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Table of Contents

The "Infinite Banking" Mirage: Tax and Structural Realities for S-Corporations

Overview

The "Infinite Banking Concept" (IBC) is being heavily promoted across multiple digital platforms, particularly through niche influencers, insurance agents, and specialized media channels. The IBC is a financial strategy centered on the use of dividend-paying, high-cash-value whole life insurance policies as a personal "private bank." The core philosophy suggests that by overfunding a policy and utilizing its liquidity through policy loans, a business owner can reclaim the interest they would otherwise pay to third-party lenders, effectively financing their own business operations or personal purchases. Proponents frame this as a way to achieve "financial recoupment," where the individual acts as both the lender and the borrower, allowing their capital to continue growing through compound interest and dividends even while it is being "used" via a loan.

However, while the concept looks good on a spreadsheet, its integration into a corporate tax structure often conflicts with the Code and Treasury Regulations regarding debt, interest deductibility, and economic substance. Those rules effectively dismantle the anticipated "tax wash" (claiming an interest expense deduction at the corporate level that offsets taxable income at the personal level).

I.R.C. §264 and the Disallowance of Interest

The first and most formidable obstacle to the IBC strategy is I.R.C. §264. While many proponents of Infinite Banking suggest that policy loans are "private" and thus outside the scope of typical IRS scrutiny, the Code is specific regarding debt incurred to carry life insurance.

I.R.C. §264(a)(3) explicitly states that no deduction is allowed for any amount paid or accrued on indebtedness incurred to purchase or carry a life insurance contract if the debt is part of a "plan of purchase" that contemplates the systematic borrowing of the policy's cash value.[1]

The IRS looks at the *substance* of the plan, not just the labels used. If a business owner consistently borrows from their policy to fund S-Corp operations or personal expenses, they are effectively demonstrating a "plan of purchase" for systematic borrowing. The IRS does not require a written contract stating an intent to borrow; the pattern of behavior is sufficient evidence. Consequently, the interest paid on these loans is strictly non-deductible. The classic "substance over form" Supreme Court case is *Groman v. Comm'r.,*[2] where the Court established that the IRS is not bound by the "labels" taxpayers put on transactions. Thus, as applied to an IBC, if an S-Corp owner

[1] *See, e.g.,* Cen-Tex, Inc. v. Campbell, 377 F.2d 688 (5th Cir. 1967); Woodson-Tenent Laboratories v. United States, 454 F.2d 637 (6th Cir. 1972), supporting the IRS position that when a taxpayer borrows from a policy as part of a pre-set strategy to fund premiums or business operations, it fulfills the "plan of purchase" definition in Reg. §1.264-4.

[2] 302 U.S. 82 (1937).

labels a transaction a "business loan," but the substance shows the S-Corp is merely acting as a conduit to pay the shareholder's insurance interest, the Court will ignore the label.[3]

Since the Supreme Court's *Groman* decision, the courts have consistently ruled that a taxpayer cannot manufacture a business deduction by moving personal investment debt through a corporate entity. If the S-Corp's borrowing is a "facilitation" for the shareholder's personal life insurance investment, the IRS has the judicial and statutory tools to disallow the deduction, recharacterize the payments as distributions, and assess penalties.

Example:

Bob is the 100 percent shareholder of Bob's Custom Widgets, Inc. (an S-Corp). Bob purchases a high-cash-value whole life insurance policy with an annual premium of $50,000. To implement an "Infinite Banking" strategy, Bob pays the first two years of premiums out of pocket. Starting in Year 3, Bob begins the following annual cycle:

1. The Policy Loan: Bob borrows $45,000 from the insurance policy's cash value at a 6 percent interest rate.
2. The S-Corp Loan: Bob "lends" that $45,000 to his S-Corp. He creates a formal promissory note where the S-Corp agrees to pay him 10 percent interest ($4,500/year).
3. The "Wash": The S-Corp pays Bob $4,500 in interest. Bob uses $2,700 of that to pay the insurance company's interest and keeps the remaining $1,800 as "profit."
4. The Tax Goal: The S-Corp deducts $4,500 as a business interest expense, reducing the profit Bob has to report on his K-1.

Upon audit, the IRS agent examines the bank statements and the policy history. Even though Bob has a formal written note between himself and the S-Corp, the IRS will disallow the deduction based on the following:

- **Evidence of a "plan":** The IRS notes that Bob has borrowed from the policy in Years 3, 4, and 5. Under Treas. Reg. §1.264-4(c)(1), borrowing in connection with more than three years' premiums creates a presumption of a systematic plan. Bob cannot prove an "unforeseen" financial need; the borrowing was intentional and repetitive.
- **Substance Over form:** The agent determines that the "loan" to the S-Corp was not for a genuine business necessity but was a circular flow of cash designed to manufacture a deduction. Under the Economic Substance Doctrine, the IRS disregards the promissory note.
- **Direct/Indirect borrowing:** Under I.R.C. §264(a)(3), the disallowance applies to interest on debt incurred "directly or indirectly" to carry the policy. The IRS argues that the S-Corp's interest payments to Bob are *indirectly* payments to carry the insurance policy

[3] In *Feldman v. Comm'r.*, 77 T.C. 1098 (1981), the court noted that when dealing with closely held entities, "the search for substance is particularly intense."

because the funds originated from the policy and the "interest" is being used to service the policy debt.

The result is that the IRS disallows the S-Corp’s $4,500 deduction. In addition, Bob will have to report $4,500 as interest income on his personal Schedule B (because he received the cash). Consequently, Bob will end up paying taxes on $4,500 of "income" that was actually just his own money moving in a circle, and he gets zero tax relief for the interest he actually paid to the insurance company.

The "4-of-7" Exception

There is a common misconception that the "4-of-7 Rule" under I.R.C. §264(d)(1) provides a loophole for IBC. This rule states that if at least four of the first seven annual premiums are paid without borrowing, the interest on subsequent loans *might* be deductible.

However, even if a taxpayer satisfies the 4-of-7 test, they must still contend with I.R.C. §264(a)(4). This subsection limits the deductibility of interest on loans from policies covering the life of any individual who is an officer, employee, or person financially interested in any trade or business carried on by the taxpayer. Even in the best-case scenario for business-owned insurance, the deductible interest is capped at a total indebtedness of $50,000. For most Infinite Banking strategies, which rely on borrowing hundreds of thousands of dollars to "fund the bank," this $50,000 ceiling renders the tax benefit negligible.

The "Interest Wash" Fallacy

A frequent tactic used to bypass I.R.C. §264 involves creating a secondary layer of debt. The shareholder borrows from their personal life insurance policy and then "lends" those funds to their S-Corp via a formal promissory note. The S-Corp then pays interest to the shareholder, intending to claim a business interest deduction, while the shareholder uses that cash to pay the interest back to the insurance company.

When an S-Corp owner creates a note to themselves to facilitate an insurance-based borrowing strategy, the IRS can argue that the transaction lacks economic substance. Since the shareholder and the S-Corp are essentially the same economic unit in the eyes of the law (given the pass-through nature of the S-Corp), moving money in a circle to manufacture a deduction is often viewed as a "sham transaction."

Court cases. Several landmark court cases and Tax Court decisions provide the legal foundation for the IRS to dismantle "interest wash" strategies and circular borrowing arrangements. These cases establish that technical compliance with the tax code (like the "4-of-7" rule) cannot save a transaction that lacks real economic purpose.

The Supreme Court, in *Knetsch v. United States*,[4] set the original precedent for disallowing interest on insurance-related debt. In this case, a taxpayer bought annuity bonds with a small down payment and borrowed the rest from the insurance company, effectively using the "interest" on the loan to create a massive tax deduction. The Supreme Court disallowed the deduction because the transaction was a "fiction." The Court ruled that there was no "indebtedness" in a legal sense when the transaction was a circular movement of funds that "did not appreciably affect the taxpayer's beneficial interest except to reduce his tax."

The IRS's power to look at the "direct or indirect" purpose of debt to carry tax-advantaged assets is often traced back to *Golsen v. Comm'r.*[5] *Golsen* is perhaps the most significant IBC case. Golsen purchased several "Executive Special" life insurance policies. These policies were designed with artificially high premiums and correspondingly high cash values from the very first day. Golsen used a "circular" funding method of borrowing the cash value from the insurance company to pay the premiums. He paid "interest" to the insurance company on those loans and the insurance company, in turn, paid him "interest" on a prepaid premium fund. The goal was to claim a massive tax deduction for the interest paid, while the interest earned was tax-deferred, resulting in a net profit purely through tax savings.

The Tax Court looked past the formal promissory notes and insurance contracts. It ruled that the entire arrangement was a sham for tax purposes. The Tax Court noted that the interest Golsen paid (4 percent) was higher than the interest he earned (3 percent). The Tax Court reasoned that no rational person would enter this deal for profit and that the only "gain" came from the tax deduction. As a result, the Tax Court concluded that the "interest" payments weren't actually for the use of borrowed money. Instead, those payments were merely the true cost of the life insurance premiums disguised as interest to make them deductible. Because the "loans" were pre-arranged to pay for the "premiums" in a closed loop, the Tax Court held that there was no real "indebtedness" created and the only purpose of the loan and interest transactions was to convert payments for insurance coverage into interest payments for tax purposes

The "gold standard" for the Economic Substance Doctrine in the context of borrowing is *Winn-Dixie Stores, Inc. v. Comm'r.*[6] Winn-Dixie purchased life insurance on 36,000 employees and borrowed against the cash value to pay the premiums. They argued they met the "4-of-7" exception of IRC §264. The court disallowed the interest deductions, calling the program a "substantive sham." The court held that even if a taxpayer follows I.R.C. §264, the transaction must still have a business purpose and economic substance beyond just generating tax deductions. Because the plan was designed to lose money on a pre-tax basis and only "profit" via tax savings, it was disregarded.

In *Kerzner v. Comm'r.*,[7] the Tax Court specifically addressed "circular" loans between owners and their entities. Under the facts of the case, the owners of an S-Corp borrowed money from their own partnership and immediately loaned it to their S-Corp to create "debt basis." The court looked at the "circular flow of cash" and determined the owners made no "economic outlay." The court

[4] 364 U.S. 361 (1960).
[5] 54 T.C. 742 (1970).
[6] 254 F.3d 1313 (11th Cir. 2001).
[7] T.C. Memo. 2009-76.

reasoned that for a loan to be respected for tax purposes, it must leave the taxpayer "poorer in a material sense." Thus, if the money starts and ends in the same economic unit (the taxpayer and the taxpayer's S-Corp), and the net effect is zero except for a tax deduction, the IRS and the courts will likely view it as a sham.

The "Economic Substance Doctrine" was codified in 2010 with I.R.C. §7701(o). For a transaction to be respected for tax purposes, it must meet two criteria:

1. The transaction must change the taxpayer's economic position in a meaningful way (apart from federal income tax effects).
2. The taxpayer must have a substantial purpose (apart from federal income tax effects) for entering into such a transaction.

Tracing Rules and Business Necessity

Even if the economic substance hurdle is cleared, the interest tracing rules under Treas. Reg. §1.163-8T create a high administrative bar. Under those rules, the IRS requires that interest expense be allocated based on the use of the debt proceeds. Thus, if the S-Corp borrows money from the shareholder, it must prove that the funds were used exclusively for business operations to justify the deduction. However, if the IRS determines that the primary purpose of the arrangement was to facilitate the shareholder's personal life insurance investment, the "business" nature of the loan is compromised. Several court cases and treasury regulations support the requirement that loan proceeds must be traced to a specific business purpose and that "tax-motivated" borrowing for personal life insurance investments can disqualify a business deduction.

Indmar Products Co., Inc. v. Comm'r,.[8] dealt primarily with whether advances were debt or equity, but it underscores the "business necessity" requirement. The court emphasized that for interest to be deductible by a corporation under I.R.C. §163, the debt must be "ordinary and necessary" for the business. The court concluded that if the S-Corp borrows money it doesn't actually need for operations such as to specifically facilitate a shareholder's personal financial strategy, the IRS can argue the debt is not "ordinary and necessary."

In the context of life insurance interest specifically, the courts have repeatedly held that if a taxpayer borrows to fund an investment that provides tax-free or tax-deferred growth (like life insurance), and there is a "sufficiently direct nexus" between the debt and the policy, the interest is disallowed under IRC §264. Thus, if an S-Corp borrows from a shareholder to "wash" interest, the IRS uses the "nexus test"[9] to prove the debt is indirectly carrying the policy.

> **Note:** If the "primary purpose" of the S-Corp taking the loan is to provide the shareholder with the liquidity needed to pay for their personal IBC policy, the business nature of the loan is compromised.

[8] 444 F.3d 771 (6th Cir. 2006).
[9] *See, e.g.,* Wisconsin Cheeseman, Inc. v. United States, 388 F.2d 420 (7th Cir. 1968).

The Risk of Constructive Distributions

When a corporation pays the personal obligations of a shareholder (such as the interest on a personal policy loan), the IRS may recharacterize those payments as constructive distributions. In the context of an S-Corp, this has two major consequences: 1) the S-Corp's interest deduction is disallowed, increasing the net income flowing through to the shareholder's K-1; and 2) the distribution reduces the shareholder's basis in the S-Corp. If the distribution exceeds the shareholder's basis, it triggers a taxable capital gain under I.R.C. §1368. This, then, turns out to be a net negative strategy. While in a perfect pass-through world, this is a "wash." If the IRS disallows the S-Corp deduction upon audit, the shareholder is left in a disastrous position of taxable interest income on their 1040, but the corresponding deduction on the S-Corp side has vanished. They are now paying taxes on the "interest" they paid themselves, while the actual interest paid to the insurance company remains a non-deductible personal expense.

Viable Alternatives: Planning with Precision

For clients who genuinely need liquidity or wealth accumulation strategies, there are more stable, transparent, and IRS-compliant alternatives to Infinite Banking.

1. **The I.R.C. §162 "executive bonus" plan.** Instead of using circular loans, the S-Corp can pay the premiums on a shareholder's life insurance policy as a bonus. The premium payment is treated as deductible compensation to the shareholder (subject to W-2 withholding). The S-Corp gets a clean, undisputed deduction. The shareholder owns the policy personally, and the cash value grows tax-deferred. There is no need for complex internal notes or "wash" schemes.

2. **Commercial financing and asset-based lending.** If the goal is to fund business growth, a traditional commercial line of credit is almost always superior to a policy loan. Commercial interest is clearly deductible under I.R.C. §163, and the interest rates are often lower than the "gross" rates charged by insurance companies. Furthermore, using commercial debt avoids the "Cost of Insurance" (COI) and surrender charges that eat into the efficiency of an IBC strategy.

3. **Qualified retirement plans (defined benefit plans).** For tax-deductible wealth accumulation, a defined benefit plan or cash balance plan allows for much larger deductible contributions (sometimes exceeding $200,000+ annually) than the "interest wash" strategy, with far less regulatory scrutiny.

Conclusion

Ultimately, while the Infinite Banking Concept offers a compelling narrative of financial autonomy, its application within an S-Corporation environment is fraught with significant tax peril. As demonstrated by a robust line of judicial precedents, from the "sham" characterization in

Golsen[10] and *Winn-Dixie*[11] to the "nexus" requirements of *Wisconsin Cheeseman*,[12] the IRS possesses a comprehensive arsenal to dismantle circular lending arrangements that lack independent economic substance. Attempting to "wash" interest through a closely held entity often results in the worst of both worlds: the loss of corporate deductions and the creation of taxable personal income. Rather than relying on aggressive whiteboard strategies that invite audit scrutiny, business owners are better served by utilizing precise, IRS-sanctioned alternatives like Section 162 plans or qualified retirement vehicles. In the eyes of the Tax Court, the substance of a transaction will always override its label. Financial planning must also align with this reality as the proper way to protect and grow corporate wealth.

[10] 364 U.S. 361 (1960).
[11] 254 F.3d 1313 (11th Cir. 2001).
[12] 388 F.2d 420 (7th Cir. 1968).

Deducting Residual (Excess) Soil Fertility

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Overview

While the practice has been utilized for some time, the recent increase in farmland values and fertilizer prices has encouraged some farmland buyers to allocate part of the total purchase price of the farmland to fertilizer that the seller applied before the purchase. The same practice may also occur when the owner dies with part of the fair market value of the land at the date of death being allocated to fertilizer that was applied before death. Such an allocation (either upon purchase or upon death) will allow a deduction for the cost of the fertilizer rather than the cost being added to the land's basis. The concept is known as deducting "residual soil fertility" and if the taxpayer can show that fertilizer or nutrients applied to the land are a separate asset that can be distinguished from the soil, and can establish their fair market value, part of the purchase price of the land can be allocated to the fertilizer or nutrients.

Rules for allocation. When a group of assets that constitute a trade or business is purchased, the buyer must use a residual method to allocate the purchase price among the assets. *I.R.C. §1060.* The seller must follow the same allocation rules to report gain or loss. *Id.* Depreciation can be claimed on depreciable assets associated with the farmland starting with the first tax year in which possession of the land is taken. Under I.R.C. §1060 the amount claimed is tied to the portion of the total cost of the farmland that can be allocated to any depreciable asset, such as fencing, field drainage tile, grain storage facilities, farm buildings, and irrigation equipment, just to name a few of the more common depreciable items.

> **Note:** The seller must use the same allocation rules as the buyer to report gain or loss on the sale of a group of assets that constitute a trade or business as defined by Treas. Reg. §1.1060-1(b)(2)(i).
>
> **Note:** The IRS implements allocations under I.R.C. §1060 via Form 8594, which both buyer and seller must use. Form 8594 sets forth the allocations to seven classes of assets.

Most farmland sales are *not* subject to the allocation rules of I.R.C. §1060 unless the land is purchased with a group of assets constituting a trade or business. Thus, while the parties to the sale transaction do not need to file Form 8594 to report the purchase price allocation, the buyer must allocate the purchase price to determine income tax basis in the land and each depreciable improvement on the land. *Treas. Reg. §1.167(a)-5*. Likewise, the seller must allocate the purchase price for purposes of gain allocation between the land and any improvements on the land based on the ratio of the fair market value of each item purchased (land and improvements) to the total combined fair market value of the assets. *Treas. Reg. §1.61-6(a).*

> **Note:** Even if Form 8594 need not be filed, many states require buyers and sellers of real estate to report the transaction and identify the parties to the transaction. If the parties made the same allocations, they are less likely to be challenged.

If the parties to the transaction have adverse interests and the transaction is a bona fide arm's length transaction, a court will generally honor the manner in which the parties allocate the purchase price among the assets purchased in a group. *See, e.g., Blackwell Industries, Inc. v. Comr., T.C. Memo. 1979-61.* Likewise, if those conditions are met, the IRS will also honor the allocation. *See IRS Pub. 225, Farmer's Tax Guide (2022), page 33.* Other than for related party sales, most farmland sales involve parties with adverse interests. The buyer wants to allocate as much of the purchase price to depreciable assets and the buyer wants to allocate as little as possible to those assets to avoid ordinary gain recognition. Conversely, the buyer wants to allocate as little as possible to land because it is in non-depreciable, but the seller does to trigger capital gain rather than ordinary gain recognition.

The Deduction

I.R.C. §180 allows a taxpayer engaged in the trade or business of farming to annually elect (by deducting the expense on the return) the cost of fertilizer, lime, potash, or other materials which enrich, neutralize or condition land used in farming that has been either purchased or acquired during the tax year. For this purpose, the definition of a "farmer" is set forth in Treas. Reg. §1.180-1(b) which cross references Treas. Reg. §1.175-3. Under the definition, a "farmer" is one who cultivates, operates, or manages a farm for gain or profit, either as owner or tenant. For a landlord, if the rent is based on production, the landlord meets the definition of a "farmer" for this purpose. A landlord receiving a fixed amount of rent will not satisfy the definition unless the landlord participates to a material extent in the operation or management of the farm. Id.

> **Note:** The I.R.C. §180 election is effective for one year, and once it is made it may only be revoked with IRS consent. *Treas. Reg. §1.180-2.*

If fertilization costs are not expensed, they are required to be capitalized with expense deductions being amortized over a presumed useful life (similar to field drainage tile and/or fencing). This means that residual soil fertility is a capital asset in the hands of an operating farmer, crop-share landlord or cash rent landlord when farmland is acquired, with the cost amortized over the useful life of the asset. That useful life is typically three to four years. The general 15-year amortization rules don't apply. Instead, the IRS position is that fertilizer costs should be amortized based on the percentage of use or benefit each year. That likely means that straight-line amortization probably does not apply. An agronomist or other soil scientist may be able to provide sufficient information so that the property annual expense allocation can be determined. *See, e.g., IRS Pub. 225, Chapter 4.*

> **Note:** It is the author's experience that usually about 60 percent is deducted in the first year, 30 percent in the second year and the last 10 percent in the third year.

For farmland inherited from a decedent, the date of the decedent's death is the measurement date for determining whether residual soil fertility exists. If it does, the cost can be amortized by the decedent's estate and/or the beneficiaries of the estate that receive the farmland.

IRS guidance. The IRS issued *Tech. Adv. Memo. 9211007 (Dec. 3, 2991)* providing guidance on the deductibility of residual fertilizer supply and emphasizing that the taxpayer claiming the deduction must have beneficial ownership of the fertilizer. Under the facts involved, a corporation was owned by shareholders A and B. The corporation bought buildings, irrigators, pumps, wells, grain bins and "residual fertilizer supply" on land that the shareholders purchased in their individual names. The shareholders leased the land to the corporation via a one-year lease that automatically renewed unless notice of termination was given. The corporation amortized the value allocated to the residual fertilizer supply over seven years. The IRS determined that the corporation could not claim any amortization deduction because it was not the beneficial owner of the fertilizer. *See also Helvering v. F. & R. Lazarus & Co., 308 U.S. 252 (1939).*

> **Note:** The Tech Adv. Memo. does not discuss claiming a deduction for the residual supply under I.R.C. §180 because the residual supply was amortized over seven years.

In addition to beneficial ownership of the residual fertilizer supply, the IRS also specified in the Tech. Adv. Memo. that the taxpayer must 1) establish the presence and the extent of the fertilizer; 2) show the level of soil fertility attributable to the fertilizer applied by the prior owner; 3) provide a basis upon which to measure the increase in fertility in the land; and 4) provide evidence indicating the period over which the fertility attributable to the residual fertilizer will be exhausted.

In 1995, the IRS published a Market Segment Specialization Program (MSSP) addressing residual soil fertility. *IRS MSSP, Guideline on Grain Farmers (Training 3149-133, Jul. 1995).* In the MSSP, the IRS notes that a deduction for residual fertilizer supply will be denied unless the taxpayer can establish (1) beneficial ownership of the residual fertilizer supply; (2) the presence and extent of the residual fertilizer; and (3) that the residual fertilizer supply is actually being exhausted. In addition, the MSSP instructs IRS examining agents to make sure that the values assigned to depreciable farm assets is reasonable.

> **Note:** If a deduction for residual fertilizer supply is taken under I.R.C. §180, the taxpayer need not provide evidence of the period over which the fertility of the fertilizer will be exhausted. This requirement applies to amortization. I.R.C. §180 does not require the taxpayer to establish that the fertilizer (or other soil conditioner) is being exhausted.

There is no guidance on *how* to amortize residual fertility. Should it be claimed on Form 4562? Likely no. That's because capitalization and amortization is what is required. The approach most likely correct is to report it as part of the fertilizer deduction on Schedule F.

> **Note:** I.R.C. §180 is the only election and that is for deducting purchased fertilizer. Residual fertilizer supply is similar to I.R.C. §611 dealing with depletion, for which there is no Form.

Points on the requirements. Some additional points about the requirements set forth in the Tech. Adv. Memo. and the MSSP can be made:

- **Beneficial ownership** – where the fertilizer and the land are purchased by the same taxpayer (e.g., farm tenant buys the farmland), a showing of beneficial ownership of the fertilizer will not be an issue.

- **Presence of extent of fertilizer –** a taxpayer claiming a deduction for residual fertilizer supply should hire an agronomist to conduct soil tests and document the presence and extent of soil nutrients. Documenting the soil sampling procedure is critical, and the sampling should occur before the taxpayer applies any additional fertilizer. If possible, soil samples should be taken at the time of purchase. For farmland that is inherited, the sampling should occur before the buyer applies any new fertilization.

  > **Note:** If farmland has an actual excess soil fertility base it will normally bring a price premium upon sale. That's the same rationale that applies when farmland with good fences, field drainage tile and grain storage facilities is purchased – a price premium applies to factor in the existence of those assets. As for residual fertilizer supply, the excess amount can be measured by grid sampling. A buyer can anticipate that grid sampling will cost of approximately $30-$50 per acre. Agronomists and agricultural soil testing labs follow certain guidelines and procedures to determine average (base) soil fertility for various soil types. Once grid soil samples are obtained, the fertility levels of those samples are compared to the base fertility guideline levels for particular soil types to establish the amount of "excess" fertility on a tract of acquired farm real estate.

- **Level of fertility attributable to prior owner –** having the soil tested at the time of purchase will distinguish the fertilizer level in the soil at the time of purchase.

- **Basis to measure increase in fertility –** difficult to establish because of the variability of soil fertility in general. The key is to obtain data for the established base soil fertility for the type of soil on the purchased farmland from comparable tracts and comparable soil types. By establishing the base soil fertility, the actual sampling on the purchased property will reveal whether excess residual fertilizer is present. But a taxpayer should be prepared for IRS to counter with its own soil analysis showing a different base fertility level.

  > **Note:** There simply is little IRS guidance on what an acceptable baseline is for measuring residual fertilizer supply or excess available nutrients.

- **Period of exhaustion –** this depends on the types of nutrients, soil, crop rotations, etc. A professional agronomic report will be needed to establish the exhaustion period.

Amount of deduction. The actual deduction might be less than the agronomist's value of the excess amount. If the land's value combined with the value of the excess fertility exceed the purchase price of the land, an allocation must be done for each one based on their respective fair market values.

> **Example:** Bill buys farmland for $8,000/acre. An agronomist pegs the excess fertility at $4,000/acre. Comparable land in the area without excess fertility sells for $7,000/acre. When the $4,000/acre for excess fertility is added to the land value without excess fertility, the total is $11,000. Thus, the land is 63.6 percent of the total value, and the excess fertility is 36.4 percent. The purchase price was $8,000/acre. 36.4 percent of that amount is $2,912/acre. That will be the amount

that IRS will accept as the deduction for excess fertilizer supply – not the $4,000/acre that the agronomist determined.

Documentation

While the IRS does not require it, perhaps the best way to document the deduction for excess soil fertility is to provide for the allocation of value to the amount of above average soil fertility in the purchase contract for the farmland. In addition, a written summary of how the computation was made and the time period over which it would deplete due to crop production should be obtained from the agronomist or other expert involved. This will be beneficial for establishing the proper amortization period for the excess soil fertility and will provide substantiation of the deduction upon any subsequent IRS (or state) audit.

Note: Depending on the soil type involved, the deduction could range from $50 per acre to over $700 per acre – perhaps exceeding 10 percent of the land's value.

Recapture

If a deduction for excess fertilizer supply is claimed and the land is later sold, the amount of the selling price attributable to the excess fertility will be recaptured as ordinary income. It does not qualify for capital gain treatment. Any remaining gain will be taxed at capital gain rates. Of course, if the taxpayer continues to own the land until death recapture is avoided.

Application to Pasture/Rangeland?

In general. Will the I.R.C. §180 deduction provide a substantial tax deduction for residual fertilizer supply on pasture and/or rangeland? The starting point on this particular question is to note that the IRS has not specifically addressed the application of I.R.C. §180 to pasture or rangeland. Indeed, the only IRS guidance on the excess soil fertility issue is the 1991 TAM and the MSSP referred to above. But, I.R.C. §180 does indicate that "land used in farming" for purposes of the provision includes "land used…for the sustenance of livestock." So, in theory, the same concepts that apply to cropland apply to land used for grazing. However, the makeup and value of the minerals differs. With pasture and rangeland the value of potassium and phosphorous contained in the soil is much less than the value of the same minerals in soil used to raise row crops. The value per unit is simply not the same such that the owner of the grazing land would simply not apply fertilizer (especially at the current high prices) to enhance the land's value – the economics disincentivize such activity.

Native pasture. The nutrient balance on a native pasture is very tight and there is no "excess" nutrient in a native pasture system. These systems are rarely if ever fertilized with commercial fertilizer or external manure applications, with the exception being (perhaps) for a native field that is hayed. Nitrogen can increase production and allow increased stocking rates, but is simply not profitable to do so. Native hay meadows are sometimes fertilized with 30-40# nitrogen and 10# phosphorous. Fertilizing native grass usually increases any cool-season grasses in the stand (e.g., Kentucky bluegrass and annual bromes) and increases broadleafs. Prescribed burning in the late spring is then recommended to set those unwanted species back the next year.

Native rangeland is very efficient as using N and gets nitrogen from lightning/rainfall and non-symbiotic fixation (e.g Clostridium and Azotobacter). There may be some symbiotic N fixation by native legumes. The year after a drought, biomass on rangeland may increase because of unused

N in the soil, if rainfall is normal or above. This increase in production not only relies on moisture, but on how the pasture was managed during the year of drought.

Application. While I.R.C. §180 applies to grazing land, pasture grass is not the same as cropland when it comes to nutrients. While the concept applies equally, the application does not. Given that rangeland has a lower per acre fair market value than does cropland and the excess soil fertility (even if it is present and can be measured) would be less than what is present on cropland, any associated I.R.C. §180 deduction would likely be insufficient to justify the work to claim the deduction – and it is a deduction and not as valuable to the taxpayer as a credit.

> **Caution:** In some states, following the IRS guidance on deducting excess soil fertility may not be good enough.

Cost Segregation – An Alternative

As an alternative to the approach laid out above for obtaining a deduction for residual fertilizer supply, an alternative approach is a cost segregation approach to identify the "available nutrients" in the soil. With a cost segregation approach, the buyer allocates part of the land's purchase price to the land's components on the basis of fair market value. *See Hospital Corporation of America v. Comr., 109 T.C. 21 (1997); A.O.D. 1999-008 (Aug. 30, 1999).*

Authority exists for allocation part of the purchase price of land to assets acquired with the land:

- **Timber.** Treas. Reg. §1.611-3(f) allows taxpayers to use scientific methodology to allocate part of the purchase price of land to standing timber acquired with the land. Procedurally, a forester would estimate the value of the trees on the land at the time of purchase by conducting a timber "cruise." See, e.g., https://extension.oregonstate.edu/forests/health-managment/planning-timber-cruise-using-it The purchase price would then be allocated to the basis of the land and the basis of the timber using the fair market values for each asset respectively.

- **Water rights.** The sale of land with vested water rights allows for the allocation of the purchase price between the taxpayer's basis in the land and the water rights. *Treas. Reg. §1.61-6(a). See also Gladden v. Comr., 262 F.3d 851 (9th Cir. 2001).* The allocation is allowed on the theory that a premium was paid for the land to acquire the water rights. In Gladden the court remanded the case to the Tax Court for a determination of the premium that was paid. The court also held that if, on remand, the Tax Court found it "impracticable or impossible" to determine the premium, the taxpayers could use the full cost basis in the land to reduce their gain on the sale of the water rights. *Id., citing Inaja Land Co. Ltd. v. Comr., 9 T.C. 727 (1947).*

  Note: The basis of water rights for land overlying the Ogallala formation is the difference in value of land with a supply of ground water and land without a supply of ground water. *Rev. Proc. 66-11. 1966-1 C.B. 624.*

- **Sod.** Sod is a natural deposit that is depletable under I.R.C. §611. *See, e.g., Meyers v. Comr., 66 T.C. 235 (1976).* Likewise, soil and loam are natural deposits. *Rev. Rul. 79-*

411, 1979-2 CB 246. Thus, taxpayers can claim a cost depletion allowance attributable to the sale of topsoil to as a partial offset to gain realized on the transaction.

When a farm is purchased, the cost segregation approach allows the purchase price to be allocated among the land, buildings, fences, tile lines, timber, mineral rights and other assets purchased with the land. Then the amount allocated to the land is further allocated to the soil and the nutrients in the soil, the cost of which could then be amortized over the anticipated period of exhaustion. Support for this position is *Hospital Corporation of America v. Comr., 109 T.C. 21 (1997).* In the case, the court held that taxpayers can allocate part of the cost of a building to components of the building, and depreciate the components over their respective (shorter) recovery periods.

Example:

Kelly Ghoulish paid $1,225,000 ($1,200,000 purchase price and $25,000 transaction costs) for 140 acres of farmland. The land was pattern tiled, contained an old machine shed and a soil test revealed that the land had high levels of soil nutrients due to the seller spreading excess hog manure. Kelly and the seller did not enter into an agreement concerning the allocation of the purchase/selling price to the nutrients or improvements, and neither of them filed Form 8594. Shortly after the purchase, Kelly met with her tax preparer, Gina Muck, who told Kelly that she could allocate part of the purchase price to the tile and soil nutrients if she could establish their value. Based on that advice, Kelly was able took the map of the tile line (obtained from the county NRCS office) that showed the tiling was 5 years old and took it to a tiling contractor (who was on an NRCS-approved list) who provided a written estimate that the tiling had another 50 years of usefulness and would cost (presently) $40,000 to replace. Based on that information, Kelly estimated that the value of the tile was $36,364 ($40,000/55 years) x 50 years). Kelly did not allocate any value to the machine shed because it was in poor shape and either needed substantial repairs to be useful or be demolished.

Kelly paid $4,000 to an agronomist to analyze the soil. The agronomist took the results of soil samples and compared them with what the state Land Grant University recommended as optimal for the various soil types of the land that Kelly purchased. The agronomist valued the available nutrients in excess of the suggested optimal amount by multiplying that excess by what it would cost Kelly to buy and apply that amount of excess. The agronomist then determined the period of time it would take Kelly to use up the excess amount based on the crops Kelly would plant in a normal crop rotation for the area if Kelly didn't add any additional nutrients to the soil. Kelly then took the agronomist's report and estimated the fair market value of the various soil nutrients on a per acre basis. Kelly hired an appraiser to provide her with an estimate of the fair market value of comparable farmland without pattern tiling and without excess nutrients. The appraisal came in at $1,100,000.

Kelly gave all of this information to Gina. Gina allocated the $1,225,000 purchase price to the land, pattern tile and soil nutrients based on the fair market value of each asset and amortized the allocated purchase price to each particular soil nutrient identified by the agronomist based on the exhaustion period the agronomist specified.

Qualified Rural Opportunity Zones

IN GENERAL

The enactment of the One Big Beautiful Bill Act (OBBBA), has fundamentally transformed the tax planning landscape for rural landowners and agricultural producers. Practitioners must now evaluate the expanded benefits of the permanent **qualified opportunity zone** (QOZ) program - specifically the new class of **qualified rural opportunity funds** (QROFs) - against traditional nonrecognition strategies such as IRC §1031 like-kind exchanges. The primary issue is determining how to structure the reinvestment of capital gains to maximize deferral, permanent exclusion of gain, and the utilization of reinstated 100% bonus depreciation.

This comparative analysis is essential because rural opportunity zones offer a materially different deferral and exclusion profile than standard like-kind exchanges. While a like-kind exchange under current law remains strictly limited to real property held for productive use in a trade or business or for investment - requiring rigid like-kind mechanics that merely carry basis into replacement property - the OBBBA rules permit the deferral of any eligible capital gain through a flexible equity investment in a qualified fund.

Crucially, the OBBBA not only made the QOZ regime permanent and established a decennial redesignation system, but it also carved out a powerful incentive for agricultural areas in the form of a favorable substantial-improvement rule for property in rural zones that slashes the required improvement threshold from 100% of adjusted basis to 50%.[1] For ag producers, satisfying these new holding periods opens the door to the complete exclusion of post-investment appreciation, presenting an entirely new playbook for rural wealth preservation.

DEFINITIONS

- **QOZ:** Originally created under the Tax Cuts and Jobs Act (TCJA), a QOZ is an economically distressed community (designated by census tract) where new investments, under certain conditions, may be eligible for preferential tax treatment. The OBBBA made this regime permanent and established a 10-year (decennial) redesignation cycle.

- **ROZ/Rural Area:** Under the OBBBA, a specialized subset of incentives was carved out for "rural areas." Statutorily, a rural area is a census tract that is **not** part of a city or town with a population exceeding 50,000 and is **not** an urbanized area adjacent to such a city or town.

STATUTORY FRAMEWORK

Like-Kind Exchanges

§1031(a)(1) provides nonrecognition treatment if real property held for productive use in a trade or business or for investment is exchanged solely for like-kind real property to be held for productive use in a trade or

[1] This lower capital hurdle significantly improves the feasibility of rehabilitating existing farm infrastructure or adaptive reuse projects.

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business or for investment. §1031(a)(2) denies this treatment for real property held primarily for sale. §1031(a)(3) imposes the familiar deferred-exchange timing rules: replacement property must be identified within 45 days after transfer of the relinquished property and received within 180 days, or by the due date of the return including extensions, if earlier.

§1031(b) requires recognition of gain to the extent of money or other non-like-kind property received, while §1031(c) disallows loss recognition in a partially taxable exchange. §1031(d) preserves the deferred gain through a substituted basis rule, adjusted for boot and recognized gain or loss. §1031(h) provides that U.S. real property and foreign real property are not like kind.

> **Note.** The 2025 Form 8824, *Like-Kind Exchanges*, instructions confirm that, for 2018 and later years, §1031 applies only to exchanges of real property, not personal or intangible property, and summarize the regulatory definition of real property and the deferred-exchange rules.

Qualified Opportunity Zones

The Opportunity Zone regime under I.R.C. §§1400Z-1 and 1400Z-2 permits taxpayers to defer eligible capital gains by reinvesting them into a Qualified Opportunity Fund (QOF). To qualify an entity as a QOZBP, you generally form a partnership or corporation (often a lower-tier subsidiary of a QOF) that meets strict statutory asset and business tests. The entity must self-certify and continually satisfy semi-annual asset testing to prove that at least 90% of its assets consist of QOZ property.

The primary hurdle to maintaining this status is qualifying previously used tangible property as Qualified Opportunity Zone Business Property (QOZBP), which triggers the mandatory Substantial Improvement Test. This requirement is triggered whenever the "original use" of the tangible property within the zone does not commence with the QOF or the QOZBP.

The Substantial Improvement Framework

- **The Baseline Rule:** To satisfy this test, the entity must make significant capital additions to the property's adjusted basis during a strict 30-month substantial improvement period, which begins immediately upon acquisition. Under the Tax Cuts and Jobs Act (TCJA), additions to basis must exceed 100% of the initial adjusted basis—effectively a "double-the-basis" rule.

- **The Denominator Mechanics:** The denominator for the substantial improvement test is the adjusted basis of the property at the start of the 30-month period. For real estate assets, the cost of land is strictly excluded from this denominator, meaning the compliance threshold applies solely to the basis of the buildings or structures.

- **The Enhanced Rural Advantage:** Under the OBBBA, properties located entirely within a rural opportunity zone benefit from a significantly reduced threshold, requiring capital additions exceeding only 50% of the initial building basis.

- **Asset Aggregation Safe Harbor:** To meet these capital deployment thresholds, eligible entities may utilize an aggregation safe harbor. This allows the cost of newly purchased, "original-use" assets (e.g., manufacturing equipment, grain processing machinery) to count toward the basis of "used" assets (e.g., an existing warehouse), provided they are used in the same trade or business and enhance the functionality of the original property.

Timeline Controls, Tolls, and Sanctions

The asset is treated as qualified QOZBP throughout the 30-month window, provided the entity reasonably expects to meet the improvement threshold and utilize the asset in an active QOZ trade or business by the end of the period. While the 30-month statutory timeline is strictly monitored, regulatory safeguards protect projects from external or government-induced delays:

- **Governmental Delays:** If governmental delays (such as protracted permitting processes) present a substantial obstacle to capital deployment, the 31-month working capital safe harbor can be tolled in tandem with the 30-month improvement period.

- **Disaster Relief:** Properties located in federally declared disaster areas may receive up to an additional 24 months to complete required improvements.

Caution: Failure to meet the substantial improvement threshold within the permitted timeframe disqualifies the asset as QOZBP. This failure can cause a QOF to breach its mandatory 90% investment standard, triggering statutory monthly penalties under I.R.C. §1400Z-2(f).

Rural Opportunity Zones

The OBBBA permanently extended and optimized the QOZ regime, introducing several structural modifications:

- **Decennial redesignation process:** QOZs are now subject to a 10-year redesignation cycle. The first new determination date is established as July 1, 2026, which governs pending 2026 investments.

- **Repeal of the deferral sunset:** The previous TCJA sunset date of December 31, 2026, for new deferral elections has been repealed, allowing for uninterrupted post-2026 eligible investments.

- **Elimination of the contiguous-tract rule:** The contiguous-tract rule has been repealed. Every census tract must now independently qualify as a low-income community to receive designation.

- **Targeted rural incentives:** The substantial-improvement threshold for eligible property located entirely within a rural area is permanently cut from 100% to 50% of its adjusted basis.

A “rural area” is defined as a census tract that is not part of a city or town with a population exceeding 50,000 and is not an urbanized area adjacent to such a city or town.

Note: Rev. Proc. 2026-14 implements the operational mechanics for the 2027–2036 zone designations. It reflects the narrower low-income-community definition and formalizes the elimination of the contiguous-tract rule.

Because these strict decennial redesignations and the elimination of the contiguous-tract rule mean older geographic assumptions are no longer reliable, practitioners must independently verify every parcel. To confirm if a property falls within a designated zone:

1. **Identify the Census Tract:** Use the U.S. Census Bureau’s geocoding tool to input the property's physical address and look up its specific 11-digit census tract number.

2. **Cross-Reference Official Lists:** Check the tract number against the official list of designated tracts published via Rev. Proc. 2026-14 (governing the 2027–2036 designations).

3. **Confirm Rural Status:** Verify if the tract meets the under-50,000 population criteria to qualify for the enhanced 50% substantial-improvement threshold.

The principal rural-zone distinction is the reduced substantial improvement threshold. Under prior law, previously used tangible property generally had to be improved by more than 100% of its adjusted basis during the applicable 30-month period. The 30-month period begins immediately following the date of acquisition and is a critical statutory window provided under the QOZ regime to allow investors and funds sufficient time to deploy capital and improve property without immediately failing the stringent asset tests required for tax-advantaged status.[2]

For tax purposes, property undergoing improvement is treated as QOZBP throughout the duration of the 30-month window, provided the entity reasonably expects that the property will meet the improvement threshold and be used in a QOZ trade or business by the end of that period.[3]

After the OBBBA, if the tangible property is located entirely in a QOZ comprised entirely of a rural area, additions to basis need only exceed 50% of the adjusted basis at the beginning of the 30-month period.[4]

The commentary on Notice 2025-50 explains several technical points that matter in practice:[5]

- The reduced threshold applies to determinations made on or after July 4, 2025.
- The rule applies to tangible property other than land.
- Land generally is excluded from the substantial-improvement computation, so the relevant basis is often only the building basis.

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[2] IRC §1400Z-2(d)(2)(D)(ii); Treas. Reg. §1.1400Z2(d)-2(b)(4)(i) specifies that tangible property is treated as substantially improved by an eligible entity only if it meets the requirements of IRC §1400Z-2(d)(2)(D)(ii) during the 30-month substantial improvement period.
[3] See Instructions for IRS Form 8996, *Qualified Opportunity Fund*.
[4] Under, IRC §1400Z-2(b)(2)(C)(ii) as modified, a "rural area" is Per IRS Notice 2025-50, 2025-43 IRB 542, approximately 38% of existing QOZs (3,309 tracts) now qualify for these enhanced rural incentives.
[5] 2025-43 IRB 542.

- Existing regulations permitting aggregation of certain original-use property costs with improvements to previously used property remain important and can make the 50% threshold significantly easier to satisfy in rural projects

That reduced threshold can be especially meaningful for adaptive reuse, industrial rehabilitation, hospitality, mixed-use, and data-center-type projects in rural tracts, because the capital required to qualify existing property as QOZ business property may be materially lower than in non-rural zones.

Comparison with like-kind exchanges

While both like-kind exchanges and the permanent QOZ regime offer tax-advantaged treatment for appreciated property, their underlying mechanics, planning constraints, and economic benefits diverge significantly. For agricultural practitioners navigating the post-OBBBA landscape, evaluating these structural differences is critical.

For those accustomed to standard IRC §1031 like-kind exchanges, thinking about QOZs requires a total shift in perspective. Here is why they are vital to compare:

Feature	I.R.C. § 1031 Exchange	Qualified Opportunity Zone (QOZ)
What triggers the gain?	**Strictly Real Property Only.** Must be real estate held for business or investment.	**Any Eligible Capital Gain.** Can be triggered by the sale of livestock, machinery, stock, or partnership interests.
How much cash must you roll over?	**Full Proceeds.** You must reinvest the *entire net sales proceeds* and replace all debt to defer 100% of the tax.	**Gain Only (Monetize Basis).** You only reinvest the *gain component*. You can immediately pocket your initial tax basis 100% cash-free.
What is the ultimate tax benefit?	**Pure Deferral.** The gain is rolled into a substituted basis. You only avoid the tax permanently if you hold it until death for a step-up.	**Permanent Forgiveness.** Offers a three-tiered benefit including permanent exclusion of a portion of the original gain (30% for rural funds after 2027) and 100% tax-free future appreciation if held for 10 years.
Where can you buy replacement property?	**Anywhere in the U.S.** No domestic geographic constraints.	**Strictly Bound to the Zone.** Capital must be funneled into designated census tracts.

A 1031 exchange is a good tool for a straightforward rollover of a stabilized, turnkey piece of real estate. However, a QOZ is a dynamic development vehicle. If a taxpayer sells highly appreciated equipment or livestock, an IRC §1031 exchange cannot help them - but a QROF can. If a landowner wants to sell an asset, pull their original cash basis out to sit in a bank account, and only risk the "house money" (the capital gain) in a new venture, an IRC §1031 exchange cannot do that - but a QOZ can. Finally, if you want to completely erase the tax on 10 or 15 years of future growth and wipe out ordinary depreciation recapture upon exit, the QOZ provides a permanent tax-elimination playbook that an IRC §1031 simply cannot match.

Scope of eligible gain. The threshold distinction between the two tools lies in the type of asset generating the gain. A like-kind exchange is strictly limited to exchanges of real property held for the productive use in a trade or business or for investment.[6] In contrast, the QOZ is significantly broader, allowing for the deferral of almost any eligible federal capital gain - including gains realized from the sale of livestock, machinery, partnership interests, or publicly traded stock - provided the gain is timely reinvested in a QOF.

> **Note.** This distinction matters immediately in practice; a client selling highly appreciated farm equipment or corporate stock cannot access a like-kind exchange but can fully utilize a QROF structure to defer that gain.

Reinvestment mechanics and liquidity. The economic footprint of the reinvestment differs fundamentally between the two provisions, offering distinct profiles for clients seeking liquidity:

- **Full proceeds vs. gain only:** To achieve full nonrecognition under §1031, a taxpayer generally must reinvest the **entire net sales proceeds** into replacement property of equal or greater value and replace any existing debt to avoid the receipt of taxable boot.
- **Monetizing basis:** Conversely, QOZ rules only require the reinvestment of the **gain component**, not the entire cash payout. This represents a major structural divergence that allows agricultural producers to immediately monetize and pocket their tax basis tax -free, while still accessing full deferral on the gain through the QOF investment.

Timing and identification. Both regimes are strictly deadline-driven, but they impose vastly different procedural hurdles:

- **Rigid like-kind exchange windows:** §1031(a)(3) requires the taxpayer to formally identify replacement property within 45 days of the initial transfer and close acquisition within 180 days, typically requiring the rigid mechanics of a qualified intermediary.
- **Flexible passthrough rules:** While QOZs also utilize a 180-day investment window, the regulations offer flexibility for passthrough entities. Partners or S-corporation shareholders may, in certain contexts, elect to start their 180-day investment window on the due date of the partnership return rather than the date the underlying gain arose.[7] For development-oriented taxpayers, this expanded runway makes a QOF structure far more workable than rushing to close a real estate acquisition under the pressure of a like-kind exchange.

Nature and longevity of the tax benefit. The ultimate tax destination of each strategy represents a choice between permanent deferral and total forgiveness:

- **Substituted basis:** A like-kind exchange is a pure deferral mechanism. The realized gain is preserved and rolled forward into the replacement property through a substituted basis rule under §1031(d). Absent another nonrecognition event or a step-up in basis at the taxpayer's death, the embedded tax liability remains.
- **Three-tiered benefit:** QROFs, by contrast, offer a unique three-tiered benefit: (1) immediate deferral of the original gain, (2) permanent exclusion of a portion of that original

[6] IRC §1031(a)(1).
[7] See Treas. Reg. §1.1400Z2(a)-1(c) regarding the start of the 180-day investment period for passthrough entities and their owners.

gain after meeting a five-year holding period, and (3) complete exclusion of all post-investment appreciation on the QOF investment itself if held for at least ten years. Unlike like-kind exchanges, which merely kicks the appreciation can down the road, the QROF structure can permanently forgive subsequent economic growth.

Geographic constraints and traps for the unwary. The broader eligibility of the QOZ regime comes with a strict trade-off regarding where capital can be deployed:

- A like-kind exchange features no domestic geographic requirements; replacement property can be located anywhere within the United States, subject only to the foreign-property restrictions of §1031(h)(1).
- QOZ benefits are strictly tethered to geography. Capital must be funneled into a QOF that directly invests in designated, qualifying census tracts and continuously satisfies stringent statutory asset and business tests.[8]

Caution. Following the enactment of the OBBBA, practitioners can no longer rely on older geographic assumptions. The OBBBA narrowed the definition of rural low-income communities and eliminated formerly eligible contiguous tracts during the decennial redesignation system.[9] Do not assume adjacent or previously compliant parcels remain eligible.

Development and rehabilitation use cases. The two regimes favor entirely different operational strategies:

- A like-kind exchange is ideally suited for exchanging stabilized, turn-key real estate for other stabilized real estate, but its tight timelines make it notoriously cumbersome for heavy construction or rehabilitation projects.
- QROFs are uniquely optimized for development upside. For rural QOZs, the OBBBA delivered a major victory by slashing the substantial-improvement threshold from 100% of the property's adjusted basis down to just 50%. Combined with the ability to aggregate certain original-use property costs, this lower capital hurdle significantly improves the financial modeling for rehabilitating rural commercial property, agricultural processing facilities, and infrastructure.

Key technical considerations and enhanced rural advantage. The following points are important to keep in mind when determining whether a like-kind exchange or QOF investment would be preferable for a client:

- A like-kind exchange remains subject to related-party limitations and transactions structured to avoid those rules can fail non-recognition treatment.[10]

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[8] IRC §1400Z-2(d)(1)–(3).
[9] IRC § 1400Z-1(c)(1), (d), *as amended by* P.L. 119-21, § 70421, together with the OBBBA redesignation rules described in P.L. 119-21, § 70421, which require decennial redesignation beginning July 1, 2026, limit QOZ designation to census tracts that satisfy the revised low-income community definition, and repeal the prior rule allowing certain contiguous tracts to qualify.
[10] IRC §1031(f).

- Like-kind exchange basis carryover means deferred gain remains embedded in replacement property.[11]
- The OBBBA permanently reinstated 100% bonus depreciation for qualifying assets placed in service after January 19, 2025. This interacts with the QROF rules in a highly complementary, albeit technical, manner.
- For investments made after January 1, 2027, in funds where assets are entirely within rural-designated tracts, the five-year basis step-up is increased from 10% to 30%.[12] This results in 30% of the original deferred gain being permanently forgiven, with only 70% recognized as taxable gain at the five-year mark.
- An investor's initial basis in a QOF interest is zero, which is the mechanism that effectuates the initial deferral.[13] Consequently, while a QOF may generate significant bonus depreciation deductions upon building new agricultural infrastructure (e.g., hog barns, grain bins, or equipment sheds), these losses are suspended at the investor level under the §704(d) basis limitation. However, these suspended losses are unlocked at the Year 5 recognition event. At that time, the recognition of 70% of the original gain, combined with the 30% rural basis step-up, creates outside basis equal to 100% of the original investment.[14] This basis allows for the full utilization of the suspended bonus depreciation, often resulting in a $0 net tax liability at the five-year milestone.
- Opportunity zone investments require attention to QOF qualification, asset testing, reporting, and the distinction between direct property ownership and lower-tier QOZ business structures.
- For rural projects, practitioners should verify whether the tract is within the applicable rural-zone list and whether the property is entirely within a rural area for purposes of the reduced substantial-improvement threshold.
- Because the OBBBA introduced decennial redesignation, zone status and nomination timing now matter more than under the original one-time designation regime.

INTERACTION WITH 100% BONUS DEPRECIATION AND COST SEGREGATION

The strategic value of a QROF is exponentially multiplied when paired with the permanent restoration of 100% bonus depreciation under the OBBBA.[15] For agricultural producers and rural developers, this synergy transforms ordinary real estate acquisitions into front-loaded tax shelters. For example, when a QOF acquires an existing agricultural facility, processing plant, or commercial building in a rural zone, it must satisfy the OBBBA's relaxed 50% substantial-improvement threshold to qualify the underlying real property. However, the capital deployed by the fund is rarely spent on a single asset class. By utilizing a cost segregation study, the fund can unbundle the acquired or rehabilitated property into distinct asset classifications:

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[11] IRC §1031(d).
[12] IRC §1400Z-2(b)(2)(B)(iii)(I) and (b)(2)(C)(i).
[13] IRC §1400Z-2(b)(2)(B)(i) and Treas. Reg. §1.1400Z2(b)-1.
[14] IRC §1400Z-2(b)(1)(B), (b)(2)(B)(ii), (b)(2)(B)(iii)(I), and Treas. Reg. §1.1400Z2(b)-1(g)(4)(ii)–(iii).
[15] IRC §168(k), as amended by the OBBBA, permanently restored the 100% additional first-year depreciation allowance for qualified property acquired and placed in service after January 19, 2025.

- **Land and structural components:** The core building structure remains 39-year nonresidential real property (unless portions qualify under the OBBBA's temporary qualified production property classification for manufacturing and refining facilities).[16]
- **Personal Property and Land Improvements:** Specialized agricultural equipment, processing machinery, fences, drainage systems, and irrigation infrastructure fall into 5-, 7-, or 15-year Modified Accelerated Cost Recovery System (MACRS) class lives.

A cost segregation study effectively divides a QROF capital investment into two distinct tax components. The portion classified as 39-year nonresidential real property contributes toward satisfaction of the QOZ substantial-improvement requirement and enhances the potential for long-term tax-free appreciation upon a qualifying 10-year exit. In contrast, assets reclassified as 5, 7, or 15-year MACRS property qualify for 100% bonus depreciation under the OBBBA, generating immediate depreciation deductions that may create substantial first-year ordinary losses for fund investors. Consequently, the QROF can pass massive, ordinary losses through to its investors in year one, effectively offsetting other operational income.

The debt-basis catch: While front-loaded bonus depreciation deductions are highly attractive, it is critical to monitor the taxpayer's basis. Because an investor's initial basis in a QOF is zero under the general statutory framework, a partner cannot immediately deduct these passed-through ordinary losses against outside income unless the QOF structures its investments using traditional partnership debt allocations under §752 to create sufficient debt basis.

Ultimately, this dual-engine planning strategy allows a taxpayer to defer an initial capital gain via the QROF, use the OBBBA's 100% bonus depreciation to wipe out current ordinary income through cost segregation, and maintain the position for ten years to completely exclude all post-investment appreciation.

Example 1. Calvin Culvert recognized a $1 million capital gain from the sale of highly appreciated breeding livestock. Within the required 180-day window, Calvin invests the $1 million of gain into a newly formed QROF (structured as a partnership). The QROF immediately deploys that cash to purchase an existing commercial grain storage and processing facility located in a newly designated rural opportunity zone for $1 million.

The QROF commissions a cost segregation study. The study unbundles the acquisition, allocating $400,000 of the purchase price to 7-year and 15-year MACRS property (equipment, grain legs, and specialized concrete land improvements). Utilizing the OBBBA's reinstated 100% bonus depreciation under §168(k), the QROF generates a $400,000 ordinary loss in Year 1.

