians who have abandoned tribal relations . . . upon the same footing" with respect to tribal property as Indians who maintained those relations. Citing precedent, the Court explains that the particular provision is not an income tax exemption. Taxpayer's attempt to find an exemption in the 1837 Treaty likewise fails. Article 5 of the 1837 Treaty guarantees to Indians "[t]he privilege of hunting, fishing, and gathering the wild rice, upon the lands, the rivers and the lakes included in the territory ceded." Taxpayer concedes that the 1837 Treaty does not mention taxation but relies on a 1999 case that found the 1837 Treaty protected the Chippewas' right "to make a 'modest living' from hunting, fishing, and gathering wild rice." The Court agrees with the holding, but notes that the case says nothing about making a "modest living" tax-free. Taxpayer's final argument, asserting tribal "sovereign tax immunity," is also unsuccessful, as the statutes cited referred only to state taxation. Because no statute or treaty expressly exempts Indians from federal taxation, the Court affirms the Tax Court's determination.

Takeaway

Be wary of arguments made by attorneys representing themselves in Tax Court. While many Indians living on tribal lands are not subject to state-level taxation, courts have repeatedly found that federal taxes apply, including income and excise taxes.

IRS issues final regulations on required distributions from qualified plans

89 FR 58886, July 19, 2024.

After the passage of the SECURE Act in 2019 (SECURE), many beneficiaries of inherited qualified plans lost the ability to "stretch" the tax benefits of the plans over their lifetimes, and instead had just 10 years to distribute (and pay taxes on) the accounts. These rules did not apply to eligible designated beneficiaries (EDBs), which include surviving spouses, minor children, and disabled or chronically ill individuals. The IRS

proposed regulations in 2022 that suggested that if a non-eligible designated beneficiary inherited the account from a participant who died after their required beginning date (RBD), that beneficiary would have to take required minimum distributions (RMDs) every year, in addition to withdrawing the full account balance after 10 years. The IRS received many comments on this proposed regulation. Given the steep penalty for missing a required distribution, IRS notices covering tax years 2021–2024 essentially waived the requirement to take a distribution from an inherited account during those years. On July 19, 2024, the IRS issued its final regulations, which will apply for tax years beginning in 2025. The final regulations closely follow the proposed regulations, including the requirement for beneficiaries to take minimum distributions from accounts of participants who died after their required beginning date. Other notable changes in the final regulations include:

- **Year-of-death RMDs:** The final regulations clarify language to make it clear that any beneficiary can take these RMDs, rather than having to divide them ratably among all beneficiaries. If, however, the deceased participant has more than one account and the accounts have different beneficiaries, then the RMD must be taken proportionally from each account but can be divided among the beneficiaries of each account in any way. For those beneficiaries who fail to take a year-of-death RMD by the end of the year, the final regulations extend the automatic penalty waiver to December 31 of the year following the date of death.
- **Surviving spouses:** Surviving spouses have no deadline to rollover a deceased participant's account into their own. While this is no different from the current rule, it is a departure from the proposed regulations. The final regulations do, however, maintain the "hypothetical RMD" requirement of the proposed regulations. If a surviving spouse initially opts to treat the account as an inherited IRA and use the 10-year rule to forego RMDs (assuming the participant died before their RBD) and later decides to roll over the account into their own name within that 10-year period, they will need to "make-up" any RMDs that they would have been required to take had they rolled over the account.
- **Minority ends at age 21:** Another important clarification is that minority ends at age 21, regardless of state law. Upon reaching age 21, minors will have to continue taking stretch-style RMDs during the following 10 years, even if the participant died before their RBD.
- **Different documentation requirements for disabled and chronically ill beneficiaries:** In one of the rare instances where employer-sponsored plans are treated differently from IRAs, disabled and chronically ill (DCI) beneficiaries of employer-sponsored plans are required to submit documentation by October 31 of the year after the participant's death to take advantage of the stretch rules. For disabled beneficiaries, a Social Security disability determination or a doctor's note will suffice, while chronically ill beneficiaries must submit a certification from a licensed healthcare professional. There is no similar documentation requirement for DCI beneficiaries of IRAs (although they still must meet the definition of disabled or chronically ill under the SECURE Act).
- **RBD for employer-sponsored Roth Accounts:** If a participant's only employer-sponsored plan account is a Roth account, then they will be deemed to have died before their RBD. This is the same treatment that a Roth IRA participant receives. If, however, a participant has funds in both an employer-sponsored Roth account and a traditional employer-sponsored account, then the funds in the Roth account would be subject to annual distributions during the 10-year rule if the participant died after their RBD.
- **RMDs for trust beneficiaries:** The final regulations clarify that for see-through trusts that are divided into separate sub-trusts for each beneficiary at the participant's death, distributions will be determined separately for each sub-trust. Before SECURE, in most cases withdrawals were based on the trust beneficiary with the shortest life expectancy. The final rule expands on the rules in the proposed regulations, which only allowed such treatment if at least one of the trust beneficiaries were disabled or chronically ill.