On paper, Calvin's distributive share of the ordinary loss is $400,000. However, under the basis limitation rules, a partner may only deduct partnership losses to the extent of their outside tax basis in the partnership interest at the end of the tax year.[17]

- **Scenario 1 (No Debt):** If the QROF purchased the facility strictly with Calvin's $1 million cash contribution and carries no liabilities, Calvin's initial outside basis in the QROF is $0.[18] Because the outside basis is zero, Calvin's allowable loss deduction is $0. The entire

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[16] See IRC §168(k)(10) and IRS Notice 2026-16 regarding the temporary 100% expensing provision for qualified production property constructed or acquired after January 19, 2025, and placed in service before January 1, 2031.
[17] IRC §704(d)(1) provides that a partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred.
[18] IRC §1400Z-2(b)(2)(B)(i).

$400,000 ordinary loss is suspended and carried forward indefinitely. The tax-sheltering benefit of the 100% bonus depreciation is completely unavailable to offset Calvin's outside income in Year 1.

- **Scenario 2 (Utilizing §752 Debt Allocation).** To unlock the suspended loss, the QROF must carry debt. §752(a) provides that any increase in a partner's share of the liabilities of a partnership is considered a contribution of money by the partner to the partnership. This deemed contribution increases the partner's outside basis under §722. As a result, assume the QROF structures the transaction differently. Instead of an all-cash purchase, the QROF buys a larger, $2.5 million facility. The fund uses Calvin's $1 million cash as a down payment and finances the remaining $1.5 million via a bank mortgage secured by the real estate (qualified nonrecourse financing).

Under §752(a), the $1.5 million mortgage is allocated to Calvin, increasing his outside basis from $0 to $1.5 million.[19] When the cost segregation study generates the $400,000 bonus depreciation loss, Calvin now has ample outside basis to absorb it. The $400,000 loss is fully deductible on Calvin's Year 1 individual tax return to offset other active or ordinary income (subject to at-risk and passive activity loss limitations), reducing his outside basis to $1.1 million.

Table 1: Partner Outside Basis Calculation Under § 752

Step / Tax Provision	Adjustment Amount	Outside Basis Balance
Initial QOF Statutory Basis (§1400Z-2)		$0
Add: Share of QOF Debt (§752 Allocation)	+ $1,500,000	
Total Adjusted Outside Basis Before Losses		$1,500,000
Deduct: Year 1 Cost Segregation & Bonus Depreciation Loss	- $400,000	(Fully Allowed)
Ending Outside Basis		$1,100,000

Note. If a client expects a QROF to generate immediate, front-loaded tax deductions via cost segregation and 100% bonus depreciation, the entity **must** carry debt. A pure equity-funded QROF will trap those losses at the fund level until the taxpayer generates basis via the expiration of the statutory deferral period or through operations.

For debt to be treated as recourse and allocated to a specific partner, the partner must bear economic risk of loss.[20] A payment obligation, such as a guarantee or a deficit restoration obligation, is only recognized if there is a reasonable expectation that the obligor will have the ability to make the required payments if

[19] The allocation of debt basis depends on whether the liability is classified as recourse or nonrecourse. For recourse liabilities, a partner's share the liability equals the portion of that liability for which the partner or a related person bears the economic risk of loss. If no partner bears economic risk of loss, the liability is nonrecourse and is generally allocated among the partners according to their share of partnership profits under the tiered rules of Treas. Reg. §1.752-3.

[20] Treas. Reg. §§1.752-1; 1.752-2; CCA 201606027 (Oct. 23, 2015).

the obligation becomes due.[21] If a partner acts through a single-member LLC that holds no assets other than its partnership interest, the IRS may disregard the obligation.[22] If there is no reasonable expectation of payment, the entire debt may be recharacterized as nonrecourse and allocated away from the general partner to the limited partners based on profit shares.[23]

Example 2. The Taterton family sold a parcel of farmland in January 2027 for $3 million, with an adjusted basis of $1,000,000.

- **Initial Step:** The Tatertons retain $1 million (basis recovery) cash-free and invest the $2 million gain into a self-certified QROF within 180 days.
- **Investment:** The QROF constructs a $2 million confinement hog finishing barn (10-year MACRS property) in a rural QOZ. The 100% bonus depreciation generates $2,000,000 in deductions, which are suspended.
- **Year 5 (2032):** The 30% rural step-up triggers. $600,000 of the original gain is permanently excluded; $1.4 million is recognized. This recognition, plus the $600,000 step-up, creates $2 million in outside basis, which absorbs the $2 million in suspended depreciation. The net tax due is $0.
- **Year 15 (2042):** The fund sells the assets for $3 million. The Tatertons elect a basis step-up to fair market value under §1400Z-2(c). The entire $3 million in appreciation and all depreciation recapture (§§1245 and 1250) is eliminated.

The example highlights the interaction between the increased 30% rural basis step-up and the utilization of suspended bonus depreciation. For investments initiated after January 1, 2027. The example also illustrates the interaction between the Year 5 gain recognition event and the unlocking of depreciation deductions which are initially restricted by the zero-basis and creates a way to achieve a zero net tax liability at the five-year milestone. The example further underscores the long-term wealth preservation power of the 10-year fair market value election, which permanently forgives both post-investment appreciation and the recapture of front-loaded ordinary deductions.

COMPLIANCE AND PLANNING CONSIDERATIONS

Because the enhanced 30% step-up and 30-year elimination window apply to investments made after January 1, 2027, clients contemplating sales in late 2026 may benefit from deferring the closing into 2027.

- **Depreciation recapture:** One of the most underappreciated benefits of the QROF is the total elimination of §§1245 and 1250 recapture upon exit after ten years. In a conventional sale, this recapture is taxed at ordinary rates (up to 37%), but the §1400Z-2(c) election includes these amounts in the eliminated gain.
- **Estate planning:** A QROF interest passing to an heir carries the decedent's original holding period. While it does not receive a standard §1014 step-up at death (as QOZ rules override the general

[21] Treas. Reg. §1.752-2.
[22] Ibid.
[23] Ibid.

rule), the heir inherits the potential for 100% gain elimination upon a subsequent sale, preserving the tax benefit across generations.[24]

- **Asset testing:** A QROF must self-certify via Form 8996, *Qualified Opportunity Fund*, and maintain at least 90% of its assets in QOZ property, measured semi-annually. Expansion of a farm business into non-rural or non-QOZ tracts must be carefully monitored to avoid disqualification.

Example 3. The Green family owns a multi-generational commercial farm and processing facility. They contracted to sell the farm's operational assets and real estate for a $10 million total gain, with $2 million of the gain subject to depreciation recapture on farming equipment and structures included as a part of the sale. The buyer wants to close November 2, 2026, and the Greens contact their tax advisor to help plan a way to reinvest the proceeds to minimize their tax burden

The Greens' advisor reviews the transaction. Because the enhanced 30% step-up and 30-year elimination window only kick in for investments made **after** January 1, 2027, the advisor suggests a critical pivot. Instead of closing November 2, 2026, they negotiate with the buyer to defer the closing date to January 5, 2027. This allows the Greens to roll their gain into a QROF under the more lucrative 2027 rules.

In a standard asset sale, that $2 million in depreciation recapture would be taxed immediately at ordinary income rates (up to 37%), resulting in a $740,000 tax bill right out of the gate. However, by rolling the full $10 million into the QROF, the Greens defer the entire amount. More importantly, when they eventually exit the fund 10 years later (in 2037), the §1400Z-2(c) election kicks in. The $2 million of recapture is permanently included in the eliminated gain, and the $740,000 tax liability is completely erased.

To deploy the capital, the Greens form their own QROF, which self-certifies using IRS Form 8996. They use the funds to purchase a new agricultural tech and processing facility located inside a designated rural opportunity zone.

Every six months, the fund must pass its asset testing to prove that at least 90% of its assets consist of QOZ property. Two years into the venture, the business expands. The advisor ensures that any new acreage or logistics hubs purchased outside the designated rural QOZ tracts do not exceed 10% of the fund's total asset value, in order to avoid disqualification.

In 2035, the family patriarch dies, and the QROF interest transfers directly to his daughter. Under §1014, the daughter would get a step-up in basis to fair market value, but she would lose the special QOZ tax incentives. Because QOZ rules override the standard step-up, she does **not** get a standard step-up at death. Instead, she inherits her father's original holding period of eight years, and she only needs to hold the fund for two more years to reach the 10-year mark. In 2037, she executes a sale of the QROF interest, achieving 100% gain elimination across generations and saving millions in taxes.

[24] IRC §1400Z-2(e)(3) provides that deferred gain not includible in the decedent's income is includible under IRC §691, and Treas. Reg. §§1.1400Z2(b)-1(c)(4)(i), (iii), (iv), (d)(1)(iii), and (g)(6), provides that a transfer by reason of death is generally not an inclusion event. As such, the recipient described in IRC §691(a)(1) succeeds to the qualifying investment, the recipient tacks the decedent's holding period, and the basis in the inherited qualifying investment remains the IRC §1400Z-2 basis rather than receiving a general date-of-death fair market value basis adjustment. IRC §1400Z-2(c) preserves the 10-year basis step-up election for a qualifying investment held at least 10 years

Financial Summary: Conventional vs. QROF Exit (Year 10)

Tax Component	Conventional Sale Exit	2027 QROF Exit (After 10 Years)
$2M Depreciation Recapture	Taxed at ordinary rates (Up to 37%)	$0 (Completely Eliminated)
$8M Capital Gains	Taxed at capital gains rates	$0 (Completely Eliminated)
Generational Transfer	Standard §1014 step-up	Holding period passes to heir for full future elimination

PLANNING APPLICATIONS

For a taxpayer selling appreciated rural real estate, the comparison often turns on the client's objectives. If the primary objective is a straightforward rollover into replacement real estate with minimal change in investment profile, a like-kind exchange may still be the cleaner tool.

- If the objective is to defer capital gain while retaining basis proceeds, diversify away from direct real estate ownership, or capture future appreciation exclusion, a QOF investment may be more attractive.
- If the target project is in a rural opportunity zone and involves rehabilitation of existing property, the OBBBA's 50% substantial-improvement rule may materially improve the economics relative to a non-rural QOZ project.

CONCLUSION

OBBBA has modified traditional wealth preservation strategies for agricultural producers and rural landowners. While a like-kind exchange remains a reliable, time-tested tool for rolling over stabilized, turnkey real estate, its strict like-kind mechanics, rigid 45/180-day execution windows, and inability to handle non-real property gains present distinct operational limits. Conversely, the newly permanent QROF regime introduces unprecedented flexibility - allowing taxpayers to defer virtually any eligible capital gain, monetize and pocket their initial tax basis cash-free, and diversify capital well beyond raw land.

Ultimately, choosing between a like-kind exchange and a QROF structure requires a careful analysis of the client's asset mix, geographic constraints, and long-term liquidity goals. Because the OBBBA introduces rigid semi-annual asset testing and a decennial zone redesignation system, meticulous compliance tracking is non-negotiable. However, when executed correctly, the QROF framework transcends simple tax deferral - offering rural families a powerful, multi-generational vehicle to wipe out tax liabilities and permanently protect agricultural wealth.

Federal Tax Update

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Table of Contents

Accounting Methods

Charitable Contributions & Deductions

- **Unqualified Appraisers:** Predetermined deal structures and zeroed noncash deductions (*Rock Cliff Reserve, LLC v. Comm'r.*) **[10]**
- **Civil Fraud Penalty Rejection:** Successful taxpayer disclosure of listed transactions (*North Donald LA Property, LLC v. Comm'r.*) **[10]**
- **Basis Limitation Adjustments:** Real estate developer inventory tracking under §§170(e) and 724(b) (*Glade Creek Partners, LLC v. Comm'r.*) **[11]**
- **Disregarded Entity Complications:** Historic preservation facade deductions claimed by wrong entities (*Corning Place Ohio, LLC v. Comm'r.*) **[11-12]**
- **Bargain Sales & Deteriorating Property:** Flawed assumptions on industrial facility asset conditions (*Leo v. Comm'r.*) **[12]**
- **Defective Donor Documentation:** Forms 8283 signed by non-qualified personnel (*Cade v. Comm'r.*) **[12]**
- **State and Local Tax (SALT) Credits:** Quid pro quo challenges to anti-SALT cap fund regulation under the *Loper Bright* standard (*New Jersey v. Bessent*) **[12-13]**
- **IRS Settlement Offer Program:** Strict timelines and terms of the time-limited settlement initiative under IR 2026-65 **[13-14]**

Digital Assets

- **Digital Asset Reporting:** Handling voluntary cost basis, the "substantiation gap," and account-by-account tracking (IRS Tax Tip 2026-7) **[14]**
- **Form 1099-DA Transition Relief:** Extension of broker requirements and customer statement electronic consent rules (Notice 2025-33 & REG-105064-25) **[14]**
- **Staking Safe Harbors:** Protecting the investment and grantor trust status for Exchange-Traded Products (Rev. Proc. 2025-31) **[15]**
- **Lot Selection Relief:** Multi-unit tracking and extensions for "specific identification" rules (Notice 2026-20 & T.D. 10000) **[15-16]**

Loan Characterization & Indebtedness

- **True Indebtedness vs. Paper Transactions:** Sham option-agreement loan arrangements lacking economic substance (*Stevens v. Comm'r.*) **[16]**
- **Partial Gift Challenges:** Compliance with the Applicable Federal Rate (AFR) on family loans (*Estate of Galli v. Comm'r.*) **[16-17]**
- **Unauthorized Withdrawals vs. Embezzlement:** Reclassifying public fund diversions and evaluating Net Operating Loss (NOL) implications (*Franklin v. Comm'r.*) **[17-18]**

Self-Employment Tax

- **Social Security Wage Base Updates:** Payroll tax cap increases and Medicare tax rates for 2026 **[18]**
- **Limited Partners & "Functional Analysis":** State law classifications vs. active operational roles in professional services and S corporations (*Soroban Capital Partners*, *Sirius Solutions*, & *Denham Capital Management*) **[18-21]**
- **Freelance Activity & 1099-K Mismatches:** Misclassifying Schedule C revenue as "Other Income" (*Clark v. Comm'r.*) **[21]**

IRS Procedures, Collections & Litigation

- **Cannabis Industry Restrictions (IRC §280E):** Full-year 2026 deduction allowances for medical marijuana operators vs. recreational market exclusions **[21-22]**
- **FIRE System Retirement:** Timeline and mandatory transition to the Information Returns Intake System (IRIS) **[22]**
- **Collection Due Process (CDP) & Installment Agreements:** Reconciling real estate asset equity, financial capacity calculations, and IRS guidelines (*Joseph v. Comm'r.* & *Bowler v. Comm'r.*) **[22]**
- **APA Rulemaking Challenges:** Inaction vs. acquiescence in proprietary tax structures (*Daines, et al. v. IRS*) **[23]**
- **The Economic Substance Doctrine:** Multi-step corporate restructuring, loophole manipulation, and the rejection of mechanical compliance shields (*Liberty Global, Inc. v. United States*) **[23]**
- **Small Partnership Exceptions:** Expanded filing carve-outs for Schedules K-2 and K-3 **[23-24]**
- **Gambling Winnings Thresholds:** New business reporting caps adjusted for inflation under the OBBBA **[24]**
- **Non-Profit Social Welfare Status:** Exemption denials for gated homeowner associations (*Mira Vista Homeowners Association, Inc. v. Comm'r.*) **[24]**
- **Qualified Non-Personal Use Vehicles:** Substantiation exemptions for unmarked public safety emergency vehicles (T.D. 10043) **[25]**
- **Fiduciary Guidance Update:** Form 1041 instruction changes covering digital assets, §174A, and agricultural land sales **[25]**
- **Asset Valuation Discrepancies:** Valuation statement requests and the "right without a remedy" doctrine (*Estate of Amplatz v. Comm'r.*) **[25]**
- **Trump Accounts Pilot Program:** Regulations, child eligibility requirements, and the $1,000 government-funded contribution mechanics **[25-26]**
- **"Luxury" Auto Depreciation Limits:** First-year MACRS dollar caps and Lease Inclusion Tables for the 2026 calendar year **[26-27]**
- **Business Interest Limitations (§163(j)):** Retrospective withdrawal pathways for electing farming businesses under the OBBBA (Rev. Proc. 2026-17) **[27-28]**
- **Tax Pro Account Portals:** Digital-first authorization workflows linking business CAF numbers to EINs **[28]**
- **Notices of Intent to Levy & Liens:** Proof of mailing challenges, post-bankruptcy discharge complications, collection alternatives, and default risk (*Foulds*, *Mongogna*, *Nelson*, & *Hillman*) **[28-29]**
- **Deficiency Assessments & Bankruptcy Disclosures:** Rational basis for income attribution based on sworn testimonies (*Veeraswamy v. Comm'r.*) **[29]**
- **Taxpayer Bill of Rights Amendments:** Clarity and plain-language requirements for IRS "math error" notices (P.L. 119-41) **[29-20]**
- **Notice Addresses:** IRS failures to prove proper mailing to a taxpayer's last known address (*Cano v. Comm'r.*) **[30]**

Credits & Losses

- **NEPA Environmental Oversight:** Solar project tax incentive eligibility and preliminary injunction constraints (*Hoffman v. United States Treasury Department*) **[47-48]**
- **Earned Income Credit Documentation:** Permanent disability verification rules (*Graham v. Comm'r*) **[49]**
- **Electric Motor Vehicle Credit:** One-time rules for first-year "placed in service" plug-in vehicles (*Moon v. Comm'r.*) **[49]**
- **Net Operating Loss Carryforwards:** Carryback conversions under older tax rules (*Mosley v. Comm'r.*) **[49]**
- **Hobby Loss Regulations & Intent:** Evaluating profit objectives, commingled funds, and business plan absences for agricultural enterprises (*Young v. Comm'r.*, *Schwarz v. Comm'r*, & *Himmel v. Comm'r.*) **[50-51]**
- **Divorce & Farm NOL Allocation:** Joint return divisions, marital asset valuations, and accounting for future tax shields **[52]**

Business & Corporate Expenses

- **Flowthrough Loss Disallowances:** Public policy grounds for blocking forfeiture write-offs linked to bribery and fraud (*Hampton v. Comm'r.*) **[52]**
- **Common-Law Employee Classifications:** W-2 payroll treatments vs. Schedule C independent contractor expense write-offs (*Gil v. United States*) **[53]**
- **Trade or Business Realities:** Disallowing jet depreciation claims for profitless entities (*Shleifer v. United States*) **[53]**
- **Cannabis Wage Allocations (IRC §199A):** Restrictions tying the QBI wage limitation to expenses surviving §280E (*Savage v. Comm'r.*) **[53]**
- **Rental Property Conversions:** Inaccurate evaluation methods for establishing fair market value cost basis (*Smith v. Comm'r.*) **[54]**
- **Cannabis Collection Calculations:** Internal Revenue Manual policies regarding gross income settlement math (*Mission Organic Center, Inc. v. Comm'r.*) **[54]**
- **Business Expense Substantiation:** Distinguishing investor legal fees from active business operator costs (*Shaut v. Comm'r.* & *Johnson v. Comm'r.*) **[54]**
- **Micro-captive & Captive Insurance Arrangements:** Evaluating risk shifting, risk distribution, operational defects, reporting rule notice-and-comment compliance, and economic substance penalties (*CFM Insurance*, *CIC Services*, *Drake Plastics*, *Haskins*, *Patel*, *Kadau*, & *Ryan, LLC*) **[55-58]**
- **Self-Employed Labor Value:** Core outlays required for cash-method time development deductions (*Nwafor v. Commissioner*) **[58]**
- **Residual Fertilizer Nutrient Studies:** "Hindcasting" estimates, forensic agronomy, and catch-up adjustment audit risks **[58]**
- **Unreimbursed Employee Expenses:** TCJA statutory suspensions for private-sector contractors (*Hussaini v. Comm'r.*) **[59]**
- **Research & Experimental (R&E) Expenditures:** Retroactive immediate deductions and automatic method changes under §174A (Rev. Proc. 2025-28) **[59]**
- **Qualified Overtime Pay Calculations:** Primary vs. secondary agricultural operations under the Fair Labor Standards Act (FLSA) **[61]**
- **Tenant Leasehold Improvements:** Business use allocation parameters and the simplified home office deduction method **[62]**

- **Legal Fee Categorization:** Distinguishing personal matters, capital expenditures, and direct rental/business operations (*Rosso v. Comm'r.*) **[62-63]**

OBBBA Adjustments & Domestic Income

- **Qualified Production Property (QPP):** 100% first-year depreciation allocation methods for industrial real estate assets (Notice 2026-16) **[63]**
- **OBBBA Penalty Relief Rules:** Transition tracking for overtime pay and cash tip reporting (Notice 2025-62) **[63]**
- **Car Loan Interest Deductions:** Simplified lender reporting rules and safety harbor allocation rules for farm pick-ups (§163(h)(4)) **[64]**
- **Clean Electricity Incentives:** Eliminating the 5% cost benchmark for wind and solar facility "Beginning of Construction" rules (Notice 2025-42) **[64-65]**
- **Trust/Estate Final Year Gains:** Distributable Net Income (DNI) flow-throughs and Net Investment Income Tax (NIIT) impact **[65]**
- **Excludible Damages:** Distinguishing physical injury, false arrest emotional distress, and constitutional violation damages (*Zajac v. Comm'r.*) **[65]**
- **Constructive Receipt & Stock for Services:** Unsolicited share transfers, Performance Rights Plans, and risk of forfeiture parameters (*Feige v. Comm'r.*) **[65-66]**
- **Depreciation Recapture Rules:** Reclassifying single-purpose agricultural structures (hog confinement buildings) under §1245 (*Hog building illustration*) **[66-67]**
- **Discharged Student Loan Debt:** Post-2025 income exclusions, cancellation of debt income (CODI) limits, and tax credit impacts **[67]**
- **S Corporation Income Diversions:** Unreported revenue flowing through via the assignment of income doctrine (*Berry v. Comm'r.*) **[67]**
- **Insurance Policy Cash Valuations:** Taxable income derived from satisfying outstanding policy loan balances (*Fugler v. Comm'r*) **[67-68]**
- **Income Reconstruction Mismatches:** 1099-K credit card receipt data vs. automated AI-generated fictitious case briefs (*Clinco v. Comm'r.*) **[68]**
- **Employment Discrimination Settlement Proceeds:** Taxable status of settlement clauses disclaiming physical injuries (*Fortune-Paladino v. Comm'r.*) **[68]**
- **Landlord Eviction Settlements:** Assessing the payor's dominant reason for tenant relocation payments (*Roman v. Comm'r.*) **[68-69]**
- **Social Security Disability Income (SSDI):** Applying the claim of right doctrine to mandatory benefit repayments (*Smith v. Commissioner*) **[69]**

Entity Issues & Structural Management

- **Promissory Note Outside Basis:** Retroactive "check-the-box" elections and the zero-basis rule for self-issued indebtedness (*Continental Grand Limited Partnership v. Comm'r.*) **[70]**
- **LLC Fiduciary Duties:** Member-managed entities, conflict of interest thresholds, and the Business Judgment Rule (*Hornbaker v. Brown*) **[70]**
- **S Corporation Estimated Tax Penalties:** "Qualified farmer" definitions, pro rata gross receipt calculations, and Form 2210-F filters **[71]**
- **S Corporation Basis Limitations:** Stock and debt rules, ordering priorities, and tracking business losses against rental income via Form 7203 **[72-73]**

- **USDA/FSA Compliance Certifications:** CPA professional liabilities and the utilization of AICPA attestation letters for segmented AGI forms (Forms CCC 942 & FSA-510) **[74]**

Tax Court Procedure

- **Retroactive Validation of Petition - Corporate Reinstatement Timing:** Whether a corporation's subsequent reinstatement of its state-suspended corporate status could retroactively validate a petition filed during the period of suspension. (*Arbor Vita Corporation v. Comm'r.*) **[74-75]**

Accounting Method

Clearly Reflect Income. Taxpayers may generally select their accounting method, but it must clearly reflect income. Here the taxpayers used the accrual method for their company, Lakeview Hospice Care, Inc., but failed to properly record income and expenses as they accrued. The IRS, upon auditing both the company and the individual taxpayers for 2015 and 2016, found significant issues: the corporate ledger contained questionable journal entries, uncategorized deductions, and irregularities in accounts receivable and payable. Due to these deficiencies, the IRS reconstructed income using the bank deposits method, which presumes all bank deposits are taxable unless shown otherwise. The Tax Court agreed with the IRS's approach but recognized that some deposits were nontaxable. However, the Court upheld the IRS's disallowance of certain business expenses because the taxpayers failed to provide adequate substantiation for those deductions. *Garibyan v. Comm'r., T.C. Memo. 2025-105.*

Form 3115. In this case, the petitioner was a corporation that owned and leased farmland to tenant farmers under oral leases. The petitioner did not personally farm any of the land. The farmland contained "base acres" –such as wheat, corn, soybeans, cotton, rice, etc., from the USDA. The farm program payments (paid pursuant to the 2008 and 2014 Farm Bills) were paid to the tenants. Under the oral leases, the tenants received all of the payments attributable to the base acres and the annual rent payment was generally 25 percent of the gross income from the farmland, with "gross income from the farmland" including any farm subsidy payments received on account of the base acres.

Before 2009, the petitioner did not claim any deductions for amortization or depreciation of the base acres. But, starting in 2009, the petitioner began claiming an amortization or depreciation deduction for base acres acquired and placed in service in 2004 through 2013 (i.e., asserting an ownership interest in an intangible asset). Changing the treatment of an asset from non-depreciable to depreciable or non-amortizable to amortizable (or vice-versa) is a change of accounting that results in an IRC §481 adjustment.

> **Note.** Why the petitioner decided to claim deductions against, essentially, cash rent, is not known. It was the tenants that were assuming the risk of production under the leases, not the petitioner. In essence, the petitioners started claiming deductions against guaranteed rental income without assuming any of the risk of the expenses under the leases.

However, the petitioner did not attach Form 3115 (application for change in accounting method) to its Form 1120 (corporate tax return) or otherwise seek IRS consent to change its accounting method. The petitioner also did not file amended returns with an explanatory statement for all open years reclassifying the base acres as amortizable under IRC §197. The petitioner also did not adopt the same accounting treatment for all bases acres that it owned.

The IRS determined that the petitioner had adopted an impermissible method of accounting and asserted deficiencies of approximately $116,000 for 2013 and $114,000 for 2014, and that an IRC §481 adjustment of $141,614 for 2009-2012 was required. The petitioner claimed that it had not changed its accounting method because of a change in underlying facts impacting its business. In addition, the petitioner claimed that even if there weren't a change in the underlying facts that supported an accounting method change, the lack of IRS consent didn't matter because the relevant tax years had closed. The petitioner also claimed that an IRC §481 adjustment wasn't necessary because it should have been made for the "year of change" (e.g., 2009) and that IRS could no longer require the adjustment because 2009 was a closed tax year.

The Tax Court (opinion by Judge Paris) agreed with the IRS noting that the petitioner had changed an accounting method in violation of IRC §446(e) which requires IRS consent for such a change, and that an IRC §481 adjustment was proper. The facts did not involve the application of an existing accounting method to a change in business practices. Indeed, there was no change in business practices - the petitioner continued to serve as landlord to the tenant farmers and didn't change the terms of the leases. Instead, the only economic consequence was the tax benefit that the petitioner received on account of the change – there was no change in existing legal or economic relationships. In addition, the petitioner continued to treat base acres acquired and placed in service in other years as nonamortizable or non-depreciable. The Tax Court determined that the petitioner has simply made a business decision in 2009 to start claiming amortization deductions on farmland what it had acquired and placed in service beginning in 2004. The corporation, the Tax Court pointed out, failed to identify the facts that had changed that caused it to change its tax treatment of the rented farmland. *Conmac Investments, Inc. v. Comm'r., T.C. Memo. 2023-40.*

> **Note.** Judge Paris brought up on her own the case of *Comr. v. Brookshire Bros. Holding, Inc., 320 F.3d 507 (5th Cir. 2003), aff'g., TC Memo 2001-150.* In that case, the appellate court, affirming the Tax Court, held that an IRS challenge to a method change for which consent was not given must be for the year of the improper change, and that failure to obtain prior consent did not serve as a basis to challenge the change for a closed year. In the present case, the Tax Court distinguished Brookshire on the basis that the corporation in the present case did not file amended returns with an explanatory statement for all open years reclassifying the base acres. In addition, based on the corporation's inconsistent treatment of the base acres depending on the year the farmland was placed in service, the Tax Court determined that finding an unauthorized change in accounting would promote consistency and wouldn't offend basic fairness.

The Tax Court also sustained the IRC §481 adjustment. The Tax Court rejected the petitioner's argument that the IRC §481 adjustment was barred by the statute of limitations after finding that the "year of the change" was the oldest open tax year. The Tax Court explained that the only limitation on an IRC §481(a) adjustment is that no pre-1954 adjustments may be made. So long as a change in an accounting method has occurred, the IRS may adjust a taxpayer's income in an open year to reflect amounts attributable to years for which the applicable statute of limitations has expired (i.e., time-barred years). *See, e.g., Huffman v. Comr., 518 F.3d 357 (6th Cir. 2008), aff'g., 126 T.C. 322 (2006).*

> **Note:** On June 6, 2025, the Eighth Circuit affirmed the Tax Court. *Conmac Investments, Inc. v. Comm'r., 139 F.4th 723 (8th Cir. 2025).* After the 8th Circuit's decision in *Conmac,* the Tax Court entered a stipulated judgment in a case involving the petitioner's change from not amortizing base acres to amortizing base acres without filing Form 3115 with the IRS for a change in accounting method. The stipulated tax deficiencies were $380,931 in 2015 and $69,222 in 2017. *Sandhill Land Company v. Comm'r., No. 33234-21 (U.S. Tax Ct. Sept. 19, 2025).*

Charitable Contribution

Charitable Deduction – Bargain Sale. The plaintiff was selling a property for an asking price of $3,995,000. The defendants proposed an unconventional "bargain sale" to a charity and agreed to secure a "Qualified Appraisal" which ultimately valued the property at approximately $5,388,000. The plaintiff would then sell the property to a non-profit organization for a reduced price of $2,160,000, intending to claim a charitable deduction for the difference between the appraised value and the bargain sale price. The plaintiff sold the property to the non-profit as planned and claimed a $2,595,000 charitable deduction. Unbeknownst to the plaintiff, the non-profit immediately sold the property to an alter ego of the defendant for a much lower amount of $2,650,000, completely undercutting the purported $5.388 million valuation. The IRS audited the plaintiff and determined the appraisal was not qualified and found the true fair market value was only $2,650,000. This drastically reduced the plaintiff's allowable charitable deduction and resulted in the plaintiff owing $1,751,824 in tax plus penalties and interest. The plaintiff sued the defendant for breach of contract, negligence, fraud, civil conspiracy and violation of the Tennessee Consumer Protection Act. The defendants failed to appear in the action, leading to a default judgment being entered against them. The trial court found the defendants liable for breach of contract, negligence, fraud, and civil conspiracy. The trial court found the deception was willful and knowing, which triggered the application of the Tennessee Consumer Protection Act (TCPA). The trial court awarded actual damages of $1,751,824 (representing the tax liability, penalties, and interest the plaintiff incurred. incurred by APC). The trial court then added treble damages of $5,255,472 as allowed under the TCPA, resulting in a total judgment of $7,007,296 plus attorneys' fees. *American Properties Company, G.P.v. Welfont Group, LLC., No. 2:22-cv-02329-SHL-tmp, 2025 U.S. Dist. LEXIS 176785 (W.D. Tenn. Sept. 10, 2025).*

Practice Pointers

- The case is one of the most significant rulings holding tax promoters and appraisers directly liable to the taxpayer for a failed transaction. By using the TCPA, the court was able to treble the damages, magnifying the financial consequences for the defendants to over $7 million.
- Taxpayers injured by fraudulent tax schemes can use state-level consumer protection statutes to pursue claims against promoters and advisors. These statutes often provide for punitive damages (like treble damages) that are not available under federal tax law.
- The trial court found that the appraisal company was the alter ego of its manager allowing the court to pierce the corporate veil and hold the individual personally liable for the judgment.

> **Observation:** The ruling highlights the catastrophic consequences when an appraisal used for a charitable deduction is found to be a sham. When a transaction is deemed fraudulent, the responsible parties are not merely liable for the tax deduction lost but for the entire resulting tax, penalties, interest, and punitive damages.

Written Acknowledgement. The taxpayers were not entitled to a charitable contribution deduction for donated land because they failed to obtain a valid contemporaneous written acknowledgment (CWA) as required by I.R.C. §170(f)(8). The taxpayers donated approximately 13.33 acres in Utah to Highland City as open space and claimed a charitable deduction of roughly $339,400 based on an appraisal valuing the property at $665,000. The IRS disallowed the deduction and asserted an accuracy-related penalty. The taxpayers argued that several documents together (the deed, a joint donation letter, and Form 8283) satisfied the CWA requirement. The court disagreed, emphasizing that the statute strictly requires an affirmative statement indicating whether the donee provided any goods or services in exchange for the donation. None of the documents clearly stated that no consideration was received, and the deed actually referenced "$10 and other good and valuable consideration." Relying on prior Tax Court precedent, the court stressed that substantial compliance does not apply to the CWA requirement. Because the acknowledgment was defective, the entire deduction was denied on summary judgment, leaving only the penalty issue for trial. *Martin v. Comm'r., T.C. Memo. 2026-39 and 2026-40.*

Charitable Deduction – Noncash Contributions. The petitioner claimed a charitable deduction for large noncash charitable contributions for ancient artifacts donated by Hobby Lobby, Inc. through several grantor trusts, including an Electing Small Business Trust (ESBT). The IRS challenged the deductions for defective substantiation based on the invalidity of Forms 8283 because of the failure to report the individual basis and acquisition date for each artifact, instead providing aggregated figures. The IRS also asserted that the Forms had missing signatures from two of the three qualified appraisers. In addition, the IRS claimed that the deductions were limited or disallowed entirely under the provisions applicable to trusts and ESBTs. The Tax Court upheld the IRS's position on the substantiation requirements but allowed the petitioner to use the statutory reasonable cause defense. The Tax Court held that the petitioner's Form 8283 was defective for lack of strict compliance with the requirements for charitable contribution substantiation. It held that the regulation requiring the individual basis and acquisition date of each item to be listed on Form 8283 was mandatory and that the petitioner's use of aggregate figures violated this requirement. The Tax Court also found that the Form 8283 for one year was invalid because the two appraisers who contributed to the appraisal did not sign the appraiser's declaration, as required by the regulations. However, despite the defective Form 8283, the court allowed the deductions to stand because the taxpayer was able to demonstrate reasonable cause for their failure to strictly comply. The Tax Court also found that the taxpayer had reasonable cause by relying in good faith on the advice of their tax advisor (Grant Thornton), who prepared the allegedly defective Forms 8283. This defense prevented the complete disallowance of the deduction that otherwise would have occurred due to the substantiation failures. The Tax Court also held that for purposes of an ESBT, the rules governing deductions are based on the fair market value of the contributed property, not just the donor's cost basis. By so holding, the Tax Court distinguished the case from precedent involving non-ESBT trusts. *Green 1993 Dynasty Trust v. Comm'r., 165 T.C. No. 7 (2025).*

> **Observation:** The Tax Court's decision is highly significant because it reaffirms two crucial and often-contested areas of tax law: 1) substantiation is a jurisdictional hurdle - all required information must be properly completed on Form 8283; and 2) reasonable cause is a lifeline – the reasonable cause defense of I.R.C. §170(f)(11) remains a viable path for taxpayers to save a deduction, even when a required form is deemed invalid due to noncompliance, provided the taxpayer relied on a competent professional.

Charitable Contribution – Appraisal. The petitioner donated a valuable early Chinese painting, "Palace Banquet," (and other art in later years) to the Metropolitan Museum of Art and claimed a significant charitable deduction (e.g., $26 million for "Palace Banquet"). However, the taxpayer failed to satisfy the technical requirement of having a "qualified appraisal" performed by a "qualified appraiser" as required for charitable deductions over $500,000. The appraisal they used, prepared by a major Chinese auction house, did not meet the IRS's strict definition because the appraiser was not an individual with the requisite educational experience and the company typically provided estimates, not formal appraisals. While the court found that the taxpayer had reasonable cause for relying on the appraisal (and thus the deduction was not disallowed entirely for lack of a qualified appraisal), it determined the Fair Market Value (FMV) of the painting to be significantly lower than claimed (e.g., $12 million instead of $26 million). The Tax Court upheld a 40% gross valuation misstatement penalty because the claimed deduction was more than 200% of the value determined by the court. *WT Art Partnership LP v. Comm'r., T.C. Memo. 2025-30.*

Observation: The case serves as a strong reminder to taxpayers to strictly comply with the technical substantiation requirements, including the use of a properly credentialed "qualified appraiser" - when claiming charitable deductions for high-value, noncash property.

Practice Pointer:

- There are several thresholds involved in noncash charitable contributions: The following is a breakdown of the key IRS thresholds for noncash charitable contributions (using Form 8283) which are organized around substantiation and reporting requirements under section 170(f)(11) and Treas. Reg. § 1.170A-16:

    - Less than $250: receipt from the donee, or reliable written records if a receipt is impracticable.

    - $250 to $500: contemporaneous written acknowledgment (CWA).

    - More than $500 to $5,000: CWA plus Form 8283, Section A, for individuals, partnerships, S corporations, and certain closely held or personal service C corporations.

    - More than $5,000: CWA plus qualified appraisal plus Form 8283, Section B, unless an exception applies.

    - More than $500,000: same as above, plus attach the qualified appraisal to the return, unless an exception applies.

Charitable Contribution – Valuation. The petitioner claimed significant charitable contribution deductions for donations of appreciated artifacts. The IRS disallowed the deductions, asserting that the property was grossly overvalued and imposed gross valuation misstatement penalties. The petitioner challenged the penalties, arguing it had reasonable cause for any valuation errors and that the IRS failed to obtain the required written supervisory approval for the penalties under I.R.C. §6751(b). The Tax Court determined that the IRS had, in fact, secured proper supervisory approval before making the initial penalty determination, but found that there was a genuine dispute of material fact regarding whether the petitioner had reasonable cause for the valuation misstatements, particularly whether the petitioner relied on qualified appraisals and conducted a good faith investigation. As a result, the Tax Court granted the IRS's motion in part (regarding supervisory approval) but denied summary judgment on the reasonable cause defense, allowing that issue to proceed to trial. *David and Barbara Green 1993 Dynasty Trust v. Comm'r., T.C. Memo. 2025-100.*

Syndicated Partnership (Conservation Easement) – Final Partnership Adjustment. The IRS examined the petitioner's return and challenged the valuation and legitimacy of a claimed conservation easement deduction. The dispute centered on the timeliness of a Final Partnership Adjustment (FPA). The petitioner (partnership) argued that the IRS failed to issue the FPA within the three-year statutory period mandated by I.R.C. §6235. To circumvent the expired assessment period, the IRS asserted the civil fraud penalty under I.R.C. §6663, which allows for an unlimited assessment period. The petitioner contested the fraud penalty, forcing the IRS to meet the high burden of proving fraudulent intent by clear and convincing evidence. Through a stipulated decision, the case concluded without a full trial, highlighting that the IRS's attempt to use the fraud penalty to "save" an otherwise time-barred assessment period failed under rigorous procedural scrutiny. *Agate Holdings, LLC, Agate Manager, LLC v. Comm'r., No. 1464-24, stipulated decision entered Mar. 19, 2026).*

Practice Pointers:

- The statute of limitations is the most formidable defense in BBA partnership audits. When the IRS targets syndicated conservation easements or other complex structures, it often attempts to overcome a missed filing deadline by reflexively invoking the civil fraud penalty to keep the assessment window open indefinitely. Even if the IRS has a strong argument regarding the merits of a tax deduction, the IRS position is fundamentally compromised if the statutory time limits of I.R.C. §6235 are not respected.
- IRS cannot use the allegation of fraud as a low-effort tool to extend the statute of limitations. The case demonstrates that the Tax Court will hold the IRS to a rigorous evidentiary standard. If the IRS cannot prove fraudulent intent with "clear and convincing" evidence, it cannot leverage that penalty to revive an expired assessment period.

Syndicated Partnership (Conservation Easement). In these consolidated TEFRA cases, the Tax Court heavily ruled in favor of the IRS against two syndicated conservation easement partnerships. The court slashed the partnerships' combined IRC §170(h) charitable deductions from nearly $26 million down to roughly $1 million, upholding the IRS's vastly lower property valuations. The Tax Court also sustained a 40% gross valuation misstatement penalty under I.R.C. §6662(h). As a result, the petitioners were completely barred from using a "reasonable-cause" defense under I.R.C. §6664(c)(3). *Kimberly Road Fulton 25, LLC, et al. v. Comm'r. T.C. Memo. 2026-36.*

Practice Pointers

- Even if a partnership perfectly satisfies the legal "conservation purposes" and procedural paperwork requirements, the deduction can still be decimated by aggressive valuation methods.

- The IRS and Tax Court continue to aggressively scrutinize and dismantle syndicated easements that rely on speculative or inflated "Highest and Best Use" property analyses.

- Because the reasonable-cause defense is statutorily barred for gross misstatements, taxpayers participating in these transactions have virtually no avenue of relief once the court determines the valuation was severely overstated.

Conservation Easement Deduction - FPA. The Tax Court held that a partnership was entitled to its full $70 million charitable contribution deduction for donating a conservation easement in Louisiana because the IRS failed to issue a timely notice of final partnership adjustment (FPA) disallowing the deduction. The case centered on the application of the statute of limitations under the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015 (BBA). Under I.R.C. §6235(a)(2), when a partnership requests a modification of an imputed underpayment, the IRS must issue the FPA within 270 days after the partnership submits all required information. The petitioner submitted its modification request on February 8, 2024, starting the 270-day clock, which expired on November 4, 2024. However, the IRS issued the FPA on January 13, after the deadline had passed. The Tax Court, following its earlier decision in JM

Assets LP v. Comm'r., 165 T.C. No. 1 (2025), found that the relevant Treas. Reg. §301.6235-1(b)(2) was invalid to the extent it extended the adjustment period beyond the statutory limit. As a result, the IRS's FPA was untimely, and the petitioner's $70 million deduction was upheld in full. *Bayou Serpent Property LLC v. Comm'r., No. 4659-25, 2025 U.S. Tax Ct. LEXIS 2698 (U.S. Tax Court Nov. 5, 2025).*

Conservation Easement – Valuation. Here, the U.S. Court of Appeals for the Eleventh Circuit affirmed a Tax Court decision that drastically reduced charitable deductions claimed by two partnerships for conservation easements. The petitioners (partnerships) had claimed approximately $37 million in deductions for 530 acres in Georgia, justifying these values by assuming the land's "highest and best use" was for industrial and quarry development. The Tax Court rejected these speculative development scenarios, finding them financially unfeasible and unsupported by market realities. Instead, the Tax Court applied a conventional sales comparison approach, resulting in allowed deductions of less than $3 million total. On appeal, the partnerships attempted to frame their challenges as legal errors regarding valuation methodologies. The Eleventh Circuit refused to reframe these factual disputes, reiterating that valuation is a fact-intensive process reviewed under a deferential "clear error" standard. The appellate court concluded that the Tax Court did not err in crediting the IRS's expert testimony over the taxpayers' speculative "megasite" and quarry narratives. Because the claimed deductions exceeded 200 percent of the court's determined values, the Eleventh Circuit affirmed the imposition of the 40 percent "gross valuation misstatement" penalty under I.R.C. §6662(h). *Jackson Crossroads LLC v. Comm'r., No. 25-10744, 2026 U.S. App. LEXIS 8731 (11th Cir. Mar. 25, 2026).*

> **Observation:** The ruling serves as a strong judicial signal that taxpayers cannot rely on improbable development scenarios or "fantasy" valuation methodologies to inflate conservation easement deductions without facing significant financial penalties.

Conservation Easement – Valuation Method. The dispute in this case involved two partnerships, Green Rock Properties and Harman Road Property, which claimed multi-million-dollar charitable deductions ($13.57 million and $18.3 million, respectively) for donating conservation easements on land in Meriwether County, Georgia. The partnerships' appraisals were built on the premise that the land's highest and best use (HBU) was as a commercial granite quarry. Under Treas. Reg. §1.170A-14(h)(3), when no comparable sales of easements exist, FMV is determined by the "before and after" method. The partnerships used Discounted Cash Flow (DCF) and royalty models - typically reserved for income-producing assets - to justify their "before" values. The Tax Court systematically dismantled the quarry hypothesis. To establish an HBU beyond current use, a taxpayer must prove the use is physically possible, legally permissible, and financially feasible. The Court found the partnerships failed on all fronts. The land was zoned for agriculture. No rezoning applications had been filed, and the partnerships provided no concrete evidence that a change to industrial quarrying was reasonably probable. For Harman Road, the presence of Flat Shoals Creek significantly hindered the feasibility of mining. The Tax Court rejected the DCF method as overly speculative for vacant land with no mining history, favoring the IRS's Sales Comparison Approach based on local agricultural and timber land. Green Rock's allowed deduction plummeted from $13.57 million to just $81,000. Harman Road's fell from $18.3 million to $145,000. Because the claimed values exceeded the correct values by more than 200 percent, the Tax Court triggered the 40 percent Gross Valuation Misstatement penalty under I.R.C. §6662(h). Crucially, under I.R.C. §6664(c)(3), the "reasonable cause" defense is unavailable for such gross misstatements, leaving the taxpayers with no shield against the penalty. *Harman Road Property, LLC v. Comm'r., T.C. Memo. 2026-23.*

Conservation Easement – Highest and Best Use. In 2007, partners of the petitioner purchased property for approximately $430,000 ($2,073 per acre). They operated a granite quarry on the site starting in 2010, but abandoned operations in 2012 after experiencing significant financial losses. In December 2017, the petitioner granted a conservation easement to a qualified organization and claimed a charitable contribution deduction of $10,234,108 (about $49,364 per acre). The petitioner's appraisal justified this steep valuation by asserting that the property's "highest and best use" was active granite mining. Upon examination, the IRS conducted its own appraisal and valued the easement at just $612,000. The Tax Court rejected the taxpayer's valuation and accepted the IRS's $612,000 appraisal. While real estate is generally valued based on its highest and best use - including the projected value of unproductive land minus the cost to make it productive - the Tax Court held that the LLC's appraisal relied on flawed, overly speculative assumptions. Specifically, the Tax Court emphasized that the property was not an active, working quarry at the time of the 2017 contribution, and prior operations had already proven financially unviable. The Tax Court also sustained a gross valuation misstatement penalty against the LLC. *Paul-Adams Quarry Trust v. Comm'r., T.C. Memo. 2025-112.*

> **Observation:** Taxpayers cannot rely on speculative "highest and best use" theories that contradict the actual economic and operational reality of the property at the time of the donation.

Conservation Easement – Economic Substance. Two partnerships claimed nearly $140 million in charitable deductions for easements on Alabama land they had purchased shortly before for only $5.4 million. The Tax Court disallowed the deductions in their entirety based on three critical failures: (1) lack of donative intent - the court found the transactions were structured purely as tax-avoidance schemes rather than genuine acts of charity; (2) valuation misstatement – the partnerships' appraisals relied on "speculative and unrealistic" assumptions—specifically, that the rural land's highest and best use was as a massive limestone quarry. The court rejected these "before" values as untethered from market reality; and (3) technical non-compliance – the deeds failed to meet the "perpetuity" requirements of I.R.C. §170(h), as the conservation purposes were not sufficiently protected. *Jackson Stone South, LLC v. Comm'r. T.C. Memo. 2025-95.*

> **Observation:** The ruling is significant because it reinforces the IRS's ability to use judicial doctrines, such as "economic substance" and "donative intent," to dismantle syndicated tax shelters. By imposing the 40 percent gross valuation misstatement penalty, the court signaled that aggressive, appraisal-inflated schemes will face severe financial consequences, further deterring the use of hypothetical industrial development to justify exorbitant tax breaks on agricultural land.

Conservation Easement – Qualification and Valuation Methodology. Two partnerships claimed substantial charitable contribution deductions for donating conservation easements on their properties. The court entirely disallowed the deduction for one easement, finding it was not a qualified conservation contribution because the preservation purposes (natural habitat and open space) failed to meet the statutory requirements. Specifically, the claimed natural habitat was found to be predominantly common pine plantation, not a significant high-quality habitat, and the claimed open space preservation did not yield a "significant public benefit." Furthermore, the baseline documentation report had significant, uncorrected errors, making it impossible for the land trust to monitor compliance with the easement's terms. On the other easement, the court rejected the taxpayer's highest and best use (HBU) valuation of the property as a granite mine - the basis for the multi-million-dollar deduction. The court found that a granite mine was not a reasonably probable legally permissible use because the property was zoned for agriculture, and obtaining the necessary rezoning and conditional use permit was highly uncertain, given the county's history of denying such applications. The court also concluded that a new mine was not financially feasible, relying on the IRS expert testimony that the local market for aggregate was oversupplied. As a result, the court accepted the IRS's lower valuation based on comparable sales, drastically reducing the claimed value for each easement (from approximately $19 million to $405,000 and $460,000, respectively). The court sustained a 40 percent gross valuation misstatement penalty against both partnerships because the claimed values were over 4,000 percent of the court-determined values, far exceeding the 200 percent threshold for a gross misstatement. *Jackson Stone South, LLC v. Comm'r., T.C. Memo. 2025-96.*

Conservation Easement - TEFRA Partnership. The petitioner claimed a $53.8 million charitable contribution deduction for the donation of a conservation easement on its 2017 tax return. The deduction was based on the property's speculative highest and best use as a cemetery. The IRS audited the partnership, and the Tax Matters Partner (TMP) initiated a partnership-level proceeding in the Tax Court under the TEFRA rules. The TMP ultimately negotiated a settlement with the IRS that was far more favorable than the IRS's original disallowance. The settlement terms included the disallowance of the original $53.8 million deduction, the allowance of an $11.6 million "other deduction" (a significant recovery for the taxpayer), and a reduction of the accuracy-related penalty from the proposed 40 percent gross valuation misstatement down to 10 percent. A non-participating partner and others moved the Tax Court to participate in the case after the settlement terms had been finalized. They argued they had a statutory right to participate and were dissatisfied with the settlement, claiming the TMP had a conflict of interest and lacked the authority to bind them. The Tax Court denied the motion, holding that a partner's statutory right to participate is not absolute and is subject to the Tax Court's Rules of Practice and Procedure. The partners had failed to take timely action, such as filing a motion to remove the TMP, and waited until they disliked the resolution to object. The Tax Court ruled they did not meet the "substantial showing" standard required to justify their delay and disrupt a valid, reasonable settlement. *Blomquist Holdings, LLC, et al. v. Comm'r., 165 T.C. No. 6 (2025).*

Practice Pointers

- Partners in a TEFRA partnership cannot wait indefinitely to exercise their right to participate in a Tax Court proceeding. Instead, they must timely elect to participate according to the Tax Court's rules (Rule 245(b)).

- The Court affirmed that to overturn or intervene late in a partnership-level proceeding, partners must make a "substantial showing" that the settlement is unreasonable or that the TMP acted inappropriately. Merely stating a willingness to litigate or expressing dissatisfaction with the outcome is insufficient.

- Partners who believe the Tax Matters Partner has a conflict of interest or is not acting in the partnership's best interest must act promptly to request the TMP's removal (using Tax Court Rule 250(b)) before a settlement is reached. Failing to do so in a timely manner is a critical procedural mistake.

Conservation Easement - Qualified Appraiser. This is a consolidated case involving four partnerships each with the same tax matters partner. The case involved charitable contribution deductions claimed for conservation easements, totaling over $62 million, along with "Other Deductions" claimed in Walton County, Georgia, for the 2015 tax year. The properties were unimproved land located in a rural area approximately 30 miles east of the Atlanta metro. One of the managing partners orchestrated the transactions central to the cases and the deals were marketed to investors who would ultimately claim the bulk of the charitable contribution deductions. The deals involved structured transactions with predetermined easement values. The appraiser was engaged after the letter of intent to investors was developed. The transactions were pitched to investors based on an advertised ratio of 4.4 to 1 for charitable contribution deduction to investor cost. The charitable and "other" deductions were claimed on the various partnership returns for 2015. The IRS disallowed most of the claimed deductions and asserted accuracy-related penalties under I.R.C. §6662(h) for 40 percent gross valuation misstatements, and in the alternative, 20 percent penalties under I.R.C. §6662(a) for substantial understatements. The Tax Court determined that the appraiser was not a "qualified appraiser" within the meaning of the regulations. This conclusion stemmed from the fact that the appraiser and the managing partner of the tax matters partner had reached a "meeting of the minds" regarding the inflated appraisal values long before any actual appraisal work was performed. Consequently, the Tax Court held that the partnerships were entitled to noncash charitable contribution deductions of zero for 2015, because they failed to secure and attach "qualified appraisal[s]" of the contributed property as required by I.R.C. §170(f)(11)(D). Based on "before" and "after" values, the Tax Court determined the actual conservation easement values totaled approximately $5.4 million. Since each partnership overstated the value of the easements by well over 200%, the Tax Court held that the 40 percent penalty for a gross valuation misstatement applied to the underpayments attributable to these misstatements. Additionally, the Tax Court found that the partnerships were liable for a 20 percent penalty for any portion of the underpayment not attributable to the gross valuation misstatement by reason of substantial understatement of income tax and negligence. *Rock Cliff Reserve, LLC v. Comm'r., T.C. Memo. 2025-73.*

Conservation Easement. The petitioner, a syndicated investment entity, purchased a 244-acre tract in Louisiana for roughly $1.1 million. Shortly thereafter, it donated a conservation easement to a land trust and claimed a $115.4 million charitable deduction. The valuation relied on an appraisal claiming the land's "highest and best use" (HBA) was as a high-output clay mine. The IRS challenged the deduction, arguing the valuation was grossly inflated and that the transaction was a "sham" designed solely for tax avoidance, subsequently asserting a 75% civil fraud penalty. The Tax Court rejected the clay mining HBU as speculative, finding no "reasonably probable" market or legal permitting for such operations. Using comparable sales, the Tax Court slashed the value to $175,824 - a 99.8% reduction. However, the Tax Court rejected the 75 percent fraud penalty because the IRS failed to prove "fraudulent intent" by clear and convincing evidence. The taxpayer fully disclosed the transaction as a "listed transaction" under Notice 2017-10. The Tax Court also disallowed over $1 million in "consulting fees," reclassifying them as non-deductible syndication costs. *North Donald LA Property, LLC v. Comm'r., T.C. Memo. 2026-19.*

Conservation Easement – Valuation. In this bench opinion, the petitioner claimed a deduction for a charitable easement donation on a 55-acre former granite quarry. The petitioner claimed the easement donation had a "going-concern" value exceeding $20.3 million, based on projected cash flows from mining the granite. It reported the after-easement value at under $100,000, thereby claiming a deduction equating to over $20 million. The IRS challenged the deduction and trial evidence established that local land sales consistently reflected values between $1,999 and $2,840 per acre. Indeed, the quarry had sold two years earlier for $1,818 per acre and was considered of lower quality due to lack of mining infrastructure and abandonment. The IRS's expert, accepting comparable per-acre rates, valued the property at $3,000 per acre before the easement and at $54,000 after, determining the charitable deduction to be $111,000. The Tax Court agreed with the IRS valuation and imposed a 40 percent gross valuation misstatement penalty under I.R.C. §6662(a). The Tax Court also stated that it would "hear further from the Commissioner regarding the imposition of section 6673 penalties against the petitioner and the petitioner's counsel" for maintaining proceedings primarily for delay or taking a position that is frivolous. *Veribest Vesta, LLC v. Comm'r., 149 F.4th 12 (2d Cir. 2025).*

Conservation Easement - Basis Limitation. Recently, the IRS has argued that deductions for conservation easements should be limited to the donor's adjusted basis in the property, rather than FMV, particularly where the property was held as inventory by a developer. In this case, the appellate court upheld the Tax Court in finding that the donated property was an inventory item in the hands of the prior owner that contributed it to the petitioner and, therefore, the petitioner's deduction for the conservation easement it donated to the Atlantic Coast Conservancy was properly limited to its adjusted basis in the easement under I.R.C. §§170(e) and 724(b). I.R.C. §724(b) provides that gain from the sale of property contributed to a partnership by a partner is treated as ordinary income for five years if the property was an inventory item in the hands of the contributing partner. I.R.C. §170(e) limits charitable deductions for contributed property to the taxpayer's adjusted basis in the property if it would have yielded ordinary income or short-term capital gain upon sale. For the year the prior owner contributed the property to the petitioner, it reported that it was a real estate dealer and reported the land contributed to the petitioner as inventory. In addition, the appellate court noted that the petitioner failed to challenge the applicability of those Code sections by failing to raise them before the Tax Court. *Glade Creek Partners, LLC v. Comm'r., No. 23-14039, 2025 U.S. App. LEXIS 13954 (11th Cir. Jun. 6, 2025), aff'g., T.C. Memo. 2023-82.*

Conservation Easement Deduction. The petitioner, a partnership, bought the 11-story Garfield Building in Cleveland for $6 million and renovated it using historic preservation tax credits. The petitioner later claimed a $22.6 million charitable contribution deduction for donating a historic preservation façade and conservation easement to a local charity. The petitioner grounded the deduction on the basis that the easement barred future development of a 45-story tower. The IRS disallowed the entire deduction and assessed penalties. The Tax Court and the Sixth Circuit affirmed this decision. The appellate court ultimately found the actual value of the easement to be only $900,000, meaning the claimed deduction was overstated by over 2,400 percent. The appellate court found the partnership was an LLC with only one member (Corning Place Investment) for a seven-week period surrounding the May 25, 2016, donation date. During this time, it was not a taxable partnership but a "disregarded entity" for tax purposes. Since the partnership's taxable year did not begin until July 7, 2016, it could not claim a deduction for a donation made on May 25, 2016. The deduction properly belonged to the sole owner (Investment) for that period, not the partnership. The appellate court also rejected the $22.6 million valuation. It emphasized that a property's "highest and best use" (HBU) must be reasonably probable, supported by concrete evidence, and not purely speculative. The hypothetical 45-story tower was deemed a "chimerical concept" because it was structurally implausible, economically unsound, and would have required Corning Place to violate the terms of the historic preservation tax credits it had already received. The appellate court upheld a valuation of $900,000 and imposed a 40 percent penalty for gross valuation overstatement. The appellate court also upheld a negligence penalty for the charitable deduction claimed in the wrong tax year for the wrong entity. The appellate court also upheld a negligence penalty against the petitioner for failing to provide documentary proof that $665,000 in related expenses were performed or paid for in 2016. *Corning Place Ohio, LLC, et al. v. Comm'r., 158 F.4 th 715 (6th Cir. 2025), aff'g., T.C. Memo. 2024-72.*

Practice Pointers

- Taxpayers must strictly comply with partnership tax procedures and timing rules. If a partnership ceases to exist as a taxable entity (e.g., becomes a single-member LLC) at the time of the donation, the partnership cannot claim the deduction on its return for a later tax year. The court rejected the "harmless error" argument, underscoring the legal separation of partnership-level and partner-level tax proceedings.

- A conservation easement deduction is measured by the reduction in value, often determined by the property's HBU before the easement. However, the HBU must be reasonably probable and supported by concrete evidence of physical feasibility, regulatory permissibility, and market demand. Hypothetical development plans, especially those that conflict with a property's current use or existing legal agreements (like tax credit covenants), will be rejected.

- The appellate court affirmed that if a claimed value exceeds the correct value by more than 200 percent, the 40 percent gross valuation overstatement penalty applies. Critically, this penalty cannot be overcome by relying on an appraiser or other tax advisors (the reasonable-cause defense is unavailable for this specific penalty).

- Taxpayers must retain and provide documentary proof for all claimed deductions, including related expenses. Reliance on advisors does not excuse failure to comply with unambiguous substantiation rules.

Valuation. The petitioners donated a former furniture factory with 136.4 acres to a Foundation in a bargain sale. They claimed a charitable deduction of $15.8 million on their return based on their expert's appraisal report, with a $50,000 bargain sale. The IRS audited the donation and valued the donation at $4.05 million reflecting the property's depreciation, physical deterioration and limited marketability. The IRS assessed deficiencies plus a 40 percent gross valuation misstatement penalty under I.R.C. §6662(h). The Tax Court agreed with the IRS appraiser's report and determined the charitable deduction was $4.05 million minus the $575,000 cash and note received. The Court questioned a number of the assumptions made by the petitioner's appraiser concerning the condition of the property including an assumption that the electrical and plumbing systems were in good condition when they were not. In addition, an adjustment for the building vacancy was 20 percent while only 50 percent of the property was leased. The Tax Court also upheld the 40 percent penalty. *Leo v. Comm'r., T.C. Memo. 2025-9.*

Charitable Deduction - Qualified appraisal. The petitioners claimed charitable contributions of $284,000, consisting of $146,000 of personal clothing items, $89,000 for granite cobblestones of various sizes, and $49,000 for pieces of commercial vinyl tile and adhesive. The attached Forms 8283 Section B Part III captioned Declaration of Appraiser were signed by various, but none of them claimed to be qualified appraisers. The Forms 8283 were signed by the donee church pastor, but there was no printed name and the signature was illegible. Among other issues the taxpayers could not show that they attached a qualified appraisal to the return. The IRS denied the charitable deduction and the Tax Court agreed. *Cade v. Comm'r., T.C. Memo. 2025-20.*

Charitable Deduction - State or Local Tax Credits. The TCJA capped the federal SALT deduction at $10,000. In response, several states, including New York, Connecticut, and New Jersey, enacted legislation to create new charitable contribution funds. These programs allowed taxpayers to make donations to these funds and, in return, receive a state or local tax credit, often for a substantial portion of the donated amount and the full deduction of the donated amount on the federal return under I.R.C. §170. This, in effect, circumvented the SALT cap. In response, IRS issued a final regulation in 2019 requiring taxpayers to reduce their federal charitable deduction by the amount of any state or local tax credit they received or expected to receive in consideration for the contribution. The plaintiff, along with New York, New Jersey, and Connecticut, sued the IRS, claiming that the regulation was unlawful because it exceeded the agency's statutory authority. The trial court upheld the regulation and the appellate court affirmed. The appellate court noted that a payment to charity is a deductible "contribution or gift" under I.R.C. §170 only to the extent it exceeds the value of any goods, services, or other benefits received in return. As such, a dollar-for-dollar state tax credit constituted a clear, substantial, and measurable return benefit to the donor. In addition, the appellate court evaluated the regulation under the *Loper Bright* standard which required the court to use "every tool" to determine the best reading of the regulation in terms of whether it comported with the relevant statute rather than simply deferring to a reasonable agency interpretation. The appellate court applied this standard and concluded that the IRS's regulation was correct because its own interpretation of the long-established quid pro quo doctrine in with respect to I.R.C. §170 led to the same conclusion as the regulation. *New Jersey v. Bessent, 149 F.4th 127 (2nd 2025).*

> **Note:** The appellate court's decision is one of the first major tax rulings to apply the *Loper Bright* standard and provides an example of how courts may independently interpret tax statutes in the future. The decision is also important because it addresses a direct conflict between the federal government's tax rules and state-level efforts to mitigate the impact of the federal cap on state and local tax (SALT) deductions.

Charitable Deduction – Valuation. The petitioner claimed a charitable deduction in 2018 for a conservation easement on a 55–66-acre granite quarry in Georgia. The taxpayer attached an appraisal to its 2018 Form 1065 that employed a projected "going concern" business model (operating a granite mine) to value the easement at over $20 million. The IRS completely disallowed the deduction on the basis that the easement had no value, that the taxpayer's appraisal was not a qualified appraisal under I.R.C. §170(f)(11), and because the deduction was unsupported, speculative, and inflated. The IRS rejected the petitioner's use of the discounted cash flow (DCF) method based on hypothetical future profits from a speculative granite quarrying business because it was unrealistic due to lack of permits, uncertain stone quality, capital needs, and operational assumptions. The IRS asserted a 40 percent gross valuation misstatement penalty under I.R.C. §6662(h). The IRS also implied that the petitioner's position might have been taken in bad faith. The Tax Court evaluated whether the taxpayer's appraisal complied with statutory and regulatory standards: conducted by a qualified appraiser, in conformance with generally accepted appraisal practices, and timely. Ultimately, the Tax Court determined that the comparable sales method was the most reliable method. Based on market data, The Tax Court determined the "before" value of the property to be no more than $165,000, with an "after" value of $54,000, leading to a fair market easement value of $111,000. The Tax Court rejected the taxpayer's experts methodology emphasizing that valuing the land based on speculative business profits (needing permits, expert labor, capital, uncertain quality of stone) defied economic logic. The Tax Court also upheld the 40 percent penalty. The Tax Court warned of possible sanctions under I.R.C.§6673 but did not impose them. *Leo v. Comm'r., T.C. Memo. 2025-9.*

IRS Conservation Easement Settlement Offer. The IRS has launched a time-limited settlement initiative targeting ongoing disputes over "abusive" conservation easement tax shelters (where pass-through entities vastly overstate property valuations to claim inflated tax deductions under IRC § 170(h)). This offer provides eligible partnerships a final opportunity to settle on terms more favorable than what they would likely face in Tax Court. Eligible partnerships will receive individualized settlement letters from the IRS.

The initiative features a strict two-tiered timeline with no extensions:

- Days 1–90 (Initial Window): The claimed charitable deduction is completely disallowed. An "other deduction" is allowed, generally equal to the partnership's out-of-pocket costs. A 10% gross valuation misstatement penalty is applied. No immediate payment is required upon electing into the initiative.
- Days 91–135 (Late Window): Partnerships can still settle, but the penalty doubles to 20%.

- Post-135 Days: The IRS will litigate. Historically, the Tax Court sides with the government, allowing an average deduction of only 5% to 7% and imposing a severe 40% penalty.

Partnerships with active Tax Court cases that have not yet been tried or settled are eligible, as are partnerships with cases currently under IRS examination. Those not eligible are cases that have already been tried or are awaiting opinion, on appeal, already settled, set for trial within 30 days, or tied to specific "test cases."

The mechanism for collecting the settlement amounts depends on the tax year regulations. For TEFRA Partnerships (Generally 2017 and earlier), the tax liabilities are processed and billed directly to the individual investors. For BBA Partnerships (Generally 2018 and later), the partnership itself is liable for the payment unless it elects to "push out" the liability to individual partners. If the partnership fails to pay, the IRS will collect from the individual investors. *IR 2026-65 (May 13, 2026).*

Digital Assets

Digital Asset Reporting. The IRS has reminded taxpayers that they must report the sale or disposal of digital assets. While brokers are now mandated to report gross proceeds from dispositions, the 2025 transition period makes cost basis reporting voluntary for most platforms. This creates a significant "substantiation gap." Taxpayers cannot rely on these forms as a complete tax record; they must maintain independent, contemporaneous logs to establish basis, especially for assets moved between custodial and unhosted wallets. Furthermore, the IRS has explicitly disallowed the "universal method" for basis tracking, requiring a wallet-by-wallet or account-by-account approach. Consequently, a Form 1099-DA showing $0 basis likely indicates a "noncovered security" transfer rather than a $0 cost, placing the burden of proof squarely on the taxpayer to avoid overpayment of capital gains tax. *IRS Tax Tip 2026-7.*

Brokers. The IRS has extended and modified the transition relief provided in Notice 2024-56 for brokers who are required to file Form 1099-DA, Digital Asset Proceeds From Broker Transactions to report certain digital asset sale and exchange transactions by customers for an additional year. *Notice 2025-33, 2025-19 IRB 1428.*

Digital Assets Safe Harbor. The IRS has provided a safe harbor for trusts and that otherwise qualify as investment trusts under Treas. Reg §301.7701-4(c) and grantor trusts to stake their digital assets without jeopardizing their tax status as investment trusts and grantor trusts for federal income tax purposes. To qualify for the safe harbor, interests in the trusts holding digital assets must be traded on a national securities exchange and meet other requirements; the procedure also provides a limited time for an existing trust to amend its trust agreement and adopt the requirements in the safe harbor. *Rev. Proc. 2025-31, 2025-48 IRB 743.*

Digital Assets – Investment and Grantor Trusts. The IRS has established a safe harbor allowing certain investment trusts and grantor trusts to stake their digital assets without jeopardizing their favorable tax classification. The safe harbor is primarily aimed at Exchange-Traded Products (ETPs) organized as trusts that hold a single digital asset and use a proof-of-stake consensus mechanism. Before the guidance, a significant concern for investment trusts holding digital assets was that staking activities could violate the requirements for their preferred tax status. Investment trusts under Treas. Reg. §301.7701-4(c)) must be structured to "protect and conserve" the trust property and cannot have a power to "vary the investment" to improve returns. The worry was that actively staking digital assets for rewards might be viewed as a business activity or a prohibited power to vary the investment, leading to reclassification as an association taxable as a corporation (which has corporate tax). Grantor trusts under Subsection J of the Code (an investment trust that doesn't have a "power to vary the investment" is often classified as a grantor trust, which is a tax-transparent entity. This allows the trust's income, gain, and loss to flow directly through to the interest holders (investors) without taxation at the trust level. Staking income was feared to potentially destroy this status. With the Rev. Proc., the IRS provides certainty that, if a trust strictly adheres to all of its requirements, the authorization and engagement in staking activities will not prevent the trust from qualifying as an investment trust or a grantor trust. To qualify for the safe harbor, a trust must satisfy a number of structural and operational requirements. The trust can only hold cash and units of a single type of digital asset, and the digital asset must be one whose transactions are carried out on a permissionless network that uses a proof-of-stake consensus mechanism. Also, the trust agreement must expressly prohibit the trustee or sponsor from exercising any power to vary the investment to improve returns. This includes variations based on the value of the digital assets or the amount of staking rewards. The purpose of staking must be to protect and conserve the value of the trust property by mitigating concentration risks in network validation, not solely to profit from market variations. The trust's activities must be strictly limited to essential functions like accepting deposits of the digital asset, holding the asset and cash, and distributing the digital assets and/or staking rewards. The trust's digital assets must be held by a custodian who facilitates the staking. Only the custodian can have access to the private keys. The staking must be directed through the custodian to an unrelated staking provider on arm's length terms. The trust, custodian, and sponsor must have no legal right or arrangement to control the staking provider's activities, except to direct the staking/unstaking of assets. All digital assets of the trust must generally be made available for staking at all times, subject to a narrowly defined liquidity reserve that is necessary to meet redemption requests. The staking rewards, net of trust expenses, must be distributed to interest holders (investors) on a periodic basis that is no less frequently than quarterly. The distribution can be in-kind (the digital asset) or as cash proceeds from selling the rewards. Trusts formed before November 10, 2025, have a nine-month window beginning on November 10, 2025, to amend their governing instruments to authorize staking and meet all the safe harbor requirements. Amending the agreement within this window will not, by itself, jeopardize their investment trust or grantor trust status. *Rev. Proc. 2025-31, 2025-48 IRB 743.*

Digital Asset Reporting. The IRS has introduced proposed regulations to simplify how digital asset brokers deliver tax statements to customers. Recognizing that crypto and digital assets are inherently electronic, the update aims to reduce administrative burdens for both brokers and taxpayers. Brokers would have a new, optional method for obtaining customer consent to receive Form 1099-DA electronically. Under this specific process, brokers would no longer be required to offer a paper delivery option. Brokers would not be required to provide a way for customers to withdraw their electronic consent once it has been established. In short, these regulations allow the reporting process to remain fully digital, matching the nature of the assets themselves. *REG-105064-25.*

The IRS has provided a one-year extension of the transitional relief originally granted in Notice 2025-7 regarding the "specific identification" of digital assets. Under Treas. Reg. §1.1012-1(j), taxpayers must generally notify their custodial brokers at the time of a sale to "adequately identify" which specific units (lots) of a digital asset are being sold. This allows for tax-optimization strategies like Highest-In, First-Out (HIFO) or tax-loss harvesting. However, many brokers have not yet fully implemented the technological infrastructure to process these real-time instructions. The "relief period" now covers transactions through December 31, 2026. During this window, taxpayers do not need to notify their brokers of lot selections. Instead, they can make an "adequate identification" solely through their own internal books and records or standing orders, provided they are recorded contemporaneously with the transaction. Without this relief, transactions in accounts without specific ID capabilities would default to First-In, First-Out (FIFO), potentially leading to higher tax liabilities for investors. Importantly, the relief does not apply to digital asset units not held in the custody of a broker. *Notice 2026-20, 2026-15 IRB 800.*

Under I.R.C. §1012(c)(1), "in the case of the sale, exchange, or other disposition of a specified security on or after the applicable date, the conventions prescribed by regulations under that section must be applied on an account-by-account basis". To that end, the IRS has issued final regulations issued to establish ordering rules for determining which units of a digital asset are treated as sold when a taxpayer holds multiple units acquired at different times or prices. *T.D. 10000.*

Loan Characterization

Economic Effect. The petitioner owned an S corporation that sold its transportation brokerage business assets for $37.5 million in 2014. Later that year, the S corporation entered into a promissory note and option agreement with an LLC. In 2016, the S corporation entered into a new promissory note and amended option agreement with the LLC. The notes purported to be loans from the LLC to the S corporation to buy the options, but the notes could only be collected against the options themselves. The petitioner claimed a total of $28 million in interest deductions related to the notes. Before claiming the deductions, the petitioner sought an opinion letter from a tax attorney. The petitioner paid $40,000 for the opinion letter, which the tax attorney would not stand behind as support for claiming the deductions. The IRS disallowed the deductions for lack of economic substance and the Tax Court agreed. The Tax Court concluded that the notes did not constitute true indebtedness for purposes of the interest deduction under I.R.C. §163. On this point, the Tax Court noted that the notes would inevitably disappear with no economic effect as the predetermined payment from the LLC to the S corporation under the option agreements would either offset or satisfy the notes upon exercise of the options. The Tax Court also held the petitioner liable for various penalties. On the penalty issue, the Tax Court noted that the petitioner solicited the tax opinion letter for protection from penalties rather than to ascertain proper tax liability. Thus, the petitioner did not have reasonable cause for claiming the disputed interest deductions and did not act in good faith with respect to the deductions and owed more than $1 million in penalties. *Stevens v. Comm'r., T.C. Memo. 2025-45.*

> **Observation:** Loan arrangement must reflect actual economic indebtedness, not just paper transactions designed to generate deductions. A taxpayer cannot rely on an opinion letter if the letter is ignored. The petitioner's accounting background undermined claims of reasonable cause.

Loan Classification. The decedent made a $2.3 million loan to his son's business. The loan was structured as a formal promissory note with a fixed term and interest set at the Applicable Federal Rate (AFR). Upon the decedent's death, the estate valued the note at a discount (approx. $1.6 million) for estate tax purposes, citing increased market interest rates and repayment risk. The IRS challenged this, arguing the initial loan was a "partial gift" because a commercial lender would have charged higher interest. The Tax Court granted summary judgment for the estate, holding that compliance with I.R.C. §7872 (using the AFR) precludes a gift tax deficiency. The Tax Court also noted that there is no violation of the duty of consistency when an estate discounts a note that was originally reported at face value for gift purposes, as different statutory valuation rules apply. *Estate of Galli v. Comm'r., No. 7003-20, 2025 U.S. Tax Ct. LEXIS 554 (Tax Ct. Mar. 5, 2025).*

Practice Pointers

- Use of the AFR is sufficient to avoid gift reclassification. The IRS's argument that the loan was a "partial gift" because it was unsecured and below "commercial" market rates was rejected.
- A loan can be valued at its face amount for gift tax purposes (per I.R.C. §7872) but still be eligible for a fair market value discount on the estate tax return if interest rates have risen or if there is repayment risk at the time of death.

Withdrawals Were Loans, not Unreported Income. The IRS claimed that the petitioner, a county Sheriff, was essentially operating a Ponzi scheme and had unreported embezzlement income as a result. The petitioner was responsible for an inmate meal fund which collected money via inmate fees to feed inmates. The petitioner set up accounts with food vendors and establish a line of credit under her own name and Social Security number. She had signatory authority over the jail food money account, into which the State of Alabama and the federal government deposited the monthly jail food funds. The account ending x2933 was used exclusively for the jail food money. In 2015, the petitioner withdrew $160,000 from the jail food money account using two cashier's checks that both were made payable to her. She temporarily invested the funds in a used-car dealership when the funds weren't needed to feed inmates. The petitioner had an expectation of a 17 percent interest rate of return and the funds were promised to be returned withing 30 days. However, it turned out that the dealership was running a Ponzi scheme when neither the principal investment was returned nor the anticipated interest on the investment. The petitioner did not report any income associated with the investment and the IRS issued a notice of deficiency asserting that the withdrawals were untaxed embezzlement income rather than loans. The petitioner noted that she had signatory authority on the account, always had dominion and control over the funds in the account, and received no accession to wealth when she withdrew the funds because she created a corresponding obligation to repay the funds and that she ultimately did repay them. Judge Paris concluded that the withdrawn funds constituted a loan from the j account. Although the petitioner's withdrawal of the funds failed to adhere to certain formalities as a written instrument, the Tax Court noted that the lack of such formalities is not, by itself, conclusive. The petitioner was never even charged with embezzlement. The Tax Court held that A the $155,000 withdrawn from the account constituted an unauthorized loan and not embezzlement income. Because the withdrawal was an unauthorized loan, the petitioner's restoration of the funds in 2016 constituted a loan repayment, rather than a repayment of embezzled funds. Consequently, the petitioner was not entitled to an NOL carryback for 2015 because the petitioner couldn't deduct repayment of loan principal because the loan proceeds were not income upon receipt. *Franklin v. Comm'r., T.C. Memo. 2025-8.*

Practice Pointers:

- Formality matters - those managing restricted funds (e. g., public fiduciaries, trustees) must maintain strict controls, professional documentation, and transparent repayment records to avoid unintentional income triggers. The presumption is that without formal loan documentation, even well-intentioned withdrawals from restricted funds are presumptively taxable income.

Self-Employment Tax

Social Security Wage Base. The Social Security Administration has announced an increase in the maximum amount of earnings subject to the Social Security payroll tax (OASDI) for 2026. The wage base will rise from $176,100 in 2025 to $184,500 in 2026, an increase of $8,400. This adjustment, which is tied to the increase in the national average wage index, means that high-income earners will pay the 6.2 percent Social Security tax on a larger portion of their earnings. Consequently, the maximum Social Security tax paid by both an employee and an employer will increase to $11,439.00 each. That's an increase of $521 for each party in 2026. The Medicare Hospital Insurance (HI) tax rate of 1.45 percent remains unchanged for both the employee and the employer for 2026 (total of 2.9 percent). Unlike the Social Security (OASDI) tax, the Medicare tax applies to all wages; there is no limit on the amount of earnings subject to the 1.45 percent Medicare tax. The Additional Medicare Tax of 0.9 percent also remains in effect. This tax is applied to employee wages that exceed $200,000 (regardless of filing status). There is no corresponding employer share of this additional tax. Therefore, for most taxpayers, the rate remains 1.45

percent, and for high earners, the total Medicare tax rate on earnings above $200,000 is $2.35 percent (1.45 + 0.9). *SSA COLA Fact Sheet, Oct. 24, 2025.*

Application to Limited Partners. A question in self-employment tax planning is whether an LLC member is a limited partner. In 1997 the IRS/Treasury issued a proposed regulation to address the issue, but it has never been finalized. The regulation establishes a fact-based analysis based on participation in management to determine limited partner status. A limited partner doesn't participate in management. For businesses other than those providing professional services, characterization of an LLC member's interest is determinative of whether the member has self-employment tax liability on amounts distributed to the member (other than guaranteed payments). That means that proper structuring of the entity matters as does the drafting of the LLC operating agreement and the conduct of the members.

Here, the U. S. Tax Court issued a fully reported opinion confirming that state law classifications of a partner's interest is not conclusive on the self-employment tax issue. ordinary income to its limited partners. However, the petitioner excluded distributions of ordinary income to its limited partners from its computation of net earnings from self-employment. Its basis for doing so was that the limited partners' interest conformed to state law. The IRS disagreed asserting that wasn't enough and that the functions and roles of the limited partners also had to be analyzed for self-employment tax purposes. The Tax Court agreed with the IRS. *Soroban Capital Partners, LP v. Comm'r., 161 T.C. 310 (2023).*

At issue was the definition of a "limited partner" for purpose of the exception from s.e. tax under IRC §1402(a)(13). The Tax Court noted that the proposed regulations provided a definition, that the Congress froze the finalization of the regulation for six months and has said very little about the issue since the freeze was lifted and has not provided a definition. The Tax Court noted that it had applied a "functional analysis" test in *Renkemeyer, Campbell & Weaver, LLP, 136 T.C 137 (2011),* but that this was the first time the Tax Court was asked to determine the self-employment tax status of limited partner in a state law limited partnership (having passed on the issue in a 2020 case).

The Tax Court determined that the functional analysis test applied based largely on statutory construction of IRC §1402(a)(13) which excludes from self-employment tax "the distributive share of any item of income or loss of a limited partner, as such." The Court concluded that the "as such" language meant that there wasn't a blanket exclusion for a limited partner. Instead, the statute only applies to a limited partner that is acting as a limited partner. If a limited partner is anything more than merely an investor, self-employment tax applies to the partner's distributive share.

> **Note:** The Tax Court noted that the petitioner cited legislative history in an attempt to support its position, but that the legislative history actually supported the position of the IRS. The Tax Court also noted that the petitioner put forth "myriad other arguments" none of which were persuasive. The petitioner even cited language in the instructions for Form 1065 which it claimed defined a limited partner, but the Tax Court noted that the definition did not purport to define a limited partner.

The Tax Court held that a functional inquiry into the roles and activities of the petitioner's individual partners under IRC §1402(a)(13) "involves factual determinations that are necessary to determine Soroban's aggregate amount of net earnings from self-employment." Accordingly, the Tax Court denied the petitioner's motion for summary judgment and set forth the rule going forward in evaluating the application of self-employment tax for limited partners in professional service businesses.

> **Note:** The manager-managed LLC provides a better result than the result produced by the member-managed LLC for LLCs that are not service partnerships. For those that are, the S corporation is the business form to use to achieve a better tax result. For an S corporation, "reasonable" compensation will need to be paid subject to S.E. tax, but the balance drawn from the entity can be received self-employment tax free. But, for farming operations with land rental income, the manager-managed LLC can provide a better overall tax result than the use of an S corporation because of the ability to eliminate the net investment income tax.

> **Observation:** With this decision the Tax Court laid down the rule that it's not enough to simply hold a limited partnership interest under state law (in the context of a professional service business). A limited partner must truly be acting as an investor and no more.

The Tax Court's opinion in *Soroban* was followed in *Sirius Solutions, L.L.L.P. v. Comm'r., No. 11587-20, 2024 U.S. Tax Ct. LEXIS 416 (U.S. Tax Court Feb. 20, 2024).* The parties in *Sirius Solutions* stipulated that the functional analysis test dictated that the state-law limited partners of *Sirius Solutions* are not "limited partners as such" for purposes of IRC §1402(a)." An appeal was filed with the U.S. Court of Appeals for the Fifth Circuit on May 15, 2024.

> **Note:** The Tax Court reached the same conclusion in *Denham Capital Management LP, et al. v. Comm'r., T.C. Memo 2024-114,* to hold that under the functional analysis test the distributive shares of five limited partners in a private equity firm did not qualify for the limited partner exception of IRC §1402(a)(13) and were includible in NESE. The partners were functionally self-employed persons and not limited partners. They devoted substantially all of their time to the LP and participated in management, their skill and expertise was a significant draw for fund investors, they exercised significant control over personnel decisions, and they had made more than an in significant investment in the LP. An appeal was filed on April 7, 2025, with the Court of Appeals for the 1st Circuit.

On the merits, the Tax Court upheld the IRS determination of a $140,000,000 deficiency on the basis that the limited partners were such in name only and were functionally managing the petitioner's business substantially in several respects based on an analysis of the facts. *Soroban Capital Partners, L.P. et al. v. Comm'r., T.C. Memo 2025-52.*

> **Note:** Another case presently in the Tax Court on the same issue is *Point72 Asset Management LP v. Comm'r., No. 12752-23 (pet. filed, Aug. 11, 2023).*

On the appeal in *Sirius Solutions*, the plaintiff, a business-consulting firm organized as a Delaware Limited Liability Limited Partnership (LLLP) based in Houston. The plaintiff excluded the distributive shares of its limited partners from self-employment (SECA) taxes. The IRS claimed that these partners were not "true" limited partners because they were active in the business that provided services and managing operations rather than being passive investors. The Tax Court agreed with the IRS applying a "functional analysis" test based on the language of the statute at issue, I.R.C. §1402(a)(13) which excludes from s.e. tax the distribute share of a limited partner, "as such." Because Congress did not simply say, "limited parter" but modified the term by including "as such" the IRS position was that Congress meant a limited partner that was a "passive investor." Because the plaintiff's partners were active, the Tax Court ruled they were not withing the exclusion of I.R.C. §1402(a)(13) and owed s.e. tax on their distributive shares. The appellate court reversed, reading out of the statute the "as such" language and holding that a "limited partner" is any partner in a limited partnership who has limited liability under state law. The appellate court, however, did not determine if it's rationale applied to members of an LLC. As such, the opinion only has direct application to limited partnerships that solely engage in consulting activities. The dissent focused heavily on the phrase "limited partner, as such" in I.R.C. §1402(a)(13), pointing out that the "as such" is not mere filler text. Instead, it strongly implies that the partner must be acting in the capacity of a limited partner (i.e., a passive investor) to receive the statutory exclusion from s.e. tax for a partner's distributive share. Indeed, the dissent pointed out, if a partner is actively managing the firm and binding the partnership, they aren't receiving income "as" a limited partner; they are receiving it as a de facto general partner. The dissent also warned that the majority's ruling creates a massive loophole that contradicts the intent of the Social Security Act. Specifically, s.e. tax is designed to fund social safety nets based on active labor. By allowing active service providers to hide behind a state-law "limited partner" label to avoid SECA taxes, the dissent pointed out that the majority effectively allowed taxpayers to opt out of the Social Security system while still performing the very labor the tax was meant to capture. The dissent also took issue with the majority's use of historical IRS tax form instructions as evidence of the law's meaning. Tax form instructions are administrative aids, not authoritative legal interpretations of a statute. The dissent argued that the IRS's past failure to strictly enforce the "passive" requirement in its paperwork shouldn't prevent the court from correctly interpreting the statute now. *Sirius Solutions v. Comm'r., 165 F.4th 374 (5th Cir. 2026).*

> **Observation:** While the majority prioritized textualism and state-law definitions, the dissent prioritized functionalism and the economic reality of the partner's role, echoing the "passive investor" test that the Tax Court has utilized in other cases. By ignoring the functional nature of "as such," the majority ignored the common-law principle that tax benefits follow the nature of the activity, not just the label on the paperwork. If "limited partner" already defines the status, "as such" must define the conduct.

Comments: The majority opinion is simply incorrect**.** A "limited partner" is a legal status, but "employee" is a functional reality. When a partner provides the very services that generate the partnership's income, that income is "earned income" from labor, not "investment income" from capital. Therefore, taxing it under SECA is mandatory, regardless of the partner's liability shield. In addition, partnerships often pay active partners a small guaranteed payment (subject to s.e. tax) and a large distributive share (which the majority said is exempt). In many partnerships junior employees are paid more than the senior partners' guaranteed payments. This establishes that a guaranteed payment is an "artificial" number designed to dodge taxes, and therefore the entire distributive share should be reclassified as taxable compensation for services. Also, federal tax definitions should not be held hostage by state legislatures. Since 1977 (the date of enactment of I.R.C. §1402(a)(13)), states have drastically expanded what "limited partners" can do (like managing the firm). But Congress in 1977 intended the term "limited partner" to mean "passive investor." Just because a state like Delaware decides to let a "limited partner" run the whole show doesn't mean the federal government has to grant them a tax exemption meant for people who just "write a check." Also, if a partner contributes no capital (or a negligible amount) but takes out $1 million in profit, for instance, while working 60 hours a week, the IRS argues that $1 million cannot be a "return on investment" because there was no investment to return. It can only be a "return on labor."

Practice Pointers:

- The IRS could issue a non-acquiescence to the court's decision taking the position that not only will it not follow the Fifth Circuit's opinion outside the Fifth Circuit, but that the court's opinion only applies to LLLPs that provide consulting services and other LLLPs such as accounting business and law practices have no such exemption for limited partners.

Similar cases are presently before the 1st (*Denham Capital Management*) and the 2nd Circuit (*Soroban Capital Partners, LP*).

Pay-Pal and 1099-K. In 2019 the petitioner earned $8,250 from freelance movie reviews and $41,972 from eBay memorabilia sales. He reported the entire $50,222 as "Other Income" on line 7a, instead of on Schedule C, and did not pay self-employment tax. PayPal issued a 1099-K, triggering an IRS mismatch and a Notice of Deficiency proposing additional tax and penalties. The Tax Court upheld the IRS position that the petitioner's total income from both activities was properly classified as self-employment income, subject to both income tax and self-employment tax. The Tax Court rejected the petitioner's argument that he relied on what he believed was an IRS "concession" (e.g. a Social Security Administration communication reducing reported self-employment income to zero), emphasizing that informal IRS correspondence does not override statutory and regulatory requirements. The Tax Court also upheld IRS imposition of an accuracy-related penalty and a penalty for substantial understatement of tax. *Clark v. Comm'r., T.C. Memo. 2025-13.*

IRS Procedures and Regulations

IRS Rescheduling Guidance on I.R.C. §280E. The Treasury and IRS have announced how they will implement the DOJ's Final Order moving specific medical marijuana products from Schedule I to Schedule III.

> **Note:** Under I.R.C. §280E, cannabis businesses are barred from claiming ordinary business deductions or credits (e.g., rent, wages), forcing them to pay tax on gross income minus Cost of Goods Sold (COGS).

For qualifying medical marijuana operators, the IRS will apply the Schedule III status to their entire 2026 taxable year. This eliminates mid-year tax bifurcation and grants a full year of ordinary business deductions. However, the relief does not apply across the board. The Schedule III shift only extends exclusively to FDA-approved marijuana drug products and marijuana sold under a qualifying, state-issued medical license. All recreational (adult-use) cannabis, unlicensed crops, bulk biomass, and unprocessed extracts remain classified under Schedule I. Consequently, I.R.C. §280E remains fully active for the recreational market. Co-located businesses operating both medical and adult-use channels must strictly apportion their overhead, payroll, and rent between the two activities. *Treasury/IRS Press Release, April 23, 2026.*

Filing Information Returns Electronically (FIRE) System. The IRS is retiring the FIRE system and transitioning all electronic information returns to the Information Returns Intake System (IRIS). Starting January 1, 2027, IRIS will be the exclusive platform for all current-year, prior-year, and corrected information return electronic filings. The key deadlines are as follows:

- **July 21, 2026:** The IRS will stop accepting new Transmitter Control Code (TCC) applications for the FIRE system.
- **December 2026:** The ability for existing users to update their FIRE applications closes. After this, FIRE accounts will become read-only for historical reference.
- **January 1, 2027:** The FIRE system officially retires. IRIS becomes the sole system for all electronic information returns.

Current FIRE users must complete an IRIS Application for a TCC and transition their workflows to the IRIS platform ahead of the 2027 filing season. *Additional guidance and resources can be found at IRS.gov/iris.*

CDP – Abuse of Discretion. Following an audit that inflated his income and disallowed his business expenses, the petitioner owed a substantial amount of back taxes. To resolve his debt, he requested an Installment Agreement (IA) during a Collection Due Process (CDP) hearing. The IRS Appeals Officer rejected the request, essentially ruling that because the taxpayer owned a home and a business property with equity, he was automatically disqualified from a payment plan and had to liquidate his assets to pay the debt. The petitioner claimed that the IRS Appeals Officer abused discretion by treating the taxpayer's real estate equity as an automatic disqualifier for an installment agreement. The Tax Court agreed, noting that the Internal Revenue Manual (IRM) requires agents to look at the total financial picture and determine if a taxpayer can borrow against their equity before rejecting an installment agreement. Here, the Tax Court concluded, the Appeals Officer jumped straight from "you have equity" to "you must sell," completely ignoring guidelines to evaluate if refinancing or securing a home equity loan was even feasible. The Tax Court concluded that while the IRS does not abuse its discretion when it follows the IRM, it does abuse its discretion when it blatantly ignores its own mandatory procedural guidelines. The case was remanded for a new hearing. *Joseph v. Comm'r., T.C. Memo. 2026-38.*

> **Observation:** Having equity in a home or business property (such as a farm or ranch) does not automatically bar a taxpayer from receiving an IRS installment agreement. The IRS is legally required to evaluate borrowing feasibility rather than simply forcing a property sale.

APA Challenge to IRS Enforcement Action. The petitioners established an Employee Stock Ownership Plan (ESOP) using a proprietary system marketed by a consulting company named Byers to obtain specific tax benefits. After years of operation without issue, the IRS audited the Byers system and subsequently disqualified the taxpayers' ESOP. While the core disqualification is being challenged in Tax Court, the taxpayers filed this separate District Court action arguing that the IRS's enforcement violated the Administrative Procedure Act (APA). The petitioner's claimed that the IRS's sudden crackdown on the Byers system constituted "legislative rulemaking." Because the IRS had implicitly accepted the system for years, the taxpayers claimed this shift represented a new rule that required the IRS to follow the APA's formal notice-and-comment procedures. The IRS moved to dismiss the complaint, arguing that no such "Byers Rule" exists and that its standard enforcement actions are not subject to the APA's rulemaking requirements. The district court agreed with the IRS, holding that inaction is not acquiescence. The court noted that the IRS cannot police every single tax transaction. Just because the agency did not challenge the Byers ESOP system for years did not mean it implicitly approved it. As such, prior regulatory inaction or apparent acquiescence does not legally prevent (estop) the IRS from enforcing the tax code later on. Changing an enforcement priority or auditing a previously ignored system does not constitute creating a "new rule" under the APA. *Daines, et al. v. Internal Revenue Service, No. 24-CV-1057, 2026 U.S. Dist. LEXIS 97409 (E.D. Wis. May 4, 2026).*

Economic Substance Doctrine. Here the court denied the taxpayer's $110 million refund claim, affirming a broad application of the codified Economic Substance Doctrine (ESD) under I.R.C. §7701(o). Following the 2017 Tax Cuts and Jobs Act, the petitioner executed "Project Soy," a multi-step corporate restructuring designed to exploit a temporary loophole between Global Intangible Low-Taxed Income (GILTI) rules and the §245A dividends-received deduction. The strategy manufactured $2.4 billion in foreign earnings and profits (E&P), allowing the petitioner to claim a 100 percent tax-free dividend deduction. The petitioner sued for a refund, arguing the underlying Treasury regulations were procedurally invalid under the Administrative Procedure Act (APA). While the trial court agreed on the APA issue, it ruled the IRS could still disallow the deduction under the ESD. On appeal, the petitioner conceded that the initial steps lacked a non-tax business purpose, narrowing the issue to whether the ESD is relevant to transactions that mechanically comply with literal statutory provisions and elective regimes. The appellate court majority rejected the petitioner's arguments, establishing four key principles: 1) mechanical compliance with the Tax Code is not a shield from ESD review if it is used to obtain a tax benefit Congress never intended; 2) there is no threshold relevancy test that links relevance directly to whether a transaction's mechanical use contradicts congressional purpose; 3) routine corporate actions (like check-the-box elections) lose immunity when integrated into a larger, tax-motivated scheme; and 4) under I.R.C. §7701(o)(5)(D), a series of steps can be analyzed as a single, unified chain. Here, because the steps generating the E&P lacked economic substance, the entire deduction failed. *Liberty Global, Inc. v. United States, No. 23-1410, 2026 U.S. App. LEXIS 11348 (10th Cir. Apr. 21, 2026).*

Small Partnership. There are some exceptions to the information that IRS requires to be reported on Schedule K-2 (part of Form 1065) and Schedule K-3 (provided to partners). Common exceptions include no foreign information, and each partner is an individual that is a U.S. citizen, an estate a domestic grantor or non-grantor trust or a resident alien. Now, IRS has expanded the exceptions to include small partnerships. A "small partnership" for purposes of not being required to complete Schedule K-2 and Schedule K-3 is one that has total receipts less than $250,000 and total assets at the end of the year of less than $1 million. In addition, all Schedule K-1s must have been timely submitted to the partners, and the partnership must not be required to file Schedule M-3. If the exception applies the partnership must provide notice to the partners, it is not filing these schedules. However, the partner may request a Schedule K-3 which the partnership must provide to the partner upon request (but need not provide to the IRS). If the partnership has a partnership as a partner and all of the partners of that partnership meet the exception requirements, the exception still applies. https://www.irs.gov/businesses/small-businesses-self-employed/form-1065-schedules-k-2-and-k-3-filing-requirements?utm_source=substack&utm_medium=email. *IRS website, updated Jun. 10, 2025.*

Gambling Winnings. The IRS has issued proposed regulations to implement a new $2,000 reporting threshold for gambling winnings, effective for payments made after December 31, 2025. This change, mandated by the One, Big, Beautiful Bill Act (OBBBA), raises the threshold from the longstanding $600 level to $2,000 for payments made in the course of a trade or business, including winnings from bingo, keno, and slot machines. The $2,000 threshold will also be indexed for inflation for calendar years after 2026. The proposed regulations update various sections of the Internal Revenue Code and Treasury Regulations, including I.R.C. §§ 6041, 6041A, and 3406, to reflect the new threshold and ensure consistency across reporting and backup withholding requirements. For bingo, keno, and slot machine play, the reporting threshold is now $2,000 per game or play, with specific rules for how winnings and wagers are aggregated. The regulations also maintain the optional aggregate reporting method, allowing payors to report multiple payments to the same individual within a 24-hour period on a single Form W-2G, provided certain recordkeeping requirements are met. These changes are expected to reduce compliance burdens for payors and align reporting requirements with current statutory law. *IRS Proposed Regulations REG-113229-25.*

IRS Settlement Officer Discretion. The petitioner requested to pay $5,000 monthly toward his tax liability, but the IRS Settlement Officer (SO) determined that his financial capacity supported a $10,000 monthly payment based on allowed expenses. The Tax Court held that the SO did not abuse discretion for two primary reasons. First, the petitioner failed to remain in compliance with current estimated tax obligations, which provided an independent, sufficient basis for the SO to deny the proposed collection alternative. Second, the Tax Court found the SO's calculation of the $10,000 monthly payment to be reasonable. The taxpayer failed to provide the necessary documentation to substantiate claims for higher expenses or evidence of a projected decline in future income that would justify a downward deviation. Consequently, the Tax Court sustained the IRS's determination, reinforcing that taxpayers bear the burden of proving that their proposed alternatives are appropriate and supported by accurate financial data when requesting relief from standard collection enforcement. *Bowler v. Comm'r., T.C. Memo. 2025-98.*

Non-Profit Status. The Tax Court upheld the IRS's denial of tax-exempt status under I.R.C. § 501(c)(4) to a homeowner's association (petitioner) for a gated community. Although the petitioner was a nonprofit and maintained common areas such as greenbelts, private streets, and recreational facilities, the Tax Court found that its activities primarily benefited its members and their guests, not the general public. I.R.C. §501(c)(4) requires that an organization operate exclusively for the promotion of social welfare, which means serving the common good and general welfare of the community, not just a select group. Because access to the petitioner's facilities was restricted and any public benefit was only incidental, the petitioner failed to meet the operational test for exemption. The Tax Court emphasized that providing benefits mainly to members, rather than the broader community, precludes qualification as a social welfare organization under I.R.C. § 501(c)(4). *Mira Vista Homeowners Association, Inc. v. Comm'r., T.C. Memo. 2025-102.*

Qualified Non-Personal Use Vehicle. The IRS has issued final regulations that expand the definition of "qualified nonpersonal use vehicles." These vehicles are exempt from the strict substantiation and recordkeeping requirements typically mandated for "listed property," such as passenger automobiles. The primary update is the inclusion of unmarked vehicles used by firefighters, rescue squad members, or ambulance crew members as a new category of qualified nonpersonal use vehicles. This change acknowledges the specific nature of these public safety roles, where the vehicle's design or usage makes personal use highly unlikely or impractical.

These regulations primarily impact governmental units that provide these specialized vehicles to their personnel. By categorizing these unmarked units as qualified nonpersonal use vehicles, the IRS simplifies the administrative burden for both the employing agencies and the employees, removing the requirement to maintain detailed mileage logs for tax purposes. *T.D. 10043, 91 Fed. Reg. 12612 (Mar. 20, 2026).*

Form Instructions. The IRS has released Instructions for the 2025 Form 1041 and Schedules A, B, G, J, and K-1 to provide guidance for fiduciaries of estates and trusts. The instructions clarify the requirements for reporting income, deductions, and credits, and detail the calculation of distributable net income (DNI) and the income distribution deduction, which are central to determining the tax liability of both the entity and its beneficiaries. The instructions incorporate recent legislative changes, such as the new I.R.C. §174A for domestic research and experimental expenditures, and I.R.C. §1062, which allows installment payment of tax on gains from the sale of qualified farmland to qualified farmers. The instructions also address the updated state and local tax deduction worksheet, new exemption amounts for qualified disability trusts, and the expanded reporting for digital asset transactions. The guidance emphasizes the importance of accurate beneficiary reporting via Schedule K-1, including the allocation of excess deductions on termination and the reporting of qualified business income items. 2025 Instructions for Form 1041 and Schedules A, B, G, J, and K-1

Valuation. At the time of death, the decedent (a renowned radiologist and inventor) held interests in a medical device company and related assets through several trusts. The estate reported the company's membership units at $0 and certain promissory notes at $1 million on the estate tax return. However, just months after the valuation date, the company was sold to a third party for $15 million. The IRS valued the assets at $15,145,000 and issued a deficiency notice for over $5.6 million in taxes, plus roughly $2.4 million in penalties. The estate filed a motion to strike the IRS's valuation because the IRS failed to provide a written statement explaining its $15 million figure, as required under I.R.C. § 7517 upon request. The Tax Court ruled that while the IRS violated I.R.C. §7517 by failing to provide the explanation, the law does not provide a "sanction" for this failure. The Tax Court refused to throw out the IRS's valuation, stating that the estate could simply obtain that information through the normal discovery process before the trial. Essentially, the Tax Court held that I.R.C. §7517 is a "right without a remedy" - the IRS is supposed to follow it, but there's no automatic penalty if it doesn't. The case will now proceed to trial to determine the actual fair market value of the company and the notes. *Estate of Amplatz v. Comm'r., T.C. Memo. 2026-35.*

Trump Accounts. The IRS issued proposed regulations that provide detailed guidance on the Trump Accounts contribution pilot program offering a one-time $1,000 government-funded contribution for eligible children. The regulations clarify eligibility, the election process, and the mechanics of the $1,000 contribution, aiming to ensure smooth implementation and equitable access. To qualify for the pilot program, a child must meet several requirements - the child must be a U.S. citizen; the child must be born in calendar years 2025, 2026, 2027, or 2028; the child must have been issued a Social Security number before the election is made; and no prior pilot program election for the child may have been made and processed by the Secretary. Additionally, the child must have a Trump Account established in their name. If a Trump Account does not exist at the time of the election, the $1,000 contribution cannot be made.

The regulations specify that the election to receive the $1,000 pilot program contribution must be made by an individual who anticipates that the child will be their qualifying child under I.R.C. §152(c) for the year in which the election is made. Typically, this will be a parent or guardian, but the rules are flexible enough to accommodate other relatives in certain circumstances. The election is not made by the child, but on behalf of the child by the eligible adult.

The election can be made as soon as the child meets all eligibility criteria, including issuance of a Social Security number. The latest the election can be made is December 31 of the calendar year in which the child turns 17. The election must be made using Form 4547, or through an electronic application or webpage provided by the IRS. The process is designed to be independent of the tax return filing process, allowing for early and flexible participation.

Upon processing a valid election, the IRS treats the child as having made a $1,000 payment against their federal income tax liability for a special taxable year, which is deemed to close immediately. Since the child will have no tax liability, this results in a $1,000 overpayment, which is then refunded directly into the child's Trump Account. Importantly, this refund is protected from offset against other federal or state debts, ensuring the full $1,000 is deposited for the child's benefit.

Only the first processed election for a child will result in a contribution, preventing duplicate payments. If an election is made erroneously or maliciously but not processed, the child remains eligible. The contribution cannot be paid in any manner other than as a deposit to the Trump Account, and if the account does not exist, no payment is made. *REG-117002-25, Mar. 6, 2026.*

"Luxury" Auto Limits. Under IRC § 280F, "luxury" passenger automobiles - a category that importantly includes most trucks and vans - are subject to specific dollar caps that override standard MACRS calculations. The IRS has provided guidance with two distinct tables for vehicles placed in service during the 2026 calendar year. The first table applies to vehicles for which I.R.C. §168(k) bonus depreciation is claimed, while the second applies to those where it is not. With bonus depreciation currently set at 100 percent for assets acquired after January 20, 2025, the first-year "luxury" limit remains a critical threshold for high-value business vehicles, preventing the immediate expensing of the entire purchase price of high-end models. To maintain parity between owning and leasing, the IRS has also provided the Lease Inclusion Table. Lessees of vehicles with a fair market value exceeding the 2026 threshold must add a specific dollar amount back into their gross income. This mechanical adjustment effectively reduces the lease deduction, ensuring that leasing a luxury vehicle does not provide a disproportionate tax advantage over purchasing one. *Rev. Proc. 2026-15, 2026-13 IRB 729.*

Table 1: With § 168(k) Bonus Depreciation

Applicable to vehicles for which the 100% additional first-year depreciation applies.

Table 2: Without § 168(k) Bonus Depreciation

Applicable if the taxpayer elects out of bonus depreciation or the vehicle is used 50% or less for business.

Lease Inclusion Amounts for 2026

If you lease a vehicle for business, you must include a dollar amount in your income to offset the lease deduction. This applies if the vehicle's Fair Market Value (FMV) exceeds the threshold.

Table 3: Income Inclusion for Leases Starting in 2026 (Sample Ranges)

> **Note:** The full table contains increments up to several hundred thousand dollars; below are common entry-level luxury brackets.

Practitioner Note:

- These limits apply to vehicles with a Gross Vehicle Weight Rating (GVWR) of 6,000 pounds or less. Heavier vehicles (like many large SUVs and pickups) are generally exempt from these "luxury" caps and may qualify for more aggressive immediate expensing under I.R.C. §179 or I.R.C. §168(k).

Business Interest. The IRS has issued procedural guidance that allows for a "reset" for those that previously made elections under the business interest limitation rules of I.R.C. §163(j). This new guidance allows farming businesses to revisit and potentially reverse key tax elections made in recent years - most notably, the election to be an "electing farming business" under I.R.C. §163(j)(7)(C). It also opens the door for late elections out of bonus depreciation, providing flexibility and potential tax savings for those who wish to realign their tax positions with the new law. I.R.C. §163(j), as amended by the Tax Cuts and Jobs Act (TCJA), imposed a limitation on the deductibility of business interest expense, generally capping the deduction at 30 percent of adjusted taxable income (ATI). However, certain businesses - including farming businesses - could elect out of this limitation by making an "electing farming business" election under I.R.C. §163(j)(7)(C). The trade-off for making this election was significant: the business was required to use the alternative depreciation system (ADS) for certain property and was ineligible for bonus depreciation under I.R.C. §168(k) for those assets. The OBBBA restored the ability to add back depreciation and amortization in calculating ATI for taxable years beginning after December 31, 2024, and made 100 percent bonus depreciation permanent for property acquired after January 19, 2025. These changes made the I.R.C. §163(j) limitation less restrictive and bonus depreciation more attractive, prompting many farming businesses to reconsider the value of their prior elections.

The IRS has now provided a unique opportunity for farming businesses that previously elected to be an "electing farming business" for tax years beginning in 2022, 2023, or 2024. Under this revenue procedure, eligible taxpayers may withdraw their I.R.C. §163(j)(7)(C) election by filing an amended return, amended Form 1065, or administrative adjustment request (AAR) for the year in which the election was made. The withdrawal must be completed by the earlier of October 15, 2026, or the expiration of the applicable period of limitations on assessment for the year in question. Crucially, if a farming business withdraws its election, it is treated as if the election had never been made. This means the business interest expense for the affected year(s) becomes subject to the I.R.C. §163(j) limitation, but the business is no longer required to use ADS for its property and regains eligibility for bonus depreciation.

Recognizing that many farming businesses may have foregone bonus depreciation as a result of their prior election, the IRS is also allowing taxpayers who withdraw their I.R.C. §163(j)(7)(C) election to make a late election under to opt out of bonus depreciation for any class of property affected by the withdrawn election. This late election must be made on the same amended return or AAR used to withdraw the election and by the same deadline. *Rev. Proc. 2026-17, 2026-11 IRB 436.*

> **Observation:** For farming businesses, the guidance is a game-changer. It allows for a comprehensive reevaluation of past tax positions in light of the new, more favorable rules. Businesses that previously sacrificed bonus depreciation to avoid the interest limitation can now reverse course, potentially unlocking significant immediate deductions and improving cash flow. The ability to make these changes retroactively for tax years as far back as 2022 provides a rare opportunity to optimize tax outcomes. By allowing the withdrawal of prior interest limitation elections and providing a path for late bonus depreciation elections, the IRS has given the agricultural sector the flexibility to adapt to a dramatically changed tax environment.

Tax Pro Accounts. Historically, the Tax Pro Account was limited to individual practitioners (sole practitioners). This update introduces a framework for tax-preparation companies, accounting firms, and large organizations to manage authorizations collectively. For the first time, firms can link their business Centralized Authorization File (CAF) number to their Employer Identification

Number (EIN) through the portal. The update allows firm administrators to manage employee access digitally, specifying which staff members are authorized to act under the business CAF for specific clients. By transitioning Power of Attorney (Form 2848) and Tax Information Authorization (Form 8821) submissions to a digital-first workflow, the IRS aims to bypass the manual processing backlogs that have historically plagued the CAF unit. Designated business representatives are allowed to manage business CAF access, including specifying which employees are authorized to act under the business CAF; link the business CAF number to the company's Employer Identification Number through their Tax Pro Account; view taxpayer information associated with the business CAF within the scope of active authorizations; and view and withdraw active authorizations on behalf of the tax professional business. *IR-2026-22.*

Notice of Intent to Levy. The petitioner sought to invalidate a levy by arguing the IRS failed to properly mail the underlying notices of deficiency. While the Tax Court acknowledged minor discrepancies in the IRS's proof of mailing (USPS Form 3877), it ultimately ruled that the Service had legally and sufficiently mailed the notices. Furthermore, the Tax Court found no abuse of discretion, confirming that the Office of Appeals fully satisfied its statutory obligations during the Collection Due Process (CDP) hearing. Specifically, the Appeals Officer verified that all applicable legal and administrative procedures were met; correctly considered all relevant issues raised by the taxpayer; and appropriately balanced the IRS's need for efficient tax collection against the taxpayer's legitimate concern that the collection action be no more intrusive than necessary. The Tax Court sustained the collection action and ruled entirely in favor of the IRS. *Foulds v. Comm'r., T.C. Memo. 2025-111.*

> **Observation:** To successfully challenge an IRS Independent Office of Appeals determination upholding a notice of intent to levy, a taxpayer must prove the IRS committed a material error or abused its discretion.