IRS issues (more) proposed regulations on the SECURE Act

89 FR 58644, RIN 1545-BQ66, July 19, 2024.

In addition to the final regulations, the IRS also proposed new regulations related to the SECURE Act. First, they clarified that the required beginning date for individuals born in 1959 is 73 (a drafting error in SECURE 2.0 resulted in those born in 1959 having to begin taking RMDs at both 73 and 75). The proposed regulations also clarify that distributions from a Roth do not count towards a participant's RMD for the year and expand on the many rules around treating a surviving spouse as the deceased participant spouse.

Comments must be received by September 17, 2024, and a hearing is scheduled for September 25, 2024.

Two courts issue injunctions against the Department of Labor's fiduciary rule

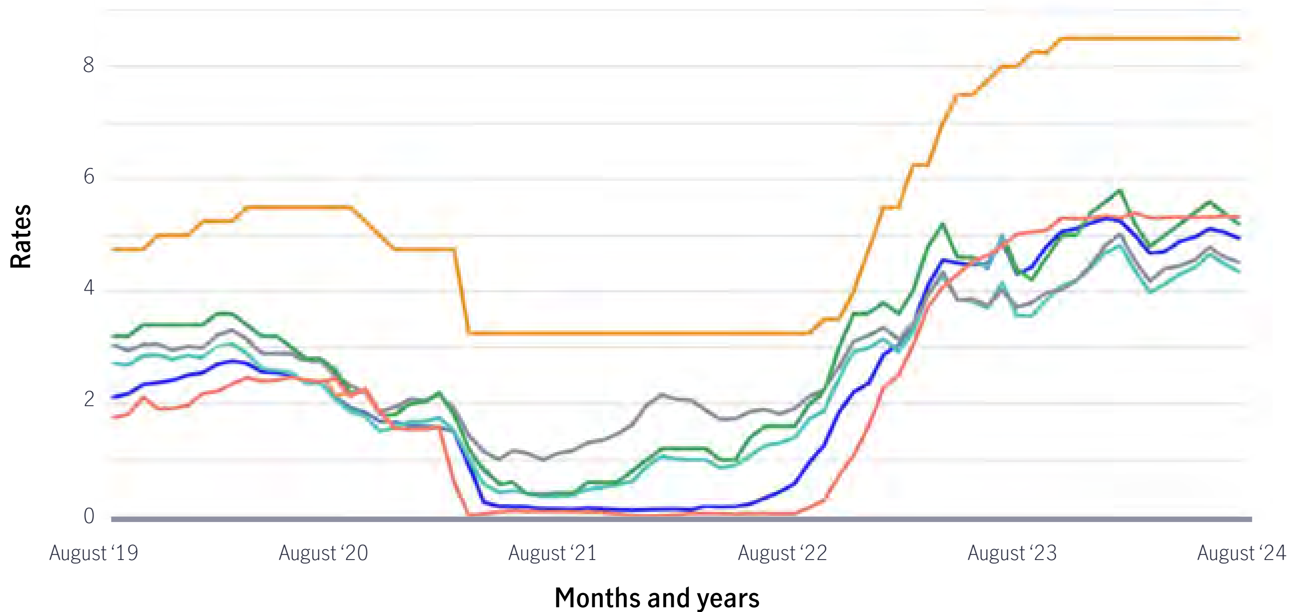
***FACC v. Department of Labor,* 6:24-cv-163-JDK (E.D. Tex., July 25, 2024) and *ACLI v. Department of Labor,* 4:24-cv-00482-O (N.D. Tex., July 26, 2024).**

The effective date of the Department of Labor's (DOL) fiduciary rule, finalized in May (and covered in our **May issue of CI**), has been stayed by two Texas courts. The September 23, 2024 effective date is now on hold nationwide, pending the resolution of these cases. These stays apply both to the effective date of the fiduciary rule and the proposed amendments to PTE 84-24 and 2020-02. In each case, the judge found that the plaintiffs challenging the rule were likely to succeed on the merits (in the words of one judge, "virtually certain"); these are the same judges who will rule on the case. If the DOL appeals either ruling, the Fifth Circuit Court of Appeals will hear the case — the same circuit that struck down the 2016 version of the rule.

Where does that leave us with respect to fiduciary status right now? The five-part test that was in effect before the 2016 rule was finalized, and again after the Fifth Circuit invalidated the 2016 rule, is again the law. That test, however, was modified by PTE 2020-02, which was narrowed by a Florida court in 2023, and is now in litigation in Texas. How the DOL will proceed with all of this litigation will likely depend in part on the outcome of the November elections.

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 August 2019 – August 2024



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

	Short-term AFR	Mid-term AFR	Long-term AFR	7520	SOFR	Prime
August 2024	4.95%	4.34%	4.52%	5.20%	5.33%	8.50%
July 2024	5.06%	4.49%	4.61%	5.40%	5.34%	8.50%

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

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