Notice of Federal Tax Lien. The petitioners owed over $288,000 in back taxes. They filed for Chapter 7 bankruptcy after the IRS had already filed a Notice of Federal Tax Lien (NFTL). Post-discharge, the IRS issued a notice of intent to levy. The taxpayers argued the debt was discharged and sought a "streamlined" installment agreement. However, they refused to provide financial disclosures regarding exempt or abandoned property from the bankruptcy. The IRS Settlement Officer sustained the levy, ruling that while bankruptcy may discharge personal liability, it does not extinguish a pre-petition tax lien attached to specific assets. The central issue was whether the taxpayers could challenge the underlying tax liabilities for 2011–2013 and 2015–2017 during a CDP hearing regarding a Notice of Federal Tax Lien (NFTL). The petitioners argued their tax debts were discharged in a prior bankruptcy. The Tax Court held that because the taxpayers had received a statutory notice of deficiency for the years in question and failed to petition the Tax Court at that time, they were barred from challenging the existence or amount of the liability under I.R.C. §6330(c)(2)(*B).* As for dischargeability under 11 U.S.C. § 523(a)(1), the Tax Court meticulously applied the "three-year rule" and the "two-year rule." It determined that the liabilities for most years were not discharged because the returns were either filed late (within two years of the bankruptcy petition) or the taxes were assessed within the 240-day "priority" window. The Settlement Officer (SO) was found to have properly verified that all legal and administrative requirements were met. Since the taxpayers offered no viable collection alternatives (like an OIC), the SO's decision to sustain the NFTL was upheld. *Mongogna v. Comm'r., T.C. Memo. 2025-89.*

> **Observation:** Bankruptcy is not a "get out of jail free" card for tax liens if the rigid timing requirements for discharge aren't met. The Tax Court will not reopen a liability debate if the taxpayer missed their original 90-day window.

Deficiency Assessment. In 2000, the petitioner and her then-husband formed Ashand Enterprises, Inc. as a 50/50 S corporation. After their separation in 2004, the petitioner was largely excluded from the business, and her husband later represented in the company's Chapter 11 bankruptcy (2013–2015) that he was the sole owner. Despite claiming she was no longer an owner for tax purposes, the petitioner filed amended proofs of claim in her husband's personal bankruptcy in 2019, asserting under penalty of perjury that she was a 50 percent equity shareholder to secure a share of the proceeds from a property sale. The IRS used these sworn bankruptcy statements to attribute 50 percent of Ashand's 2014 income (capital gains and rental income) to her. The Court held the IRS's deficiency assessment had a "rational basis" because Veeraswamy had repeatedly identified herself as a 50 percent owner in related bankruptcy filings. This shifted the burden to her to prove otherwise - a burden she failed to meet without contemporaneous documentation of an ownership transfer. The petitioner argued that a prior bankruptcy confirmation plan (which listed her husband as "sole owner") precluded the IRS from asserting her ownership. The Second Circuit disagreed, noting the bankruptcy court never actually litigated or decided the ownership issue on its merits. *Veeraswamy v. Comm'r., No. 25-102cv, 2026 U.S. App. LEXIS 3925 (2nd Cir. Feb. 9, 2026).*

Taxpayer Rights. The President has signed into law legislation requiring that IRS "math error" notices under I.R.C. §6213(b) must be clearer and more detailed, giving taxpayers a better chance to understand and contest adjustments within the critical 60-day deadline. Specifically, the law requires the IRS to provide taxpayers with significantly more detailed and clearer information when sending a notice about a math or clerical error on their return. Notices must include a plain-language description of the specific error, the line number where it appeared, and an itemized computation of all adjustments made to the taxpayer's account (income, deductions, credits, etc.). The law also sets clear standards and procedures for taxpayers to request an abatement (cancellation) of taxes assessed due to a math or clerical error, ensuring they understand how to contest the IRS's automatic adjustment. The law directs the Treasury Department and the IRS to implement a pilot program to test sending certain math or clerical error notices via certified or registered mail. The goal is to measure how this more formal delivery affects taxpayer engagement and response times. *H.R. 998, The Internal Revenue Service Math and Taxpayer Help Act, P.L. 119-41.*

> **Observation:** By requiring greater transparency and clearer explanations in IRS correspondence, the law directly reinforces the principles of the existing Taxpayer Bill of Rights, specifically the Right to Be Informed and the Right to Challenge the IRS's Position and Be Heard. The legislation is Congress's response to longstanding concerns from tax professionals and advocates that previous IRS math error notices were confusing, lacked detail, and often left taxpayers unaware of their right to challenge the adjustment.

Deficiency Notice. The IRS claimed the taxpayer filed his Tax Court petition late. The Tax Court noted the taxpayer's last known address when the Notice of Deficiency was mailed was 220 6th Street. The Notice was erroneously addressed to him at 2206 TH St. (the city was correct). The Court found that the IRS failed to prove that a valid Notice of Deficiency was mailed to the taxpayer's last known address. *Cano v. Comm'r., T.C. Memo. 2025-65.*

Collection Due Process. The petitioner received a $244,695 lump-sum military retirement distribution in 2016 but omitted the bulk of it from his tax return. The IRS issued a Notice of Deficiency for $71,042 plus penalties. Although the petitioner received the Notice, he failed to petition the Tax Court within the 90-day window, choosing instead to send letters to the IRS. When the IRS subsequently issued a Notice of Intent to Levy, the petitioner requested a Collection Due Process (CDP) hearing. The Tax Court determined it lacked jurisdiction to hear the case because the petitioner received a Notice of Deficiency but failed to file a timely Tax Court petition.

In so holding, the Tax Court reaffirmed that a CDP hearing is not a "second bite at the apple" for liability disputes if a prior opportunity existed. The IRS Settlement Officer (SO) sustained the levy after Sullivan failed to propose a concrete collection alternative (like an Offer in Compromise or Installment Agreement). In the process of declining jurisdiction, the Tax Court noted that an SO does not abuse discretion by sustaining a levy when a taxpayer fails to provide requested financial documentation or a viable payment plan. *Sullivan v. Comm'r., T.C. Memo. 2025-92.*

Levy. The Tax Court sustained the IRS's decision to proceed with a levy action against the petitioner, the former Commissioner of the Mississippi Department of Corrections. The dispute centered on the procedural requirements of I.R.C. §6330 and the discretion of the Independent Office of Appeals. Because the underlying tax liability stemming from unreported income and fraud-related assessments linked to a high-profile bribery scheme was not properly at issue, the Court reviewed the Appeals Officer's (AO) determination for an abuse of discretion. The petitioner challenged the AO's rejection of an Installment Agreement (IA) or Offer-in-Compromise (OIC). The Court held that the AO acted reasonably because the petitioner failed to submit the necessary financial documentation (Form 433-A) and a compliant written proposal. Under I.R.C. §6330(c)(2)(A), the burden is on the taxpayer to propose specific alternatives. The Tax Court affirmed the AO's finding that no "economic hardship" existed under Treas. Reg. § 301.6343-1. The AO's review of Epps's available assets and financial status determined that the levy would not deprive him of basic living expenses. *Epps v. Comm'r., T.C. Memo. 2025-85.*

Challenging Underlying Liabilities. The petitioner sought to challenge her underlying liabilities for 2016–2019. However, the Tax Court affirmed that under Treas. Reg. § 301.6330-1(e)(3), a taxpayer is precluded from disputing the underlying tax if they had a prior opportunity to do so. Since the liabilities were based on the petitioner's own filed returns, the assessments were deemed valid. The core of the dispute involved the AO's rejection of a proposed installment agreement. While the IRS initially noted substantial home equity ($178,000), the AO correctly adjusted the analysis based on the petitioner's inability to borrow against that equity due to a poor credit score. Despite the AO offering two reduced-payment installment agreement options, the petitioner failed to return a signed agreement or propose an alternative by the extended deadline. The Tax Court held that sustaining a Notice of Federal Tax Liens not an abuse of discretion when a taxpayer fails to finalize the very collection alternatives they requested. *Hillman v. Comm'r., T.C. Memo. 2025-84*

> **Observation:** The Tax Court's ruling emphasizes that "good faith" negotiations in CDP hearings must culminate in timely, signed documentation; mere participation in the hearing does not stay collection action if the taxpayer remains non-compliant with procedural deadlines.

Practitioner Note

- To allow the taxpayer to benefit from those expenses in a post-TCJA environment, the employer would have needed to shift from a high hourly wage to an Accountable Plan under Section 62(a)(2)(A). Since the TCJA suspended unreimbursed employee deductions, the only way to make these costs "tax-free" is to have the employer pay them directly or reimburse them under a formal plan, effectively shifting the deduction from the employee's Schedule A (where it is currently disallowed) to the employer's business return.

IRA Rollover Deadline. Taxpayers A and B received an alert on their computer, leading them to contact what they thought was a legitimate tech company. A scammer, posing as a representative, convinced them that a virus had compromised their accounts and directed them to a second scammer, posing as a representative from their bank. The fake bank representative provided a forged letter and convinced Taxpayer A to make several wire transfers to a cryptocurrency account, claiming the funds were being moved to "secure locker accounts" pending an investigation. One of the amounts transferred (Amount 1) originated from Taxpayer A's Traditional IRA (IRA X). The taxpayers realized they were scammed when the contact numbers for the "representatives" disconnected. They immediately filed reports with banks and governmental agencies. An agency successfully secured and recovered the wired funds (Amount 2, which included Amount 1 from the IRA) and returned them to Taxpayer A after the 60-day rollover period had expired. Taxpayer A requested a ruling on whether the IRS would waive the 60-day rollover requirement for Amount 1 from the IRA, asserting the failure was directly due to being a victim of fraud. The IRS found that the facts and documentation supported the taxpayer's claim that the failure to timely roll over the funds was caused by being a victim of a fraud scheme and waived the 60-day rollover requirement of I.R.C. §408(d)(3) for Amount 1. The IRS granted Taxpayer A a period of 60 days from the date of the ruling letter to contribute the recovered Amount 1 into a new rollover IRA. *Priv. Ltr. Rul. 202535015 (Aug. 29, 2025).*

Proposed Regulations – Third Party Settlement Organizations. The IRS has issued proposed regulations that would revise the threshold for when certain third-party settlement organizations are required to perform backup withholding to comply with changes made in the One, Big, Beautiful Bill Act. The proposed regulations provide clarity on backup withholding and would provide that third party settlement organizations generally are not required to backup withhold on payments settled through third party payment networks unless the gross amount of reportable payment transactions to a payee exceeds $20,000 and the number of transactions exceeds 200. *Prop. Reg. § 31.3406(b)(3)-5.*

Railroad Retirement Tax Act Rates. The IRS has issued the tier 2 tax rates under the Railroad Retirement Tax Act that apply to compensation paid in calendar year 2026. The tier 2 tax rate for 2026 under I.R.C. §3201(b) is 4.9 percent of compensation; (2) the tier 2 tax rate for 2026 under I.R.C. §3221(b) is 13.1 percent of compensation; and the tier 2 tax rate for 2026 under I.R.C. §3211(b) is 13.1 percent of compensation. *90 Fed. Reg. 53444.*

Statute of Limitations. The Court dismissed the government's complaint that the government filed on January 27, 2025, seeking to take to judgment a tax liability assessed against a married couple on September 29, 2014, because it was filed outside of the 10-year statute of limitations in I.R.C. §6502(a). The government claimed that the statute of limitations was tolled by an installment agreement request the taxpayers allegedly submitted in 2019 but the court found that the government failed to allege any facts or provide any documents which would support its argument that tolling applied. *United States v. Phelps, No. 7:25-CV-241-BO-BM, 2025 U.S. Dist. LEXIS 227791 (E.D. N.C. Nov. 19, 2025).*

Penalty Approval. The IRS denied the taxpayer a deduction for a charitable conservation easement and assessed penalties. The record established that the IRS Revenue Agent's supervisor timely approved the penalties. She affixed her electronic signature to the penalty lead sheet on August 12, 2019, using Adobe software. She stated that she was providing "written managerial approval for all penalties determined in the FPAA". The Tax Court noted the supervisor had the discretion to approve or disapprove of the penalties. The taxpayer challenged the status of the Revenue Agent who made the initial determination to assert the penalties. The taxpayer contended that a different employee made the initial determination. The Tax Court noted that employee simply provided technical assistance on TEFRA cases. When that employee reviewed the penalty it had already been approved. The Tax Court found that argument and another similar argument were frivolous and that the requirements of supervisory approval were met. *Ivey Branch Holdings, LLC, v. Comm'r., T.C. Memo. 2025-63.*

Trust Fund Recovery Penalty. The IRS sued the defendant, a business manager, who failed to pay federal employment tax for two entities that the defendant managed. The claim was based on I.R.C. §6672, the Trust Fund Recovery Penalty (TFRP), which allows the IRS to hold an individual personally responsible for the taxes withheld from employees' wages (known as "trust fund" taxes, which include federal income tax and the employee portion of Social Security and Medicare taxes). For both entities, the defendant held managerial roles with significant financial authority. Her responsibilities included determining financial policy, authorizing payroll, directing bill payments, and making federal tax deposits. For one entity, she was the sole member and had the exclusive signature authority on bank accounts. The IRS informed the defendant of the substantial outstanding tax liabilities for both entities. Despite this knowledge, she authorized payments to numerous other creditors including utilities, rent, suppliers, and payroll instead of paying the IRS. For one entity, she also authorized payments for personal expenses (e.g., her credit card, her husband's mortgage, and ATM withdrawals) from the business accounts while the trust fund taxes remained unpaid. The Government filed a Motion for Summary Judgment. Although the defendant failed to file a timely legal opposition, the trial court reviewed the facts and law and found that the defendant met the legal criteria for both a "responsible person" and "willfulness." The trial court granted summary judgment for the United States and held the defendant personally liable for the total unpaid federal employment tax of $204,466.54 (plus statutory interest). *United States v. Flaim, No. 5:25-cv-1498, 2025 U.S. Dist. LEXIS 215181 (E.D. Pa. Oct. 31, 2025).*

> **Observation:** The TFRP allows the IRS to bypass the corporate veil and hold an individual personally liable for a business's unpaid withholding taxes. The business entity (LLC, corporation, etc.) may protect owners from general business debts, but it does not shield a "responsible person" from TFRP liability. Also, a person's title (e.g., CEO, manager, bookkeeper) is less important than their functional authority. In the case, the court looked at whether Ms. Flaim had a duty to collect, account for, and pay over the taxes. She also had the ability to determine which bills got paid, authorize payroll and bank account transactions, and set financial policy.

Form 8825. The IRS has made significant changes for Form 8825 with its December 2025 revision (for the 2025 tax year and beyond), the Form used by partnerships and S corporations to report income and expenses from rental real estate. The revisions are designed to provide the IRS with deeper transparency into property transactions and to standardize how "other" expenses are reported and will require taxpayers to track specific events and distinguish between different types of revenue.

If the entity owns rental property, the changes are particularly significant. Under the prior version of the Form, a rental property owner only needed to report the address of the property, the type of rental property, the number of days rented and the number of personal days. Now, the format is changed. While Form 8825 is specifically for pass-through entities. Landlords filing a Schedule E, these specific "codes" don't apply to a landlord directly, though the data will eventually flow to the landlord’s personal return. Taxpayers that file Schedule M-3 will face the most significant new burden because they will have to use new Schedule A to the Form 8825.

One of the biggest additions is Line 1, Column (c). This column is now required for partnerships and S corporations that file Schedule M-3 (generally those with total assets of $10 million or more). A letter code will be used to identify specific "events" that occurred with each property during the tax year.

Note: Code E is currently reserved for future use

While property type codes existed previously, they remain a critical part of the 2025/2026 reporting framework. You must categorize every property using these numeric codes:

Single-family residence

Multi-family residence

Vacation or short-term rental

Commercial

Land

Royalties

Self-rental

Other (requires a written description)

Beyond the codes, the form itself has been redesigned to accommodate more data:

Expanded Property Capacity: Page 2 has been redesigned to allow for four additional properties per page, making it easier for entities with large portfolios to list assets without excessive attachments.

Separation of Income (Line 2): In the past, "Other Income" was often lumped in with gross rents. Now, the IRS requires a split:

Line 2a: Gross Rents.

Line 2b: Other income related to rental real estate (e.g., late fees, laundry income, parking fees).

New Schedule A (Form 8825): For Schedule M-3 filers, you can no longer simply list "Other Expenses" on Line 17. You must now complete Schedule A, which provides 20 specific categories for these "other" costs, such as asset management fees and prepayment penalties.

Suggested Document Checklist

1. Transactional "Event" Records (New Column c)

If the entity files Schedule M-3 (generally assets over $10M), property transactions must be coded. Keep a "Property Life Cycle" folder for each asset containing:

Acquisition/Contribution (Codes A & C): Closing statements (HUD-1), contribution agreements (Section 721/351), and appraisal reports to establish initial basis.

Exchanges (Code B): Documentation for 1031 or 1033 exchanges, including identification letters and intermediary statements.

Capital Improvements (Code D): Invoices and contracts for construction or major renovations:

Distinguish these from "Repairs" (Line 11), as Code D tracks basis additions.

Dispositions (Codes F, G, & H): Settlement statements for sales, distribution agreements for transfers to partners, or "Affidavits of Abandonment" if a property is walked away from.

2. Revenue Bifurcation (Lines 2a & 2b)

Accounting software should now have two distinct accounts for rental income:

Gross Rents (2a): Base rent payments from lease agreements.
Other Rental Income (2b): This is where many taxpayers get tripped up. You must provide documentation for:

Late fees and application fees.

Pet rent or amenity fees (parking, laundry, storage).

Utility reimbursements (if not already netted against expenses).

3. "Other Expenses" Detail (Schedule A)

For large filers, the "Other" line is dead. Expenses must now be mapped to 20 specific categories. The ledger should generate reports for:

Asset Management vs. Property Management: Distinguish between high-level oversight (asset management) and daily operations (management fees).

Building vs. Grounds: Keep "Building Maintenance" (Category 3) separate from "Landscaping/Grounds Maintenance" (Categories 8 and 11).

Financing Costs: Specifically track Prepayment Penalties and Debt Extinguishment Costs as their own line items.

4. Occupancy Verification (Columns d & e)

The IRS is looking closer at "personal use" in pass-through entities.

Fair Rental Days Log: Records showing when the property was actually occupied by a paying tenant.
Personal Use Log: Documentation of any days a partner or shareholder used the property (or rented it at a "friends and family" discount), which can trigger expense disallowance under Section 280A.

The most efficient way to handle this is to set up a Chart of Accounts to mirror the 20 categories in the new Schedule A (Form 8825). This provides the ability to export a report at year-end that plugs directly into the tax software without manual "re-grouping."

Collection Due Process – Proposed Levy. The petitioner requested a CDP hearing before the IRS Independent Office of Appeals. During the CDP process, the petitioner challenged the IRS's collection efforts, but the record showed that he either had already received prior opportunities to dispute the underlying liabilities or failed to properly raise viable alternatives to collection. Appeals verified that the IRS had complied with all statutory and administrative requirements before approving the levy action. The petitioner did not provide Appeals with sufficient financial information or a workable collection alternative that would justify halting collection activity. Instead, much of his argument focused on challenging the underlying tax liabilities and procedural objections. The Tax Court emphasized that under I.R.C. §6330, a taxpayer generally cannot relitigate the underlying liability in a CDP proceeding if the taxpayer previously had an opportunity to contest it. The Tax Court reviewed the Appeals determination under the "abuse of discretion" standard and held that Appeals appropriately balanced the government's need for efficient tax collection against the taxpayer's concerns about intrusiveness, as required by I.R.C. §6330(c)(3). Because Appeals followed the required procedures and reasonably evaluated the case, the court sustained the levy determination in favor of the IRS. *Nelson v. Comm'r., T.C. Memo. 2025-117*.

Levy Abandonment and Collection Appeals. The taxpayer filed untimely federal income tax returns for tax year 2010 in the fall of 2012. At the time these returns were filed, she was married and the couple filed returns as married filing separately. Her 2010 return did not show tax liability, but her husband's return showed a significant liability that resulted in him submitting an offer-in-compromise to the IRS. The same tax year, the couple made two estimated tax payments totaling $50,000. That amount was applied to the husband's tax liability of $385,000, but the couple had intended for the $50,000 to be credited to her. However, the checks were in his name only despite having been drawn from their joint bank account, so the IRS did not allocate the amount as requested.

Several weeks after submitting her 2010 return, she filed an amended return reporting an additional $71,000 in retirement distribution income triggering a tax liability of $28,000. She again sought IRS to use the $50,000 to offset this liability for a net refund of approximately $22,000. The IRS subsequently moved to collect on her unpaid $28,000 balance by stating its intent to levy. She sought a collection due process hearing in accordance with I.R.C. §6330 and informed the IRS appeals office or what she claimed to be a misallocated $50,000. The appeals office sustained the levy, and she then filed a Tax Court petition in accordance with I.R.C. §6330(d)(1). During the pendency of the case, the taxpayer became entitled to tax refunds that were applied towards her outstanding liability until it was paid in full. The Tax Court then determined that it no longer had jurisdiction because the case involved a collection action under I.R.C. §6330, and that it was irrelevant that the IRS arguably misallocated the $50,000.

On appeal, the appellate court reversed, determining that the IRS erred in crediting the tax payments to the taxpayer's husband's account. The appellate court remanded the case to the Tax Court, but the IRS petitioned the U.S. Supreme Court for review. The Court reversed the appellate court, concluding that CDP hearings only relate to levies. Since the levy was removed when the tax liability was fully paid, the Court concluded that "…it would be strange if a taxpayer could use a §6330 appeal to resolve tax disputes that no longer have any connection to an ongoing levy." *Zuch v. Comm'r., No. 24-416, 2025 U.S. LEXIS 2277 (U.S. Jun. 12, 2025), rev'g., and rem'g. sub nom., Zuch v. Comm'r., 97 F.4th 81 (3rd Cir. 2024).*

Practice Pointers:

- **File a protective refund claim.** The most critical takeaway is the heightened need to file a protective refund claim, even while a CDP case is active. A taxpayer who believes they have overpaid, or who is having their disputed liability satisfied through IRS offsets, can no longer rely on the CDP process to resolve the underlying tax dispute. The only remaining avenue to recover the funds is a separate refund suit in a U.S. District Court or the Court of Federal Claims. Failure to file a timely refund claim, generally within three years from the time the return was filed or two years from the time the tax was paid, whichever is later, could permanently bar the taxpayer from recovering the funds.

Key Point:

Anticipate the IRS strategy. The Court's opinion indicates that the IRS could strategically moot a Tax Court case it anticipates losing. If the IRS identifies a weakness in its case regarding the underlying tax liability during a CDP proceeding, it can now effectively halt the litigation by satisfying the debt through other means, such as refund offsets. This prevents an unfavorable precedent from the Tax Court and forces the taxpayer into a different, and often more costly, legal venue.

Impact of CDP hearings. The CDP hearing process was designed to provide taxpayers with a pre-payment opportunity to contest a tax liability before the IRS seizes their assets. The Zuch decision curtails this avenue where the IRS can satisfy the debt without an active levy. This is a significant shift, as taxpayers may now find themselves in a "pay-to-play" situation, where they must first pay the disputed tax before they can litigate its validity.

> **Communication.** The Court's decision points out the need to monitor a client's accounts with the IRS and communicate with the IRS on a client's behalf. Proactive communication with the IRS to contest the application of refunds to a disputed liability is critical.
>
> **Observation:** Should the Code be amended to toll the statute of limitations for refund claims while a CDP case is pending, or otherwise allow the Tax Court to retain jurisdiction to decide the merits of a disputed liability even if the collection action that triggered the hearing becomes moot?
>
> **Note.** The Supreme Court's decision fundamentally alters the strategic calculus for tax professionals representing clients in disputes with the IRS. The key takeaway is the immediate need to safeguard a client's right to recover potentially overpaid taxes by filing protective refund claims and not relying solely on the CDP process to resolve underlying tax liabilities. Practitioners must now navigate a more complex procedural environment where the forum for a tax dispute can be dictated by the IRS's collection actions.

In light of the Supreme Court's opinion, it's important to understand how to file a protective claim to preserve the right to a refund.

When an income tax dispute arises with the IRS, taxpayers may find themselves in a situation where their right to a potential refund is contingent on a future event, such as the outcome of litigation or a change in tax law, or during an active CDP case. In these circumstances, filing a protective claim for a refund is a critical step to preserve the taxpayer's right to that refund beyond the standard statute of limitations.

A protective claim essentially notifies the IRS of a potential refund request that cannot yet be definitively claimed because the underlying issue is unresolved. This proactive measure ensures that if the contingency is resolved in the taxpayer's favor, they will not be barred from receiving the refund due to the expiration of the statutory period for filing a claim.

Filing a protective claim is advisable in various situations where the right to a refund is not yet certain but may arise in the future. Common scenarios include:

- Ongoing Audits or Appeals: If an audit or appeal of another taxpayer's return (for example, a partner in a partnership) could affect your tax liability.
- Pending Litigation: When a court case involving a similar tax issue could set a precedent in your favor.
- Anticipated Changes in Law or Regulations: If a potential change in tax law, regulations, or IRS guidance could retroactively create a refund opportunity.
- Contingent Liabilities: When the amount of a deductible expense, such as a loss from a lawsuit, is not yet determined.

There is no specific, dedicated IRS form exclusively for filing a protective claim for income tax purposes. Instead, taxpayers can utilize existing forms or submit a detailed written statement. The key is to provide the IRS with clear and sufficient information about the nature of the claim.

Option 1: Using Form 1040X, Amended U. S. Individual Income Tax Return

For individual taxpayers, a common method is to file a Form 1040X. Here's how to adapt it for a protective claim:

Write "Protective Claim for Refund" at the top of the Form 1040X. This immediately alerts the IRS to the nature of the filing.

Complete the taxpayer's name, address, Social Security number, and the tax year for which the protective claim is being filed.

In Part III, "Explanation of Changes," provide a detailed narrative. This is the most crucial part of the protective claim. Clearly state:

That this is a protective claim.

The specific tax year at issue.

A thorough description of the contingency upon which the refund depends (e. g., the specific court case, pending legislation, or unresolved audit).

The specific line items on the original return that may be affected.
A statement that you will file a formal amended return to claim the exact refund amount once the contingency is resolved.

Do not calculate a specific refund amount on the form unless the amount is certain. It is acceptable to state that the amount is not yet determinable.

Sign and date the Form 1040X.

Option 2: Using Form 843, Claim for Refund and Request for Abatement

Form 843 is another avenue for filing a protective claim, particularly for issues not related to income tax, such as certain penalties or employment taxes. However, it can also be used for income tax situations.

Clearly state "Protective Claim for Refund" at the top of the form.

Complete the required taxpayer information.

In Line 7, "Explanation," provide the same detailed information as you would in Part III of the Form 1040X, outlining the contingency and the basis for the potential refund.

Sign and date the form.

Option 3: Informal Written Claim

While using an official form is generally recommended for clarity and processing, a formal letter to the IRS can also serve as a protective claim. This letter must contain all the essential elements:

A clear statement that it is a "Protective Claim for Refund. "

The taxpayer's full name, address, and Social Security number.

The tax year(s) at issue.

A detailed explanation of the contingent event.

The specific tax items that are the subject of the claim.

A statement that a formal refund claim will be filed upon resolution of the contingency.

The letter must be signed by the taxpayer under penalties of perjury.

The protective claim should be filed with the IRS service center where the original return was filed. The claim must be filed before the statute of limitations for the tax year in question expires. Generally, the statute of limitations for claiming a refund is the later of three years from the date the return was filed or two years from the date the tax was paid.

Once the uncertain event is resolved, the taxpayer must "perfect" the protective claim by filing a formal amended return (Form 1040X) or a complete Form 843. This subsequent filing will report the exact amount of the refund due and provide the necessary documentation to support the claim. It is crucial to reference the previously filed protective claim in this subsequent filing.

By taking the deliberate step of filing a protective claim, taxpayers can effectively safeguard their right to a potential refund that might otherwise be lost to the passage of time. Given the nuances involved, consulting with a qualified tax professional is highly recommended to ensure the protective claim is prepared and filed correctly.

Tax Debt - Revocation of Passport. The petitioner's tax debt exceeded $59,000 at the time it was certified. The IRS served the petitioner with notice and after the petitioner exhausted administrative rights under I.R.C. §6320 without contesting the IRS tax liens or underlying deficiency, the debt became "seriously delinquent subjecting the petitioner to passport revocation. Only after his passport was in jeopardy did he attempt to dispute the IRS collection and enforcement actions. The Tax Court, upholding the IRS certification of the petitioner's seriously delinquent tax debt, noted that I.R.C. §7345 plainly forecloses such an eleventh-hour collateral attack on a person's underlying tax liabilities. The petitioner also argued that he paid down the debt below the threshold. However, the Tax Court noted the law requires that certification may be reversed only if the debt is fully satisfied or is being paid through an installment agreement. Consequently, the Tax Court held that the IRS certification of the petitioner's tax debt was not erroneous. *Pfirrman v. Comm'r., T.C. Memo. 2025-22.*

Statute of Limitations - Fraud. The plaintiff underpaid her federal income taxes from 1993 to 1999. The underpayments were a result of false and fraudulent entries made on her returns by her tax preparer who acted with the intent to evade tax. The plaintiff was not aware of the fraud and had no intent to evade taxes. More than 20 years after the returns were filed, the IRS issued a notice of deficiency to the taxpayer. The plaintiff claimed that the assessment was barred because it fell outside the typical three-year statute of limitations. However, the IRS claimed that the indefinite statute of limitations for false or fraudulent returns under I.R.C. § 6501(c)(1) applied. The Tax Court agreed with the IRS, and the plaintiff appealed. The appellate court focused on the specific language of I.R.C. §6501(c)(1), which states that in the case of a "false or fraudulent return with the intent to evade tax," the tax may be assessed at any time. The appellate court clarified that the exception allowing the IRS to assess tax "at any time" for a false or fraudulent return with intent to evade tax does not require the taxpayer's personal intent. Instead, the intent of a third party, such as a tax preparer, is sufficient to trigger the indefinite assessment period. *Murrin v. Comm'r., 152 F.4th 136 (3rd Cir. 2025), pet. for cert. filed, Feb. 17, 2026.*

Practice Pointers:

- The appellate court's analysis emphasized that the statute's focus is on the nature of the return itself and whether it is "false or fraudulent" rather than on the taxpayer's personal state of mind. The phrase "with the intent to evade tax" modifies the "false or fraudulent return," not the taxpayer's actions. The appellate court found that interpreting the statute to require the taxpayer's personal intent would render the provision ineffective in cases of preparer fraud, as the fraud often goes undetected until years later.

- The decision protects the government's ability to collect taxes in cases where a tax preparer, not the taxpayer, is the one committing fraud. It prevents a "get out of jail free" card for taxpayers who unknowingly benefit from their preparer's illegal actions.

- While this ruling is a win for the IRS, it places an even greater burden on taxpayers to be vigilant when selecting and monitoring their tax preparers. A taxpayer can be held liable for an indefinite period for a preparer's fraud, even if they had no personal involvement or knowledge of the wrongdoing. This reinforces the importance of using reputable tax professionals and carefully reviewing any documents before they are submitted to the IRS.

Offer in Compromise – Criteria. The petitioners, a married couple, sold real property used as an early childhood education facility that resulted in a substantial tax liability. They bought replacement property but failed to qualify for a like-kind exchange. In a collection due process hearing the IRS denied the petitioners' Offer-in-Compromise. The petitioners claimed that a lien would cause them significant financial hardship. On Form 656 they checked the box for Effective Tax Administration and for "The amount offered is based on my exceptional circumstances other than economic hardship." They did not check the box for "Paying more than the amount offered would create a financial hardship." They offered $75,000 to settle their approximate $600,000 liability. The IRS rejected the offer on the basis that the case did not meet criteria for effective tax administration on grounds other than economic hardship. The Tax Court agreed with the IRS. *Brown v. Comm'r., T.C. Memo. 2025-17.*

Partnership Reporting Rules. The IRS has proposed regulations to delay and revise the reporting requirements for partnership interest exchanges. The proposed regulations aim to address compliance challenges and improve accuracy by aligning certain deadlines with a partnership's annual tax return filing. I.R.C. §751(a) applies to sales or exchanges of partnership interests to the extent attributable to certain ordinary income assets. Under current regs, partnerships are required to file Form 8308, Report of a Sale or Exchange of Certain Partnership Interests, for each Section 751(a) exchange and furnish a statement to both the transferor and transferee by the later of January 31 of the year following the transaction, or within 30 days of receiving notice of the exchange. In 2020, the IRS revised Form 8308 to require additional reporting in Part IV, including the partnership's gain or loss from a deemed sale under I.R.C. §751 and the transferor partner's share of such amount. Many partnerships, particularly those with complex structures, reported to the IRS difficulty in meeting the accelerated January 31 deadline for providing the detailed information required in Part IV, noting that the information necessary to complete this section is often not available until after year-end accounting and allocations are finalized. This led to the increased possibility of incomplete or inaccurate reporting. The newly proposed regulations would revise the timing requirements for furnishing information to transferors and transferees. Under the proposal, partnerships would be required to provide only Parts I, II, and III of Form 8308 — or a statement containing the same information — by the later of January 31 of the year following the exchange or 30 days after receiving notice of the transaction. The more detailed information required in Part IV, which includes the partnership's gain or loss and the transferor's share, would be due with the partnership's annual tax return for the relevant year. *Prop Reg. REG-108822-25, Aug. 19,2025, effective for returns filed for tax years ending on or after the date the final regs are published, but partnerships may rely on the proposed rules for exchanges occurring on or after January 1, 2025, and before the final regs are published.*

> **Observation:** Farm and ranch partnerships typically operate with lean staffing and seasonal workflows. The current January 31 deadline for full detailed reporting often falls at a time of the year when year-end accounting is still in progress. By deferring Part IV info to the return filing deadline, farms and ranches should be better able to ensure that Part IV's intricate details involving the reporting of realized gains or losses tied to I.R.C. §751(a) come from fully reconciled books.

Procedure - IRS Amended Pleadings. The petitioner claimed a conservation easement deduction for an easement contributed to the Atlantic Coast Conservancy in 2017. The IRS challenged the deduction, and the case was brought before the U.S. Tax Court. The IRS sought to amend its answer to include a civil fraud penalty under I.R.C.§ 6663. The petitioner objected, arguing that the IRS's motion was made in bad faith, caused prejudice, and was futile. The Tax Court granted the motion, concluding that the taxpayer would have ample time to respond to the amended answer and prepare a defense. The Tax Court also found the futility argument to be a non-starter because the IRS plead enough facts to support the fraud claim. *Silver Moss Properties, LLC v. Comm'r., 165 T.C. 37 (2025).*

Practice Pointer:

- The case involved the application of Rule 41 which governs amended and supplemental pleadings. The court's decision hinged on the principle that the standard for allowing an amendment is not whether the new claim would make the case harder or more expensive for the petitioner, but whether it would cause them an unfair disadvantage. Given that discovery was ongoing and the case was not yet scheduled for trial, the court determined that the petitioner would have sufficient time to address the new allegations.

  Observation: The case also involved a constitutional argument regarding the right to a jury trial for civil tax fraud penalties. In an amicus brief, the Center for Taxpayer Rights argued that the Seventh Amendment, which guarantees the right to a jury trial in suits at common law, should apply to challenges of civil tax fraud penalties. The brief contended that because the U.S. Tax Court is not an Article III court and does not hold jury trials, these penalties cannot be imposed administratively or through Tax Court proceedings. This argument is a significant constitutional challenge that could have broader implications for how tax penalties are litigated.

Regulations - Fringe Benefits. Under I.R.C. §132, several types of employer-provided fringe benefits are excluded from an employee's gross income if the benefit relates to the employer's "line of business" in which the employee actually provides services. The IRS has proposed regulations to modernize compliance under I.R.C. §132. Under current rules, an employer's line of business is identified via the Enterprise SIC (ESIC). The proposed regulations switch the identification to the use of the North American Industry Classification System (NAICS). Under the NAICS, employers would be grouped by four-digit NAICS industry groups to determine their business lines - making the standard more relevant and precise. Also, currently and "aggregation" rule groups retail operations that would be considered part of the same line of business if they appeared in a department store. The proposal replaces "department store" with "general merchandise store, including warehouse clubs and super-centers." The proposed regulations are an attempt to reduce administrative burden and ensure the rules reflect modern commerce. *REG-132805-17, August. 5, 2025.*

Practice Pointers

- Retailers with diverse product lines in one location may now be able to aggregate these under a single line of business if they align with offerings typical of a general merchandise store or super-center.

The proposed regulations will become effective after a public hearing and publication in the Federal Register.

Tip Income – Regulations. The IRS has issued regulations on the above the line deduction for qualified tips under I.R.C. §224 for 2025 through 2028. The regulations note that tips must be in cash and voluntary. The regulations also note that an automatic tip gratuity does not qualify for the deduction. In addition, the tip deduction is not allowed for specified service trade or business even if the person performing the services may otherwise qualify. Such a person would need to be employed by the business rather than performing services for the business as a self-employed person. The regulations also verify that the tip deduction is not a trade or business deduction for independent contractors. As such, it does not reduce self-employment income. The regulations also clarify that the maximum deduction is $25,000 no matter the taxpayer's filing status and indicate that the tip deduction is not allowed if it relates to an illegal activity such as prostitution or drug dealing. The regulations also provide details on occupations that normally have employees who received tips. *REG 110032-25, 90 Fed. Reg. 66750 (Sept. 22, 2025).*

> **Practice Pointer:** Practitioners should note that many employees for 2025 will assume that all their tips will qualify for the deduction and advise employer-clients accordingly. This is particularly true for restaurants that have a policy of automatic gratuities.

Supervisory Approval. The petitioner, a Missouri LLC taxed as a partnership, acquired land in Louisiana in 2018. In 2019, the petitioner granted a conservation easement over the property and claimed a charitable contribution deduction of approximately $60 million for this donation on its Form 1065 for tax year 2019. After an examination by a revenue agent, the IRS disallowed the deduction, determined an imputed underpayment, and asserted accuracy-related penalties under I.R.C. §6662. A civil fraud penalty under I.R.C. §6663 was asserted later in court proceedings. The petitioner challenged the IRS' disallowance of its deduction for the conservation easement donation, as well as its assessment of an accuracy-related penalty. The Tax Court noted that under I.R.C. §6751(b)(1), no penalty can be assessed unless the initial determination of applying a penalty is approved, in writing, by the immediate supervisor of the individual making the determination or by a designated higher-level official. Here, the revenue agent made the initial determination to assert penalties against the petitioner under I.R.C. §6662 and I.R.C. §6662 A and the agent's immediate supervisor digitally signed the penalty lead sheet in September 2022, approving the determinations. The proposed tax adjustments and penalties were formally communicated to the petitioner in 2023. The IRS issued a Final Partnership (FPA) notice in February 2024, disallowing the conservation easement deduction and determining penalties. The Tax Court found that the IRS properly and timely obtained supervisory approval for the penalties. *River Moss, LLC v. Comm'r., T.C. Memo. 2025-79.*

Regulations - Whistleblower. The taxpayer contributed to investigations into his employer's (Rabobank Group) which led to and IRS investigation the company's tax avoidance scheme – a "Midco" transaction involving tax shelter intermediaries reselling the shares they purchased from shareholders and the use of the resulting loss to offset gain. The IRS' Whistleblower Office determined that the taxpayer's information did not trigger an audit, expand the IRS investigatory scope or lead the IRS to continue to pursue the investigation. The IRS denied any whistleblower award and the Tax Court affirmed. The taxpayer died during the pendency of his case with the Tax Court. His estate appealed and the appellate court reversed determining that the IRS Whistleblower Office should have assessed whether the taxpayer's tip was significant enough to pass the substantial-contribution test as specified in the underlying regulations. The taxpayer, in 2002, supplied the IRS with a credit application from one of the companies involved in the scheme revealing that the company used foreign bank loans as “special-purpose vehicles” to avoid taxes. The tip led the IRS to summons Rabobank, which produced more documents that showed the companies used loans to create exchanges to mischaracterize them as factoring transactions, a tax deductible financial practice that aims to improve cash flow. The appellate court noted that the findings led the IRS Office of Chief Counsel to adjust the tax liability of the two companies, which they eventually agreed to settle internally with the IRS. Under 2012 proposed regulations, people whose information led the agency to initiate a new audit, expand the scope of an ongoing action or continue to pursue an ongoing action that would not have continued unless for the information provided. However, the final regulations, issued in 2014, did not adopt the proposed test. *Estate of Insinga v. Comm’r., No. 24-1048, 2025 U.S. App. LEXIS 20111 (D.C. Cir. Aug. 8, 2025).*

Livestock Sales - Deferral of Gain. The IRS has issued its annual Notice providing an extension of the replacement period for farmers and ranchers who were forced to sell or exchange livestock due to severe drought conditions. This relief allows for deferral of the capital gains tax that results from these involuntary sales. The extended replacement period is for certain livestock sales or exchanges made solely on account of drought, which allows taxpayers to defer recognizing the gain on the excess number of animals sold. The relief applies to sales of livestock (excluding poultry) held for draft, breeding, or dairy purposes that are in excess of the number a taxpayer would normally sell. The sale must be due to drought, flood, or other weather-related conditions that caused the region to be designated as eligible for federal assistance. Normally, the replacement period for an involuntary conversion is two years. For drought-forced sales, the two-years period is generally extended to four years after the close of the first tax year in which any part of the gain is realized. For an eligible taxpayer whose four-year replacement period was scheduled to expire at the end of 2025 (or a fiscal year including August 31, 2025), the replacement period is automatically extended until the end of the taxpayer's first tax year that ends after a future "drought-free year" is declared for the applicable region. The Notice includes an appendix listing counties and other jurisdictions across 49 states and the District of Columbia that experienced "exceptional, extreme, or severe drought" during the 12-month period ending August 31, 2025. The presence of a taxpayer's county, or a contiguous county, on this list means that the 12-month period ending August 31, 2025, is not considered a drought-free year, thereby triggering the automatic extension of the replacement period. *Notice 2025-52, 2025-39 IRB 1.*

Innocent Spouse - Joint Return. The plaintiff had worked as a licensed practical nurse filed joint tax returns with her husband for 2013-2015. She claimed innocent spouse relief from the joint tax debt, claiming the debt related to her husband’s income rather than hers. The Tax Court denied her request and did not rule on the validity of the joint return. She also claimed that the Tax Court judges had unconstitutional job protection under I.R.C. §7443(f) which restricts the President’s ability to remove them before the expiration of their 15-year term (other than for cause) in violation of the principal of separation of powers. The appellate court also did not rule on this issue because the petitioner suffered no harm as a result and would not have been entitled to any relief. On the core claim, the appellate court noted that the plaintiff was injured on the job in 2012, causing her to stop working and begin receiving Social Security income. She claimed that both her attorney and tax return preparer told her she no longer needed to file tax returns. However, Wright and her husband filed joint returns excluding her Social Security earnings of about $18,900 for 2013 and more than $17,000 for 2014. The plaintiff said she didn't know that her husband had filed the joint returns, despite the requirement that she sign the returns. The IRS denied her request for relief from the additional taxes, saying the debt was solely linked to her undeclared Social Security income. The appellate court affirmed the Tax Court’s denial of her claim, noting that the deficiency was attributable to her failure to pay tax on her Social Security income regardless of whether a joint or single return was filed. *Wright v. Comm'r., No. 24-10563, 2025 U.S. App. LEXIS 19229 (11th Cir. Jul. 31, 2025).*

Innocent Spouse. The petitioner sought relief under I.R.C. §6015(b), (c) and (f) from joint and several liability for tax obligations incurred on joint returns filed with her former spouse for the 2017 and 2018 tax years. The tax liabilities stemmed from underpayments of tax (insufficient withholding) and understatements of income (unreported income or improper deductions) primarily attributed to the former spouse. The IRS and the Tax Court denied relief. The petitioner failed to prove she did not know, or have reason to know, that the tax reported on the returns would not be paid, given her former spouse's history of financial problems and prior unpaid tax liabilities. While she was relieved of liability for the portion of the deficiency allocable to his understatement of income, she was held liable for the underpayment resulting from insufficient withholding on her own income. In making its determination, the Tax Court weighed various factors including an abuse claim. However, the Tax Court determined that her claims of abuse were not sufficiently specific or supported by the record to overcome the presumption of knowledge, especially since she herself was found guilty of disorderly conduct and domestic violence for biting and punching her then-husband. *Vanover v. Comm'r., T.C. Memo. 2025-37.*

Innocent Spouse. The case focused on the petitioner's request for equitable relief from tax underpayments and understatements totaling over $200,000 for the years 2011–2016. The petitioner and spouse filed joint returns for the years at issue. IRS claimed that the petitioner had "reason to know" the taxes wouldn't be paid. The Tax court applied the seven non-exclusive factors of Rev. Proc. 2013-34 and pointed to the couple's affluent lifestyle that exceeded their reported income, including a $1.4 million home, country club memberships, and luxury cars (Maserati/BMW), to note that the failure to pay taxes essentially funded the couple's lifestyle. The Tax Court held that the petitioner had a duty to inspect the returns. Her "business sophistication" and knowledge of her husband's history of financial deceit meant she had a "reason to know" the taxes would not be paid. Also, the petitioner's requested relief was further hindered by her own post-separation non-compliance, including late-filed returns and omitted income on her individual filings. In addition, the petitioner's income (spousal support and rental income) exceeded 250% of the federal poverty guidelines, resulting in the Tax Court determining that she suffered no economic hardship, even though her self-reported expenses were high. *Walsh v. Comm'r., T.C. Memo. 2025-91.*

> **Observation:** The case is a reminder that "lavish lifestyle" is a double-edged sword in innocent spouse cases. If the unpaid tax dollars are visibly supporting a high standard of living, the Tax Court is highly unlikely to find that the requesting spouse "had no reason to know" of the delinquency. "Innocence" in tax law requires more than just staying out of the checkbook; it requires a standard of living that remains consistent with the income actually reported.

Innocent Spouse – Res Judicata. The petitioner and her spouse failed to report foreign bank accounts and related income. After entering and withdrawing from the IRS Offshore Voluntary Disclosure Program, they were audited and assessed back taxes alongside fraud and accuracy penalties. The couple petitioned the Tax Court, ultimately reaching a final, stipulated decision. The wife subsequently filed this separate action seeking innocent spouse relief. The Tax Court denied the relief, holding that her claim was barred by res judicata. Generally, a final judgment on a specific tax year precludes a party from seeking innocent spouse relief later, even if the claim wasn't raised initially. To escape res judicata under I.R.C. §6015(g)(2), the requesting spouse must prove that her innocent spouse claim was not an issue in the prior case and that she did not "participate meaningfully" in that proceeding. The Tax Court found the taxpayer failed the second prong. Because she was engaged alongside her husband and represented by counsel during the settlement process of the initial Tax Court case, her active involvement constituted "meaningful participation," legally barring her subsequent claim. *Vettel v. Comm'r., T.C. Memo. 2025-110.*

Information Returns - Distribution from Qualified Plan. The petitioner failed to file a Form 1099 reporting a distribution from a qualified plan. In addition, the taxpayer was not yet 59-1/2 and did not qualify for any of the exceptions to a penalty. The taxpayer argued that he was owed a refund from a prior year that would offset the liability. However, the Tax Court held it could not rule on the issue because it lacked jurisdiction. *Campana v. Comm'r., T.C. Memo. 2025-23.*

Filing Deadline – Collection Due Process. The petitioner, a solo-practice law firm, failed to timely file information returns for 2012. The IRS imposed an "intentional disregard" penalty and, when the petitioner didn't respond, moved to levy the firm's property to collect the debt. The petitioner sought a Collection Due Process (CDP) hearing resulting in the levy being upheld. This gave the petitioner 30 days to file a petitioner with the U.S. Tax Court under I.R.C. §6330(d)(1). The petitioner filed with the Tax Court one day late and the Tax Court rejected the petition for lack of jurisdiction. The appellate court affirmed. However, the U.S. Supreme Court unanimously reversed. The Court determined that the statute is not jurisdictional and that Congress can make a deadline jurisdictional only by clearly saying that it is. Because Congress did not clearly write the statute as a jurisdictional one, the deadline was merely a procedural rule that can be extended under the doctrine of equitable tolling. Thus, if the petitioner pursued its rights diligently and faced extraordinary circumstances beyond their control, the lateness of the petition can be excused. On remand at the Tax Court, the Tax Court determined that the petitioner did not qualify for equitable tolling. The petitioner did not follow up with its attorney or staff to ensure timely filing and there was no documentation of efforts to meet the deadline. The Tax Court held that simply being busy or making a mistake about a deadline date does not trigger equitable tolling. As such, the Tax Court dismissed the case for lack of jurisdiction. *Boechler, P.C. v. Comm'r., No. 18578-17L (Jul. 15. 2025), on remand from Boechler, P.C. v. Comm'r., 596 U.S. 199 (2022).*

Filing Deadline – Notice of Deficiency. The plaintiffs, a married couple, received a notice of deficiency triggering I.R.C. §6213(a)'s 90-day timeframe to file a petition in the U.S. Tax Court to challenge the deficiency. However, their legal counsel filed the petition nine days late. The Tax Court dismissed the petition for lack of jurisdiction, ruling that the 90-day deadline was an absolute bar to a late filing. The plaintiffs appealed, arguing that the deadline should be considered a non-jurisdictional rule, subject to equitable tolling - a judicial doctrine that can extend a filing deadline based on extraordinary circumstances and where the taxpayer has otherwise done everything in the taxpayer's control to meet the 90-day deadline. The appellate court, reversing the Tax Court, held that the 90-day deadline is not jurisdictional but is rather a non-jurisdictional "claim processing" rule that can be waived, forfeited, or be subject to equitable tolling. The Supreme Court has on multiple occasions instructed lower courts to treat a statutory deadline as jurisdictional only if Congress has "clearly stated" that it is. The Second Circuit found no such clear statement in the language of I.R.C. §6213(a). The appellate court noted that the statutory language that "the taxpayer may file a petition...within 90 days" is directed at the taxpayer's procedural obligations rather than the Tax Court's authority. This permissive language, the appellate court concluded, does not speak in jurisdictional terms. Importantly, the appellate court did not decide whether the plaintiff's factual situation met this standard. The appellate court remanded the case to the Tax Court to make that determination. *Buller v. Comm'r., 152 F.4th 84 (2nd Cir. 2025).*

> **Observation:** The decision gives the Tax Court more flexibility and discretion in handling late-filled petitions. Instead of automatically dismissing cases on jurisdictional grounds, the Tax Court will now have to engage in a fact-intensive inquiry to determine if equitable tolling is warranted. This could lead to a greater number of cases being heard on their merits. The decision also creates a split

among the circuit courts of appeal. The Eighth and Eleventh Circuits have determined that the statute is jurisdictional. Even in the Second Circuit, the jurisdictional bar remains high. However, for taxpayers in the Second Circuit, the decision provides an avenue for relief that previously did not exist.

Practice Pointer:

- The decision represents a significant shift from previous understandings and has direct implications for how practitioners advise clients facing deficiency notices.

Collection Due Process. The petitioner failed to pay employment taxes reported on its Form 941 for the quarter ending December 31, 2021. The IRS issued a Final Notice of Intent to Levy on February 28, 2023. The petitioner sought a Collection Due Process (CDP) hearing, claiming it had submitted an amended Form 941-X asserting eligibility for an Employee Retention Tax Credit (ERTC) that would eliminate the liability. The IRS Appeals Officer requested documentation to substantiate the credit, but the petitioner failed to respond. The Tax Court granted the IRS's motion for judgment on the pleadings, holding that the levy was properly sustained and that the IRS did not abuse its discretion. The Court concluded that it lacked jurisdiction to consider credit claims not raised during the CDP hearing and it cannot adjudicate overpayments in CDP cases. *PeopLease, LLC v. Comm'r., T.C. Memo. 2025-14.*

Practice Pointer

- Taxpayers must timely submit required documentation to support credit claims during the CDP process and raise all relevant issues at that stage; otherwise, the IRS can sustain collection actions even if credits are pending

FBAR. The plaintiff failed to timely file FBARs for foreign financial accounts the plaintiff held during calendar years 2011, 2012, and 2013. The IRS assessed a penalty of $1,020,922.50 against the plaintiff for willful failure to file and upon the plaintiff's failure to pay, filed suit to reduce the assessed penalties to a final judgment. The court granted the plaintiff's motion to dismiss the case with prejudice. The court found that the FBAR penalty assessment did not comply with the Seventh Amendment right to a jury trial, and therefore dismissed the case. The court found that a suit to collect a civil penalty for a willful FBAR violation is analogous to a suit that would have been heard by a jury in 1791. The court cited the Supreme Court's decision in *SEC v. Jarkesy, 114 S. Ct. 2117 (2024),* which established that when the government seeks to impose a civil penalty in a matter that is traditionally a common law action, it must afford the penalized individual the opportunity for a jury trial in an Article III court before the penalty is assessed. By assessing the penalty administratively, the court reasoned that the IRS was acting as both prosecutor and judge, fundamentally undermining the role of the Seventh Amendment in providing a neutral factfinder. The court concluded that the government's subsequent lawsuit to "reduce [an already assessed] penalty to judgment" was insufficient to cure the initial constitutional violation. The court did not address the plaintiff's other arguments regarding the statutory language or the Eighth Amendment's Excessive Fines Clause. *U.S. v. Sagoo, No. 4:24-cv-01159-O, 2025 U.S. Dist. LEXIS 184336 (N.D. Tex. Sept. 19, 2025).*

Credits

Research and Development Credit. This case involved an evaluation of seven poultry research trials (e.g., vaccines, genetics, and feed additives) to determine if they met the statutory requirements for qualified research for purposes of the R&D credit of I.R.C. §41. The core issue was whether the trials were routine farming or satisfied the "elimination of uncertainty" requirement. The IRS argued the trials were routine farming activities, not qualified research. The Tax Court ruled that the costs of raising the chickens (feed, etc.) could qualify as supply qualified research expenditures (QREs) under the "pilot model" rules of I.R.C. §174, as the birds were produced to resolve technical uncertainty regarding broiler health and yields. The Court allowed credits for trials supported by contemporaneous records (e.g., specific genetic line data) but disqualified those where a retrospective "credit study" contradicted daily business logs. For example, a trial for a drug dosage was rejected because feed recipes showed the dosage never actually changed throughout the study. The Court affirmed that taxpayers can claim supply QREs without claiming related wage QREs, rejecting the IRS's attempt to link the two for substantiation. Accuracy-related penalties were waived, as the Court found the taxpayer's reliance on their tax consultant (alliantgroup) was in good faith despite the study's partial failure. *George v. Comm'r., T.C. Memo. 2026-10.*

Practitioner Note:

- The "chicken or the egg" debate here favored the taxpayer only when the research (and documentation) came first. Successful agricultural R&D claims require rigorous, contemporaneous technical data that matches the daily business reality, rather than reliance on post-hoc narrative studies.

NEPA Review. Landowners in Kansas sued under the Administrative Procedure Act (APA) challenging the Treasury Department and related federal agencies. They sought a preliminary injunction barring issuance of federal tax credits under the Inflation Reduction Act (IRA) to a proposed solar farm, alleging an absence of environmental review under NEPA and asserting that public support for the credits improperly influenced local zoning and approvals for the project. At issue was whether the federal tax credit programs trigger environmental oversight requirements before projects can qualify. The federal trial court denied as moot the plaintiffs' request for a preliminary injunction, because the project had not yet claimed the disputed tax credits and was in pre-permit/option stages, making the request premature. The trial court granted the government's motions to dismiss for failure to state a claim. The trial court concluded that the complaint lacked a legal basis to require NEPA review simply because federal tax incentives were available. The IRA and implementing IRS regulations did not mandate any environmental study. *Hoffman v. United States Treasury Department, No. 5:25-cv-04003-HLT-BGS, 2025 U.S. Dist. LEXIS 124918 (D. Kan. Jul. 1, 2025).*

> **Note:** On the issue of agency deference, the court said that the Supreme Court's opinion in *Loper Bright Enterprises v. Raimondo, 603 U.S. 369 (2024)* that repealed the "Chevron Doctrine" on agency deference didn't apply because the IRS was not asking the court to give deference to its interpretation and because the Notice carries no force of law and is not entitled to deference in any event.

Employee Retention Credit - IRS Guidance. The plaintiff is a tax advisory and technology firm that assists businesses with tax credits and financial solutions, particularly with filing Employee Retention Credit (ERC) claims. It is paid from the proceeds of credits refunded to clients and is not otherwise compensated. It devotes significant resources to complying with IRS policy positions on the ERC and adjusts its business practices accordingly. The plaintiff claimed it was "injured" by IRS positions that the plaintiff claimed "unlawfully narrow or limit the availability of ERC for businesses." Specifically, the plaintiff claimed that IRS Notice 2021-20, a 102-page IRS Q and A providing guidance on the ERC constituted improper lawmaking in violation of the Administrative Procedure Act (APA) and exceeded the statutory authority of the IRS and was arbitrary and capricious. The plaintiff also sought a preliminary injunction enjoining the IRS from placing a moratorium on ERC claim processing. The court held that the plaintiff had standing to challenge the Notice because the Congress created the CARES Act which the ERC was a part of for the benefit of the plaintiff's clients and that the plaintiff (and other tax preparation services) are essential in carrying out Congress' intent with respect to such clients. The court also rejected the government's sovereign immunity argument concluding that the Notice constituted final agency action for which there was no other adequate remedy in a court. On the plaintiff's APA claim, the court noted the distinction between legislative rules (which require notice-and-comment procedures under APA Section 553) and interpretive rules that don't. On FAQ No. 6, specifying that household employers are not considered to be operating a trade or business and are not eligible for the ERC, the court determined that this was an interpretation of the statutory language and was not creating new law and, thus, was not subject to the APA. On FAQ No. 10 which limited "orders from an appropriate governmental authority" to federal, state or local governments with jurisdiction over the employer's operations, the court held that this was a "natural interpretation" of the plain statutory meaning. On FAQ No. 11, which defined "nominal portion" of business operations suspended by a governmental order as 10 percent of gross receipts or employee hours, the court agreed with the government that this was a safe harbor and not an absolute cut-off and thus, not a legislative rule. On FAQs Nos. 14-16 which clarified that voluntary suspensions would not qualify as a suspension due to a governmental order, the court also found those to be interpretive in nature. As for the recordkeeping requirements of FAQs Nos. 70-71 requiring employers to substantiate eligibility and keep employment tax records for at least four years, the court found this to be interpretive of I.R.C. §6001 and the regulations thereunder. The court rejected the plaintiff's assertion that the Notice effectively amended with ERC statute without going through the APA requirements, and was not arbitrary and capricious, distinguishing the facts of the case from those in *CIC Services LLC v. IRS, No. 3:17-cv-110, 2022 U.S. Dist. LEXIS 105376 (E.D. Tenn. Jun. 2, 2022),* noting that in this case the Notice interpreted an "organic statute itself," not a regulation and involved interpretation of statutory terms and that policy disagreements cannot be arbitrary and capricious. *Stenson Tamaddon LLC v. IRS, et al., No. CV-24-01123-PHX-SPL, 2025 U.S. Dist. LEXIS 117356 (D. Ariz. Jun. 18, 2025).*

Earned Income Credit. Here the Tax Court held that a married couple were not allowed to claim the earned income tax credit under I.R.C. §32(a) for the wife's sister, who was 64 years old, suffered a stroke and was confined to a wheelchair, and who the taxpayers claimed lived with them for more than six months in the year at issue. The Tax Court found that the taxpayers provided no documentation to support the assertion that the wife's sister lived with the taxpayers for more than six months or that she was permanently and totally disabled. *Graham v. Comm'r, T.C. Memo. 2025-116.*

Electric Motor Vehicle Credit. The petitioners, a married couple, purchased a new Chevrolet Volt (a plug-in electric vehicle) in 2013 and began using it that year. For every subsequent year, including the year at issue, 2019, they continued to claim the maximum $7,500 credit under I.R.C. on their income tax returns. The IRS disallowed the credit for years under review. The Tax Court agreed with the IRS, noting that the vehicle was "placed in service" in the year they originally purchased and began driving it, which was 2013. Because the statute allows for a one-time credit, the taxpayers were only entitled to claim the $7,500 credit in the year the vehicle was first placed in service (2013) and the repeated claims of the same one-time credit in subsequent years were improper. *Moon v. Comm'r., 165 T.C. No. 4 (2025).*

Losses

Net Operating Loss. The petitioner claimed a net operating loss (NOL) carryforward and a capital loss carryforward on her 2018 return. The IRS disallowed both deductions. At the Tax Court, the primary issues were whether the petitioner properly elected to carry back the NOL (under pre-2018 rules), or whether failing to elect meant she could carry forward the NOL instead. In addition, the Tax Court considered whether the petitioner's capital loss classification was valid, given that she claimed it as ordinary rather than capital, and whether it should therefore generate a loss carryforward. The Tax Court held that because Mosley did not elect to carry back her NOL to prior years, she was not entitled to carry it forward under the rules in effect for her tax year. The correct treatment was a carryback, and she could not simply convert it into a forward carryover. Thus, the Tax Court denied both the NOL carryforward and the capital loss carryforward were denied, effectively eliminating both items from the petitioner's 2018 return and leading to a deficiency. *Mosley v. Comm'r., T.C. Memo. 2025-7.*

Hobby Losses – Profit Motive Established in Cattle Ranching Activity. The petitioner operated an 836-acre multi-generational Texas ranch that he assumed management of after his father's death in 2016. At the time, the ranch infrastructure was in significant decline, requiring extensive expenditures to remove invasive vegetation, restore pastureland, and rebuild fencing. The IRS disallowed more than $205,000 of claimed farm losses for 2016, asserting that the ranch lacked a bona fide profit motive, particularly because the petitioner also received approximately $2.3 million in oil and gas royalty income associated with the property.

The Tax Court held that the taxpayer's cattle ranching activity was engaged in for profit under I.R.C. § 183, despite substantial and continuing losses. The Tax Court first rejected the IRS's attempt to aggregate the ranching activity with the petitioner's profitable mineral interests and general land appreciation. Instead, the Tax Court treated the cattle operation as a separate activity for purposes of the hobby-loss analysis under Treas. Reg. § 1.183-2(b). Applying the nine-factor test, the Tax Court found persuasive the taxpayer's substantial agricultural expertise, including academic degrees in animal science and biology, together with his active and methodical efforts to rehabilitate and improve the ranching operation. The court also gave considerable weight to extraordinary external events that materially hindered profitability, including damage from Hurricane Harvey, a severe winter freeze, and workforce disruptions caused by the COVID-19 pandemic, including the deaths of three employees. *Kolar v. Comm'r., T.C. Memo. 2026-15.*

> **Observation:** The decision underscores that persistent losses alone do not establish the absence of a profit objective, particularly where a taxpayer demonstrates operational expertise, substantial personal involvement, credible business planning, and faces significant unforeseen setbacks beyond the taxpayer's control.

Hobby Losses. The petitioners claimed significant losses from their "Pecandarosa Ranch" on their joint federal income tax returns for the years 2013 and 2014. The activities included horse breeding, ranching, and other farm-related operations. The IRS claimed that the ranching operation was an "activity not engaged in for profit" (a hobby) and denied associated deductions. The Tax Court applied the nine factors of the I.R.C. §183 regulations for years 2013 and 2014 and noted that the petitioners commingled personal and business funds, failed to maintain a general ledger, and lacked a formal, contemporaneous business plan. Their records were deemed sufficient only for tax preparation, not for informed business decision-making. The Tax court also noted that the ranch had a long and unbroken history of substantial losses, totaling nearly $3 million from 2008 through 2022. The court found these significant losses continued long after any initial "startup" phase. Excluding the land itself, the Tax Court found no genuine expectation that the remaining ranch assets (such as structures or horses) would appreciate enough to offset the large losses. While the husband had significant ranching experience, the Tax Court found no clear evidence that he applied it to improve profitability during the years at issue. While the petitioners did work full-time on the ranch and were involved in physical labor, they had no experience in turning a previous loss venture around, other factors clearly supported that the activity was conducted without a profit intent. *Young v. Comm'r., T.C. Memo. 2025-95.*

Hobby Loss – Constitutional Challenge. In a previous case involving the petitioner, the Tax Court determined that the petitioner's farming/ecotourism and construction/real estate activities were separate activities and that the petitioner was not engaged in the farming activity with a profit intent. Thus, the Tax Court denied the deduction of several million dollars' worth of losses from the "farming" activity as an offset to the petitioner's high non-farm income. *Schwarz v. Comm'r, T.C. Memo. 2024-55.* The petitioner challenged the hobby loss regulations as invalid under the rationale of Loper Bright Enterprises v. Raimondo, 603 U.S. 369 (2024). In the later decision on that issue, the Tax Court held That it need not consider the taxpayers arguments because it determined that the portions of the hobby loss regulations necessary to decide the case were largely based on case law existing at the time I.R.C. §183 and the regulations were adopted. As a result, the Tax Court again determined that the taxpayer did not engage in the Schedule F activity with the intent to make a profit. *Schwarz v. Comm'r., T.C. Memo. 2025-122.*

Hobby Loss – Recordkeeping. The petitioners, a married couple, claimed significant Schedule F losses for their "Pecandarosa Ranch" over the 2013 and 2014 tax years. The husband had extensive ranching experience, and the ranch was used for various activities, including horse training, roping, and later, an events venue. The wife had a background in accounting and managed a separate, highly profitable S corporation. The IRS challenged the deductions, arguing the ranch was an "activity not engaged in for profit" under I.R.C. §183. The Tax Court applied the nine factors established in Treas, Reg. §1.183-2(b) to determine the petitioners' actual and honest profit motive. The court found most factors weighed against the taxpayers. The Tax Court noted that the petitioners commingled personal and business funds in a single account, failed to maintain adequate books and records (relying only on spreadsheets sufficient for tax preparation, not business decisions), and lacked a contemporaneous business plan to achieve profitability. The ranch also had a long and unbroken history of substantial losses of nearly $3 million over seven years, long after any "startup" phase. In addition, the petitioners had substantial income from the wife's profitable S corporation, indicating the ranch losses were being used to offset unrelated income. While the Tax Court acknowledged the petitioners dedicated significant time and effort and had some ranching experience, the presence of personal pleasure (team roping, horse training) combined with the persistent lack of business planning suggested the activity's dominant motive was not profit. The Tax Court concluded that the petitioners lacked a genuine profit objective, disallowed the Schedule F losses, and upheld the 20 percent accuracy-related penalties because the petitioners could not demonstrate reasonable cause or good-faith reliance on a professional (their accountant merely prepared returns, but did not provide substantive tax advice). *Young v. Comm'r., T.C. Memo. 2025-95.*

Practice Pointers

- Even when a taxpayer dedicates substantial time and effort and possesses expertise, the lack of a formal, written business plan and the commingling of personal and business funds will weigh against the taxpayer.

- A long history of losses becomes indefensible without objective evidence of attempts to change operations, cut expenses, or adopt new business strategies designed to break the cycle of deficit. Using business losses to repeatedly shelter large amounts of unrelated income (such as, in this case, from the wife's S corporation) is a red flag that strongly suggests a lack of actual profit motive.

Hobby Losses. The petitioners operated a sole proprietorship called "Plantation Arabians," involving the breeding, boarding, showing, and training of Arabian horses, reporting significant losses for many years. Before the Tax Court, the issue was whether the petitioners conducted their horse activity with the requisite "honest and objective intent" of making a profit, as required for a loss to be deductible as a business expense under I.R.C. §§162 or 212, rather than as a non-deductible hobby loss under I.R.C. §183. The Tax Court examined the nine factors of Treas. Reg. §1.183-2(b) to determine whether the petitioners were conducting the activity with the requisite profit intent to allow deductibility of the associated losses. The Tax Court found that most of the factors weighed against the taxpayers. While they devoted significant amounts of time and effort and maintained books and records, the Tax Court concluded these were primarily for tax reporting purposes, not to improve profitability. The petitioners' failure to change operating procedures despite persistent losses, their infrequent sale of horses compared to successful comparable operations, and the significant element of personal pleasure (love of Arabian horses) all indicated a lack of a true profit motive. Consequently, the Tax Court sustained the IRS's disallowance of the substantial loss deductions the petitioners claimed from the activity for the years at issue. The Tax Court also sustained the additions to tax for failure to timely file the returns. *Himmel v. Comm'r., T.C. Memo. 2025- 35.*

Practice Pointer:

- This case serves as a crucial reminder for taxpayers that even activities requiring substantial effort and investment can be reclassified as a hobby if the objective facts don't support an honest intent to realize an economic profit.

Net Operating Loss – Divorce. The handling of a farm net operating loss (NOL) is handled in a divorce can be tricky. A significant question is whether it is divisible or can be assigned a value? For example, assume that the husband farms and the wife is an off-farm W-2 wage earner. Also assume that the husband has small farming operation and $150,000 net operating loss carryover from past years attributed to the farm losses on their joint tax return. There is no LLC or corporation involved. There is no question that the farming assets (equipment, seed etc.) are marital. Assume that the couple is divorcing and will be filing as MFS. The question is how to handle the loss on their separate returns.

For married persons who filed jointly in the past, that $150k loss is a "marital" tax attribute, but the IRS has specific rules on how it follows the individuals after the split. You can divide the NOL, but not necessarily 50/50. The IRS generally follows the rule that a carryover loss belongs to the spouse who actually sustained the loss. Even on a joint return, the IRS views the income and losses as belonging to the individual whose business generated them. Since the husband is the farmer and the losses were generated by his sole proprietorship, the IRS typically allocates the $150k NOL to him for his future separate returns. However, if any portion of that loss can be traced to the wife's participation or separate capital investment in the farm, she might have a claim to a portion of it. But, in a standard "Husband runs the farm, wife has a W-2" scenario, the IRS default is that the loss follows the farmer.

Even if the IRS says the loss stays with the husband, family courts might view the tax savings power of that loss as a marital asset. In other words, if the husband keeps the full $150k NOL, he is essentially walking away with a "tax shield" that makes his future income tax-free until the

$150k is used up. At a hypothetical 20% tax rate, that is worth $30,000 in actual cash he won't have to pay the government. There are ways to address this. The wife's attorney might argue that because the husband is keeping a $30,000 tax benefit created during the marriage, the wife should receive an offsetting $15,000 in cash or other marital property (like more equity in the home or a larger share of a retirement account). But valuing an NOL is tricky because its value depends on the husband's future income. If he doesn't make a profit next year, the loss is worth $0 that year. Usually, an accountant performs a "present value" calculation based on projected earnings.

With all that said, parties can often negotiate the "equitable distribution" of tax benefits. If the husband and wife agree to split the loss, they can sometimes do so, though they must ensure it complies with IRS Pub. 504 and Regs. regarding the "allocation of a joint NOL."

One final point. If the husband keeps the loss, the divorce decree should clearly state he is responsible for any future audits related to those years to protect the wife.

Deductions

Business Expenses - Fines and Penalties. The petitioner pleaded guilty to bribery, fraud, and money laundering in 2013, which ultimately led to the U.S. Marshals Service's seizing money from him and his S Corporation's bank accounts in 2016. The taxpayer deducted a flowthrough loss from the forfeiture of the S Corp's portion of seized funds. The IRS disallowed the loss deduction. Other issues in the case were abandoned by the taxpayer or were computational. The Tax Court sustained the IRS position of disallowing the forfeiture loss deduction on public policy grounds. *Hampton v. Comm'r., T.C. Memo. 2025-32.*

Employee/Independent Contractor. The plaintiff was a financial professional working for Wells Fargo for about 35 years. He claimed that he was an independent contractor for tax purposes, which entitled him to claim substantial business expense deductions (e.g., for client entertainment, advertising, travel) on Schedule C. The IRS rejected this classification, treating him as a common-law employee and denied the deductions. The plaintiff filed a refund suit for the disallowed deductions and the abatement of a frivolous return penalty. The court determined the plaintiff's status by applying the common-law test. In applying the test, the court noted that Wells Fargo paid him via Form W-2, withheld federal and state taxes, provided him with a computer/printer, paid for office space and utilities, and employed/paid his office assistants. The court also noted that the plaintiff had significant flexibility in his schedule and client base and had to cover many of his own work-related expenses because he didn't meet the company's revenue threshold for reimbursement. The court granted the IRS' motion for summary judgment and denied the plaintiff's cross-motion. The court determined Gil was entitled to smaller refunds of $17,074 plus interest for 2020 and $14,413 plus interest for 2021, rather than the larger amounts he claimed. *Gil v. United States, 801 F. Supp. 3d 547(E.D. Pa. 2025).*

Business Expenses. The taxpayers, a married couple, filed a tax refund lawsuit seeking a $1,898,786 refund for the 2014 tax year related to depreciation deductions taken on business travel expenses and a private jet used by Mr. Shleifer, who was a partner at an investment firm and owner of SLS Travel LLC. SLS Travel LLC purchased a 37.5% interest in a private jet for $19,687,500. The couple claimed a $5,917,589 depreciation deduction for the jet on Schedule C producing a loss. The IRS denied the refund in its entirety on the basis that SLS Travel LLC was not operated to generate profit and had no income in 2014. The court upheld the IRS position disallowing the claimed loss and denying a refund because SLS Travel LLC was not operated as a trade or business for profit. Even though it was not properly raised in the original refund claim filed with the IRS, the court stated that the "variance doctrine" precludes consideration of the depreciation deduction as an unreimbursed partnership expense. *Accordingly, the court granted* *the government's motion for summary judgment. Shleifer v. United States, No. 24-CV-80713-Rosenberg, 2025 U.S. Dist. LEXIS 108788 (S.D. Fla. Jun. 9, 2025), appeal filed, Aug. 7, 2025.*

Cannabis – QBID Deduction. The petitioner, a shareholder in S corporations that operated cannabis businesses. The petitioner claimed that all W-2 wages paid by the businesses should count toward the wage limit for the qualified business income (QBI) deduction under I.R.C. §199A, regardless of the fact that the I.R.C. §280E denies all deductions and credits for a business that consists of trafficking in controlled substances (like cannabis), with the exception of costs of goods sold (COGS). I.R.C. §199A allows eligible taxpayers to deduct up to 20 percent of their qualified business income limited by a formula that references the amount of W-2 wages paid by the business. The Tax Court held that only those W-2 wages that are deductible after the application of I.R.C. §280E can be included in the wage limitation. The Tax Court relied on the language in I.R.C. §199A(b)(4)(B), which states that "W-2 wages" do not include amounts that are "not properly allocable to qualified business income." Because wages disallowed by are not "allowed in determining taxable income," the court reasoned they cannot be considered a "qualified item" of deduction and therefore are not "properly allocable" to QBI. The Tax Court's rationale effectively ties the I.R.C. §199A wage limitation directly to the expenses that survive the restrictions of I.R.C. §280 *E. Savage v. Comm'r., 165 T.C. No. 5 (2025).*

> **Observation:** The Tax Court's decision creates a "double penalty" for cannabis businesses: (1) disallowance of most ordinary business deductions such as rent, non-COGS wages, utilities, etc., under I.R.C. §280E; and (2) using non-deductible wages to increase potential the QBI deduction.

Depreciation – Establishment of Cost Basis. The petitioner owned a rental property and later converted it to personal use. The petitioner claimed depreciation during the time the property was a rental but failed to establish the property's fair market value at the time of conversion to personal use. The IRS denied depreciation deductions and the Tax Court affirmed. The Tax Court determined that the sources the taxpayer used were too inaccurate to satisfy the standards for establishing value. In addition, the Tax Court noted that the property had been acquired as a result of a loan to a relative that transformed into a tenant-in-common situation preceding ownership. The petitioner failed to establish a cost basis and value sufficient to substantiate the claimed depreciation deductions. *Smith v. Comm'r., T.C. Memo. 2025-24.*

Cannabis Business. The IRS challenged petitioner's deductions associated with its cannabis dispensary business under I.R.C. §280E. When the IRS moved to collect past-due taxes, the petitioner sought a "collection due process" hearing and proposed an offer-in-compromise. In their settlement math, the dispensary subtracted their day-to-day business operating costs from their income to show they had very little money left for the IRS. Because the petitioner's offer was based on their actual profits (after expenses), and the IRS's calculation was based on their gross income (ignoring expenses), the Settlement Officer rejected the offer as being "substantially lower" than what the government believed they could pay. The Tax Court agreed with the IRS, noting that the Settlement Officer followed the Internal Revenue Manual. The Tax Court also held that the IRS has the right to adopt a policy that treats cannabis businesses differently - essentially saying that if you can't deduct an expense on your tax return, the IRS doesn't have to count it when deciding how much money you can afford to pay back. *Mission Organic Center, Inc. v. Comm'r., 165 T.C. No. 13 (2025).*

Substantiation. The Sixth Circuit affirmed the Tax Court's denial of deductions for business expenses, theft loss, and net operating loss (NOL) carryovers that the petitioner claimed. The appellate court emphasized that under IRC §162, deductions for ordinary and necessary business expenses require substantiation that the expenses were paid or incurred in the taxable year and were directly connected to an active trade or business. The petitioner's legal fees were found to relate to his role as an investor, not as a business operator, and most were not incurred in the relevant year. For the theft loss under IRC §165, the appellate court held that the taxpayer must prove the existence of theft under the relevant state law, the amount of the loss, and the year of discovery. The appellate court found insufficient evidence that the petitioner was a victim of theft, as opposed to having made poor investment decisions, and also found that the loss was not properly attributable to the year claimed. Regarding the NOL carryover under IRC §172, the appellate court reiterated that taxpayers bear the burden of substantiating both the existence and amount of any NOL. The petitioner failed to provide adequate evidence beyond prior tax returns, which are not conclusive. *Shaut v. Comm'r., No. 25-1568, 2026 U.S. App. LEXIS 7571 (6th Cir. Mar. 12, 2026), aff'g., T.C. Memo. 2024-103.*

Substantiation. The petitioner claimed significant cash contributions ($43,258) to an I.R.C. §501(c)(3) foundation. The Tax Court denied these deductions because the taxpayer failed to provide a Contemporaneous Written Acknowledgment (CWA) that met the requirements of I.R.C. §170(f)(8). A letter produced during trial was deemed unreliable due to inconsistent formatting and a lack of corroborating bank records or ATM receipts. Deductions for a purported cleaning business were also disallowed. The Tax Court applied the "carrying on" test, finding the taxpayer's testimony too vague to establish that an actual trade or business existed. Under I.R.C. §162(a), a taxpayer must prove expenses are "ordinary and necessary" and incurred in a current business activity; mere intention or sporadic activity without records (ledgers, client lists, or rate sheets) is insufficient. *Johnson v. Comm'r., T.C. Memo. 2025-87.*

> **Observation:** The case serves as a blunt reminder that the Tax Court will rarely use the Cohan rule to estimate deductions when a taxpayer fails to maintain basic records, especially for cash-heavy charitable claims and nascent business ventures. However, had the petitioner provided even minimal secondary records, the technical landscape would have shifted.

Micro-captive Insurance - Deduction of Premiums. The petitioner was a captive insurance company created by owners of a chain of grocery stores. The petitioner elected under I.R.C. §831(b) to be taxed only on its investment income. Various operating companies paid premiums to petition to insure various risks. The IRS challenged the arrangement, arguing that the petitioner was not a genuine insurance company and that the premium payments were not deductible. The Tax Court's analysis went through the four-part test for determining the existence of a legitimate insurance arrangement: risk shifting, risk distribution, insurable risk, and whether the transaction meets the commonly accepted notion of insurance. The Tax Court determined that the insurance policies did, in fact, shift risk from the parent companies to the petitioner and that the risks covered were legitimate "insurance risks." The Tax Court also found for the petitioner on the risk distribution issue concluding that the insurance of multiple grocery stores and their various operations, with a wide range of employees, products, and suppliers, created a sufficient number of independent risk exposures to achieve adequate risk distribution. However, the Tax Court held that the petitioner's arrangement had operational defects demonstrating that the petitioner did not operate like a real insurance company. For instance, the premiums were consistently set just under the I.R.C. §831(b) limit, suggesting a tax-driven motive rather than an actuarially sound process. The petitioner also failed to consider its own history of losses when setting future premiums. The Tax Court also found the claims process to be "unusual and haphazard." Some claims were paid before the formal notice of claim was submitted, and in at least one instance, a policy was issued after the claim had already occurred, with the policy limit changed to accommodate the payment. In addition, many of the petitioner's policies had conflicting terms and ambiguous language, uncharacteristic of a standard insurance company. However, the Tax Court did not uphold penalties against the petitioner because the petitioner relied on a tax professional with reasonable cause and in good faith. *CFM Insurance, Inc. v. Comm'r., T.C. Memo. 2025-83.*

Captive Insurance. Here, the federal trial court granted summary judgment for the IRS, upholding the agency's 2025 Final Rule regarding "microcaptive" insurance reporting. The dispute in the case originated in 2016 when the IRS issued Notice 2016-66, labeling certain small captive insurance arrangements as "transactions of interest" to curb tax avoidance under I.R.C. §831(b). The plaintiff successfully challenged that notice, leading to a 2021 Supreme Court victory and a 2022 federal district court ruling that vacated the notice for violating the Administrative Procedure Act (APA) because the IRS failed to follow "notice-and-comment" procedures. The IRS responded by initiating formal rulemaking, culminating in the 2025 Final Rule. The plaintiff challenged this new rule, alleging it remained "arbitrary and capricious." *However, the Court found that the IRS had successfully cured its previous defects*. Unlike the original notice, the 2025 rule underwent a full notice-and-comment period, with the IRS considering and addressing over 100 public comments. The trial court noted the IRS now provided a robust administrative record, including recent Tax Court precedents (e.g., Avrahami, Caylor) that demonstrated how such captive structures are often used for tax avoidance rather than bona fide insurance. The trial court determined that the IRS acted within its Congressional mandate to identify and require disclosure of potentially abusive tax schemes. The decision confirms that the revamped disclosure requirements are legally enforceable, marking a major victory for the IRS in its decade-long campaign against microcaptive tax shelters. *CIC Services, LLC v. Internal Revenue Service, No. 3:25-cv-146, 2026 U.S. Dist. LEXIS 45519 (E.D. Tenn. March 5, 2026).*

Micro captive Insurance Reporting Rule. Here the court vacated IRS's micro captive reporting rule marking a significant setback for the Service's campaign against perceived tax avoidance in the insurance space. By striking down the designation of micro captive arrangements as "listed transactions," the court emphasized that the IRS failed to satisfy the Administrative Procedure Act's (APA) notice-and-comment requirements, echoing the judiciary's recent, more rigorous stance on regulatory overreach post-Loper Bright. *Drake Plastics Ltd. Co. v. Internal Revenue Service, No. H-25-2570, 2026 U.S. Dist. LEXIS 82472 (S.D. Tex. Apr. 15, 2026).*

Practice Pointers:

- The decision provides immediate relief from burdensome reporting requirements and the associated threat of strict liability penalties under I.R.C. §6707A. However, the ruling should not be interpreted as a green light for aggressive structures. The court's decision addressed the procedure of the designation rather than the underlying merits of micro captive legitimacy. The IRS remains fully empowered to challenge individual arrangements through audit and litigation by applying the economic substance doctrine and other established principles.

- The ruling underscores a broader judicial trend requiring the IRS to provide robust administrative justification when labeling transactions as abusive. While this victory limits the Service's ability to impose sweeping reporting mandates, it leaves the fundamental tax risks of structured micro captives unchanged and likely invites intensified scrutiny on a case-by-case basis.

Micro captive Insurance – Lack of Economic Substance. The petitioner, an Oklahoma oil businessman, entered into a micro captive insurance arrangement, attempting to claim deductions under I.R.C. §831(b). The Tax Court determined that the arrangement failed to meet the requirements of the economic substance doctrine under IRC §7701(o). Specifically, The Tax Court found that: 1) the transaction did not meaningfully change the taxpayer's economic position; 2) the transaction involved a circular flow of funds among related entities, which the court cited as a strong indicator that the transaction lacked genuine economic substance; and 3) the primary motive for the arrangement was to obtain tax benefits rather than to engage in legitimate risk management. The Tax Court concluded the arrangement did not constitute "insurance" in the commonly accepted sense, as it lacked the essential elements of legitimate risk shifting and risk distribution. The Tax Court upheld a 40% accuracy-related penalty under IRC § 6662(i). This increased penalty was applied because the transactions were found to lack economic substance and, crucially, were not adequately disclosed on the taxpayer's returns. The Tax Court noted that merely reporting an "insurance" deduction without disclosing the underlying micro captive structure was insufficient to alert the *IRS to the nature of the transaction. Haskins v. Comm'r., T.C. Memo. 2026-34.*

Practice Pointer

- The case serves as a further warning that the Tax Court remains highly skeptical of microcaptive structures that do not adhere to rigorous actuarial and risk-management standards.

Captive Insurance. The petitioner ran an eye surgery practice and research companies. He and his wife formed two micro-captive insurance companies (Magellan and Plymouth). They claimed tax deductions for over $4.5 million in premiums paid to these captives between 2013 and 2016. In the initial Tax Court case (*T.C. Memo. 2024-34*), the Tax Court ruled that the premium payments were not deductible because the arrangement failed to qualify as "insurance" for tax purposes. The companies failed the criteria for genuine insurance, specifically lacking adequate risk distribution (due to a circular flow of funds) and not being operated as insurance companies in a commonly accepted sense. The premiums were also set to maximize the deduction limit under I.R.C. § 831(b) rather than based on actuarial science. In the present case, the Tax Court addressed the IRS penalties, specifically the strict-liability penalty for transactions lacking economic substance. On that issue, the Tax Court held that the codified Economic Substance Doctrine (which requires a transaction to have a non-tax purpose and meaningfully change the taxpayer's economic position) can only be considered if the threshold relevancy determination of I.R.C. §7701(o) is met. The court stated that the statute itself requires this, applying the doctrine only "[i]n the case of any transaction to which the economic substance doctrine is relevant." After affirming the threshold test, the court easily found that the doctrine was relevant to the petitioners' micro-captive arrangement. The arrangement failed the economic substance test because it did not change the taxpayers' economic position in a meaningful way apart from tax effects and did not have a substantial non-tax business purpose. The court upheld the application of the penalties under I.R.C. § 6662(b)(6) (20% penalty for lack of economic substance) and, crucially, increased the penalty to 40% under I.R.C. § 6662(i) for the tax years in which the transaction was not "adequately disclosed." The petitioners failed to attach a statement or provide sufficient information on their returns to enable the IRS to identify the potential controversy. Penalties for some years were ultimately excluded because the IRS failed to secure timely supervisory approval under I.R.C. §6751(b). *Patel, et al. v. Comm'r., 165 T.C. No. 10 (2025).*

Practice Pointers:

- The Tax Court formally established that applying the codified economic substance doctrine under I.R.C. § 7701(o) requires two steps:

  - **Step 1: Relevancy Threshold:** The court must first determine if the doctrine is "relevant" to the transaction at all. This is a win for taxpayers, as it suggests the IRS cannot simply apply the doctrine to every tax-advantaged transaction.

- **Step 2: Two-Prong Test:** If relevant, the transaction is then subjected to the two-prong test (objective economic effect and subjective business purpose).

- This case is a stark warning about the financial consequences of aggressive tax planning that is not disclosed. Once a transaction is found to lack economic substance, the 20% penalty is strict liability (meaning the taxpayer's intent or good faith reliance on advice generally does not matter). In addition, failure to adequately disclose a reportable transaction on the original tax return increases the penalty rate to 40 percent. The court clarified that disclosure must be made at the time of filing, not later during an audit.

- The case confirms the IRS's aggressive stance on micro-captive insurance structures that are perceived as primarily tax motivated.

Captive Insurance. The petitioners, owners of an S corporation, set up a "captive insurance" company and paid it large premiums for purported insurance coverage. By shifting money from their main business to their captive company, they sought to claim a tax deduction for the expenses. The IRS challenged the arrangement, arguing it wasn't a legitimate transfer of risk, but rather a way to shield income from taxes. The Tax Court agreed with the IRS focusing on a four-part "litmus test" to determine if an arrangement actually qualifies as insurance. The Tax Court held that for a payment to be deductible, it must involve a real insurance risk, shift that risk away from the company, distribute the risk across a broad pool of policyholders, and operate like a commonly accepted insurance business. The Tax Court found that the petitioners' arrangement failed on almost every count. There was no "risk distribution" because the insurer wasn't protecting a large enough pool of people to spread the danger. In addition, the captive company was "undercapitalized," meaning it didn't actually have enough money to pay out a major claim. The Tax Court also found the contracts weren't "arm's length" deals. The petitioners were paying their own company 2.5 to 3.5 times more than what they would have paid a commercial insurer for the same coverage. Because the arrangement so clearly lacked a business purpose other than tax avoidance, the Tax Court disallowed the deductions and upheld accuracy-related penalties. *Kadau v. Comm'r., T.C. Memo. 2025-81.*

Captive Insurance – Regulation. The plaintiff, a tax consulting firm, had standing to bring an action to vacate and set aside Treas. Reg. §1.6011-10, which requires the disclosure of transactions involving captive insurance companies as transactions of interest or listed transactions. The court found that the taxpayer sufficiently alleged that it is a material advisor that is directly regulated by the final regulations and properly plead that the final rule is arbitrary and capricious. *Ryan, LLC v. IRS, No. 3:25-CV-0078-B, 2025 U.S. Dist. LEXIS 217971 (N.D. Tex. Nov. 5, 2025).*

Labor Expense – Self-Employed. The petitioner, a sole proprietor of an engineering firm who used the cash method of accounting, attempted to deduct the monetary value of his own time spent developing a mathematical modeling program for his business. He valued his labor at $371,210 based on the hours worked and an hourly rate. The IRS disallowed the deduction, arguing that the value of the taxpayer's own labor does not constitute an expense that was "paid or incurred" as required by the Code. The Tax Court agreed with the IRS, applying a long-established principle that a deduction under (or related provisions for development costs) requires an actual economic outlay or a genuine liability that has been "paid or incurred." The Tax Court stated that "Labor performed by a taxpayer does not constitute an amount 'paid or incurred' by him." Since the taxpayer's cash-basis business never actually paid him for the development work, nor did it recognize this amount as a company liability, there was no deductible expense. *Nwafor v. Commissioner, T.C. Memo. 2025-27.*

Residual Fertilizer Supply. Many CPAs and other tax preparers are being bombarded by clients who have hired companies to conduct soil analyses of their purchased farmland so they can deduct the residual soil fertility, or "legacy nutrients," as it is euphemistically called. The guidance is fairly clear on the rules for residual fertility studies that are conducted close in time to when the subject land is purchased or inherited. But promoters are pushing the idea that a deduction can be claimed for soil nutrients on a farm purchased up to 15 years ago (or more). These promoters are encouraging the use of Form 3115/change of accounting method to go back and claim the nutrients they say (based on their analysis) were present at the time of acquisition. However, the "useful life" of those nutrients is likely 3–7 years. If a taxpayer tries to claim a deduction in 2025 for nutrients that were technically "exhausted" several years ago, the taxpayer is essentially asking for a retroactive catch-up on an asset that no longer exists. As for the agronomic reports, the most contentious part is forensic agronomy. Since the taxpayer had a soil test conducted years ago upon acquisition/inheritance, the promoter uses "hindcasting" (working backward, subtracting applied fertilizer, and adding back crop removal) to "prove" what was there many years ago upon acquisition/inheritance. The IRS is historically skeptical of "estimates" and "forensic" recreations. Without a contemporaneous 2012 soil test, the IRS can argue the taxpayer has failed to "establish the presence and extent" required by TAM 9211007. In addition, the taxpayer must actually have enough basis in the land to reallocate the claimed deduction to the nutrients.

> **Observation:** For tax preparers deciding to move forward with claiming a deduction for residual fertilizer in such situations, thought should be given to the fact that if the nutrients were exhausted years ago, taking an I.R.C. §481(a) catch-up adjustment highlights the lack of documentation from the actual purchase year. Also, the client engagement letter should include specific language stating that the nutrient valuation was provided by a third party and that the tax preparer is not an agronomist capable of verifying the "hindcasting" data. And keep in mind that, thanks to the promoters, the IRS has recently added "residual soil fertility" to its list of issues being monitored for potential "Dirty Dozen" or specialized audit campaigns because of the high dollar amounts and the "promoter" nature of the service.

Unreimbursed Employee Business Expenses. For tax years 2018 through 2025, the TCJA suspended all miscellaneous itemized deductions subject to the 2% floor. This includes unreimbursed employee expenses that were previously deductible under I.R.C. §162. The petitioner worked as a contractor for military facilities in Maryland and New Jersey. Because of strict security protocols, he was required to work on-site and incurred significant travel and lodging expenses. He attempted to deduct these on Schedule 1 as "allowable" business expenses. The Tax Court ruled that unless a taxpayer fits into specific carved-out categories such as Armed Forces reservists, fee-basis state/local officials, or qualified performing artists, employee business expenses are currently non-deductible. Despite the "extraordinary" nature of his travel required by military security, the law provides no exception for private-sector contractors. The Tax Court also sustained an accuracy-related penalty, finding that the petitioner did not have "substantial authority" for a position that contradicts a clear statutory suspension. *Hussaini v. Comm'r., T.C. Memo. 2025-82.*

Research and Experimental Expenditures. The IRS has issued a Revenue Procedure providing administrative and procedural guidance for taxpayers regarding the treatment of domestic research or experimental (R&E) expenditures under the new rules contained in I.R.C. §174A enacted by the One, Big, Beautiful Bill Act (OBBBA). For tax years beginning after December 31, 2024, OBBBA generally allows taxpayers to immediately deduct domestic R&E expenditures (including software development costs), reversing the requirement from the Tax Cuts and Jobs Act (TCJA) that mandated capitalization and amortization over five years. Taxpayers can, alternatively, elect to capitalize and amortize these domestic R&E costs over at least a 60-month period under. The Revenue Procedure allowing qualified small business taxpayers to retroactively apply the new deduction rules to R&E expenditures paid or incurred in tax years beginning after December 31, 2021 (the TCJA years). This retroactive election allows these small businesses to treat previously capitalized domestic R&E costs as immediately deductible, potentially generating refunds by filing amended returns or Administrative Adjustment Requests (AARs). The guidance addresses how taxpayers must recover the remaining unamortized balance of domestic R&E costs that were capitalized under the prior TCJA rules (2022-2024 tax years). Taxpayers are generally given options, including an accelerated deduction of the remaining balance in the first tax year beginning after December 31, 2024. The Rev. Proc. provides automatic consent procedures for taxpayers to change their method of accounting to conform with the new rules, which significantly simplifies the process compared to seeking private letter rulings. Recognizing that the guidance was released after many taxpayers filed their 2024 returns, the IRS granted an automatic six-month extension for eligible taxpayers to file superseding 2024 returns (from the original due date of the return) to make the elections and method changes provided in the procedure. The final deadline for making retroactive elections (for the 2022-2024 tax years) is generally the earlier of July 6, 2026, or the expiration of the statute of limitations for the applicable tax year. *Rev. Proc. 2025-28, 2025-38 I.R.B. 393.*

Criminal Forfeiture. The petitioner was a financial advisor who operated his business through an S corporation of which he was the sole shareholder. He engaged in a bribery, fraud, and money laundering scheme, paying illegal kickbacks to a state official to obtain securities trades, resulting in $3.2 million in commissions. In 2014, the petitioner was criminally convicted and ordered to pay a forfeiture money judgment of approximately $2.2 million. In 2016, the U.S. Marshals Service seized over $865,000 from bank accounts held in the name of his S corporation as substitute property to satisfy the forfeiture judgment. On its 2016 tax return, the S corporation claimed a loss deduction under I.R.C. §165 for the full amount of the seized funds, which flowed through to Hampton's personal tax return. The IRS disallowed the deduction. The Tax Court agreed on the basis that allowing the deduction would frustrate a sharply defined national policy against bribery, fraud, and money laundering. The Tax Court rejected the petitioner's argument that the loss was a legitimate business casualty under I.R.C. §165, finding that the seizure was directly tied to property derived from illegal acts. It also rejected the argument that the S corporation was a separate, "innocent" entity, noting that the forfeiture statutes treat a wholly owned and controlled entity as the alter ego of the convicted individual. *Hampton v. Comm'r., T.C. Memo. 2025-32.*

Practice Pointers:

- Even though I.R.C. §165 (allowing a deduction for losses) does not have the same explicit public policy prohibitions as I.R.C. §162 (business expenses), public policy principles still govern whether a loss stemming from a criminal forfeiture is deductible. The Tax Court found that granting a tax benefit for criminally forfeited funds would effectively undermine the criminal penalties.
- A loss resulting from the forfeiture of assets used in or derived from illegal activities is generally not deductible for tax purposes.
- For purposes of applying the public policy doctrine to forfeiture, the court may disregard the separate corporate identity of a closely-held company. The S corporation was considered the alter ego of the petitioner (as sole owner) and the seizure of the S corporation's bank accounts was deemed the seizure of the owner's criminally derived property.

- If the taxpayer believed the forfeiture was unauthorized or excessive, the proper legal recourse was to challenge the forfeiture in the federal court that issued the order, not to claim a subsequent tax deduction for the seized funds in Tax Court.

Interest Deductibility. The petitioners, a married couple, via their S corporation, engaged in a complex arrangement involving a purported loan and the purchase of a "Bermuda Call Option Agreement" from the same issuer. The transaction was structured to mimic genuine debt, but the repayment obligation was effectively tied to the performance of the option. The petitioners claimed millions of dollars in interest deductions under I.R.C. §163 to offset the gain from their business sale. The claimed deductions were grossly disproportionate to the actual economic cost of the transaction. The IRS challenged whether the arrangement constituted bona fide indebtedness for tax purposes and whether the transaction had economic substance beyond generating tax deductions. The Tax Court ruled entirely in favor of the IRS, disallowing the deductions and upholding significant penalties. The Tax Court found that the "loan" did not represent a true, unconditional obligation to repay, as all aspects hinged on the option's expiration. Since the purported debt was a sham designed solely to generate a deduction, the interest deductions were disallowed. As such, the transaction lacked any real business purpose or economic substance other than the creation of the tax benefits. The Tax Court also upheld an accuracy-related penalty against the petitioners for negligence and making an excessive refund claim, noting the "too good to be true" nature of the deductions (millions in deductions for a small economic cost). The petitioners' reliance on a tax opinion letter was deemed not in good faith because the opinion was solicited for penalty protection, and the taxpayers knew their advisor did not stand behind the deductions. *Stevens v. Comm'r., T.C. Memo. 2025-45.*

Overtime Deduction. A California business operates both a farming operation and a commercial packing facility. Some products grown by the entity and related partnerships are packed at the commercial packing shed. However, those products represent less than 50 percent of the total product packed at the facility. The business currently files Form 943 for farm laborers and Form 941 for employees working in the commercial packing operation. The question is whether, for purposes of the new qualified overtime rules, is it correct that employees reported on Form 943 (farm laborers) would not qualify, but that employees reported on Form 941, for hours worked within the commercial packing facility, would qualify. Additionally, is there any percentage threshold that could change this analysis? For example, would the result differ if more than 50% of the product packed consisted of crops grown by the entity or related partnerships, as opposed to less than 50%?

This is largely on the right track, but the "50 percent threshold" is actually the pivotal legal "tipping point" for determining whether a packing facility is considered a commercial operation or a secondary agricultural operation under the Fair Labor Standards Act (FLSA).

Under federal law (FLSA Section 3(f)), there are two types of agriculture:

- Primary Agriculture: Actual farming (tilling, growing, harvesting). These employees are almost always exempt from federal overtime.
- Secondary Agriculture: Operations performed by a farmer or on a farm as an incident to or in conjunction with such farming operations (e.g., packing, woodcutting, hauling).

The critical distinction for a packing shed is whose product is being packed. If > 50 percent is your own product: The facility is generally treated as "secondary agriculture." In this scenario, even the packing shed workers might be exempt from federal overtime because they are performing work incident to the entity's own farming operations. If < 50 percent is your own product (current state): The facility is legally classified as a commercial operation. Because you are packing more of "other people's" crops than your own, the work is no longer considered "incident to" your own farming. It is a separate business. So, given the current setup, the analysis is correct: the Form 941 employees in the packing shed do qualify for overtime because they are working in a commercial, non-exempt facility.

Keep in mind that under the FLSA, the agricultural exemption is applied on a workweek-by-workweek basis. If a packing shed employee handles even one crate of a third party's product during a week where you are trying to claim the ag exemption, they may lose that exemption for the entire week.

Now, California's AB 1066 has phased out the ag exemption entirely. That means the 50 percent threshold might not matter for state overtime; the employer may eventually have to pay overtime to everyone (both 943 and 941 employees) regardless of whether they are "farm laborers" or "commercial workers." But the bottom line remains that the IRS and the DOL look for consistency. If Form 941 is filed for an employee, that essentially tells the government they are not agricultural laborers. If it is later claimed that they are exempt from overtime because they are "agricultural," that creates a red flag for an audit.

So, in California the employer has to pay overtime to ag workers, but it's not deductible on the federal return.

Tenant Deduction of Business Portion of Improvements. When a tenant that is renting a home pays for improvements to the home for business use, the expenses are generally treated as leasehold improvements and can be recovered over time. Since the improvements benefit the business, they are capitalized (the cost is not immediately deductible). The cost is typically recovered over the shorter of the remaining life of the improvement or the remaining term of the lease. This process is often called amortization or depreciation of leasehold improvements. Crucially, the deduction is only for the portion of the improvement that relates to the business use (i.e., the percentage of the home used as a home office. If the improvements are made to the entire home (not just the office space), the tenant must first determine the percentage of the home used for business. This percentage is used to allocate the cost of the improvement that can be deducted. A renter (as well as an owner) that uses a portion of their home for business must meet specific IRS requirements for the home office deduction (e.g., exclusive and regular use as a principal place of business). Upon satisfying those requirements, the improvements are treated as an indirect expense for the business use of the home. The deductible portion of the improvement cost is based on the business use percentage of the home. If the taxpayer uses the simplified method for the home office deduction, the taxpayer cannot claim depreciation or amortization on the home itself (including improvements) used for business. In other words, the taxpayer is not able to separately recover the cost of the home improvements (leasehold improvements) over time.

Under the simplified method, the taxpayer may take a flat deduction per square foot instead, and the improvement cost would not be separately recovered for that year. The renter must still meet the standard requirements for the home office deduction: 1) the space must be used exclusively and regularly for business; 2) the home must be the principal place of business (or a place where you regularly meet clients, etc.); and 3) the deduction is only available to the self-employed (not

W-2 employees). The deduction is calculated by taking a standard rate of $5 per square foot of the qualified business area, up to a maximum of 300 square feet. The maximum deduction is $1,500.

> **Note:** The main advantage of the simplified method is that it dramatically simplifies recordkeeping. The taxpayer does not have to calculate the business percentage of actual expenses like rent, utilities, or insurance.

Deduction of Legal Fees. Here, the Tax Court held that the petitioner's legal fees were nondeductible personal expenses because she failed to prove they were directly related to the production of income. While the case was decided under prior tax law - back when certain miscellaneous itemized deductions for income-producing legal fees were allowed - it highlights a permanent tax principle that the origin and character of the claim dictate its tax treatment. *Rosso v. Comm'r., T.C. Memo. 2025-115.*

Practice Pointers:

- Even though standard miscellaneous itemized deductions for personal income-producing legal fees have been eliminated, the case illustrates how the IRS categorizes legal expenses based on their relationship to the underlying activity:

    - **Personal Expenses (Nondeductible):** Legal fees stemming from personal matters cannot be deducted.
    - **Capital Expenditures (Capitalized):** Legal fees incurred to acquire, improve, or defend title to a property (such as purchasing a rental property) cannot be deducted immediately. Instead, they must be capitalized and added to the property's cost basis.
    - **Business/Rental Expenses (Deductible):** Legal fees that directly relate to the ongoing operation and maintenance of an income-producing asset remain deductible.

OBBBA

Bonus Depreciation – Qualified Production Property. The IRS has provided interim guidance on I.R.C. §168(n), a provision introduced by the OBBBA that allows 100% first-year depreciation for "Qualified Production Property" (QPP) placed in service after July 4, 2025, and before Jan. 1, 2031. The Notice bridges the gap before proposed regulations, defining the operational boundaries for immediate expensing of industrial real estate. In the guidance the definition of QPP is limited to MACRS nonresidential real property used as an integral part of a Qualified Production Activity (QPA). Construction must have commenced after January 19, 2025. To qualify as a QPA, the activity must fundamentally change the form or function of inputs (e.g., steel rods to bolts). Minor assembly or packaging is explicitly excluded. If 95% or more of a building's physical space is used for QPAs, the entire structure qualifies - effectively ignoring ancillary space. For facilities that fall below that threshold, the IRS requires a "reasonable and consistent" allocation of the building's basis. I.R.C. §1245 recapture applies if the property ceases QPP use within 10 years, a significantly stricter window than typical real property rules. Under the Notice, taxpayers must use one of three methods to separate QPP from non-qualifying real estate (e.g., general corporate offices or storage for finished goods): 1) the "square footage method" requires an allocation of basis on the ratio of the total usable square footage dedicated to the QPA versus the total square footage of the building; 2) the specific identification (engineering) method is a more technical approach where specific structural components (reinforced flooring for heavy machinery, specialized HVAC for clean rooms) are directly assigned to the QPP basis, while general components (roofing, lobby) are pro-rated; or 3) the cost-to-cost method allocates basis based on the relative construction costs of the production area versus the non-production area. This method will often be used when the production space requires significantly more expensive materials than the office space. *IRS Notice 2026-16.*

> **Caution:** If the "production-to-total" ratio drops below the original allocation percentage within the 10-year lookback period, a proportional amount of the 100 percent depreciation must be recaptured as ordinary income under I.R.C. §1245.

> **Comment:** The Notice is a "pro-manufacturing" lever that essentially converts 39-year assets into immediate deductions. The inclusion of related-party leasing exceptions allows consolidated groups to claim the benefit even when the real estate is held in a separate entity from the production work.

Penalty Relief – Tips and Overtime. The IRS has provided penalty relief from the new information reporting requirements for cash tips and qualified overtime compensation under the One Big Beautiful Bill Act (OBBBA) to employers and other payors for not filing correct information returns and not providing correct payee statements to employees and other payees. Employers and other payors will not face penalties for failing to provide a separate accounting of any amounts reasonably designated as cash tips or the occupation of the person receiving such tips. In addition, employers and other payors will also not face penalties for failing to separately provide the total amount of qualified overtime compensation. The relief is limited to returns and statements filed and provided for tax year 2025 and applies only to the extent that the person required to make the return or statement otherwise files and provides a complete and correct return or statement. Forms W-2 and 1099 for tax year 2025 will not be updated to account for the OBBBA-related changes. Therefore, tax year 2025 will be treated as a transition period for IRS enforcement and administration of the new information reporting requirements for cash tips and qualified overtime compensation under the OBBBA. *Notice 2025-62, 2025-48 IRB 740.*

Car Loan Interest Deduction. OBBBA adds new I.R.C. §163(h)(4) allowing taxpayers to deduct up to $10,000 of interest related to the purchase of a personal passenger vehicle associated with loans incurred after 2024 and before 2029. The IRS has provided guidance and penalty relief for lenders (and other interest recipients) regarding information reporting requirements for interest received on a specified passenger vehicle loan in calendar year 2025. The guidance allows lenders to satisfy their reporting obligation for 2025 by simply making a statement available to the borrower, by January 31, 2026, which indicates the total amount of interest received on the specified passenger vehicle loan during 2025. This is a simplified requirement compared to the full, detailed reporting that will be mandatory in subsequent years. Lenders will not have to file any type of official IRS Form with the taxpayer or the IRS. Instead, the lender can meet their reporting requirements by reporting the interest paid:

- On an online portal that the buyer can easily access;
- In a regular monthly statement;
- On an annual statement that is provided to the buyer; or
- By other similar means designed to provide accurate information to the buyer regarding interest received.

IRS Notice 2025-57, 2025-44 IRB.

> **Note:** For farmers who use the 75 percent business use safe harbor when purchasing a pick-up for the farm and purchase it this year with a loan, the interest will be allocated 75% to Schedule F and the remaining 25% will be allowed as a deduction on the new Schedule 1-A.

Overtime Pay. Section 70202 of the H.R. 1, the One Big Beautiful Bill Act (OBBBA) provides an income tax deduction for employees who receive "qualified" overtime pay. The deduction is capped at $12,500 (single filer) and $25,000 (MFJ). The deduction phases out as MAGI exceeds $150,000 (single) and $300,000 (MFJ). The provision defines "qualified overtime compensation" as compensation paid to an individual required under Section 7 of the Fair Labor Standards Act of 1938 that is in excess of the regular rate. FLSA Section 7 generally requires time-and-a-half pay for overtime (over 40 hours/week) for most employees. However, FLSA Section 13(a)(6) specifically exempts agricultural workers from the overtime pay requirement, meaning ag employees are only entitled to their regular rate for overtime hours, not time-and-a-half. This exemption means agricultural employers are not legally required to pay time-and-a-half overtime to farmworkers. Since ag employers are not required to pay overtime at time-and-a-half, any overtime paid at a premium rate is voluntary, not mandated. But if an ag employer does pay overtime at a premium rate, those wages can count. However, it is not permissible for an employer to reclassify ag labor to overtime so as to provide a tax deduction for the employee. If the ag employer files IRS Form 943 to report these wages, the employer will be subjected to penalties.

OBBBA – "Beginning of Construction." The IRS has provided guidance on when construction is considered to have begun for wind and solar facilities under the One Big Beautiful Bill Act (OBBBA). This directly impacts eligibility for the Clean Electricity Production Credit of I.R.C. § 45Y and the Clean Electricity Investment Credit of I.R.C. §48E. For most wind and solar projects, the IRS has eliminated the existing five percent safe harbor. Except for "low-output solar" facilities (1.5 MW AC or less), a project can no longer qualify based solely on paying or incurring at least 5 percent of total project costs. Also, to establish that construction has begun, developers must perform "physical work of a significant nature." This includes activities like excavation, installation of racks, mounting equipment, inverters, transformers, and other integral site work—whether on-site or off-site under binding contracts. Cost doesn't matter – only the nature and substance of the work. Project must also maintain a continuous program of construction, meaning ongoing significant physical work. Excusable delays like permitting or weather remain acceptable—but the "continuous efforts" test (e.g., simply entering into contracts or securing permits) has been eliminated. The four-year "safe harbor" window for placing the facility into service still applies. The new rules apply only to projects that have not begun construction under prior guidance before September 2, 2025. Projects that have already started under older rules may still rely on those methods (such as the 5 percent safe harbor). *IRS Notice 2025-42, 2025-36 IRB, aligning with Executive Order No. 14315, Jul. 7, 2025.*

Income

Capital Gain - Final Year of Estate or Trust. Long-term capital gains tied to investment assets (assets not used in the decedent's trade or business) that are distributed in the final year of an estate or trust are included in investment income for purposes of determining the beneficiary's Net Investment Income Tax (NIIT). In the final year, all of the estate's or trust's undistributed net income (DNI) is passed through to the beneficiaries, including capital gains, even if they would not have been included in DNI in other years. Treas. Reg. §1.661(a)-2(f), allows capital gains to be allocated to DNI in the final year - even if they wouldn't be in a regular year. Thus, capital gains are reported on Schedule K-1 (Form 1041), Line 14 – "Final Year Deductions" and possibly under Line 4a or 4b (for capital gains). The instructions to IRS Form 8960 specify that capital gains distributed to a beneficiary from an estate or trust retain their character and are included in net investment income on the beneficiary's return unless excluded under a specific exception. Thus, if a final-year distribution includes long-term capital gains, they flow through to the beneficiary via Schedule K-1, are included in the beneficiary's gross income, and are included in NII for purposes of the NIIT (assuming the beneficiary is otherwise subject to it).

Emotional Distress Damages. The petitioner received an award for several reasons, some of which were for physical injury and emotional distress sustained from a false arrest. The Tax Court determined that these damages were excludible from income under I.R.C. §104. However, damages received from claims related to constitutional violations were not excludible. *Zajac v. Comm'r., T.C. Memo. 2025-33.*

Constructive Receipt. The petitioner was a former employee of a U.S. subsidiary of an Australian company. As part of her compensation, the petitioner was granted performance rights that would vest into stock shares over time. In 2014, the petitioner was terminated from her job. Her separation agreement explicitly stated that all unvested performance rights would be forfeited. Shortly after her termination, Linc Energy transferred 100,000 shares of its stock into her brokerage account. The transfer was unsolicited and occurred after her right to the shares had seemingly been extinguished. The petitioner discovered the transfer, but despite attempts to contact her former employer for guidance, she received no instructions. Linc Energy subsequently issued a Form W-2 to the petitioner, reporting the value of the shares as taxable compensation. The petitioner believed the transfer to be a mistake and did not report the income on her 2014 tax return. The IRS later issued a notice of deficiency for the unreported income. The Tax Court upheld the IRS position, holding that the petitioner was required to include the value of the stock in her gross income for the 2014 tax year. The Tax Court noted that the shares were, in fact, transferred "in connection with" the petitioner's services, despite the company's subsequent financial difficulties and her termination. The key factor was the underlying compensation plan that established her right to receive the shares. The petitioner claimed that the stock was not taxable because she did not have a claim of right to it and because there was a "substantial risk of forfeiture" since the transfer was a mistake. However, the Tax Court pointed out that a "substantial risk of forfeiture" under I.R.C. §83 exists only if the right to the full enjoyment of the property is conditioned upon the future performance of substantial services. Because her employment had already been terminated, this condition did not apply. The Tax Court also noted that her attempts to contact the company were not a sufficient indication that she would not be able to dispose of the shares. The Tax Court also noted that the petitioner bore the burden of proof and that her informal attempts to seek clarification were insufficient to carry the burden. She did not provide a written notice of error as the compensation plan required, nor did she take any action, such as a formal lawsuit, to challenge the transfer or have the shares returned. *Feige v. Comm'r., T.C. Memo. 2025-88.*

Practice Pointers:

1) A passive protest or an unfulfilled intention to return the property is not enough to negate income inclusion.

2) To avoid tax liability, a taxpayer must take timely and decisive action to disclaim, return, or otherwise legally contest the property. This may involve formal written communication, legal action, or even an attorney's advice on how to handle the situation.

3) The court's decision hinged on the petitioner's lack of a proper, documented attempt to return the shares. Thus, it is critical to keep detailed records and correspondence related to any financial transfers or disputed income.

4) The Tax Court's decision provides a clear legal framework for how the IRS and Tax Court will likely view unsolicited transfers in the future.

The default position is that if the property is transferred "in connection with services," it is taxable income, and the burden is on the taxpayer to prove otherwise.

Depreciation Recapture. A recent question was raised about a client that has several hog confinement buildings. One of the buildings was acquired/constructed in 2020 for $800,000 and set up as 10-year MACRS depreciation property, for which bonus depreciation was taken. The building is now fully depreciated. The farmer now wants to sell the building in 2025 for $800,000. Will the character of the gain be I.R.C. §1245 ordinary income recapture, even though it is considered real property? The taxpayer has large capital loss carryovers available that they were hoping to be able to use to offset the gain on sale of the hog building.

Answer: Unfortunately, the farmer is out of luck on this one. The entire gain will be characterized as ordinary income recapture under I.R.C. §1245 and he will be unable to use the capital loss carryovers to offset the gain. A single-purpose agricultural or horticultural structure is specifically defined as I.R.C. §1245 property. This classification overrides the general rules for real property (I.R.C. §1250 property). While most buildings are considered real property, single-purpose agricultural structures are treated similarly to personal property for depreciation recapture purposes. Since the entire $800,000 gain on the sale of the hog building is reclassified as ordinary income under I.R.C. §1245, it is not a capital gain. Consequently, the farmer cannot use his large capital loss carryovers to offset this specific gain. More specifically, I. R.C. §1245(a)(1) sets out the general rule for ordinary income treatment. It states that if "Section 1245 property" is disposed of, the gain is treated as ordinary income to the extent of the depreciation deductions taken. I.R.C.§1245(a)(3)(D) provides the key definition for this situation. It explicitly includes "a single purpose agricultural or horticultural structure (as defined in I.R.C. §168(i)(13))" in the list of what constitutes "Section 1245 property."

This explicit inclusion in Section 1245 is what overrides the usual rules for real property (which are generally subject to Section 1250 recapture) and causes the entire gain, up to the amount of depreciation taken, to be treated as ordinary income. Since your farmer's building was fully depreciated, and the sale price is equal to the original cost, the entire gain is considered a recapture of the bonus depreciation and other MACRS depreciation and is therefore ordinary.

Discharge of Indebtedness – Student Loan Debt. For those with discharged student loan debt, IRC Sec. 108(f)(5) was amended by ARPA to exclude the discharged amount from income for discharges occurring in 2021-2025. The relief applies to loans "expressly for the postsecondary educational expenses, private education loans, certain loans made by tax-exempt educational organizations, and loans made by other exempt organizations to refinance loans." OBBBA narrowed the exclusions post-2025 to discharges due to death, total an permanent disability, certain public service or health professional programs, or specific Dept. of Education processes. Post 12/31/25, other discharged student loan debt will be treated as CODI. One estimate is that the effect for a borrower making $50,000 could be an additional $9,178 in federal tax. The income exclusion effect could also trigger a reduction or elimination of the EITC or the CTC.

S Corporation Income. The petitioners, a married couple, were audited for their 2016 tax year concerning unreported income from an S corporation (PCR) of which the husband was a part owner. The IRS claimed that PCR failed to report significant income from three sources, which subsequently flowed through to the petitioners' personal tax return. A client paid $74,382 for PCR services, but the money was directed to pay for a motorhome belonging to the husband's father. There was also $21,008 in cash payments from clients for change orders that were not recorded on the S corporation's books. There were also $59,000 of unsubstantiated bank deposits that the S corporation could not prove were non-income items (like loans or repayments). The Tax Court ruled for the IRS, upholding both the substantial income deficiencies (totaling over $77,000 in unreported S corporation income) and the accuracy-related penalty under I.R.C. §6662(a).The Tax Court rejected the claim that the $74,382 diversion was a loan, finding that since the payment was for services rendered by the S corporation, it was the S corporation's income under the assignment of income doctrine. The Tax court also found that the husband remained an owner of the S corporation for the entire year, despite claiming he had stepped down as an officer, thus the unreported income was properly attributed to him via his Schedule K-1. The Tax Court also rejected all claims regarding the cash and bank deposits because the petitioners failed to provide admissible and credible evidence to prove the funds were not income. *Berry v. Comm'r., T.C. Memo. 2025-109.*

Insurance – Constructive Receipt. Here the Tax Court held that a married couple who took out loans against the cash value of two life insurance policies and then terminated the insurance policies in 2018 constructively received proceeds in the amount of the outstanding loan balances (which were completely satisfied) in addition to receiving a check for the remaining balance of each policy. The Tax Court found that the proceeds the taxpayers actually received (the checks) as well as the proceeds they constructively received (the amounts used to satisfy the outstanding policy loan balances) represented taxable income under I.R.C. §§61(a)(9) and (11) to the taxpayers to the extent the proceeds exceeded the premiums they paid. *Fugler v. Comm'r, T.C. Summary 2025-10.*

Income Reconstruction. The petitioner an attorney and entrepreneur who operated MedCafe Westwood, a single-member LLC restaurant. The IRS examined the 2015 tax year, where Clinco had reported over $1.6 million in gross receipts but claimed a net loss of $400,000. The IRS used bank deposit analysis and 1099-K data (credit card receipts) to find nearly $2.3 million in unreported income. The petitioner admitted during the audit that roughly 10 percent of revenue was cash that never hit the bank. The petitioner claimed depreciation for two rental properties in Pasadena but provided zero documentation (no closing statements or appraisals) to prove his cost basis. The estate's attorney filed a brief containing fictitious case citations (likely generated by AI) to argue that the IRS notice was invalid because it lacked a "wet" signature. The Tax Court disallowed significant depreciation deductions on two Pasadena rental properties because the estate failed to provide basic records (closing statements or appraisals) to establish the cost basis. The Tax Court also reaffirmed that under I.R.C. §6212, a Notice of Deficiency does not require a manual signature to be valid, provided it is issued by an authorized delegate. *Clinco v. Comm'r., T.C. Memo. 2026-16.*

Practice Pointers:

- Digital or delegated signatures on a Notice of Deficiency are valid; manual ink signatures are not a jurisdictional requirement. Practitioners have a duty under Tax Court Rule 33(b) (similar to FRCP 11) to ensure that the legal contentions in their filings are warranted by existing law. The Court explicitly stated that submitting fictitious caselaw is "unacceptable" and a "recipe for sanctions."

Settlement Award. The petitioner received a settlement from with her former employer to resolve a lawsuit concerning allegations of sexual harassment and discrimination. The Tax Court noted the language of the settlement agreement was unambiguous in that the settlement proceeds were intended to compensate for "alleged emotional distress, anxiety and humiliation," but not for "any physical injury relating to her sexual discrimination/retaliation employment claims." Paragraph 11 of the agreement, titled "No Injuries Alleged," clearly disclaimed any allegations of physical harm. The rest of the record supported this disclaimer. The Tax Court held the award was includable in the taxpayer's income. *Fortune-Paladino v. Comm'r., T.C. Memo. 2025-101.*

Settlement Proceeds. The Tax Court held that a $135,000 settlement the petitioner received in connection with a sexual harassment, sex discrimination, and retaliation lawsuit was includible in gross income and not excludable under IRC section 104(a)(2). The Tax Court noted that I.R.C. §61(a) includes in gross income all income from whatever source derived, including settlement proceeds unless a specific exclusion applies. The relevant exclusion, I.R.C. §104(a)(2), applies only to damages received on account of personal physical injuries or physical sickness. The Tax Court also noted the flush language of I.R.C. §104(a), under which emotional distress is not itself treated as a physical injury or physical sickness unless it flows from physical injury. In deciding whether the settlement qualified for exclusion, the Tax Court focused on the nature of the claim that was the actual basis for the settlement, looking primarily to the settlement agreement and the complaint. The agreement expressly stated that the payment compensated alleged emotional distress, anxiety, and humiliation, and specifically disclaimed any physical injury relating to the employment claims. The complaint likewise alleged harassment, discrimination, and retaliation, but did not allege physical injury or physical sickness. Because the taxpayer neither alleged nor proved physical injury or physical sickness arising from the misconduct, the court held that section 104(a)(2) did not apply. *Fortune-Paladino v. Comm'r., T.C. Memo. 2025-101.*

In this case the appellate court affirmed that a $700,000 settlement payment the petitioners received from their landlord was taxable income rather than excludable damages for physical injury under I.R.C. §104(a)(2). The dispute arose when the property owner paid the petitioners to vacate their apartment to satisfy a condition for selling the building to a new buyer. The settlement agreement required the petitioners to move out and release all pending legal claims, but it notably contained no language compensating them for personal physical injuries or sickness. The Tax Court and the appellate court both focused on the "payor's dominant reason" for the payment. They concluded that the landlord's primary intent was to secure the building's sale by ensuring the premises were vacant, not to compensate for physical injuries. Because the petitioners failed to establish a "direct causal link" between the payment and any physical injury, the amount was deemed fully taxable. The appellate court also upheld accuracy-related penalties, confirming that the payment could not be excluded from gross income, as it was effectively compensation for surrendering possession of the property. *Roman v. Comm'r., No. 24-2220, 2026 U.S. App. LEXIS 7962 (9th Cir. Mar. 18, 2026), aff'g., T.C. Memo. 2023-142.*

Social Security Disability Insurance (SSDI). In 2022, the petitioner received $26,802 in SSDI benefits. However, the Social Security Administration later determined he was ineligible because he had been employed during the benefit period. The petitioner was required to repay the full amount, which he began doing in 2023. Consequently, he did not report the benefits on his 2022 tax return. The IRS issued a deficiency, asserting that 85 percent of the benefits ($22,782) were taxable under I.R.C. §86. The Tax Court ruled for theIRS, applying the "claim of right" doctrine. This legal principle holds that if a taxpayer receives earnings under a claim of right and without restriction as to its disposition, the income is taxable in the year received, even if it is later determined that the taxpayer was not entitled to it and must repay it. *Smith v. Commissioner, T.C. Memo. 2026-25.*

Practice Pointer:

- The case reinforces that taxability is determined on an annual accounting basis. While a taxpayer may be entitled to a deduction or credit in the year of repayment (under I.R.C. §1341), the taxpayer is still legally required to include the benefits in his gross income for the year of receipt. This serves as a technical reminder that subsequent repayment does not retroactively "erase" the tax liability of a prior year.

Risk of Forfeiture (Stock for Services). The petitioner received 100,000 shares from her former employer after her employment had terminated - a transfer the company later claimed was an administrative error under their Performance Rights Plan. Under I.R.C. §83(a), the Tax Court held that property transferred "in connection with the performance of services" is taxable when it is either transferable or not subject to a substantial risk of forfeiture. Despite the employer's potential claim for restitution, the Court found no risk of forfeiture under Treas. Reg. § 1.83-3(c) because the rights were not conditioned on future services. The petitioner argued she lacked "dominion and control" (the *Glenshaw Glass* standard). However, the Court ruled that because the shares were in her brokerage account and could be sold, she had sufficient legal control to trigger income. The Tax Court also upheld I.R.C. §6651(a) penalties, rejecting the "complexity of tax law" as reasonable cause for failure to file. *Fiege v. Comm'r., T.C. Memo. 2025-88.*

> **Observation:** Once stock is in a taxpayer's account without explicit vesting hurdles, it is generally taxable compensation, regardless of whether the issuance was a corporate blunder.

Practice Pointer:

- In a start-up business (and on-going entities) it's not unusual for an officer, employee, or outside contractor to receive shares or an interest in the company for services performed.

Entity Issues

"Check-the-Box" Election. This case addressed a sophisticated intersection of entity classification and partnership basis rules. The case centered on a partner who contributed a self-issued, unsecured promissory note to a partnership and subsequently made a retroactive "check-the-box" election under Treas. Reg. § 301.7701-3 to change the partnership's classification for tax purposes. The primary issue was whether the retroactive election could "recharacterize" the nature of the contributed note to generate immediate outside basis under I.R.C. §722. Generally, a partner's own promissory note has a zero basis and does not increase their outside basis until payments are made on the principal. The taxpayer argued that the retroactive change in entity status triggered a deemed liquidation and reformation that should have stepped up the basis of the note. The Tax Court rejected the taxpayer's position, holding that a retroactive entity election cannot override the fundamental principle that a partner has no basis in their own indebtedness. The Tax Court clarified that basis is determined at the time of the contribution event. The Tax Court noted that retroactive elections change the tax treatment of the entity but do not retroactively create a cost basis in a self-issued instrument where none existed. *Continental Grand Limited Partnership v. Comm'r., 166 T.C. No. 3 (2026).*

> **Observation:** This decision shuts the door on using "check-the-box" timing as a loophole to bypass the zero-basis rule for promissory notes, reinforcing that the economic reality of the contribution governs the tax consequences, regardless of retroactive classification shifts.

LLC – Fiduciary Duty. The litigation centered on Wilderness Holdings, LLC, a real estate investment entity. The plaintiff (acting as Trustee) brought a derivative suit against fellow members claiming that those fellow members, acting both individually and through their respective trusts, breached their fiduciary duties of loyalty and care by self-dealing and mismanaging LLC assets to the detriment of the plaintiff's interest. The trial court ruled for the plaintiff, determining that the defendants had prioritized their personal financial interests over the health of the LLC. On appeal, the appellate court affirmed. The appellate court reiterated that members in a member-managed LLC owe one another the "utmost good faith." The evidence suggested that the defendants engaged in transactions that benefited their separate entities at the expense of Wilderness Holdings. The defendants argued their actions were protected business decisions. However, the appellate court clarified that the Business Judgment Rule does not shield members from liability when there is evidence of self-dealing or a conflict of interest. Once a conflict is shown, the burden shifts to the defendants to prove the "entire fairness" of the transaction. The appellate court upheld plaintiff's right to sue derivatively on behalf of the LLC, noting that the demand requirements were either met or would have been futile given the control that the defendants exerted. *Hornbaker v. Brown, No. 128,392, 2026 Kan. App. Unpub. LEXIS 151 (Kan. Ct. App. Mar. 13, 2026).*

Practice Pointer:

- The case underscores the danger of informal management styles in multi-member entities. When members act in dual capacities - as trustees of their own estates and as managers of a joint venture - the lines of loyalty can easily blur. The court's refusal to disturb the trial court's findings emphasizes that once the trial court judge makes a credibility determination regarding "bad faith," it is nearly impossible to overturn on appeal. In Kansas, if you are diverting a business opportunity away from your LLC, disclosure and consent are not optional, they are jurisdictional prerequisites to avoiding liability.

S-Corporation and Estimated Tax Penalties. Why does the IRS not consider shareholders in a Sub-S corporation to be farmers for the purpose of avoidance of estimated tax penalties? For example, what about the farmer with an S-corporation with approximately $100,000,000 in grain sales annually, which comprises more than 90 percent of his total gross income. He files and pays the due tax on or before March 1, yet IRS claims he is not exempt from the penalty for underestimated tax.

This is a common and frustrating point of contention in ag tax practice. While it seems logically inconsistent, the IRS distinction boils down to the difference between a pass-through of income and the conduct of the activity itself. Under I.R.C. §6654(i), a "qualified farmer" is an individual whose gross income from farming is at least two-thirds of their total gross income. The "mystery" usually stems from how the IRS interprets "gross income from farming" when that income originates from an S corporation. IRS position, supported by Rev. Rul. 87-121, is that while a shareholder's pro rata share of an S corporation's gross income can retain its character as farming income for certain purposes, it does not automatically make the shareholder a "farmer."

There is a partnership parallel. Under Treas. Reg. §1.702-1(c)(1)(iv), partners in a farming partnership do include their distributive share of gross farming income for estimated tax purposes. But there's an S corp. gap. For S corporations, the IRS historically argued that since the corporation is a separate legal entity, the shareholder is providing services to the corporation (as an employee/officer) rather than "operating or managing" the farm directly.

Even if the IRS accepts that the character of the income passes through (which Treas. Reg. §1.1366-1(c)(1) generally supports for I.R.C. §6654(i)), the rejection often triggers because of how "gross income" is calculated on the 1040:

Wages vs. Distributions: If the taxpayer draws a salary (W-2) from the S corporation, those wages are not farming income; they are compensation for services. In a $1M grain sale operation, if the non-farm income (wages, interest, spouse's income) exceeds one-third of the total gross income, the status is lost.

Gross vs. Net: For the two-thirds test, the IRS looks at gross income, not net profit. For an S corp shareholder, "gross income" is their pro rata share of the corporation's gross receipts—not the bottom-line K-1 income. If the IRS is looking only at the K-1 (net) vs. other gross income (like W-2s or dividends), the ratio might be failing their automated filters.

Form 2210-F: If the return is filed by March 1, the taxpayer must still affirmatively "claim" the status. If the IRS is rejecting the explanation, it may be because they are failing to look through the K-1 to the underlying Schedule K, which identifies the activity as farming.

The primary authority the IRS relies on to narrow the definition of a "farmer" is the requirement that the individual be "personally involved" in the risks of farming. While an S- corporation shareholder has a beneficial interest, the IRS sometimes treats the corporation as the "farmer" and the individual as merely a "shareholder." Also, Form 2210-F should be checked to ensure that the "Gross Income from Farming" line includes the pro rata share of the S corporation's gross receipts (from the 1120-S, Line 1c), not just the net income from the K-Often, the IRS computer flags the return because the "Farm Income" on the 1040 (which usually looks at Schedule F) is $0, while the $100,000,000 in sales is "hidden" inside the S corp.

Basis – Partnership Interest. Here, the U.S. Tax Court addressed whether a German parent company (FC) could claim basis in a promissory note it issued to its wholly owned disregarded subsidiary (FS), which was then contributed to a partnership in exchange for a partnership interest. After FS elected to be disregarded as an entity separate from FC, the Tax Court held that, for federal tax purposes, the issuance of the note by FC to FS was disregarded, and the contribution of the note to the partnership was treated as if FC had contributed its own note directly to the partnership. Under I.R.C. §§722 and 723, the Tax Court determined that the basis of a partner's interest in a partnership, and the partnership's basis in contributed property, is generally the adjusted basis of the property in the hands of the contributing partner. Since FC did not pay anything to create its own note, the adjusted basis in the note was zero. Therefore, both FC's basis in its partnership interest and the partnership's basis in the note were zero. The Tax Court rejected arguments that the note's fair market value or the amount of the obligation should be considered basis, emphasizing that a maker's own note does not create basis under the Code. *Continental Grand Limited Partnership v. Comm'r., 166 T.C. No. 3 (2026).*

> **Note:** When a partner contributes its own promissory note to a partnership - whether directly or, as in this case, through a disregarded entity - the partner takes a zero basis in the partnership interest, and the partnership takes a zero basis in the note. This result is driven by the principle that a taxpayer does not have basis in its own obligation, because there is no cost incurred to create a liability to oneself. The Tax Court reaffirmed that the check-the-box regulations (Treas. Reg. §§301.7701-1, -2, and -3) require disregarding transactions between a disregarded entity and its owner for federal tax purposes, so the contribution of a note by a disregarded entity is treated as a contribution by the owner of its own note. The Tax Court rejected arguments that the fair market value of the note or the amount of the obligation should be used as basis, distinguishing cases involving contributions to corporations (such as *Lessinger v. United States, 872 F.2d 519 (2d Cir. 1989), rev'g, 85 T.C. 824 (1985),* and *Peracchi v. Comm'r, 143 F.3d 487 (9th Cir. 1998), rev'g, T.C. Memo. 1996-191)* and emphasizing that those cases do not apply to partnership contributions. The Tax Court also noted that the

substance-over-form doctrine does not override the clear statutory and regulatory rules in this context

Basis – S Corporation. Assume that a taxpayer has zero basis in an S Corp. Then for 2025 has a $200,000 operating loss, but $80,000 in rental income from same S Corp. The question is whether the taxpayer can write off the operating loss to the extent of the rental income? And, if so, how it would be entered into the software to get it to work. To answer the question it is necessary to analyze the S corporation shareholder basis limitation rules, the ordering of basis adjustments, and how losses and income from different activities (ordinary business vs. rental) interact for basis purposes and on Form 7203. There are four main limitations (applied in the following order) on a shareholder's ability to deduct S corporation losses: 1) stock and debt basis limitation (IRC §1366(d)) - losses and deductions passed through to a shareholder are only deductible to the extent of the shareholder's basis in S corporation stock and direct loans to the S corporation; 2) at-risk limitation (IRC §465) - losses are limited to the amount the shareholder is at risk; 3) passive activity loss limitation (IRC §469): losses from passive activities are limited to passive income; and 4) excess business loss limitation (IRC §461(l)) - noncorporate taxpayers may be subject to an additional limitation on business losses.

Under the stock basis and ordering rules, stock basis is increased by all income items (including rental income) and decreased by distributions, nondeductible expenses, and losses/deductions, in that order. If a shareholder has $0 basis at the start of the year, any income allocated to them during the year (such as $80,000 of rental income) increases their basis dollar-for-dollar. Losses and deductions are only deductible to the extent of the shareholder's basis at the end of the year, after all increases and decreases are applied.

As applied to the specific question, at the start of 2025, the shareholder had zero basis. During 2025, the S corporation allocated $80,000 of rental income and $200,000 of ordinary business loss to the shareholder. Thus, basis would be increased by the $80,000 of rental income and then decreased $200,000 by the ordinary business loss resulting in a $120,000 suspended loss due to lack of basis. The suspended amount is carried forward indefinitely. Note that, for basis purposes, it doesn't matter that the income is from a rental activity and the loss is from ordinary business activity. All income increases basis, and all losses reduce basis, regardless of activity type, unless there are separate classes of stock or other special circumstances.

Form 7203 is used to track stock and debt basis and to determine the allowable loss.

Enter $0 as beginning stock basis.

Enter $80,000 as income (line 3b for rental real estate income).

Enter $200,000 as loss (line 35 for ordinary business loss).
The form will calculate that only $80,000 of the loss is allowable (up to the basis created by the rental income), and $120,000 is suspended.

If the software allows you to allocate losses by activity:

Enter the $80,000 rental income in the rental activity section.

Enter the $200,000 ordinary loss in the business activity section.
The software should automatically apply the basis limitation across all losses, regardless of activity, unless you have separate blocks of stock or other special circumstances.

If you want to show the suspended loss by activity:

The allowable loss ($80,000) should be pro-rated between the activities if you have both current year and prior year suspended losses from multiple activities. However, if all the loss is from the business activity and all the income is from rental, the entire $80,000 allowable loss will be from the business activity, and the $120,000 suspended loss will also be from the business activity.

There is no need to enter a portion of the loss on the rental 7203. Form 7203 is not activity-specific for basis purposes. It is a single calculation for all S corporation activities unless you have separate blocks of stock.

If the shareholder does not materially participate in the business, the $200,000 loss may also be limited by the passive activity loss rules, and the $80,000 rental income may or may not be passive income depending on the shareholder's participation and the nature of the rental activity. Also, if the shareholder is not at risk for the full amount of basis, the allowable loss may be further limited.

CPA Certification of USDA Forms. Tax practitioners frequently receive inquiries regarding the propriety of signing specific United States Department of Agriculture (USDA) and Farm Service Agency (FSA) compliance documents. These typically include Form CCC 942 (Certification of Average Adjusted Gross Income) and Form FSA-510 (Request for an Exception to the AGI Limitation). The genesis of current protocols dates back to 2012, when the USDA issued over 15,000 compliance reviews. These reviews required producers to either submit three years of federal tax returns or provide a formal "certification" from a Certified Public Accountant (CPA) verifying that the producer's Adjusted Gross Income (AGI) remained below statutory thresholds. Directly signing government forms can create significant professional liability and ethical conflicts for practitioners. In 2012, the American Institute of Certified Public Accountants (AICPA) collaborated with the FSA to establish standardized "agreed-upon procedures" and sample attestation letters. These templates were designed to satisfy FSA regulatory requirements while ensuring the practitioner remains in compliance with AICPA Statements on Standards for Attestation Engagements (SSAE).

Key applications of these standardized letters include:

Segmented AGI Calculations: Used in instances where a producer exceeds the AGI limitation solely due to a Married Filing Jointly (MFJ) election. The CPA may certify that the individual's AGI would have fallen below the threshold had they filed Married Filing Separately (MFS). Under current regulations, a retroactive filing change is not required; the CPA simply performs a pro forma calculation.

The 75% Farm Income Exception: For programs offering enhanced payment limits to producers whose farm-related AGI exceeds 75% of total AGI, a specific supplemental sample letter is utilized to verify these ratios without necessitating a direct signature on agency-prescribed forms.

Practitioners should resist pressure from local FSA offices to execute internal agency forms. A CPA's professional obligations are better met through the issuance of a formal letter on firm letterhead, following the AICPA-approved templates.

If a local office insists on a signature on the form itself, practitioners should refer agency personnel to the FSA Handbook 6-PL (or subsequent program-specific handbooks). These internal USDA guidelines explicitly recognize the validity of third-party CPA certifications in lieu of a signature on the form, provided the certification adheres to the established professional standards.

Tax Court Procedure

Retroactive Validation of Petition. The U.S. Tax Court addressed whether a corporation's subsequent reinstatement of its state-suspended corporate status could retroactively validate a petition filed during the period of suspension. The petitioner, a California corporation, faced IRS collection actions for unpaid unemployment taxes and penalties. After the IRS issued a Notice of Determination sustaining a federal tax lien, the corporation filed a timely petition for a Collection Due Process (CDP) hearing. However, at the time of filing, the corporation's powers and privileges were suspended by the California Franchise Tax Board due to unpaid state taxes. Although the corporation obtained a Certificate of Revivor months later, this occurred well after the 30-day statutory period for filing a Tax Court petition had expired. The Tax Court granted the Commissioner's motion to dismiss for lack of jurisdiction. The Court held that the petitioner lacked the legal capacity to initiate proceedings under Tax Court Rule 60(c) at the time of filing. Furthermore, because California law did not provide for retroactive validation that would prejudice the Commissioner's accrued statute of limitations defense, the later revival could not cure the defect. The Court also rejected the taxpayer's claim for equitable tolling. *Arbor Vita Corporation d.b.a. Hemediagnostics v. Comm'r., 166 T.C. No. 5 (2026).*

> **Observation:** Legal capacity to sue must exist at the exact moment the petition is filed. A "cure" or reinstatement of corporate status after the fact will not save a petition that was defective at the time of submission if the statutory filing deadline has passed.

Practice Pointers:

- Ensure a business entity is in "good standing" with the relevant state authorities before initiating any formal legal or tax proceedings. A suspension for unpaid state taxes can act as a jurisdictional "poison pill" that nullifies the ability to challenge IRS actions.

- Do not assume that the doctrine of "relation back" (where a late action is treated as if it happened earlier) applies to corporate capacity in the Tax Court. The Court distinguishes between a mere defect in procedure and a total lack of legal capacity to initiate a suit.

- The Tax Court is a court of limited jurisdiction. Statutory deadlines for petitions are strictly construed, and the Court is generally unwilling to apply equitable doctrines (like equitable tolling) to extend these deadlines based on a taxpayer's own failure to maintain their corporate status.

Tax Issues for Retiring Farmers

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Why Farm Retirement Planning Is Uniquely Tax-Sensitive

A farmer's retirement "nest egg" is rarely a single asset that can be sold and taxed at one favorable rate. Instead, a farm exit usually involves multiple categories of property - land, machinery, equipment, buildings, grain or other inventory, livestock, and sometimes a farmhouse or entity interests.[1] Each category can produce a different tax result. That is the central reason farm retirement planning is so technical: the client sees one farm, but the Internal Revenue Code sees many separate assets with different character, basis, and timing rules.[2]

The practical danger is that a farmer may assume the retirement event will generate mostly capital gain, when in fact a substantial portion of the proceeds may be taxed as ordinary income, may trigger self-employment tax, or may reflect built-in gain that could have been reduced or eliminated through better basis planning. In addition, charitable planning and newer tax-payment timing rules may help in some cases, but only if they are coordinated with the underlying asset mix.

The recurring mismatch between economic value and after-tax value. Farmers often measure retirement readiness by land value, machinery value, and debt reduction. Tax law measures retirement proceeds differently. A tractor that has been fully depreciated may still have significant resale value, but most or all of that value may be taxed as ordinary income under I.R.C. §1245. Land may have appreciated dramatically over decades, but whether that appreciation is taxed currently, deferred, offset, or eliminated depends heavily on basis, transfer method, and transaction structure. A lease that appears to be passive retirement income may still be subject to self-employment tax if the retired farmer remains materially involved.

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[1] I.R.C. §1231(b). This section defines "property used in the trade or business," which forms the basis for the multi-category tax treatment of a farm exit. Categories include depreciable property and real property used in the business and held for more than one year, such as land and buildings. Specific holding periods apply to mammals: cattle and horses must be held for 24 months or more, while other livestock (excluding poultry) must be held for 12 months or more to qualify for I.R.C. §1231 treatment. Harvested crops and grain inventory are excluded from I.R.C. §1231 and are generally treated as noncapital assets producing ordinary income.

[2] I.R.C. §1060; Treas. Reg. §1.1060-1. The "residual method" is mandatory for the sale of a group of assets constituting a trade or business if the buyer's basis is determined solely by the amount paid for the assets. Taxpayers must allocate the lump-sum purchase price among seven distinct classes: Class I (cash), Class II (actively traded personal property), Class III (accounts receivable), Class IV (inventory), Class V (tangible business assets like land and equipment), Class VI (Section 197 intangibles), and Class VII (goodwill and going concern value). This allocation determines the character and timing of the seller's gain and the buyer's future depreciation schedule.

Major Threats to the Retirement Nest Egg

The principal technical threats are:

- Depreciation recapture on machinery and equipment, especially where I.R.C. §179 and bonus depreciation have driven basis close to zero.
- Self-employment tax exposure from crop-share or similar arrangements where the retired farmer materially participates.
- Poor basis planning, especially lifetime gifting of highly appreciated land that otherwise might have received a basis adjustment at death.
- Charitable planning mismatches, where the chosen technique does not align with the client's income, deduction, or family-control objectives.
- Liquidity strain on land sales, even where newer rules may permit payment of tax over four years for certain qualifying farmland sales.

Depreciation Recapture on Machinery and Equipment: The Ordinary-Income Trap

One of the most significant threats to a farmer's retirement proceeds is the conversion of expected gain into ordinary income through depreciation recapture.[3] This is often the first major surprise in a farm sale.

Why section 1245 matters so much in farming. Farm machinery and equipment are classic I.R.C. §1245 property. When I.R.C. §1245 property is sold, gain is treated as ordinary income to the extent of prior depreciation deductions. That includes depreciation claimed through regular MACRS, I.R.C. §179 expensing, and bonus depreciation. In other words, accelerated deductions taken during the operating years often reappear as ordinary income when the farmer retires and sells the assets.

> **Observation:** This is especially important in farming because many operators have used aggressive cost recovery over time. Tractors, combines, planters, irrigation systems, and similar assets may have little or no adjusted basis by the time they are sold. If those assets still command meaningful resale prices, the resulting gain may be almost entirely ordinary income.

Why accelerated deductions can become a retirement problem. During the operating years, I.R.C. §179 and bonus depreciation improve cash flow by accelerating deductions. That is often entirely appropriate. But those deductions do not make gain disappear permanently. Instead, they frequently create a future recapture problem. A farmer may think, "I already wrote that machinery off years ago, so the sale should not be a big tax issue." In reality, that prior write-off is exactly why the sale may produce ordinary income.

Example: Sale of fully depreciated machinery

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[3] See I.R.C. §1245(a)(1)–(3) (requiring ordinary income recapture on disposition of section 1245 property, generally up to prior depreciation or amortization allowed or allowable); I.R.C. §1250(a), (c) (providing ordinary income recapture rules for certain depreciable real property and defining I.R.C. §1250 property); see also I.R.C. §1245(a)(2)(C) (treating I.R.C. §179 deductions as amortization for recapture purposes). In a farm sale, this issue commonly arises with machinery, equipment, certain farm structures, and other depreciable assets, so gain that a seller may expect to receive capital gain treatment can instead be recharacterized, in whole or in part, as ordinary income.

Ben E. Volent purchased a combine for $500,000 and deducted the full amount through I.R.C. §179 and bonus depreciation. Ten years later, the combine is sold for $180,000.

Adjusted basis: $0

Amount realized: $180,000

Gain: $180,000

Because the prior depreciation deductions reduced basis to zero, the entire $180,000 gain is generally recaptured as ordinary income under I.R.C. §1245. It is not taxed at favorable capital gain rates.[4]

> **Observation:** This result often surprises clients because economically they view the combine as a capital asset used in the business. But for tax purposes, prior depreciation controls the character of the gain.

Asset-by-asset analysis is essential. In a whole-farm sale, recapture is not determined by looking at the transaction as a whole. It must be computed asset by asset. Thus, a practitioner must identify the full array of a farm client's assets. This can include the following:

- Machinery and equipment,
- Single-purpose agricultural structures,
- Depreciable real property,
- Land,
- Inventory,
- Livestock, and any personal-use or mixed-use assets.

> **Observation:** A single purchase agreement with one total price is not enough. The allocation of price among assets directly determines how much of the sale proceeds become ordinary income versus section 1231 gain.

Interaction with installment-sale planning. Another common misunderstanding is that deferred payments automatically defer all tax consequences. That is not true. Depreciation recapture generally is not deferred under the installment method in the same way as other gain. Thus, a farmer may receive sale proceeds over time but still owe current tax on recapture in the year of sale.[5]

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[4] However, "ordinary income" for I.R.C. §1245 purposes is not the same thing as self-employment income under I.R.C. §1402. I.R.C. §1402 separately excludes gain from the sale of business property of this kind from net earnings from self-employment. In other words, the gain can be ordinary for income tax character purposes and still not be subject to SE tax. The gain would generally be reported on Form 4797, with the recapture computed in Part III and carried to Part II as ordinary gain. IRS instructions state that depreciable tangible trade or business property sold at a gain is first reported in Part III if held more than one year.

[5] See I.R.C. §453(i)(1)(A)–(B) (providing that, notwithstanding the installment method, any recapture income must be recognized in the year of disposition, and only gain in excess of recapture income may be reported under the installment method); IRC §453(i)(2) (defining recapture income by reference to the ordinary income that would arise under §§1245 or 1250 if all payments were received in the year of sale); see also IRS Pub. 537 (2025), Installment Sales (explaining that depreciation recapture income must be reported in full in the year of sale even if no installment payment is received that year, and only the excess gain may be deferred under the installment method). In a farm sale,

Practitioner Note: When advising on retirement sales, practitioners should quantify I.R.C. §1245 recapture before discussing "capital gain" expectations. Otherwise, the client may make retirement decisions based on an unrealistically favorable tax assumption.

Self-Employment Tax and Rental Arrangements

Many farmers do not retire by selling everything. Instead, they stop operating directly and lease the land to a child, neighbor, or unrelated operator. That transition can be tax-efficient - but only if structured carefully.

General rule: rents are usually excluded. As a general matter, rentals from real estate are excluded from net earnings from self-employment.[6] That makes rental arrangements attractive for retirement planning.

The farm exception: crop-share plus material participation. Farming has a critical exception. If income is derived under an arrangement where another person produces agricultural commodities on the land and the owner materially participates in production or management of production, the rental exclusion may not apply.[7] In that case, the income may still be subject to self-employment tax.

> **Observation:** This is where many retired farmers get into trouble. They believe they have become landlords, but their continued involvement may be enough to keep the income within the self-employment tax base.

Why crop-share arrangements are risky in retirement. A fixed cash-rent lease is generally the cleaner structure if the goal is to avoid self-employment tax and truly step back from operations. A crop-share arrangement is more likely to create self-employment tax exposure, especially if the retired farmer continues to:

- Approve cropping decisions,
- Participate in fertilizer or seed decisions,
- Direct marketing strategy,
- Supervise conservation practices,
- Negotiate input purchases, or
- Otherwise remain involved in management.

Example: Cash rent versus crop share

Suzanne retires and leases 500 acres to a neighboring operator.

Scenario 1: Fixed cash rent

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this means that gain attributable to prior depreciation on machinery, equipment, and certain other depreciable assets may trigger current ordinary income tax even though the purchase price is paid over time.

[6] I.R.C. §1402(a)(1).

[7] I.R.C. §1402(a)(1)(a).

Suzanne receives $175,000 annually under a fixed cash-rent lease and has no meaningful role in production decisions. The rental income is not subject to self-employment tax as being within the exception for "rents from real estate and personal property leased with real estate."[8]

Scenario 2: Crop share with management involvement

Suzanne receives one-third of the crop and continues to advise on planting, chemical applications, and grain marketing. In that case, the arrangement would fall within the farm exception to the rental real estate exception, and the income may be subject to self-employment tax.[9]

> **Note:** The economic difference between the two arrangements may not seem dramatic to the client, but the employment-tax consequences can be materially different.

Entity overlay. Entity structure can complicate the analysis. S corporation income generally is not self-employment income, although shareholder-employees must receive reasonable compensation subject to employment tax.[10] Partnership and LLC structures can produce different results, especially where the retired farmer remains active.[11] Accordingly, retirement planning should not stop with the lease terms; it must also consider the client's continuing role through any entity.

Strategic Use of Charitable Remainder Trusts

Charitable remainder trusts often arise in farm retirement planning because they appear to offer a combination of tax deferral, lifetime income, and charitable benefit.[12] In the right case, they can be very effective. But they are not a universal solution.

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[8] I.R.C. §1402(a)(1).

[9] I.R.C. §1402(a)(1)(a). The rental income would be reported on Form 4835.

[10] Rev. Rul. 74-44, 1974-1 C.B. 287. Although S corporation dividends are generally not considered "net earnings from self-employment" under I.R.C. § 1402, the IRS maintains the authority to recharacterize distributions as wages subject to FICA tax if the shareholder-employee fails to take reasonable compensation for services performed.

[11] I.R.C. § 1402(a)(13); see also Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. 137 (2011). The exclusion for limited partners does not apply to partners or LLC members who provide substantial services or otherwise participate materially in the farming operation. Soroban Capital Partners L.P. v. Comm'r., T.C. Memo. 2025-52 (applying the "functional analysis" test announced in 161 T.C. 310 (2023); *but see* Sirius Solutions, L.L.L.P. v. Comm'r., 165 F.4th 374 (5th Cir. 2026)(rejecting the Tax Court's "functional analysis" test for a state law defined limited partner interest test).

[12] See I.R.C. § 664(d)(1)–(2) (defining charitable remainder annuity trusts and charitable remainder unitrusts as split-interest trusts that pay a specified annuity or unitrust amount to one or more noncharitable beneficiaries for life or a term of years, with the remainder passing to charity, and requiring, among other things, a payout of at least 5 percent and a charitable remainder value of at least 10 percent); I.R.C. § 664(c)(1) (generally exempting a qualifying charitable remainder trust from income tax at the trust level); Treas. Reg. § 1.664-1(a)(1)(i) (describing a charitable remainder trust as an irrevocable trust that provides annual payments to one or more beneficiaries and an irrevocable remainder interest for charity); see also I.R.C. § 664(b); Treas. Reg. § 1.664-1(d)(1) (providing the tier system under which distributions to noncharitable beneficiaries carry out ordinary income first, then capital gain, then other income, and finally corpus). These features can make a charitable remainder trust attractive in farm retirement planning, particularly where appreciated assets are involved and the seller wants an income stream plus a charitable remainder. But the structure is highly technical, irrevocable, subject to strict qualification rules, and distributions to the noncharitable beneficiary remain taxable under the statutory ordering rules, so it is not a one-size-fits-all planning device.

Why CRTs are attractive in the farm context. Farmers often hold highly appreciated land with low basis. They may want to diversify, create an income stream, and satisfy charitable goals without triggering immediate full recognition of gain from an outright sale. A CRT can be appealing in that setting.

The best CRT asset is usually appreciated land, not machinery. The most natural CRT candidate in a farm retirement plan is appreciated land. Land often has substantial built-in gain but more favorable character economics than machinery. Machinery and equipment frequently carry heavy I.R.C. §1245 recapture, which makes them less attractive assets for CRT planning.

Example: Land versus machinery as CRT funding assets

Assume that Bill owns the following assets:

- Farmland worth $2,000,000 with basis of $300,000, and
- Machinery worth $400,000 with basis of $0.

If Bill is considering charitable planning, the land is generally the more logical CRT asset because it is the appreciated asset most likely to fit the intended planning objective. The machinery, by contrast, carries a large ordinary-income recapture component that can undermine the expected tax efficiency of the structure.

Timing matters. CRTs generally must be implemented before the sale is effectively locked in. If the farmer has already negotiated and committed to the sale and then tries to contribute the property to a CRT at the last minute, assignment-of-income concerns may arise.[13] Debt on the property can also complicate the planning.

CRTs must be compared with other charitable alternatives. A CRT should not be discussed in isolation. It should be compared with:

- An outright gift of appreciated land,
- A bargain sale,
- A qualified conservation contribution,
- A testamentary charitable transfer, and
- A taxable sale followed by charitable giving.

Each technique solves a different problem. A CRT may provide an income stream. An outright gift may maximize charitable transfer value. A conservation easement may preserve family ownership while generating a deduction. The right answer depends on whether the client's primary objective is income, deduction, family retention, estate reduction, or some combination.[14]

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[13] *See, e.g.,* Palmer v. Commissioner, 62 T.C. 684 (1974), *aff'd on other grounds*, 523 F.2d 1308 (8th Cir. 1975); see also Rev. Rul. 78-197, 1978-1 C.B. 204. To avoid the assignment of income doctrine, the farmer must ensure that the property is contributed to the CRT *before* a binding legal obligation to sell the property exists.

[14] See I.R.C. §170(a), (c), (f)(2)(A) (allowing charitable contribution deductions, defining qualified charitable donees, and generally denying a deduction for a remainder interest transferred in trust unless the trust is a charitable remainder annuity trust, charitable remainder unitrust, or pooled income fund); I.R.C. § 170(f)(3)(A)–(B) (generally denying deductions for partial-interest gifts, but excepting, among other items, a remainder interest in a personal residence or farm, an undivided portion of the donor's entire interest, and a qualified conservation contribution); I.R.C. §170(h)(1)–(5) (defining a qualified conservation contribution as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes, generally protected in perpetuity). A CRT is only one charitable

Basis Planning: The Hidden Driver of Retirement Outcomes

Basis is often the most important variable in determining how much of the farm's value the family actually keeps. Two farms with similar fair market values can produce very different after-tax outcomes because of basis differences.

Why basis matters so much. Gain is measured against adjusted basis. In farming, basis profiles are often uneven. For example,

- Land may have very low historic basis,
- Machinery may be fully depreciated,
- Raised livestock may have little or no basis,
- Buildings may have partial remaining basis, and
- Entity interests may have complicated inside/outside basis differences.

Because of this, retirement planning that ignores basis is incomplete.[15]

Lifetime gifts versus transfers at death. One of the most important succession questions is whether appreciated property should be transferred during life or held until death.

Lifetime gifts. Lifetime gifts can shift future appreciation out of the transferor's estate and may help move the farm to the next generation gradually. But gifted property generally carries over basis. That means the built-in gain remains embedded in the property.[16]

Transfers at death. Property acquired from a decedent generally receives a basis adjustment under I.R.C. §1014, typically to fair market value at death. For highly appreciated farmland, that basis adjustment can eliminate a large amount of built-in gain.

Example: Gift during life versus retention until death

Mitch owns land worth $3,000,000 with basis of $400,000. If he gifts the land during life the donee generally takes the $400,000 carryover basis. If the donee later sells for $3,000,000, there is generally $2,600,000 of built-in gain.

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planning technique among several. An outright gift of appreciated land may maximize the charitable transfer and avoid a sale altogether; a bargain sale can combine donative intent with partial liquidity; a qualified conservation contribution can preserve family ownership while generating a deduction; a testamentary charitable transfer may better fit clients who do not need lifetime income; and a taxable sale followed by charitable giving may be preferable where flexibility or basis planning matters more than split-interest trust structure. Because each technique addresses different objectives and constraints, the choice should turn on the client's priorities regarding income stream, current deduction, retention of land, estate tax reduction, and charitable intent.

[15] In a farm sale, gain or loss is determined asset by asset by comparing amount realized with adjusted basis, so similarly valued farms can produce materially different tax results depending on their basis composition. That is especially true because farm basis is often highly uneven: land may carry very low historic basis; machinery may have basis reduced to zero by depreciation, I.R.C. §179, or bonus depreciation; raised livestock often has little or no basis if raising costs were deducted; buildings may retain only partial basis after depreciation; and partnership or corporate structures can create differences between asset-level basis and owner-level basis. Because taxable gain is measured against adjusted basis, retirement planning that does not analyze basis is incomplete.

[16] I.R.C. § 1015(a) (providing that property acquired by gift generally takes the donor's basis, except that if the donor's adjusted basis exceeds fair market value at the time of the gift, fair market value is used for purposes of determining loss); see also I.R.C. § 1015(d); Treas. Reg. § 1.1015-1(a).

If Mitch holds the land until death, the heirs generally receive a basis adjustment to fair market value. If the value at death is $3,000,000, the heirs' basis is generally stepped up to $3,000,000. A prompt sale at that value may produce little or no gain.

> **Observation:** For many farm families not exposed to federal estate tax, this difference can be economically enormous.

Trust Design and Basis Consequences

Revocable trusts often preserve estate inclusion and therefore may preserve basis adjustment at death, while also avoiding probate.[17] Irrevocable trusts may remove assets from the estate, but that can come at the cost of losing a later basis step-up. In farm planning, that tradeoff must be modeled carefully rather than assumed.[18]

Entity Basis Issues

Where the farm is operated through a partnership, LLC, or corporation, basis analysis becomes more complicated.[19] Selling entity interests is not the same as selling underlying assets. Partnership basis, I.R.C. §754 elections, corporate-level tax concerns, and valuation issues can materially affect retirement planning. Thus, where a farm is operated through a partnership or LLC taxed as a partnership, retirement planning must distinguish between an interest sale and an asset sale, account for outside basis versus inside basis differences, and evaluate whether a §754 election or mandatory §743 adjustment changes the economics for the buyer and seller.

If the farm is operated through a corporation, the analysis differs again because a stock sale is generally distinct from an asset sale, and basis must be determined at the shareholder level rather than by reference to the corporation's underlying assets. Valuation also matters because the tax consequences of selling entity interests can diverge materially from the consequences of selling the farm's assets directly

New Charitable Deduction Rules - Changed Economics for Retirement-Year Giving

Charitable planning remains important in farm retirement, but the deduction landscape has changed.

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[17] See I.R.C. § 1014(a)(1), (b)(2), (3), and (9) (providing that property acquired from a decedent generally takes a date-of-death basis and treating certain revocable or amendable trust property, and more broadly property included in the decedent's gross estate, as property acquired from the decedent)

[18] If assets are transferred to an irrevocable trust in a completed gift and are not includible in the grantor's gross estate at death, I.R.C. §1014 does not apply merely because the trust was treated as a grantor trust for income tax purposes during life; under Rev. Rul. 2023-2, those assets do not receive a basis adjustment at death and instead retain their pre-death basis.

[19] See I.R.C. § 754 (permitting a partnership to elect basis adjustments under §§734 and 743 with respect to distributions and transfers of partnership interests); I.R.C. § 743(a)–(d) (providing that, on a sale, exchange, or death transfer of a partnership interest, partnership asset basis generally is not adjusted unless a §754 election is in effect or the partnership has a substantial built-in loss, and prescribing partner-specific inside basis adjustments when applicable); see also IRS Pub. 541 (Dec. 2025) (explaining that the sale or exchange of a partnership interest usually produces capital gain or loss measured by amount realized over the partner's adjusted outside basis, while the partnership's inside basis generally is unaffected absent an optional basis adjustment election).

Individual Deduction Floor

For taxable years beginning after December 31, 2025, individuals are subject to a new 0.5% floor on charitable contribution deductions.[20] That means only contributions exceeding 0.5% of AGI are deductible, subject to carryforward rules.

Nonitemizer deduction. The above-the-line charitable deduction for nonitemizers is made permanent and increased to $1,000 ($2,000 for joint filers).[21]

Corporate floor. For taxable years beginning after December 31, 2025, corporations are subject to a 1% floor on charitable deductions, subject to the existing cap and carryforward framework.[22]

> **Observation:** Farmers often consider making large charitable gifts in the same year as a major sale. The assumption is that the charitable deduction will offset a significant portion of sale-year income. That may still be true in part, but the new floor changes the economics and should be incorporated into planning.

Example: **Sale-year charitable gift**

Seth retired from farming. Assume he has AGI of $2,000,000 in 2026 after selling farmland and makes a $300,000 cash gift to a public charity. Under the post-2025 rules, an individual's charitable deduction is allowed only to the extent total charitable contributions exceed 0.5% of contribution base (generally AGI). Seth's 0.5% floor is $2,000,000 × 0.5% = $10,000. So even though Seth gives $300,000, only the excess over $10,000 ($290,000) is potentially deductible.

Thus, Seth may expect a $300,000 deduction, but the immediate allowable deduction is only $290,000, before considering any other applicable percentage limitations. If Seth instead gave $8,000, none of it would be deductible because the gift would not exceed the $10,000 floor. If he gave $15,000, only $5,000 would be deductible.[23]

> **Observation:** The deduction may still be valuable, but the new floor means the full amount may not produce immediate deduction value in the way that Seth expects. That makes it even more important to compare outright gifts, CRTs, conservation contributions, and testamentary charitable transfers.

Conservation contributions remain important. Qualified conservation contributions can still be especially relevant for farmers and ranchers.[24] In the right case, they can preserve land use,

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[20] I.R.C. §170(a)(4), as amended. This floor applies to the aggregate of all charitable contributions made during the taxable year, effectively limiting the deduction to the amount that exceeds 0.5% of the taxpayer's adjusted gross income.

[21] I.R.C. §62(a)(22). This provision allows taxpayers who do not elect to itemize deductions to claim a limited deduction from gross income for qualifying cash contributions.

[22] I.R.C. §170(b)(2)(A), as amended. This 1% corporate floor operates independently of the existing 10% or 25% taxable income limitations for corporate charitable contributions.

[23] See I.R.C. § 170(b)(1)(I) (providing that an individual's charitable contribution deduction is allowed only to the extent aggregate contributions exceed 0.5 percent of the taxpayer's contribution base, and prescribing the ordering rule for applying the floor); see also I.R.C. § 170(b)(1)(H) (defining contribution base as adjusted gross income computed without regard to any net operating loss carryback).

[24] See I.R.C. § 170(h)(1)–(5) (qualified conservation contributions); I.R.C. § 170(b)(1)(E)(i)–(v) (special percentage limitations and carryover rules for qualified conservation contributions, including the special rule for qualified farmers

support family legacy goals, and generate favorable deduction treatment. But they require careful attention to valuation, substantiation, perpetuity requirements, and long-term family objectives.

Four-Year Payment of Tax on Certain Farmland Sales

A newer development in farm retirement planning is the ability, in certain cases, to pay tax on qualifying farmland sales in four equal annual installments.

What the rule does. New I.R.C. §1062 allows payment of tax in four equal annual installments for certain sales of farmland property to qualified farmers, effective for applicable sales in taxable years beginning in 2026.

Why the rule matters. This provision can help address one of the biggest practical problems in retirement sales: liquidity. A farmer may have substantial gain on land but insufficient cash to pay the resulting tax immediately, especially where the sale is structured to facilitate transfer to another farmer on manageable terms.

What the rule does not do. This provision should not be overstated. <u>It does not:</u>

- Eliminate gain,
- Convert ordinary income into capital gain,
- Replace installment-sale reporting under section 453, or
- Eliminate I.R.C. §1245 recapture on machinery sold in the same transaction.

> **Note:** I.R.C. §1062 is a tax-payment timing rule, not a broad exclusion or character-conversion rule.

Example: Land sale with machinery included

Assume a retiring farmer sells farmland that qualifies for I.R.C. §1062 treatment, along with machinery that has substantial I.R.C. §1245 recapture. The land-related tax may be payable over four years if the statutory requirements are met. But the machinery recapture remains a separate issue and may still create immediate ordinary income consequences.[25]

> **Observation:** If the client hears only that the "farm sale tax can be spread over four years," the client may be badly surprised.

Integrated Whole-Farm Sale Hypothetical

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and ranchers); see also I.R.C. § 170(b)(1)(E)(v) (defining a qualified farmer or rancher by reference to gross income from the trade or business of farming).

[25] I.R.C. § 1062(a), (d)(1)–(2) (allowing, at the taxpayer's election, payment in four equal installments of the portion of net income tax attributable to gain from the sale or exchange of qualified farmland property to a qualified farmer, and defining both "applicable net tax liability" and "qualified farmland property"); I.R.C. § 1062(c)(1)–(2) (requiring the election by the return due date and providing that, for partnership or S corporation sales, the election is made at the partner or shareholder level). See also I.R.C. § 1245(a)(1)–(3) (requiring ordinary income recapture on disposition of section 1245 property to the extent of prior depreciation or amortization allowed or allowable, including certain expensing deductions). Thus, even where gain from qualifying farmland may support installment payment of the related tax under § 1062, gain from separately sold machinery is analyzed under §1245 on an asset-by-asset basis and may produce current ordinary income recapture rather than deferred land-sale treatment.

The following hypothetical illustrates how quickly a farmer's expected retirement value can erode when the sale is not analyzed asset by asset.

Facts

Jack and Clarissa, both in their late 60s, decide to retire in 2026. They sell most of their farming operation to an unrelated younger farmer. The transaction includes:

- Farmland: FMV $4,000,000; basis $700,000
- Machinery and equipment: FMV $900,000; basis $50,000
- Single-purpose hog building: FMV $300,000; basis $0
- General farm building: FMV $250,000; basis $120,000
- Grain inventory: FMV $200,000; basis $0
- Farmhouse and surrounding personal residence acreage: FMV $450,000; basis $180,000

The machinery had largely been expensed through I.R.C. §179 and bonus depreciation. They also retain 300 acres and leases that retained acreage to the buyer under a crop-share arrangement. After the sale, they continue to advise on planting decisions, fertilizer applications, and grain marketing for the retained acreage.

The buyer pays cash for the machinery, buildings, and inventory, but the land sale is financed over time. Jack and Clarissa want to know how much of the sale proceeds will actually be available for retirement.

Step 1: Separate the assets by tax character

A mistake would be to treat this as one sale producing one type of gain. It is not.

- Land. The farmland is generally the asset most likely to produce I.R.C. §1231 gain if held for use in the farming business and held for more than one year.
- Machinery and equipment. The machinery is I.R.C. §1245 property. Because basis is only $50,000 against value of $900,000, most of the gain is likely ordinary income through recapture.
- Single-purpose agricultural structure. The hog building may also be I.R.C. §1245 property. With zero basis and $300,000 of value, that creates another potentially large ordinary-income component.
- General farm building. The general farm building may produce gain subject to depreciable real property rules rather than I.R.C. §1245 treatment, depending on the facts and depreciation history.
- Grain inventory. The grain inventory produces ordinary income.
- Farmhouse. The farmhouse raises separate issues, including possible principal residence treatment if the requirements are met.

Step 2: Estimate the likely character consequences (using simplified assumptions)

- Land: $4,000,000 value less $700,000 basis = $3,300,000 gain, generally section 1231 in character
- Machinery: $900,000 value less $50,000 basis = $850,000 gain, likely largely ordinary income under section 1245

- Single-purpose hog building: $300,000 value less $0 basis = $300,000 gain, likely ordinary income under section 1245
- General farm building: $250,000 value less $120,000 basis = $130,000 gain, character depends on depreciation history and applicable rules
- Grain inventory: $200,000 ordinary income
- Farmhouse: separate residence analysis required

Even before considering rates, this shows the core problem is that a large portion of the transaction does not result in favorable capital gain treatment.

Step 3: Analyze timing and liquidity

The farmer may assume that because the land is financed over time, the tax burden will also be spread over time. But that assumption is only partly correct.

- The land may be eligible for installment-sale treatment under section 453, depending on the structure. If the statutory requirements are met, the land sale may also implicate I.R.C. §1062's four-year tax-payment regime.
- But the machinery recapture generally is not deferred in the same way.
- The grain inventory produces current ordinary income.
- Cash received for machinery, buildings, and inventory may create a large current-year tax bill even though the land proceeds come in over time.

> **Observation:** Jack and Clarissa may face a significant immediate tax burden despite not having received all sale proceeds.

Step 4: Analyze post-retirement lease income

The retained 300 acres are leased under a crop-share arrangement, and the retired farmer continues to advise on production and marketing decisions. That creates a serious self-employment tax issue. If the farmer materially participates in production or management of production, the crop-share income may remain subject to self-employment tax. In other words, the farmer may have sold most of the operation and still not fully escaped employment-tax exposure.

Step 5: Identify planning lessons from the hypothetical

This hypothetical illustrates several recurring lessons:

- The whole-farm sale must be broken into components.
- The client's "one sale" is actually many tax events.
  - Machinery can consume retirement value through ordinary-income recapture.
  - Prior I.R.C. §179 and bonus deductions often create a large retirement-year tax cost.
  - Inventory remains ordinary income.

> **Observation:** Clients often overlook this when estimating sale proceeds.

  - Deferred land payments do not solve all timing problems.
  - Recapture and inventory income can still create immediate tax.
  - Retirement leasing must be tested for self-employment tax exposure.

    - Crop-share plus continuing involvement can keep the retired farmer in the SE tax base.
- Asset allocation matters.
    - Purchase-price allocation can materially affect character and timing.
    - The farmhouse requires separate analysis.
    - Residence rules may differ from the rules applicable to business assets.

Practice Pointers for Advisers

- **Start with an asset schedule, not a sale price.** Before discussing tax consequences, prepare a detailed asset schedule showing:
    - Fair market value,
    - Adjusted basis,
    - Depreciation history,
    - Likely character on sale, and
    - Expected timing of payment.
- **Model the transaction before documents are finalized.** Once the parties have fixed economics and signed documents, planning flexibility narrows. Modeling should occur before the sale structure is locked in.
- **Test retirement leases carefully.** If the client intends to retain land and lease it out, determine whether the arrangement is fixed cash rent or crop share, and whether the client's continuing involvement creates material participation.
- **Coordinate income-tax and transfer-tax planning.** A recommendation to gift land during life may be sensible in some cases, but not if it unnecessarily sacrifices a valuable basis adjustment at death. Basis and estate considerations must be analyzed together.
- **Match charitable tools to actual objectives.** Do not recommend a CRT, conservation contribution, or outright gift simply because the client is charitably inclined. The technique must fit the client's income needs, family goals, and asset mix.

Note: The decision to start receipt of Social Security benefits should not be made independently of the farm sale structure. A farmer who is still materially involved in retained acreage and who is recognizing substantial sale income may be in a poor position to benefit from early commencement. By contrast, a farmer who fully exits operations, uses fixed cash rent, and wants to preserve appreciated land or defer additional dispositions may find that Social Security provides the stable income floor needed to support a more tax-efficient retirement structure.

Social Security Planning as Part of the Farmer's Retirement Income Structure

In General

Social Security planning belongs in the same discussion as farm sale planning because both affect the same retirement questions: cash flow, taxable income, timing, and preservation of wealth. A farmer deciding whether to sell land, lease acreage, continue consulting on operations, or defer retirement is also deciding, directly or indirectly, when Social Security benefits should begin and how valuable those benefits will be in the broader retirement plan.

For many farmers, Social Security is not the primary retirement asset in the way it may be for wage earners with modest savings.[26] But that does not make it secondary from a planning standpoint. It is often the only inflation-adjusted lifetime income stream in the plan, and its timing can materially affect liquidity needs, investment drawdown, and the pressure to sell or lease farm assets on unfavorable terms.

There are numerous threats to the farmer's retirement nest egg arising from asset disposition and tax characterization. Social Security adds a different dimension:

- It may reduce the need for immediate liquidation of farm assets;
- It may affect whether the farmer can afford to wait for a better sale structure;
- It may influence whether the farmer chooses fixed cash rent rather than a more active crop-share arrangement;
- It may change the desirability of continuing to work or materially participate after "retirement"; and
- It may alter the tax profile of the retirement years because benefits can become partially taxable depending on the farmer's other income.

> **Observation**: Social Security planning is part of the same integrated modeling exercise as I.R.C.§ 1245 recapture, I.R.C. §1402 exposure, income tax basis planning, and charitable planning.

General Social Security Timing Framework

The basic Social Security timing issue is familiar: starting earlier produces a smaller monthly benefit for a longer period, while delaying produces a larger monthly benefit for a shorter period.[27] The economic answer depends heavily on life expectancy, continued earnings, need for current cash flow, and whether the taxpayer expects to consume or invest the benefits.

> **Observation:** Delaying receipt of Social Security benefits increases the eventual accumulated value of invested benefits. However, the advantage of waiting typically does not emerge until much later in life (typically when the recipient reaches the mid-80s). This is an important lesson for farmers. While delaying benefits can improve long-run value, it only does so if the farmer lives long enough and does not need the earlier cash flow.[28]

Core Mechanics

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[26] In practice, many farmers build retirement wealth less through wage-based retirement systems and more through ownership of appreciated land, equipment, livestock, and closely held farm businesses, while farm income patterns may be irregular and not always produce consistently high Social Security-covered earnings.

[27] See I.R.C. § 86(d)(1) (defining Social Security benefits for federal income tax purposes); Retirement benefits claimed before full retirement age are permanently reduced, with the reduction generally equal to 5/9 of 1 percent per month for the first 36 months and 5/12 of 1 percent for additional months); Delaying commencement beyond full retirement age increases the benefit through delayed retirement credits, up to age 70, and for individuals born in 1960 or later yields 124 percent of primary insurance amount at age 70 versus 70 percent at age 62).

[28] Social Security Administration, When to Start Receiving Retirement Benefits, Publication No. 05-10147. Break-even analysis depends on the internal rate of return and cost-of-living adjustments (COLA); however, for most retirees, the cumulative value of waiting until age 70 to claim benefits does not surpass the cumulative value of claiming at age 62 until the recipient reaches their early to mid-80s.

The amount of a Social Security retirement benefit depends on the worker's earnings history and the age at which benefits begin. The benefit at full retirement age is derived from the worker's average indexed monthly earnings and primary insurance amount, and that beginning benefits before full retirement age reduces the monthly amount, while delaying beyond full retirement age increases it.

Farmers often have irregular earnings histories, years of low reported earnings, years of losses, and entity structures that may affect how much compensation was subject to Social Security taxes over time. Thus, two farmers with similar land wealth may have very different Social Security benefit profiles.

> **Observation:** A farmer with a relatively modest projected benefit may rely more heavily on farm asset liquidity, while a farmer with a stronger projected benefit may have more flexibility to defer a sale, use a CRT, or retain land for lease.

Continued Work and the Earnings Limitation

One of the most important Social Security planning points for farmers is that many do not retire all at once. They continue operating part-time, consult with children, lease land under active arrangements, or remain involved through entities. That creates a direct interaction between Social Security timing and continued earnings.

If a taxpayer begins receiving Social Security before full retirement age and continues to work, benefits may be reduced if earnings exceed the applicable annual limit.[29] A taxpayer with substantial continued earnings could not effectively collect benefits before full retirement age because the earnings reduction would eliminate the payment. This point is unusually important in farm retirement because many farmers:

- Continue to receive earned income from ongoing operations;
- Remain active in a partnership or sole proprietorship;
- Receive wages from an S corporation;
- Continue custom work or consulting; or
- Remain materially involved in crop-share arrangements.

If the farmer starts Social Security early but still has substantial earned income, the expected benefit may be reduced or effectively unavailable during that period.

Connection to I.R.C. §1402 planning

If a retired farmer structures post-retirement land use as a crop-share arrangement with material participation, that arrangement may not only create I.R.C. §1402 self-employment tax exposure, but may also indicate continued earned-income activity inconsistent with an "early benefits while still working" strategy.

Example: Gradual Retirement

[29] 42 U.S.C. §403(f). For the 2026 tax year, if a taxpayer is below full retirement age, the Social Security Administration deducts $1 from benefit payments for every $2 earned above the annual exempt amount of $23,400. In the year an individual reaches full retirement age, a higher threshold and a $1-for-$3 reduction applies.

Debbie is age 63 and wants to begin Social Security immediately, but also plans to:retain 400 acres, continue managing crop decisions with a tenant, receive compensation from an S corporation for transition services, and perform seasonal consulting for neighboring farms.

Result: If those activities produce substantial earnings, Debbie may find that early Social Security benefits are reduced under the earnings limitation rules. At the same time, the crop-share arrangement may create I.R.C. §1402 exposure if she materially participates. The result is that "partial retirement" may be inefficient both from an employment-tax perspective and from a Social Security timing perspective.

Social Security and the Taxable-Income Spike in the Retirement Transition Year

A farmer's retirement transition year is often unusually tax-heavy. That year may include gain from machinery sales (and the resulting I.R.C. §1245 recapture, inventory income, installment-sale gain, lease income, entity distributions, charitable deductions, and possibly the start of Social Security benefits.

If a farmer begins Social Security in the same year as a major whole-farm sale, the benefits may add less net after-tax value than expected because the sale-year income already places the farmer in a high-income posture. This means the Social Security start date should be modeled together with the sale date. A farmer may conclude that beginning benefits before the sale year helps cash flow but adds taxable income during a high-income period. As a result, delaying benefits until after the major sale year may reduce immediate tax friction, or beginning benefits earlier is still preferable if liquidity needs outweigh the tax cost.

To accurately determine the taxability, data regarding the retiree's "modified adjusted gross income" (MAGI) and specific statutory thresholds are required. These thresholds (e.g., $32,000 or $44,000 for joint filers) are the points at which 50% or 85% of Social Security benefits are included in gross income.[30] Without this specific income data, the exact "taxable-income spike" cannot be quantified, but the logic requires a comparison of total income against these base amounts to determine the inclusion percentage.

> **Observation:** The correct time to start claiming benefits for any particular person depends on the facts. However, the start of receiving Social Security benefits should be coordinated with other retirement-year income events.

Example: Sale year versus post-sale year

Assume Peter sells machinery and grain inventory in 2026, generating substantial ordinary income and recapture, and also closes on a financed land sale. If Peter also begins Social Security in 2026, the benefits may be taxed in a year already burdened by sale-related income. If Peter delays benefits until 2027, after the highest-income transition year has passed, the after-tax result may be better even if the nominal benefit stream begins later.

Social Security as a Tool to Reduce Pressure on Asset Disposition

[30] I.R.C. § 86(a)–(c).

Relationship to I.R.C. §1245 Recapture and Forced Sales

If a farmer lacks dependable retirement cash flow, the farmer may feel compelled to sell machinery, inventory, or land on a timetable driven by liquidity rather than tax efficiency. A predictable Social Security stream can reduce that pressure. That may allow the farmer to:

- Spread dispositions over multiple years,
- Avoid bunching recapture and inventory income into one year,
- Negotiate better installment terms,
- Retain appreciated land until death for section 1014 basis adjustment, or
- Choose fixed cash rent rather than an active crop-share arrangement.

Relationship to CRT Planning

If the farmer has some baseline retirement income from Social Security, the farmer may be better positioned to use a CRT for appreciated land because the CRT does not need to carry the entire burden of retirement cash flow. Social Security can function as the stable floor, while the CRT or lease income provides supplemental income.

Social Security and Life-Expectancy Risk

Delaying Social Security often improves long-run value only if the taxpayer lives long enough for the larger monthly benefit to overcome the years of forgone payments.[31]

Why This Matters for Farmers

Farmers often think in terms of preserving the farm or maximizing estate value, but retirement planning also requires confronting longevity risk. A farmer in poor health, or one who expects to need current cash flow, may rationally choose earlier benefits even if delaying could produce a larger cumulative value under optimistic assumptions. Conversely, a healthy farmer with substantial nonfarm liquidity may prefer to delay.

Holding appreciated land until death may maximize basis efficiency under I.R.C. §1014, but that strategy may also mean the farmer is asset-rich and cash-poor during life. Social Security timing can help bridge that tension. Earlier benefits may support lifetime cash flow while the farmer retains appreciated land for later basis adjustment. Delayed benefits may be preferable where the farmer already has sufficient liquidity and wants to maximize later-life guaranteed income.

> **Observation:** Social Security planning fits into the overall scheme of farm retirement planning because it affects the core variables of timing, liquidity, taxable income, and the need to monetize farm assets. The decision when to begin benefits is highly sensitive to continued earnings, life expectancy, and the taxation of benefits when other income is present. For farmers, those variables are inseparable from I.R.C. §1245 recapture, I.R.C. §1402 rental-activity issues, basis planning under I.R.C. §1014, charitable strategies, and the timing of farmland sales.

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[31] Whether delay improves lifetime economic value depends on longevity and discount-rate assumptions, because the taxpayer gives up earlier payments in exchange for a larger later annuity stream; under lower discount rates and longer survival horizons, later claiming is more likely to maximize expected lifetime benefits, while higher discount rates and shorter lifespans tend to favor earlier claiming.

Conclusion

The greatest threat to a farmer's retirement nest egg is not simply "tax" in the abstract. It is the failure to recognize that a farm retirement transaction is composed of multiple assets, multiple character rules, multiple timing rules, and often multiple planning objectives. Machinery and equipment may generate substantial ordinary income through section 1245 recapture. Crop-share or similar arrangements may continue to produce self-employment tax after "retirement." Lifetime transfers may preserve built-in gain that could otherwise have been eliminated through basis adjustment at death. Charitable strategies may help, but only if they are matched to the right assets and the right objectives. And newer rules allowing four-year payment of tax on certain farmland sales may improve liquidity, but they do not eliminate gain or solve recapture.

For that reason, sophisticated farm retirement planning must be asset-specific, basis-sensitive, and fully integrated across income tax, employment tax, charitable planning, and succession planning

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Farm Program Planning Strategies Under the OBBBA During a Challenging Farm Economy

Considerations for Financial Success

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TABLE OF CONTENTS

⚓ Overview

Facing compressed operating margins, elevated interest rates, and fluctuating trade dynamics, producers are increasingly forced to reevaluate their foundational business structures. Operational decisions that once seemed routine – such as signing a bank loan renewal or selling an underutilized combine – now carry sophisticated, sometimes hidden, tax and regulatory consequences.

By coupling operational agility with proactive tax planning – such as auditing ownership splits to protect OBBBA payment limits and streamlining multi-tiered entities to avoid the four-layer transparency wall – family-owned operations can fully leverage expanded safety nets and emergency deductions to insulate themselves from market volatility and preserve operational equity for the next generation.

⚓ The Phantom Tax Traps of Entity Restructuring

For decades, the general partnership has been a traditional vehicle for family farming operations. Moving from a general partnership to a Limited Liability Company (LLC) is commonly viewed as a tax-free "non-event"—essentially maintaining the same owners, the same machinery, and the same land. However, while the underlying assets remain unchanged, the legal character of the operation's liability shifts dramatically under Internal Revenue Code (IRC) Section 752, introducing severe structural tax risks if debt allocations are mismanaged.

Due to decades of intensive tax planning—including prepaid farm expenses, rapid equipment depreciation via Section 179 and bonus expensing, and accumulating operating loans—many mature family farms maintain a negative tax capital account balance. In a general partnership, this negative balance is naturally insulated because every general partner remains personally liable for the entity's debt obligations. Under IRS rules, this recourse debt provides the necessary tax basis to support those negative balances without triggering gain recognition.

The Core Risk: *When transitioning to an LLC, all debts legally shift from recourse to nonrecourse by default unless explicit personal guarantees are executed. If two partners step up to guarantee a bank loan while a third partner is omitted or released from the paperwork, that third partner's share of liabilities drops immediately to zero.*

Under the strict mechanical operations of Subchapter K, the IRS views a reduction in a partner's share of debt as a constructive distribution of cash under IRC § 752(b). If this constructive cash distribution exceeds the partner's remaining tax basis, the excess is immediately treated as a taxable gain under IRC § 731(a)(1). To make matters worse, because farm assets frequently consist of heavily depreciated machinery, this 'phantom gain' does not qualify for preferential long-term capital gains rates; instead, it is largely triggered as ordinary income via depreciation recapture under IRC § 1245.

Practitioners should ensure that sufficient basis is preserved through appropriate liability allocations, guarantees, deficit restoration obligations, or other planning mechanisms before the restructuring is completed.

⚓ The OBBBA Subchapter K and S Corporation Direct-to-Owner Pivot

For operations organized as LLCs or S corporations, the OBBBA has fundamentally re-engineered how safety net commodity payments are distributed and qualified for under federal farm programs. Historically, the Farm Service Agency (FSA) enforced strict adjusted gross income (AGI) means tests directly at the entity level. If a farm entity experienced a single highly profitable year or crossed the statutory income ceiling, the entire operation faced absolute disqualification from receiving safety net payments, penalizing all owners regardless of their personal financial status.

The OBBBA substantially alters this dynamic by ignoring the business entity's consolidated earnings and evaluating the income threshold strictly at the individual owner level. For instance, if an LLC is comprised of three equal partners, the entity effectively receives three separate payment limit evaluations. If two partners individually qualify under the income limitations while the third partner exceeds them, the entity only loses the third partner's pro-rata share. The qualifying partners are no longer structurally punished for the high-income status of their co-owner.

Example: *Assume an LLC receives a potential $120,000 commodity payment and has three equal owners. If one owner exceeds the applicable AGI limitation while the other two qualify, the operation may retain eligibility for approximately two-thirds of the payment rather than losing the entire benefit.*

Despite this favorable shift, ownership splits require diligent scrutiny. Ownership percentages now dictate the exact scale of payment vulnerability. If a majority stakeholder holding the lion's share of equity breaks the individual income limit, the operation will lose the vast majority of its payout. Producers must carefully audit and plan their ownership structures prior to the upcoming crop year to optimize safety net eligibility.

Note: *Any restructuring undertaken to maximize payment eligibility should be coordinated with the operation's estate and succession plan. Altering ownership percentages solely to increase program benefits can create unintended gift tax consequences, affect future basis adjustments, and disrupt long-term transition planning.*

⚓ The Four-Layer Transparency Limit in Farm Program Payments

As modern operations utilize increasingly sophisticated multi-tiered entities for asset protection, estate planning, and business succession, they must remain acutely aware of the FSA's strict structural transparency limits. When distributing program dollars, the FSA utilizes look-through rules to trace funding through corporate structures until it identifies the living individuals behind the business. However, federal law enforces an absolute statutory barrier to this tracing: tracking terminates precisely after four distinct levels of ownership.

The operational mechanism behaves like a multi-tiered corporate family tree:

Level 1: The primary operating farm entity receiving the payment.

Level 2: A corporate holding company or operating equipment LLC.

Level 3: A management company or family limited partnership.

Level 4: A family trust or secondary entity.

If a living human individual does not surface by the fourth layer of ownership, the tracing hits a statutory wall. For payment-limitation purposes, attribution generally ceases after the fourth ownership level, which can result in the loss of payment eligibility attributable to ownership interests that cannot be traced to an eligible individual. Consequently, the portion of the payment tied to that deeper entity is permanently forfeited. This reduction is not driven by a regulatory violation or non-compliance; it is a purely mechanical penalty resulting from excessive paperwork and layers.

Operations utilizing stacked companies or complex trusts must carefully map their ownership chains to ensure that human beneficiaries surface clearly before reaching the fourth-level restriction.

⚓ Capital Asset Disposals and the Muddy Waters of Estimated Taxes

With operational margins tightening, many farmers are strategically consolidating capital or selling off underutilized machinery. However, doing so under current IRS interpretations creates significant uncertainty regarding the qualifying rules for quarterly estimated tax payments. Traditionally, qualified farmers enjoy an invaluable administrative exception: if they derive at least two-thirds (66.67%) of their gross income from farming, they can bypass the burden of quarterly estimated tax filings entirely. Instead, they can opt to make a single estimated payment in January or file their return and pay their total liability by March 1st with zero underpayment penalties.

Clearing this two-thirds gross income hurdle requires a precise classification of revenue, which is where machinery and equipment disposals create administrative friction. When a tractor, combine, or implement is sold, the gain generated—frequently substantial due to historic depreciation deductions—must be categorized. If those dollars qualify as gross income from farming, they assist the producer in clearing the two-thirds threshold. If they are excluded, a significant machinery sale can inadvertently disqualify a producer, exposing them to retroactive underpayment penalties.

The IRS's internal posture on this issue has fluctuated considerably. Historically, the agency excluded equipment gains from farm gross income, later reversing course to include them. In the most recent revisions of the IRS Publication 225 (Farmer's Tax Guide), the agency quietly removed the explicit, clear written narrative authorizing the inclusion of equipment sales. However, the IRS left an active, unrevised computational example within the text that continues to count equipment sales toward the farm income total. This contradiction leaves producers in a regulatory gray area, making early consultation with an agricultural tax specialist essential before relying on machinery sales to defer estimated tax deadlines.

Caution: *The same classification issues may arise with gains from breeding livestock sales, draft animals, and other farm business assets, making annual gross-income computations particularly important when producers are attempting to qualify for the farmer estimated-tax exception.*

⚓ Strategic Survival in an Economic Downturn

A recent economic forecast by a group of ag economists points toward a challenging agricultural environment characterized by compressed margins, elevated interest rates, and softened export volumes to major historical trade destinations like China. Despite these challenges, modern producers possess an arsenal of sophisticated financial and tax mitigation tools that were entirely unavailable during previous cyclical downturns, such as the 1980s farm crisis.

Note: *In a period of elevated borrowing costs, preserving working capital is* *often more important than minimizing taxes. Producers should evaluate whether aggressive expensing elections create future liquidity constraints by generating tax deductions today while reducing deductions available in future years.*

Chief among these modern statutory defenses is the OBBBA's permanent restoration of 100% first-year bonus depreciation. This mechanism allows operations to immediately expense and write off the full purchase price of major capital assets, including specialized machinery, implements, and grain storage facilities, rather than amortizing those costs over extended recovery periods.

Furthermore, producers can combine this with flexible tax planning strategies, such as:

Deferred-Payment Contracts: Shifting grain or livestock revenue into the subsequent tax year to lock in prices while managing the current year's bracket thresholds.

Farm Income Averaging (IRC § 1301): Spreading current taxable income over the preceding three tax years to smooth out spikes and mitigate the impact of progressive tax brackets.

Installment-Sales (IRC §453): Where appropriate, installment-sale treatment may allow recognition of gain over multiple tax years, smoothing taxable income and preserving eligibility for various deductions, credits, and farm-program limitations.

New IRC §1062: Also, the OBBBA creates new IRC §1062 which allows the gain on the sale of farmland to a buyer that continues farming the land for 10 years to be paid in four equal installments if all statutory requirements are satisfied.

Active Ownership Structuring: Taking advantage of revised farm program rules that permit family-held LLCs to maximize and expand their total payment eligibility based on the documented active management and participation of the individual owners.

While macro trade patterns show a decline in direct shipments to China, global demand continues to diversify across alternative international markets. By coupling operational agility with rigorous entity planning and proactive tax structuring, family-owned agricultural enterprises can successfully insulate themselves from market volatility and preserve operational equity for the next generation.

⚓ Conclusion

Surviving an era of compressed operating margins, elevated interest rates, and shifting international trade dynamics demands that modern agricultural operations look beyond field management and focus on corporate and tax precision. The economic downturn cannot be countered by productivity alone; it requires a defensive posture rooted in structural and regulatory optimization. Every safety net dollar and tax deduction counts toward preserving family equity. Failing to audit entity ownership splits under the new OBBBA rules can cause a farm to inadvertently forfeit its safety net payments based on a single owner's personal financial picture. Similarly, letting complex estate and liability plans drift past the FSA's strict four-layer transparency wall will cause critical program payments to permanently vanish.

These cash flow losses are entirely avoidable, triggered not by a failure of the farm itself, but by unexamined paperwork. Ultimately, the path through a challenging economic market is paved with proactive adjustments. By taking immediate steps—such as securing explicit personal debt guarantees before executing an LLC transition, coordinating with an accountant on equipment sale timing, and utilizing tools like 100% bonus depreciation and farm income averaging—producers can effectively insulate themselves from macro-level volatility.

The producers who emerge strongest from the current downturn are unlikely to be those with the highest yields or largest acreage. Rather, they will be the operations that integrate tax planning, entity design, farm-program eligibility, and succession planning into a unified business strategy. In the post-OBBBA environment, those disciplines are no longer separate planning exercises – they are increasingly inseparable components of farm profitability.

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Top Five Legal (& tax) Issues That Farmers Don't Think About, But Should

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1. Miscellaneous Tax and Estate Issues

a. Tax "Complacency"

For years, farmers feared the 2026 "sunset," where estate tax exemptions were expected to drop to slightly over $7 million. However, the One Big Beautiful Bill Act (OBBBA) set a new permanent exemption of $15 million per individual ($30 million per couple).

The Overlooked Issue: Many farmers may be tempted to not do estate planning because they believe they are "under the limit." However, many farmers underestimate their asset values and a modest farming operation can push the present exemption limit. A related problem is that, without a plan, portability of the unused exemption at the death of the first spouse may be lost. To port over an unused exemption, Form 706 must be filed in the first spouse's estate even when no tax is due.

b. Mismanagement of the "Step-Up in Basis"

The step-up in basis is the single most valuable tax tool for farm families. It resets the "cost" of land to its fair market value at the time of the owner's death.

The Overlooked Issue: Farmers may "gift" land to children while they are still alive to "get it out of the estate." This triggers a "carryover basis" in the hands of the donee(s). It is often better to transfer operations during life but transfer land ownership at death.

c. Entity "Checkups" for Section 199A (QBID)

The I.R.C. §199A deduction, which allows farmers to deduct 20% of their qualified business income, was made permanent in 2025.

The Overlooked Issue: The deduction is limited by the amount of W-2 wages the farm pays or the basis of property it owns. Many farms operate as "informal" general partnerships or sole proprietorships that don't pay W-2 wages to family members.

The Strategy: Transitioning to an S-Corp or a structured LLC that pays reasonable W-2 wages can often unlock a larger I.R.C. §199A deduction. In 2026, there is also a new $400 minimum deduction for small producers that many may fail to claim.

d. The "Machinery Trade-In" Tax Trap

Since the 2017 tax changes, "Like-Kind Exchanges" (I.R.C. §1031) no longer apply to equipment - only to real estate.

The Overlooked Issue: When you trade a $300,000 tractor for a new one, the IRS treats it as a sale of the old tractor and a purchase of a new one.

The Risk: If you have already fully depreciated the old tractor (using I.R.C. §179), the "sale" triggers depreciation recapture, which is taxed as ordinary income.

The 2026 Update: While bonus depreciation was restored to 100% in early 2025, if you don't have enough new purchases to offset the "gains" from your trades, you could face a massive, unexpected tax bill. It is imperative to structure "trade" transactions properly.

e. Ignoring "Fair vs. Equal" in Operating Agreements

"Partition" lawsuits among siblings are a leading cause of family farm liquidation.

The Overlooked Issue: Farmers often leave the land to all children equally in a Will or Trust. However, the "on-farm" heir has no legal protection from the "off-farm" siblings who may want to sell their share to a developer or neighbor.

The Solution: Move land into an LLC with a strict Operating Agreement. This agreement should include:

1. **Buy-Sell Provisions:** Allowing the farming heir to buy out siblings at "Ag Value" rather than "Market Value."
2. **Long-term Payouts:** Allowing the buyout to happen over 15–20 years so the farm's cash flow can handle the debt.

f. The "Active Participation" Trap in Business Structuring

Many producers use a "landlord-tenant" setup where their operating entity (LLC) rents land from them personally or from a separate land-holding LLC.

The Overlooked Risk: If not structured correctly, the IRS may recharacterize that rental income as self-employment income subject to the 15.3% SE tax if the owner is "materially participating" in production.

The Strategy: Smart structuring involves a "Manager-Managed LLC" or an S-Corp to bifurcate "labor" income from "investment" income. Failing to do this often results in farmers paying thousands more in Medicare and Social Security taxes than legally required.

g. **Not Structuring the Business Properly**

Issue	Sole Proprietorship	LLC (Pass-through)	S-Corporation
Self-Employment Tax	Paid on all net income	Paid on all net income	Paid only on W-2 salary
Liability Protection	None	Full	Full
Step-up in Basis	Applies to all assets	Applies to all assets	Applies only to stock
199A Deduction	Easy to claim	Requires W-2/Basis	Strongest potential

2. Agricultural Labor Compliance & The "Joint Employer" Standard

Perhaps the most pressing "hidden" regulatory risk involves ag labor. Farmers frequently share labor or use "custom harvesters" and labor contractors.

The Overlooked Risk: Under federal Fair Labor Standards Act (FLSA) and state laws, a farmer can be held liable as a "joint employer" for the wage and safety violations of a third-party contractor. If a custom harvester or a labor boss fails to pay overtime or meet safety standards, the farm owner can be sued for back wages.

Regional Nuance: In 2021, Colorado has passed aggressive labor protections (SB21-087) that removed many traditional agricultural overtime exemptions. Producers who cross the border from KS or NE into CO with their crews often fail to realize they are suddenly subject to different wage-and-hour math.

The Strategy: Ensure all "Custom Work" contracts include indemnification clauses and require proof of Workers' Compensation and FLSA compliance from the contractor.

3. Water Right "Abandonment" and Compact Compliance

In the Tri-State area (specifically the Republican River Basin), water is a legal property right that can be lost through non-use.

The Overlooked Risk: Farmers in Colorado and Kansas are subject to the "use it or lose it" doctrine. If a producer stops using a portion of their water right - perhaps due to a shift in crop rotation or conservation efforts - the state may determine the right has been abandoned.

The "Abandonment" Clock: 5 vs. 10 Years

The most immediate difference is how long you can leave your water untouched before the state starts asking questions.

Feature	Kansas (K.S.A. 82a-718)	Colorado (C.R.S. 37-92-402)
Statutory Period	5 successive years of non-use.	10 successive years of non-use.
Trigger	Automatic "deemed" abandonment.	Rebuttable "presumption" of abandonment.
Burden of Proof	State must show non-use; owner must show "due and sufficient cause."	State puts you on an Abandonment List; owner must prove they intended to keep the right.

Colorado: The "Intent" Factor

In Colorado, non-use for 10 years is not an automatic "death sentence" for your water right. The law requires both non-use AND intent to abandon.

The Abandonment List: Every 10 years (next one in 2030), the State Engineer publishes a list of rights they believe are dead.

Rebutting the Presumption: You can fight to stay off the list by showing "No Intent to Abandon." Evidence includes:

- Maintaining your headgates, ditches, and pumps (if you were planning to abandon it, why would you fix the pump?).
- Leasing the water to a neighbor or a water bank.
- Good faith efforts to sell the water right.

Kansas: "Due and Sufficient Cause"

Kansas law is generally stricter. After 5 years of non-use, the right is "deemed abandoned" unless you can prove due and sufficient cause.

The "Rain" Defense: Kansas is unique in that it allows "adequate moisture" as a defense. If it rained enough that you didn't *need* to pump for 5 years, you haven't abandoned the right.

Closed Aquifers: If your farm is in an area where the aquifer is closed to new appropriations (common in Western KS), the law is more lenient because the state doesn't want to "punish" you for saving water in a depleted zone.

The "Conservation Trap"

This is the biggest issue for modern farmers. If you install a highly efficient pivot or drip system that saves 30% of your water, or if you enroll in a fallowing program, are you "losing" that 30%?

Partial Abandonment: Both states can declare partial abandonment. If you have a right for 500 acre-feet but only use 300 for a decade, the state can permanently reduce your right to 300.

The Solution (Water Banking): To prevent this, farmers in KS and NE often use Water Banks or Conservation Programs. Enrolling in an approved state program "tolls" the clock - meaning the years you don't use water while in the program don't count toward the 5 or 10-year abandonment period.

Summary of Protections

If you are shifting crop rotations or trying to conserve water, you should take these legal steps immediately:

File for a "Suspension of Use": In Kansas, you can file a "Request to Reinstate a Water Right" or participate in a Water Rights Conservation Program (WRCP).

Maintain Infrastructure: Never let a ditch fill with silt or a pump fall into disrepair. The state uses the physical condition of your equipment as "Exhibit A" in abandonment hearings.

Document "Why": If you aren't pumping, keep records showing it was due to high rainfall, broken equipment being repaired, or economic hardship—all of which can serve as "due and sufficient cause."

> **Note:** KS and NE have been in perpetual litigation over the Republican River Compact. If a farmer in Nebraska over-pumps in a way that violates the compact with Kansas, they may face sudden "Compact Compliance" shut-offs without compensation.

4. Sales and Use Tax Exemptions on "Dual-Use" Equipment

Items like ATVs, lawnmowers, tools, and certain building materials are frequently flagged during state audits in KS, NE, and CO.

The Overlooked Risk: If an ATV is used 60% for checking cattle and 40% for recreation or hunting, the exemption may be voided. State auditors are increasingly aggressive about checking for "personal use" on tax-exempt agricultural purchases.

The Paper Trail: Producers rarely keep a "log" of equipment use. Having a simple logbook showing agricultural vs. personal use for dual-purpose vehicles is essential to defend against a Department of Revenue audit.

5. The "Fencing" and Boundary Liability Gap

In the High Plains, "good fences make good neighbors" is only true if you understand who is legally responsible for the "good" part. Boundary disputes are a top cause of litigation when land is sold or inherited.

The "Right-Hand Rule" vs. Statutory Duty Most farmers in KS, NE, and CO follow the "Right-Hand Rule" - two neighbors face each other at the fence's midpoint, and each maintains the half to their right.

> **The Overlooked Issue:** This is often a custom, not a recorded legal agreement. If a new neighbor moves in and refuses to follow the custom, the "handshake" won't hold up in court.
>
> **The Risk:** In Kansas, for example, the law requires owners of adjoining lands to build and maintain partition fences in equal shares (K.S.A. 29-301). If your neighbor doesn't graze livestock but you do, you might still be able to "force contribution" for the fence, but the process requires formal "Fence Viewers" to intervene.

Liability for Escaped Livestock The legal consequences of a downed fence vary wildly across state lines in the Tri-State area.

> **"Fence-In" vs. "Fence-Out":** Kansas is a "fence-in" state, meaning the livestock owner is liable for trespass if their animals escape due to negligence. However, "open range" counties in Colorado utilize a "fence-out" rule where a landowner cannot recover damages for crop loss unless they had a "lawful fence" to keep animals out.
>
> **The Overlooked Issue:** If your livestock escape through a portion of the fence that was your neighbor's responsibility to maintain, are you liable for the resulting car accident on the highway?

Adverse Possession and "Fence Creep" A fence that is "off-line" for 10 to 20 years can eventually become the new legal boundary.

- **The Risk:** Farmers often place fences where it's *convenient* (e.g., around a rocky outcrop or a creek) rather than on the surveyed line. Over decades, this "convenience" results in the legal loss of acreage through adverse possession.
- **The Strategy:** Every 10 years, or before any major fence reconstruction, verify boundaries with a GPS survey. If a fence must be off-line, execute a simple Permissive Use Agreement with the neighbor, stating that the fence location is for convenience and does not signal a change in the legal boundary. This "permission" prevents a claim of adverse possession from ever starting.

Should a Niche Farm Be an LLC or a Public Benefit Corporation?

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Overview

For decades, advising a client launching a "mission-driven" or high-value niche agricultural venture meant a standard fork in the road: structure as a traditional entity to maximize tax efficiency, or pursue a non-profit status and accept severe operational constraints.

For the 2026 tax year, the landscape looks entirely different. Driven by consumer demand for sustainable practices and accelerated by the landmark passing of the One Big Beautiful Bill Act of 2025 (OBBBA), two legal structures dominate the niche farming conversation: the Limited Liability Company (LLC) and the Public Benefit Corporation (PBC). The PBC is the less commonly known entity.

State Statutes

Currently, 43 states plus Washington, D.C., and Puerto Rico have enacted statutory legislation authorizing the creation of Public Benefit Corporations (or "Benefit Corporations").

> **Note:** As of 2026, the seven states that do not have an enacted statutory Public Benefit Corporation (PBC) framework are:
>
> 1. Alaska
> 2. Mississippi
> 3. Missouri
> 4. North Dakota
> 5. South Dakota
> 6. Wyoming
> 7. North Carolina[1]

[1] North Carolina previously allowed a related hybrid entity called a Low-Profit Limited Liability Company, or L3C, but repealed it and has not passed a standard corporate PBC statute. For the states without a PBC statute, there are strategic "workarounds." For example, a niche farm physically located in one of these seven states can incorporate as a PBC in a state with a robust statute (such as Delaware or Kansas) and then file for certificate of authority to do business as a foreign entity in their home state. This allows the directors to secure the fiduciary liability protections of the forming state's laws. Also, because the LLC is a creature of contract, specific balancing mandates and environmental metrics can be drafted directly into a domestic LLC's Operating Agreement. While doing so lacks the

Since Maryland first introduced the structure in 2010, the vast majority of the country has adopted it to provide a safe harbor for mission-driven businesses. Only a small handful of states (primarily in the upper Midwest and pockets of the South) have yet to pass enabling legislation.

Statutory variations. While 43 states allow the *corporate* form (PBC), only 7 states have extended this framework to pass-through entities by authorizing a statutory Public Benefit Limited Liability Company (PBLLC). This is a crucial distinction for ag clients who demand partnership taxation but want statutory fiduciary shields.

A few states utilize slightly different terminology that achieves a similar result. For example, Washington, California, Florida, and Texas offer a Social Purpose Corporation (SPC) framework, which allows a company to focus on one single dedicated social or environmental objective rather than the broader, tripartite balancing mandate required by standard PBC statutes

Structure & Fiduciary Duties

Understanding the fundamental difference between an LLC and a PBC requires looking at the corporate "genes" governing director and manager liability. Niche farms frequently balance profitability with environmental stewardship (e.g., soil regeneration, organic certifying) and social goals (e.g., community food security, fair labor standards).

The Limited Liability Company (LLC). The LLC remains the ultimate contractual chameleon. By default, it prioritizes absolute operational flexibility.

- **Fiduciary Baseline:** While state statutes vary, the primary duty of LLC managers is typically owed to the members (owners), maximizing wealth or operating purely according to the LLC Operating Agreement.

- **The Mission Risk:** If an LLC manager sacrifices short-term profit to pursue an expensive environmental initiative (such as transitioning land to a five-year permaculture cycle), minority members can potentially sue for breach of the duty of care or loyalty, claiming a waste of corporate assets. Protecting a mission requires meticulous, custom-drafted provisions within the Operating Agreement.

The Public Benefit Corporation (PBC). A PBC is a statutory, for-profit corporate entity designed specifically to shield mission-driven leadership.

- **Tripartite Fiduciary Duty:** Directors of a PBC *must* balance three competing interests:

    1. The pecuniary (financial) interests of the stockholders.
    2. The specific public benefit(s) identified in the corporation's charter (e.g., "promoting regenerative agricultural practices").
    3. The best interests of those materially affected by the corporation's conduct (e.g., the local ecosystem, farm laborers)
    .

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automatic default shield of a statutory PBC, it creates a binding internal governance framework that achieves similar operational goals.

- **The Fiduciary Shield:** Statutory PBC provisions explicitly protect directors from stockholder lawsuits when they choose a sustainable path over a marginally higher-grossing, environmentally destructive alternative.

I.R.C. § 179 and Bonus Depreciation

Niche farming is capital-intensive. Whether purchasing high-efficiency hydroponic arrays, specialized tractors, or processing equipment, capital recovery is a primary driver of tax planning. The OBBBA fundamentally altered this calculus for 2026.

The new math of I.R.C. § 179. Under the OBBBA, the I.R.C. §179 expensing rules have been dramatically expanded, providing a massive upfront cash-flow advantage.

Tax Provision	Pre-OBBBA Rules	Post-OBBBA (2026 Tax Year)
Maximum § 179 Deduction	$1,250,000	$2,560,000
Phase-Out Threshold	$3,130,000	$4,090,000
Bonus Depreciation	Scheduled to step down	100% (Permanently Restored)

Structuring the deduction: LLC vs. PBC (C-Corp). While the limits are identical on paper, *how* these deductions flow to the taxpayer depends entirely on the entity's underlying tax classification.

The LLC pass-through. If the farm is an LLC taxed as a partnership or S-Corporation, the I.R.C. §179 deduction faces the taxable income limitation under I.R.C. § 179(b)(3).

- The deduction cannot exceed the aggregate taxable income derived from the active conduct of any trade or business.
- For a startup niche farm operating at a loss in Year 1 or Year 2, an LLC cannot use a § 179 deduction to create or increase a Net Operating Loss (NOL) at the entity level. Any excess is suspended and carried forward indefinitely under I.R.C. § 179(b)(3)(B).
- Because the OBBBA permanently restored 100% bonus depreciation under I.R.C. §168(k), pass-through niche farms can utilize bonus depreciation to generate or increase an NOL, which can then flow through to the owners' individual returns (subject to I.R.C. §461(l) excess business loss rules).

The PBC organized as a corporation. A PBC is legally structured as a corporation. While it can theoretically elect S-Corporation status if it meets the restrictive shareholder rules, most venture-backed or multi-investor PBCs operate as C-Corporations.

- **Loss Isolation:** If the PBC is taxed as a C-Corporation, the I.R.C. §179 deductions and 100% bonus depreciation amounts are trapped at the corporate level.
- **The Tax Bracket Arbitrage:** Corporate losses cannot offset the investors' outside personal income. However, with the permanent stabilization of corporate tax brackets, a

PBC C-Corp can carry forward these OBBBA-fueled NOLs to shield future corporate profits directly at the flat 21% federal corporate tax rate.

Simplified Reporting Rules for "Small-Scale Benefit Entities"

Historically, attorneys and CPAs shied away from the PBC structure for smaller clients due to administrative friction. Standard PBC statutes require bi-annual (or annual) third-party transparent reporting to shareholders detailing how the entity promoted its public benefit.

However, modern state frameworks have adapted to support "small-scale benefit entities" - generally defined under prevailing state model acts as entities generating under $5 million in gross revenues.

Streamlined compliance. Small-scale PBCs are no longer required to retain expensive, certified third-party standard-setters to audit their operations. In most jurisdictions, a small-scale farm PBC can fulfill its statutory benefit obligation via a simplified internal narrative report distributed directly to shareholders. This report simply outlines the environmental or social metrics achieved (e.g., gallons of water conserved via drip irrigation; tons of compost applied). This regulatory easing brings the administrative overhead of a small-scale PBC down to near parity with an LLC's annual reporting requirements, removing a significant hurdle for smaller, community-supported agriculture (CSA) operations.

Structural Alignment Matrix

The following is a comparative guide to clients weigh their operational and tax goals:

Decision Metric	**Limited Liability Company (LLC)**	**Public Benefit Corporation (PBC)**
Tax Default Treatment	Pass-through taxation (Partnership/Sole Prop) under I.R.C. § 701.	Corporate taxation (C-Corp default) subject to double taxation or I.R.C. Subchapter C.
Mission Protection	Weak by default. Must be hardcoded into a custom Operating Agreement.	Strong by default. Statutory mandate protects directors prioritizing the public benefit.
Capital Intensive Assets (§ 179 / § 168(k))	Losses flow through to owners, subject to active participation and basis limits.	Losses are trapped at corporate level to offset future 21% corporate income.
Investor/Venture Funding	Less appealing to institutional investors due to K-1 complexity and tax pass-throughs.	Highly attractive to ESG funds, impact investors, and institutional venture capital.

Decision Metric	**Limited Liability Company (LLC)**	**Public Benefit Corporation (PBC)**
Administrative Burden	Minimal. Annual state filing and internal bookkeeping.	Moderate. Requires annual/bi-annual benefit reports, corporate formalities, and board minutes.

Conclusion

When advising niche agricultural clients practitioners must look beyond simple liability protection. The choice hinges on cash-flow architecture and investor composition:

1. **Choose the LLC if:** The farm is closely held, relies heavily on utilizing initial tax losses to offset the owners' other ordinary income streams, and needs the flexibility of pass-through treatment to maximize the immediate pass-through impact of the OBBBA's 100% bonus depreciation.
2. **Choose the PBC if:** The farm intends to raise outside capital from impact investors, has a highly visible public mission that could conflict with pure profit-maximization, and prefers to lock in capital expensing (up to the new $2,560,000 I.R.C. §179 limit) to shield future corporate-level profits.

By utilizing the enhanced provisions of the OBBBA alongside the evolved, small-scale reporting rules of modern benefit corporations, practitioners can design an entity that is both legally protected and structurally optimized for the modern green economy.

APPENDIX

Statutory Blueprint: The Kansas Public Benefit Corporation Framework

The Kansas Public Benefit Corporation (PBC) architecture is codified under K.S.A. § 17-72a01 through § 17-72a09.

Kansas also allows for the formation of a Statutory Public Benefit Limited Liability Company (SPBLLC) under K.S.A. § 17-76,149, providing a parallel option for clients who prefer pass-through partnership taxation but want statutory mission protections.

Formation and Mandatory Disclosures

To establish a PBC in Kansas, a niche farm cannot simply rely on a generic purpose clause. The entity's foundational "bones" must explicitly broadcast its dual-nature intent.

- **The Articles of Incorporation:** Under K.S.A. §17-72a02(a), the entity must state clearly in the heading of its articles that it is a public benefit corporation. Its name must include the identifier "Public Benefit Corporation," "P.B.C.," or "PBC" (K.S.A. §17-7919(b)).

- **Specific Public Purpose:** The articles must identify one or more specific public benefits to be promoted. Under the statute, a "public benefit" is defined broadly as a positive effect (or the reduction of negative effects) on persons, communities, or interests, explicitly including environmental, cultural, economic, or educational impacts (K.S.A. §17-72a02(b)). A niche farm might define its statutory purpose as "promoting soil health via regenerative cultivation and providing pesticide-free produce to regional markets."

The Kansas Balancing Mandate & Director Liability

The heart of the Kansas statute is its explicit alteration of corporate governance priorities, protecting directors from standard shareholder litigation when balancing profits against sustainability goals.

The Balancing Act: K.S.A. § 17-72a02(a) dictates that the board *shall* manage the corporation in a manner that balances the stockholders' pecuniary interests, the specific public benefits identified in the articles, and the best interests of those materially affected by the corporation's conduct.

- **The Liability Shield: K.S.A. § 17-72a05** directly addresses the director's exposure. A director is deemed to have satisfied their fiduciary duties to stockholders and the corporation if their balancing decision is both *informed and disinterested*, and it is not a decision that no person of ordinary, sound business judgment would make.

- **Protection against Conflicting Loyalties:** The statute explicitly notes that a director's duty to balance these three prongs does not create a conflict of interest that would strip them of the protections of the Business Judgment Rule.

Enforcement and Standing Barriers

A common fear among operators is that inserting an environmental or social mandate into corporate filings opens the door for outside activists or disgruntled consumers to sue the farm for failing to meet its "green" standards. The Kansas statute strictly closes this door.

- **Exclusive Standing:** Under **K.S.A. § 17-72a07**, a lawsuit to enforce the balancing requirement (including derivative suits) can *only* be brought by a shareholder or group of shareholders who individually or collectively own at least **2% of the corporation's outstanding shares** (or, if listed on a national exchange, shares valued at the lesser of 2% or $2 million).

- **No Outside Action:** Neighbors, consumers, environmental groups, or local government agencies have zero standing to sue a Kansas PBC for a failure to achieve its stated public benefit.

Reporting, Transparency, and the Third-Party Standard

Kansas ensures accountability to investors while remaining highly practical for smaller businesses.

- **Annual Reporting:** Under K.S.A. § 17-72a06, a Kansas PBC must provide its stockholders with an annual statement detailing its progress. This statement must include the specific objectives established by the board, the standards adopted to measure progress, objective factual data tracking that progress, and an internal assessment of their success.

- **The Website Mandate:** If the PBC maintains a public website, its most recent benefit report must be posted openly (K.S.A. § 17-72a06(e)). Proprietary financial data and director compensation can be redacted from the public version, protecting operational privacy.

- **The "Third-Party Standard" Rule:** Unlike Delaware, which allows purely internal metrics, the original Kansas statutory drafting favors using an independent, third-party standard to define and assess the promotion of the public benefit (K.S.A. § 17-72a06(d)). However, the board retains the authority to select the standard that best fits an agricultural footprint, allowing niche farms to use established ag-focused sustainability metrics.

Dissenting Shareholder Protection: Appraisal Rights

Transitioning an existing traditional entity into a mission-driven PBC can fundamentally alter an investor's risk profile. To balance this, the Kansas General Corporation Code protects minority owners who want out.

- **Appraisal Rights Trigger:** Under **K.S.A. § 17-72a03**, if an existing traditional Kansas corporation amends its articles to convert into a PBC, any shareholder who voted against the conversion is entitled to statutory appraisal rights.

- **The Exit Cleanout:** The corporation must buy out those dissenting shareholders at the "fair value" of their stock, determined independently if necessary. For an older family farm with off-farm heirs who favor pure asset liquidation, attempting a conversion to a PBC could trigger a mandatory buyout obligation that the operating farm cannot afford to fund.

IRS Updates

Cathy Murphy, CPA, EA

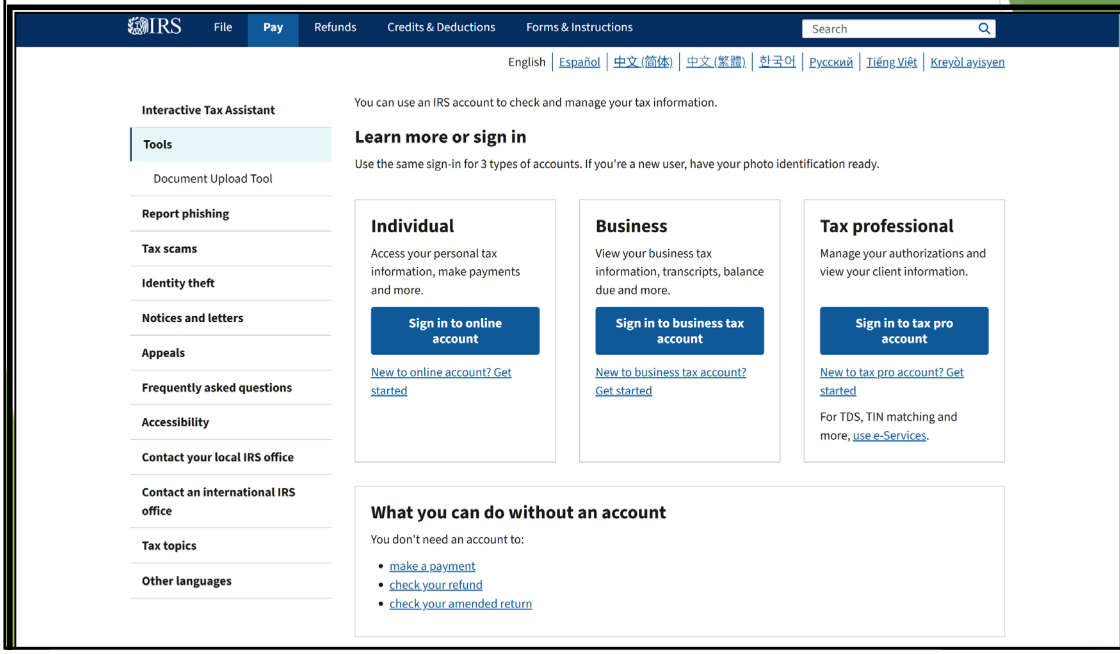
1

Topics we will cover

- Online with IRS
- Fraud reporting
- IRS TDS
- Taxpayer advocate
- General updates

2

IRS Online Accounts



3

IRS Individual Online account

- More information was posted to the online account during the 2026 filing season:
  - W-2s
  - 1095A
- These forms will be available for tax years 2024 and 2025 under the Records and Status tab in the taxpayer's Online Account.

4

Create an IRS Individual Online Account

- View key details from their most recent tax return, such as Adjusted Gross Income.
- Request an identity protection PIN and view it throughout the year.
- Check refund status.
- Get account transcripts, including wage and income records.
- Sign tax forms like powers of attorney or tax information authorizations.

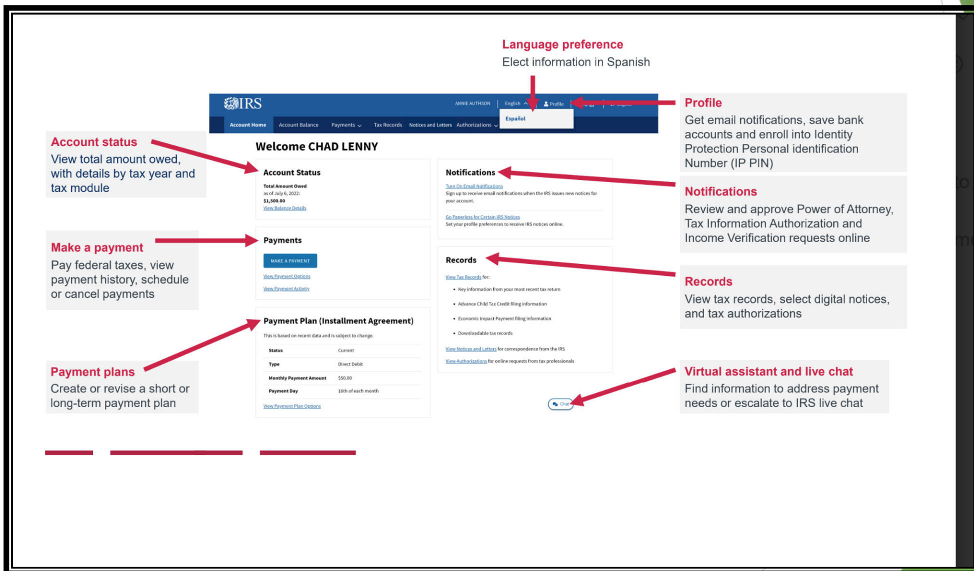
5

IRS Individual Online account

- View and edit language preferences and alternative media.
- Receive and view over 200 IRS electronic notices.
- View, make and cancel payments.
- Set up or change payment plans and check their balance.

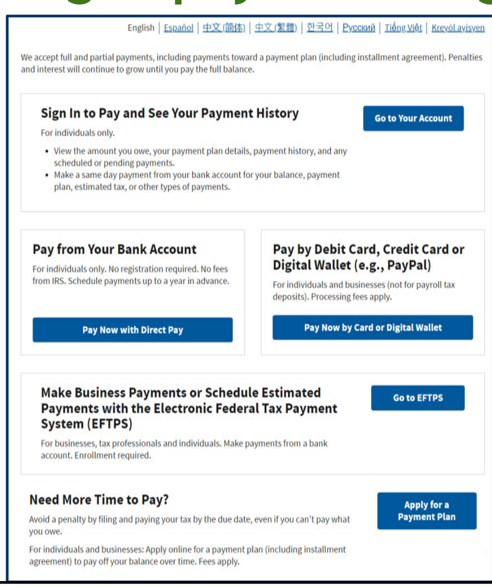
6

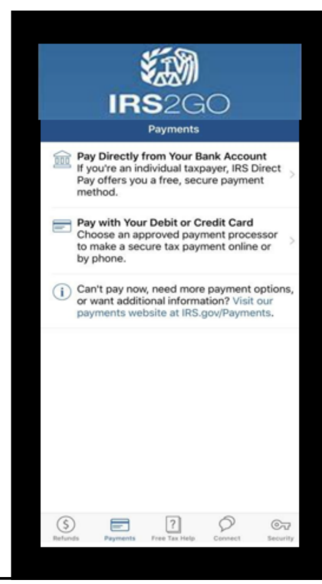
IRS Account info



7

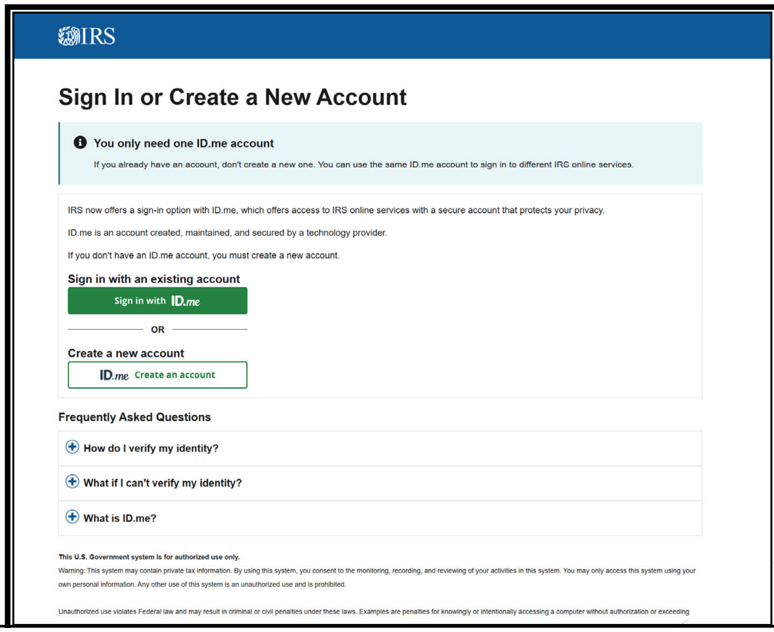
Pay Online
IRS.gov/pay and IRS.gov/IRS2GO





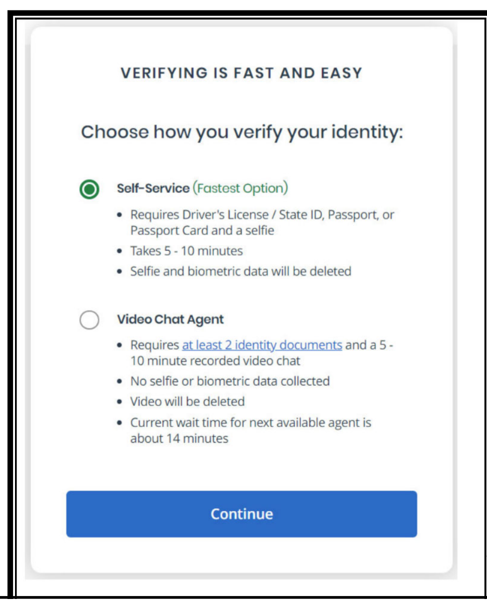
8

Create your account



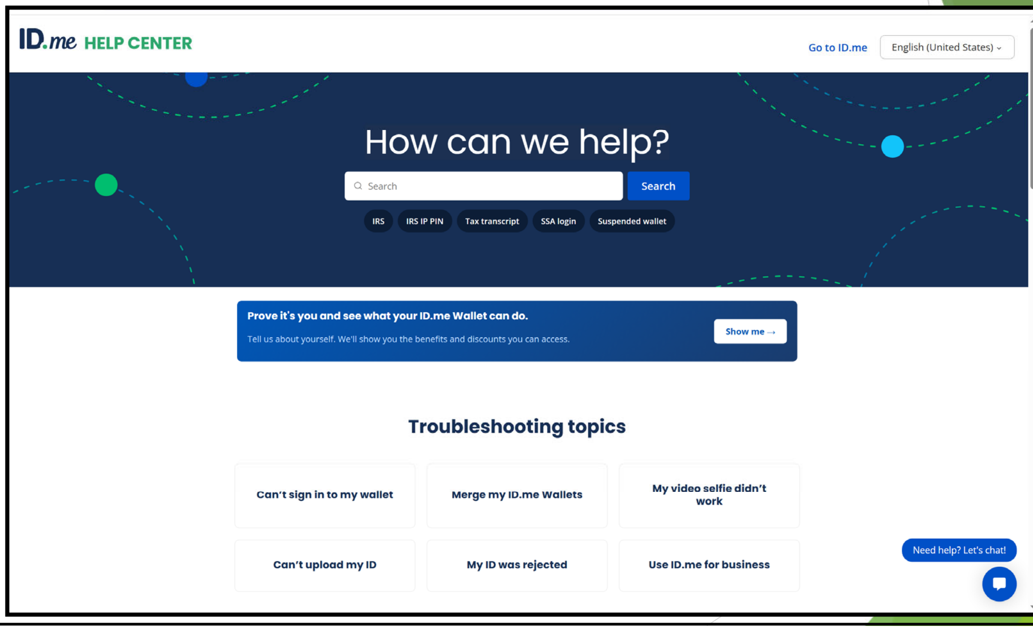
9

Verifying your identity



10

ID.me help line



11

CP 53E Notices

- You could receive a CP53E notice when:
  - Your tax return shows a refund, but the bank information is invalid, missing, or rejected, or
  - A return with a balance due is corrected by the IRS and now results in a refund, such as
    - Unreported Estimated Payments with your return, or
    - Math errors such as addition or subtraction

12

What you need to do

- When you receive the CP53E notice you have 30 days to update or add a new bank account or select an exception condition to allow a paper check.
- If you opted-in to receive refund status notifications in your online account, when you receive the notification, you may immediately update your direct deposit information

13

How to update your direct deposit information

- Sign in or create an online account.
- Check your **Notifications** in your **Account Home**.
- Select the **Add bank account** notification.
  (This option will only be present when a CP53E notice has been issued)
- Follow the prompts to add your account details. Guidance is provided if you don’t have a bank account.
- Allow around **2-5 business days** for your refund status to update in your online account.
- Other option is through your Profile on the online account.
- If you encounter any systemic issues that prevent you from updating your bank account information, read the message carefully and try again later.

14

Online payments

- Same day or schedule payments
- Short term Installments
- OIC options
- Cancel or change payments before the scheduled date
- View up to 5 years of payment history

15

Alerts available on IRS online account

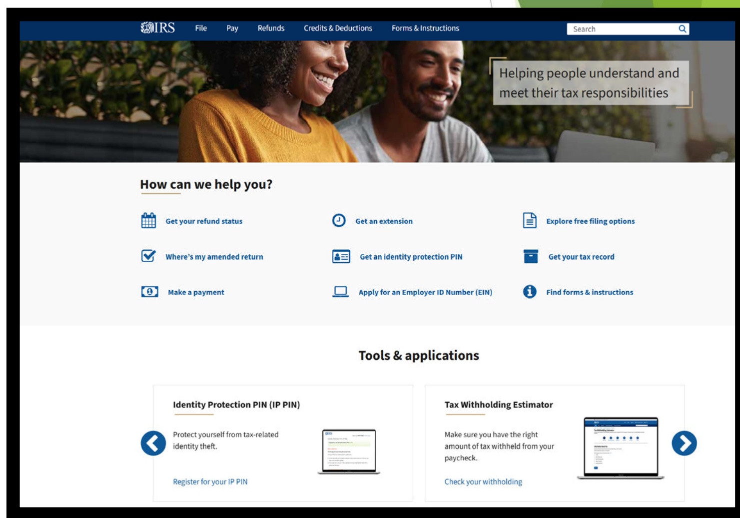
- You can now opt in to receive an email when your refund has changed status.
  - Return received
  - Return processed
  - Return sent
- Alert on Federal Liens
- Audit Status

16

IRS Taxpayer Protection Program

Expanded use of IP PIN

- Was originally used for targeted Identity theft victims.
- Now everyone can request an IP Pin
- You can now optout of the IP Pin



17

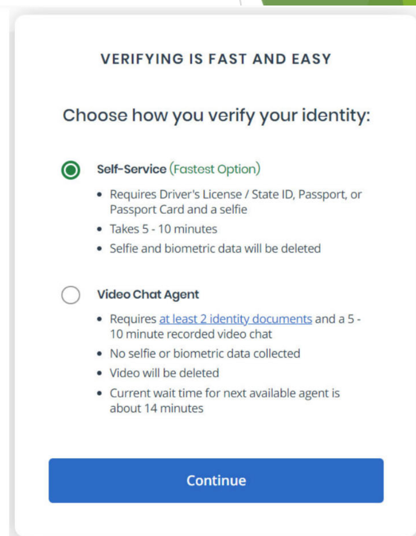
Getting your IP PIN

- Go to your online account
- Online through the IRS (get an IP Pin)
- Fill out an application (Form 15227)
- Go into an office to request one. (Appt needed)

18

New way to secure an IP Pin

Choose how you **verify your identity**.



19

IRS Taxpayer Protection Program

2026 filing season - Duplicate dependent claim

- Dependent claimed already
- Taxpayer has valid IP PIN
- Efile is now accepted – but IRS will still have to review

20

Online Account for Sole Proprietors

If you are a sole proprietor who filed

a **Schedule C, Profit or Loss from Business**

or **Schedule F, Profit or Loss from Farming** to account for your business income with an **employer identification number (EIN)**,

once registered, you will have full access to features and business information.

21

2024-2025 PLATFORM EXPANSION

Legacy Entities

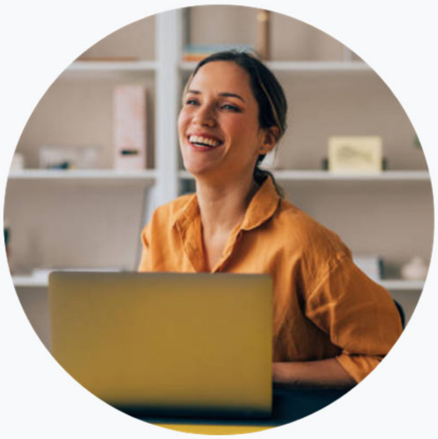
Initially launched for **Sole Proprietors** filing with an EIN. These users continue to have the most comprehensive account access as the foundational user base.

Newly Eligible Entities

The rollout now includes **Partnerships, S-Corporations, C-Corporations**, and non-profits. This allows diverse organizational structures to manage compliance digitally.

22

Empowering Sole Proprietors



- View federal tax balances in real-time.
- Download account and tax return transcripts.
- Manage payments and view history.
- Approve lender requests via IVES integration.

Full control for independent business owners through a centralized dashboard.

23

Unified Visibility Tools

Tax Transcripts

Access payroll, income, and business tax return transcripts instantly without mail delays.

Payment History

A comprehensive log of all digital payments, including pending and scheduled transactions.

Digital Notices

View and download select IRS notices directly within the portal for faster response times.

24

Electronic Payment Control

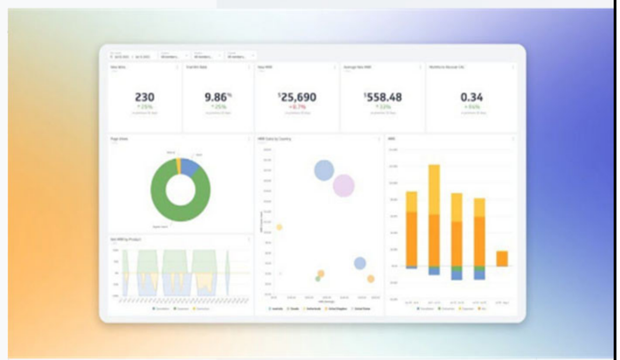
Financial Agility

Make one-time electronic payments for any tax liability.

Set up and schedule future payments to manage cash flow.

Cancel or modify scheduled payments easily online.

Real-time confirmation of transaction status.



25

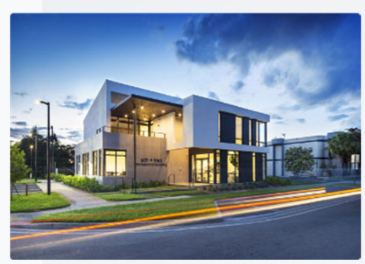
The Designated Official Role

Corporations

CEOs, CFOs, and Presidents can act as Designated Officials (DOs) with full access.

Partnerships

Managing members or authorized partners can view balances and compliance reports.



Gov/Tax-Exempt

Authorized officers for federal, state, and local entities manage entity visibility.

26

Setup Journey via ID.ME

1

Verify Identity

Use ID.me to verify your individual identity with photo ID.

2

Select Role

Identify as a Sole Proprietor or a Designated Official.

3

Input EIN

Provide the Employer Identification Number for the business.

4

Authorization

Complete validation via recent tax documents or PIN.

27

Access Level Matrix

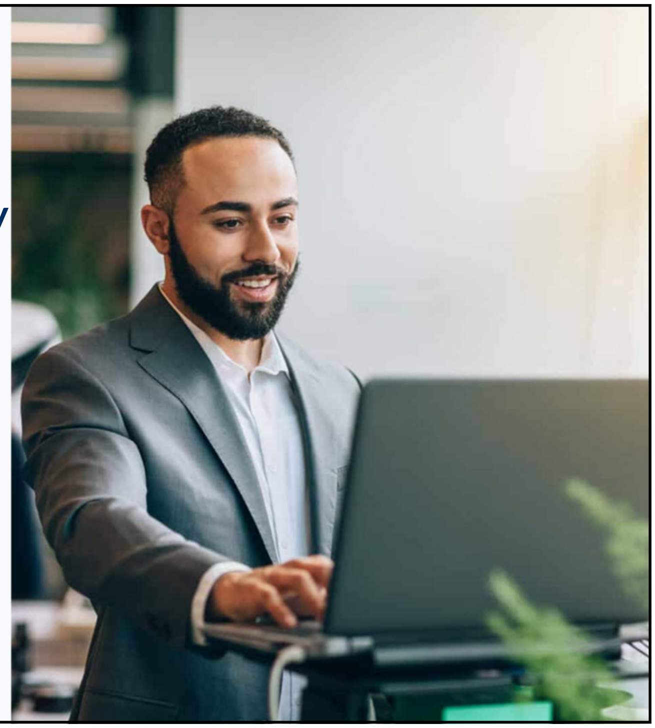
Feature	Sole Proprietor	Designated Official	Partner/Shareholder
View Balance Due	Full Access	Full Access	View Only
Make Payments	Full Access	Full Access	Not Available
IVES Authorizations	Full Access	Full Access	Not Available
Tax Transcripts	Download Ready	Download Ready	View Only
Account Revalidation	Not Required	Annual Requirement	Not Required

28

Strategic Value

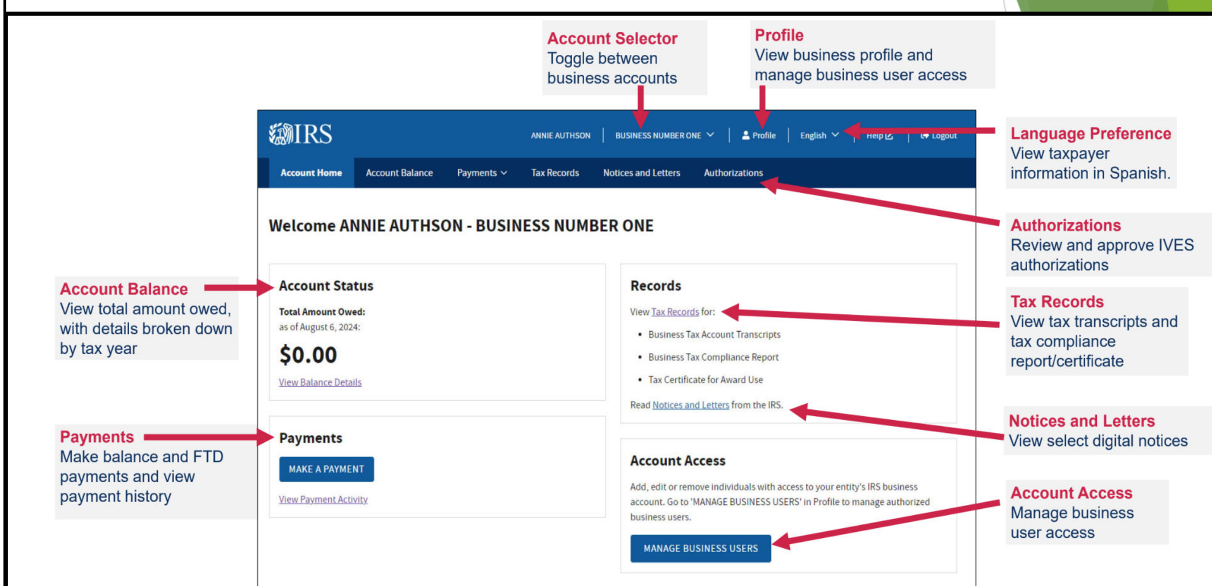
Drive Compliance & Efficiency

- **Security:** Advanced encryption and multi-factor authentication via ID.me.
- **Speed:** Instant access to historical data and current status.
- **Sustainability:** Shift to paperless interactions and clean energy credit registrations.



29

Business accounts



Access to business information and features varies based on *business type* and *taxpayer role*

30

Other information available to Sole Proprietors

Business profile

- View business information on file

Account balance and payments

- Make federal tax deposit payments
- Make balance due payments
- View payment history

31

Other information available to Sole Proprietors

Tax records

- View tax transcripts
- View tax compliance report
- View tax certificate for award use

Other features

- View notices and letters
- Manage third-party authorizations – Income Verification Express service

32

Tax compliance report vs. transcript

- **A tax compliance report** shows less of your personal or business information and covers a longer period. A tax compliance report shows whether you have filed tax returns and paid taxes on time. Employers, federal agencies, banks and other authorities sometimes request a tax check to see if you've met all your tax obligations.
- **A tax transcript** shows the full details of your tax return (including income, dependents and filing status) and covers only 1 year.

33

Partnership

Individual partner (limited access)

If you are a partner of a partnership that files

- a Form 1065, U.S. Return of Partnership Income
- and you receive a Schedule K-1 (Form 1065), Partner's Share of Income Deductions, Credits, etc. ,
- you will be able to register as an individual partner.

Once registered, you will have access only to years when you received a Schedule K-1. Tax years 2012-2023 are currently available.

34

Partnership information

Business profile

- View limited business information on file

Account balance and payments

- View balance due
- Make payments on balance due modules
- View payment history

Tax records

- View tax transcripts

35

S Corporations

Individual shareholder (limited access)

- If you are a shareholder of an S-Corporation that filed
- a Form 1120-S, U.S. Income Tax Return for an S Corporation, you and received a Schedule K-1 (Form 1120-S), Shareholder's Share of Income, Deductions, Credits, etc . Tax years 2006-2023 are currently available.

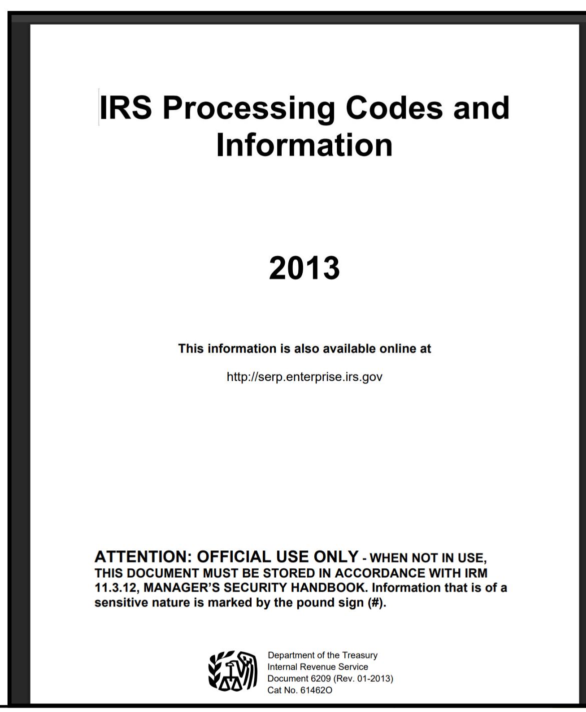
36

Working with transcripts

- Document 6209 – download
  - https://www.irs.gov/pub/irs-6209/document6209.pdf
- Use your e-Services account to pull up the TDS

37

Document 6209



IRS Processing Codes and Information

2013

This information is also available online at

http://serp.enterprise.irs.gov

ATTENTION: OFFICIAL USE ONLY - WHEN NOT IN USE, THIS DOCUMENT MUST BE STORED IN ACCORDANCE WITH IRM 11.3.12, MANAGER'S SECURITY HANDBOOK. Information that is of a sensitive nature is marked by the pound sign (#).

Department of the Treasury
Internal Revenue Service
Document 6209 (Rev. 01-2013)
Cat No. 61462O

38

Transacation Codes - Page 107

The ANMF system provides a means for assessing, collecting and reporting of Full Collection Child Support payments. #
State Child Support Enforcement Agencies provide the Secretary of Health and Human Services (HHS) with information #
of certain individuals (obligors) [redacted]. HHS will certify and forward the case to IRS for #
collection activity. (For more details see IRM 3.17.46.6). #

10 Transaction Codes

NMF TC	MF TC Code	D/C	Remarks
	011		EIN, SSN Change
	013		Name Change
	014		Address Change
	015		Location and/or Zip Change

Any line marked with # is for official use only

7-3

NMF TC	MF TC Code	D/C	Remarks
X-ref field only on ANMF			Spouse SSN Change
	030	D	Loc Code Change
	150		Tax Assessment Return
	150		Entity Created by TC 150
	160	D	Manually Computed Delinquency Penalty
	161	C	Abate Delinquency Penalty
	170	D	ES Tax Penalty
	171	C	Abate ES Tax Penalty
	180	D	Deposit Penalty (FTD)
	181	C	Abate Deposit Penalty (FTD)
340	190	D	Manually Assessed Interest - Transferred in (See TC 370)
341	191	C	Abate Assessed Interest - Transferred in
	200	D	Identification Number Penalty
	201	C	Abate TC 200
	234	D	Manual Daily Delinquency Penalty
	235	C	Abate TC 234/238
234	238*	D	Generated Daily Delinquency Penalty
235	239*	C	Abate Daily Delinquency Penalty
	240	D	Miscellaneous Penalty
	241	C	Abate Miscellaneous Penalty
	246*	D	Form 1065 – Missing Information
	270	D	Failure to Pay Tax Penalty (Manual)
	271	C	Abate FTP Tax Penalty (Manual)
	276*	D	FTP Tax Penalty
	277*	C	Abate FTP Tax Penalty
	280	D	Bad Check Penalty (manually assessed)
	281	C	Bad Check Penalty (Manually abated)
	286*	D	Bad Check Penalty (Systemically assessed)
	287*	C	Bad Check Penalty (Systemically abated)
	290	D	Additional Tax Assessment
	291	C	Abate Prior Tax Assessment
	294*	D	Adjusts TC 295 or 305
	295*	C	Tax Decrease with int. Date
	298*	D	Additional Assess with Int. Date
291	299*	C	Abate Prior Tax with Int. Date
	300	D	Examination Tax Assessment
	301	C	Abate Prior Tax Assessment
300	304*	D	Examination Adjust TC 305 or 295
301	305*	C	Exam tax decrease with Int. Date
300	308*	D	Additional Tax Assess with Int. Date
301	309*	C	Abate TC 308
	310	D	Penalty - Failure to Report Income from Tips
	311	C	Abate TC 310

39

Document 6209

NMF TC	MF TC Code	D/C	Remarks
	480		Offer-in Compromise Pending
	481		Offer-in Compromise Rejected
	482		Offer-in Compromise Withdrawn
	483		Correction of TC 480
	500		Military Deferment
	502		TC 500 Error Correction
	520		IRS Litigation
	521		Reverse IRS Litigation
	522		TC 520 Error Correction
	524		Collateral Pending
	525		Reverse TC 524
	531		Reverse TC 530
	532		Correction of TC530 Processed in Error
530	534*	C	Expired Balance Write-off
531	535*	D	Reversal of TC 534
531	537*		Reversal of Uncollectible Status
	550		Collection Statute Extension
	582		Indicates Federal Tax Lien Filed
	583		Reverses TC 582
	606	C	Small Debit Cleared
	607	D	Small Debit Cleared
	608	C	Collection Statute Expiration cleared
	609	D	Reverse CSED cleared
	610	C	Payment received with return
	611	D	Check Returned Unpaid by Bank
	612	D	Reverse Payment with return
	640	C	Advanced Payment
	641	D	Designated Advanced Payment Returned Unpaid by Bank
	642	D	Advanced Payment Error
	650	C	FTD Credit
	651	D	Federal Tax Deposit (FTD) Returned Unpaid by Bank
	652	D	Error FTD Credit
	661	D	Estimated Tax Payment Returned Unpaid by Bank
	662	D	Error on Estimated Payment
	670	C	Subsequent Payment
	671	D	Subsequent Payment Returned Unpaid by Bank
670	678*	C	Credit for Treasury Bond
672	679*	D	Reversed TC 678
	680	C	Designated Interest Payment
	681	D	Designated Interest Payment Returned Unpaid by Bank
	682	D	Correction of 680 Processed in Error
	690	C	Designated Penalty Payment
	691	D	Designated Penalty Payment Returned Unpaid by Bank
	692	D	TC 690 Error Correction
	694	C	Designated Payment of Fees and Collection Costs
	695	D	Reverses TC 694
	700	C	Credit Applied
702	701*	D	Reverse TC 706
	702	D	TC 700 Error Correction
700	706*	C	Overpayment Applied From Another Tax Module
	710	C	Credit Elect Overpayment Applied
	712	D	TC 710 or 716 Error Correction
	716	C	Credit Elect Overpayment Applied
841	720*	C	Refund Payment
843	721*	D	Bad Check Refund Repayment
843	722*	D	TC 720 Error Correction
	730	C	Overpayment Credit Interest Applied
730	736*	C	Interest Overpayment Applied
	740	C	Undelivered Refund Check Deposited
	742	D	Correction of TC 740 Processed in Error
700	756*	C	Overpayment Interest from IMF
	760	C	Substantiated Payment

40

Document 6209

7-5

NMF TC	MF TC Code	D/C	Remarks
	762	D	Correction of TC 760 Processed in Error
	764	C	Earned Income Credit
	765	D	Earned Income Credit Reversal
	766	C	Refundable Credit Allowance
	767	D	Reverses TC 768
764	768*	C	Earned Income Credit
	770	C	Interest Due Taxpayer
	771	D	TC 770 or 776 Int. Reversal
	772	D	TC 770 or 776 Error Correction
770	776*	C	Interest Due on Overpayment
	777	D	Reversal Interest Due Taxpayer
	780		Master File Account Compromise
	781		Defaulted Account Compromise
	782		TC 780 Error Correction
700	790*	C	Manual Overpayment from IMF
820	792*	D	TC 790 or 796 Error Correction
700	796*	C	Overpayment Credit from IMF
	800	C	Credit for Withheld Taxes and Excess FICA
802	807	D	Withholding Credits Reversed
	820	D	Credit Transferred
822	821*	C	Reverses TC 826
	822	C	Reverses TC 820
820	824*	D	CR Transfer Releases 130 Frz
820	826*	D	Overpayment Transferred
	830	D	Credit Elect Transferred
	832	C	TC 830 or 836 Correction
830	836*	D	Credit Elect Transferred
	840	D	Refund Prior to Settlement
	841	C	Cancelled Refund Deposited
	842	C	Refund Deletion
840	843	D	Check Cancellation Reversal (TC 841) Returned Unpaid by Bank
	850	D	Overpayment Int. Transferred
	851	C	Reverse TC 856
	852	C	Correction of TC 850
850	856*	D	Overpayment Int. Transferred
	860*	D	Reverses An Erroneous Abatement after ASED has expired
	862	C	Reverses TC 860
850	876*	D	Overpayment Int. Transfer to BMF
820	890*	D	Overpayment Cr. Transfer to BMF
822	892*	C	TC 890 or 896 Error Correction
820	896*	D	Overpayment Credit Offset
822	897*	C	DMF Offset Reversal
	912		Reverses TC 914
	914		Active Intell. Investigation (a module)

Listed are the transaction codes used within the ANMF system. Almost all of the transaction codes used on the Master File are applicable on the Non Master File. However, there are some distinct differences. (D = Debit, C = Credit, * = Transaction codes must be converted for NMF processing)

41

Actual case - handout 1

Taxpayer Identification Number: XXX-[redacted]

[redacted]

POWER OF ATTORNEY/TAX INFORMATION AUTHORIZATION (POA/TIA) ON FILE

— Any minus sign shown below signifies a credit amount —

Account balance:	$8,525.96		
Accrued interest:	$296.52	As of:	06-08-2026
Accrued penalty:	$0.00	As of:	06-08-2026
Account balance plus accruals (this is not a payoff amount):	$8,822.48		

**** Information from the return or as adjusted ****

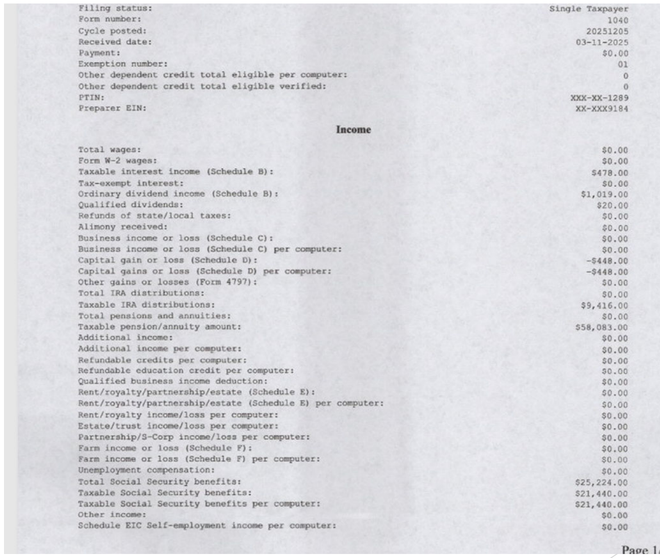
Exemptions:	01
Filing status:	Single
Adjusted gross income:	$0.00
Taxable income:	$0.00
Tax per return:	$0.00
SE taxable income taxpayer:	$0.00
SE taxable income spouse:	$0.00
Total self employment tax:	$0.00
Return due date or return received date (whichever is later):	04-01-2025
Processing date:	04-28-2025

TRANSACTIONS

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Substitute tax return prepared by IRS 11210-887-00015-5	20251505	04-28-2025	$0.00
140	Inquiry for non-filing of tax return		07-10-2024	$0.00
971	Notice issued CP 0059		07-29-2024	$0.00
960	Appointed representative		01-16-2025	$0.00
494	Final notice before tax is determined by IRS		02-04-2025	$0.00
495	Resolved tax determination		04-01-2025	$0.00
595	Account referred for review		04-08-2025	$0.00
570	Additional account action pending		04-28-2025	$0.00
610	Payment with return 00		05-06-2025	-$6,418.00
270	Penalty for late payment of tax	20254705	12-08-2025	$822.12
170	Penalty for not pre-paying tax 12-08-2035	20254705	12-08-2025	$207.30
160	Penalty for filing tax return after the due date 12-08-2035	20254705	12-08-2025	$1,422.90
196	Interest charged for late payment	20254705	12-08-2025	$2,545.64
971	Notice issued CP 0022		12-08-2025	$0.00
670	Payment 00		01-12-2026	-$1,500.00
470	Claim pending		05-04-2026	$0.00

42

Tax return transcript



Filing status:	Single Taxpayer
Form number:	1040
Cycle posted:	20251205
Received date:	03-11-2025
Payment:	$0.00
Exemption number:	01
Other dependent credit total eligible per computer:	0
Other dependent credit total eligible verified:	0
PTIN:	XXX-XX-1289
Preparer EIN:	XX-XXX9184

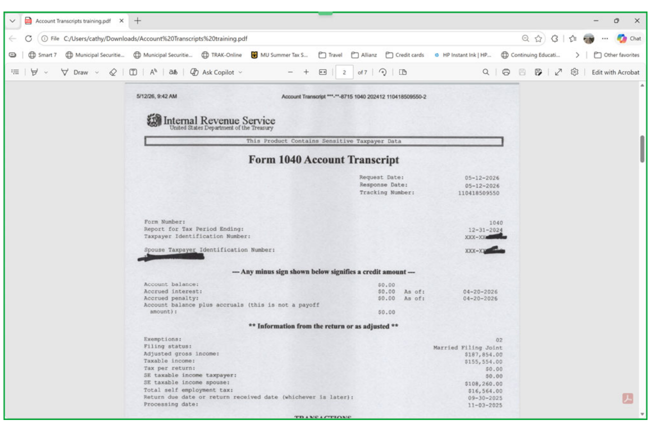
Income

Total wages:	$0.00
Form W-2 wages:	$0.00
Taxable interest income (Schedule B):	$478.00
Tax-exempt interest:	$0.00
Ordinary dividend income (Schedule B):	$1,019.00
Qualified dividends:	$20.00
Refunds of state/local taxes:	$0.00
Alimony received:	$0.00
Business income or loss (Schedule C):	$0.00
Business income or loss (Schedule C) per computer:	$0.00
Capital gain or loss (Schedule D):	-$448.00
Capital gains or loss (Schedule D) per computer:	-$448.00
Other gains or losses (Form 4797):	$0.00
Total IRA distributions:	$0.00
Taxable IRA distributions:	$9,416.00
Total pensions and annuities:	$0.00
Taxable pension/annuity amount:	$58,083.00
Additional income:	$0.00
Additional income per computer:	$0.00
Refundable credits per computer:	$0.00
Refundable education credit per computer:	$0.00
Qualified business income deduction:	$0.00
Rent/royalty/partnership/estate (Schedule E):	$0.00
Rent/royalty/partnership/estate (Schedule E) per computer:	$0.00
Rent/royalty income/loss per computer:	$0.00
Estate/trust income/loss per computer:	$0.00
Partnership/S-Corp income/loss per computer:	$0.00
Farm income or loss (Schedule F):	$0.00
Farm income or loss (Schedule F) per computer:	$0.00
Unemployment compensation:	$0.00
Total Social Security benefits:	$25,224.00
Taxable Social Security benefits:	$21,440.00
Taxable Social Security benefits per computer:	$21,440.00
Other income:	$0.00
Schedule EIC Self-employment income per computer:	$0.00

Page 1/

43

Account transcript - Handout 2



5/12/26, 9:42 AM

Account Transcript ***-**-8715 1040 202412 110418509550-2

Internal Revenue Service
United States Department of the Treasury

This Product Contains Sensitive Taxpayer Data

Form 1040 Account Transcript

Request Date:	05-12-2026
Response Date:	05-12-2026
Tracking Number:	110418509550

Form Number:	1040
Report for Tax Period Ending:	12-31-2024
Taxpayer Identification Number:	XXX-XX[redacted]
Spouse Taxpayer Identification Number:	XXX-X[redacted]

[redacted]

— Any minus sign shown below signifies a credit amount —

Account balance:	$0.00		
Accrued interest:	$0.00	As of:	04-20-2026
Accrued penalty:	$0.00	As of:	04-20-2026
Account balance plus accruals (this is not a payoff amount):	$0.00		

**** Information from the return or as adjusted ****

Exemptions:	02
Filing status:	Married Filing Joint
Adjusted gross income:	$187,854.00
Taxable income:	$155,554.00
Tax per return:	$0.00
SE taxable income taxpayer:	$0.00
SE taxable income spouse:	$108,260.00
Total self employment tax:	$16,564.00
Return due date or return received date (whichever is later):	09-30-2025
Processing date:	11-03-2025

TRANSACTIONS

44

Account transcript – Handout 2

Processing date: 11-03-2025

TRANSACTIONS

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Tax return filed 70205-674-00406-5	20254205	11-03-2025	$0.00
660	Estimated tax payment 00		04-13-2024	-$1,000.00
660	Estimated tax payment 00		06-14-2024	-$1,000.00
660	Estimated tax payment 00		09-13-2024	-$1,000.00
660	Estimated tax payment 00		01-11-2025	-$1,000.00
460	Extension of time to file tax return		04-11-2025	$0.00
846	Refund issued		11-03-2025	$4,000.00
670	Payment 00		02-20-2026	-$45,798.00
570	Additional account action pending		03-16-2026	$0.00
971	Amended tax return or claim forwarded for processing		02-13-2026	$0.00
977	Amended return filed 33277-458-67369-6		02-13-2026	$0.00
960	Appointed representative		02-19-2026	$0.00

Page 1/2

5/12/26, 9:42 AM Account Transcript ***-**-8715 1040 202412 110418509550-2

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
196	Interest charged for late payment	20261105	04-06-2026	$2,351.60
826	Credit transferred out to 30 20231231		02-20-2026	$958.65
971	Notice issued CP 0021		04-06-2026	$0.00
971	Notice issued		04-06-2026	$0.00

45

Account transcript – Handout 2

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
660	Estimated tax payment 00		09-13-2024	-$1,000.00
660	Estimated tax payment 00		01-11-2025	-$1,000.00
460	Extension of time to file tax return		04-11-2025	$0.00
846	Refund issued		11-03-2025	$4,000.00
670	Payment 00		02-20-2026	-$45,798.00
570	Additional account action pending		03-16-2026	$0.00
971	Amended tax return or claim forwarded for processing		02-13-2026	$0.00
977	Amended return filed 33277-458-67369-6		02-13-2026	$0.00
960	Appointed representative		02-19-2026	$0.00

Page 1/2

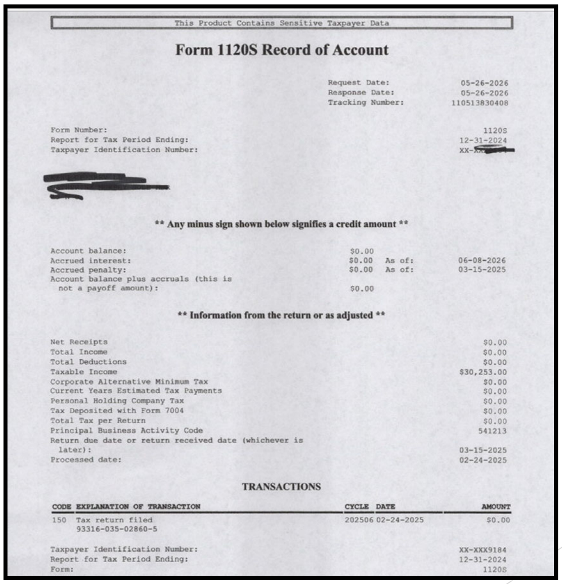
5/12/26, 9:42 AM Account Transcript ***-**-8715 1040 202412 110418509550-2

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
196	Interest charged for late payment	20261105	04-06-2026	$2,351.60
826	Credit transferred out to 30 20231231		02-20-2026	$958.65
971	Notice issued CP 0021		04-06-2026	$0.00
971	Notice issued CP 0049		04-06-2026	$0.00
570	Additional account action pending		04-06-2026	$0.00
571	Resolved additional account action		04-13-2026	$0.00
846	Refund issued		04-13-2026	$1,606.19
776	Interest credited to your account		04-13-2026	-$10.44

This Product Contains Sensitive Taxpayer Data

46

Handout 3



This Product Contains Sensitive Taxpayer Data

Form 1120S Record of Account

Request Date:	05-26-2026
Response Date:	05-26-2026
Tracking Number:	110513830408

Form Number:	1120S
Report for Tax Period Ending:	12-31-2024
Taxpayer Identification Number:	XX-[redacted]

[redacted]

**** Any minus sign shown below signifies a credit amount ****

Account balance:	$0.00		
Accrued interest:	$0.00	As of:	06-08-2026
Accrued penalty:	$0.00	As of:	03-15-2025
Account balance plus accruals (this is not a payoff amount):	$0.00		

**** Information from the return or as adjusted ****

Net Receipts	$0.00
Total Income	$0.00
Total Deductions	$0.00
Taxable Income	$30,253.00
Corporate Alternative Minimum Tax	$0.00
Current Years Estimated Tax Payments	$0.00
Personal Holding Company Tax	$0.00
Tax Deposited with Form 7004	$0.00
Total Tax per Return	$0.00
Principal Business Activity Code	541213
Return due date or return received date (whichever is later):	03-15-2025
Processed date:	02-24-2025

TRANSACTIONS

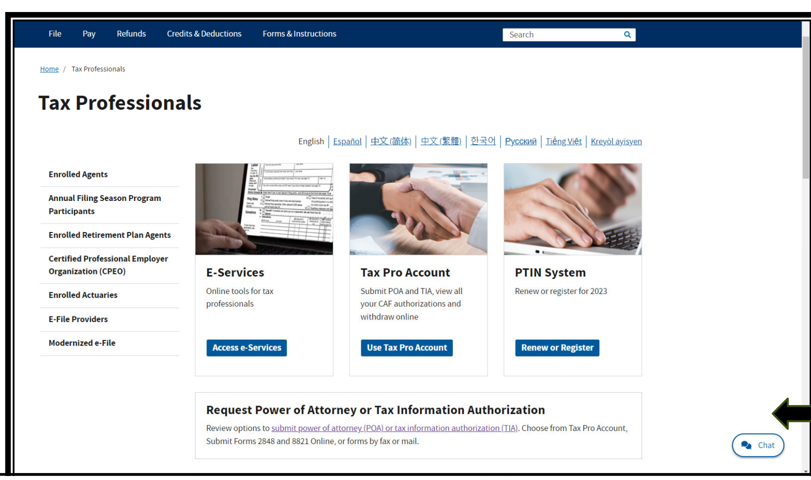
CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Tax return filed 93316-035-02860-5	202506	02-24-2025	$0.00

Taxpayer Identification Number:	XX-XXX9184
Report for Tax Period Ending:	12-31-2024
Form:	1120S

47

New features in Tax Pro Account

- New CAF program available
- Now able to see all authorizations on e-services



48

Link your CAF Number to your e-services

Account Home / Your Profile / Link Your CAF Number

Link Your CAF Number

Do more in Tax Pro Account when you link your Centralized Authorization File (CAF) number.

This one-time process lets you:

- View active authorizations for individuals and businesses recorded on the CAF
- Withdraw in real-time from any active authorization

If you choose not to link your CAF number, you can still use Tax Pro Account, including requesting POAs and TIAs.

How It Works

Linking your CAF number is a one-time process. It lets you view your active authorizations for individuals and businesses recorded on the CAF.

The CAF number must be assigned to you as an individual and only you can link it. If you have more than one CAF number, you may link them all.

To link your CAF number, you'll need to verify your identity as the person who is assigned the number.

Follow these steps:

STEP 1

Request a PIN

To start the process, you'll need to request a Personal Identification Number (PIN).

We'll mail your assigned PIN in an IRS notice to the address associated with your CAF number. Allow 1-2 weeks for the PIN to arrive.

REQUEST PIN

STEP 2

Enter the PIN

Enter your PIN and CAF number in Tax Pro Account to link your CAF number.

Once the CAF number is linked, you can view your active authorizations for individuals and businesses recorded on the CAF.

ENTER PIN

Back to Profile

Help Topics

49

Receive notice in mail

IRS
Department of the Treasury
Internal Revenue Service
Ogden, UT 84201-0002

For your reference	
Notice name	CP310
Notice date	10/11/2023
CAF number	****07291

For more information
Visit irs.gov/cp310 to learn more. You can also call 866-860-4259.

000190.371008.391462.29502 1 SP 0.630 371

CATHERINE MURPHY
29 N OAKLAND DR
CASEYVILLE, IL 62232

000190

Thank you for using Tax Pro Account

We assigned you a Personal Identification Number (PIN)
You requested to associate your existing Centralized Authorization File (CAF) number to your personal information through Tax Pro Account for identity assurance. A CAF number is a unique nine-digit identification number we assigned to you the first time you filed a third-party authorization with the IR [redacted]

We generated the following PIN in response to your request. Use the PIN to verify your identity and complete your request.

Your PIN is: 30158823

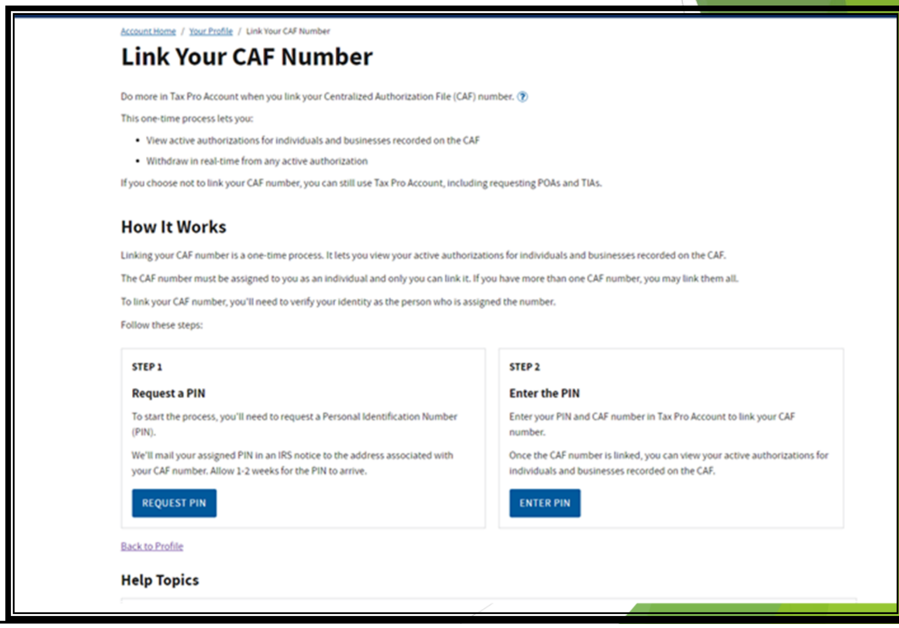
What you need to do
- Sign in to Tax Pro Account at irs.gov/taxproaccount.
- Associate your CAF number to your personal information by entering the PIN number.
- You don't need to call or respond to this notice.

What you should know about your PIN
- It is for one-time use only and will expire in 30 days.
- It is unique to this CAF number.
- It can only be used to verify ownership of your CAF number in Tax Pro Account.
- It is for your use only. Don't share it with anyone.

What you should know about keeping your PIN secure
The IRS doesn't contact taxpayers or tax professionals by email, text message or social media to request personal or financial information. This includes requests for PIN numbers, passwords or similar access information for credit cards, banks or other financial accounts.

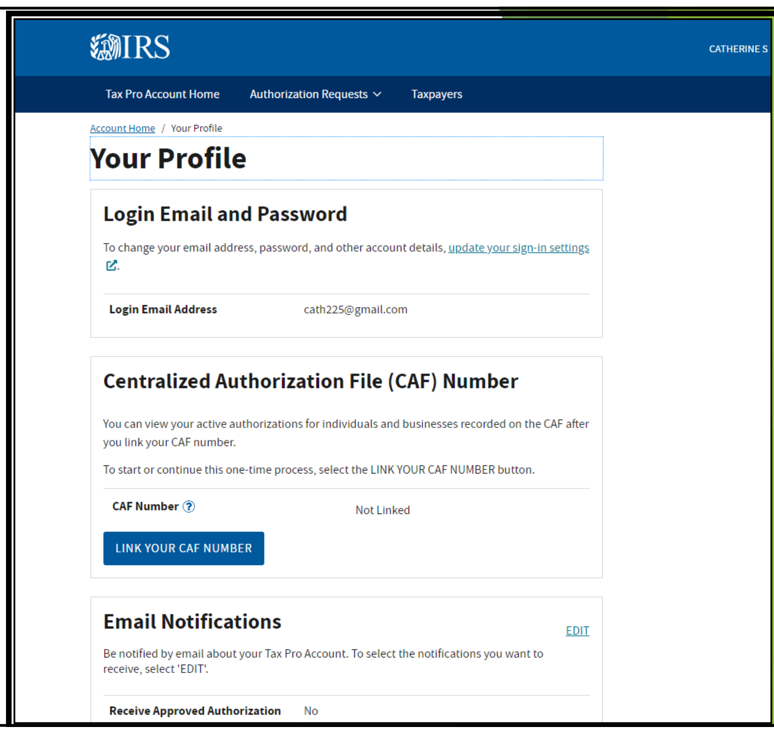
50

Enter your pin from notice to your e-services



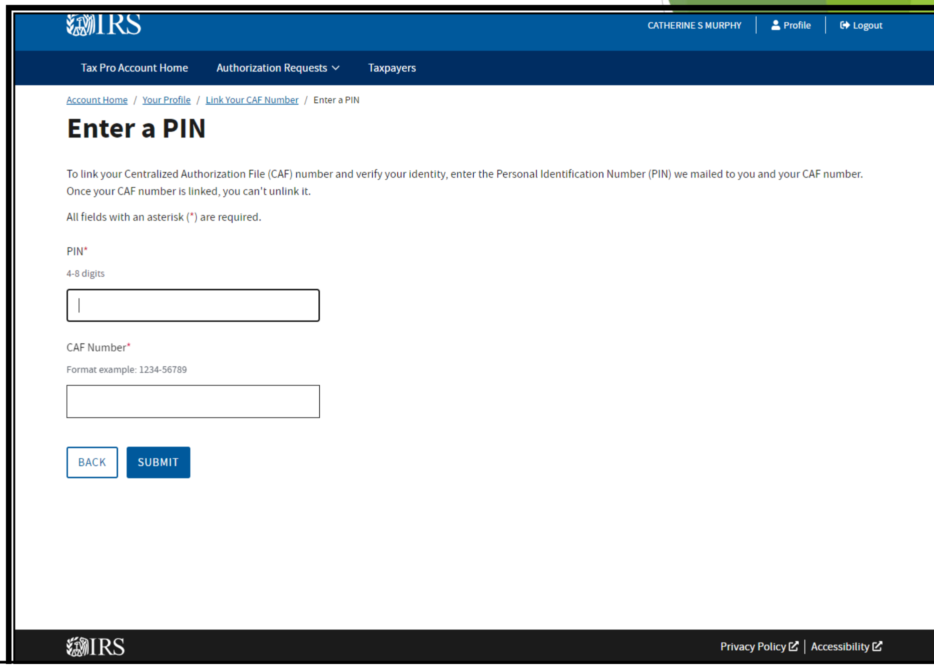
51

In your profile, link your CAF number



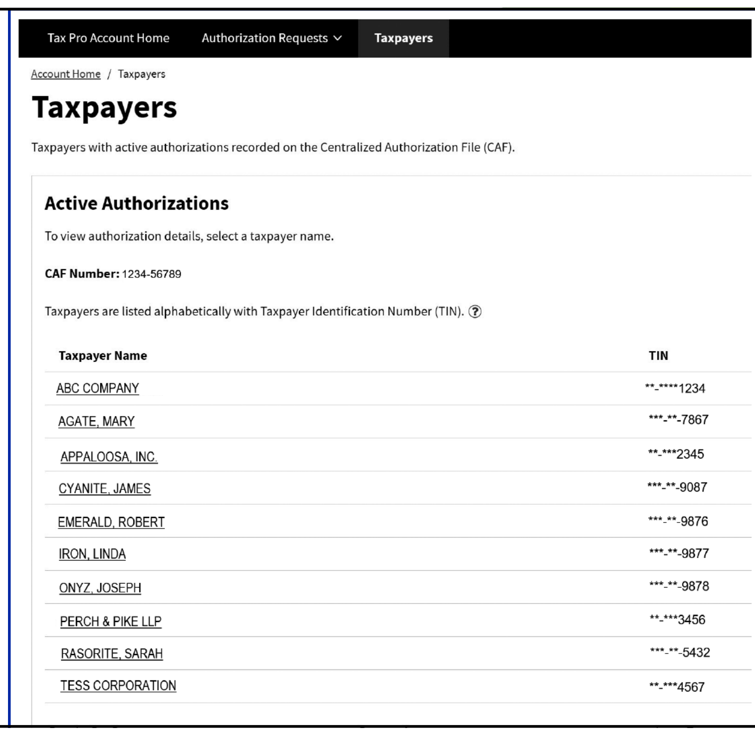
52

Enter your PIN



53

Select a taxpayer



54

Select a taxpayer

To view details for this taxpayer, select a tab.

Note: Account information shown is under your authorization only. Balance due doesn't include information outside your authorization.

Authorizations Account Balance

Authorizations

Active Authorizations

To view or withdraw an authorization for this taxpayer, select the authorization Type. Authorizations are listed by the most recent Signature Date.

Type	Signature Date	Periods	Tax Form
Form 2848	06/14/2021	Dec 2018 - Dec 2020	1040 Series

Results Per Page 10 | Page 1 of 1 | PREVIOUS 1 NEXT | Jump To GO

Back to Taxpayers

Help Topics

Type of Authorization

55

Type of Authorization and Withdraw

Form 2848, Power of Attorney and Declaration of Representative

Signature Date: 08/09/2022

Form Details

Tax Form	**1040 Series**
Periods	Dec 2019 - Dec 2025

Authorization Information

Designation	Certified Public Account
Communications	Authorized to receive copies of notices and other written communications

Back to Taxpayer Details

Withdraw this Authorization

You can withdraw an authorization at any time. Once you withdraw, the authorization is immediately and permanently removed from the CAF database.

To withdraw this authorization, provide your electronic signature.

Electronic Signature

All fields with an asterisk (*) are required.

☐ By checking this box, you are electronically signing your request to withdraw this authorization from the CAF database.*

WITHDRAW

56

Scams - be aware

57

Social media: Fraudulent form filing and bad advice

- Social media can circulate inaccurate or misleading tax information, and the IRS has recently seen schemes that encourage people to submit false, inaccurate information in hopes of getting a refund or taking advantage of a credit, such as the Employee Retention Credit and the Fuel Tax Credit. Taxpayers should always remember that if something sounds too good to be true, it probably is.

58

Bogus self-employment tax credit

Social media advice continues to circulate about a non-existent "Self-Employment Tax Credit" that's misleading taxpayers into filing false claims. Promoters market it as a way for self-employed people and gig workers to get payments of up to $32,000 for the COVID-19 pandemic period.

- In reality, the underlying credit being referred to in social media is not called the "Self-Employment Tax Credit," it's a much more limited and technical credit called the Credits for Sick Leave and Family Leave. Many people simply do not qualify for these credits, and the IRS is closely reviewing claims coming in under this provision.

59

Online Account help from third-party scammers

- Scammers pose as a "helpful" third party and offer to help create a taxpayer's IRS Online Account at IRS.gov, but their real goal is to steal personal information. Taxpayers should access their account directly through IRS.gov.

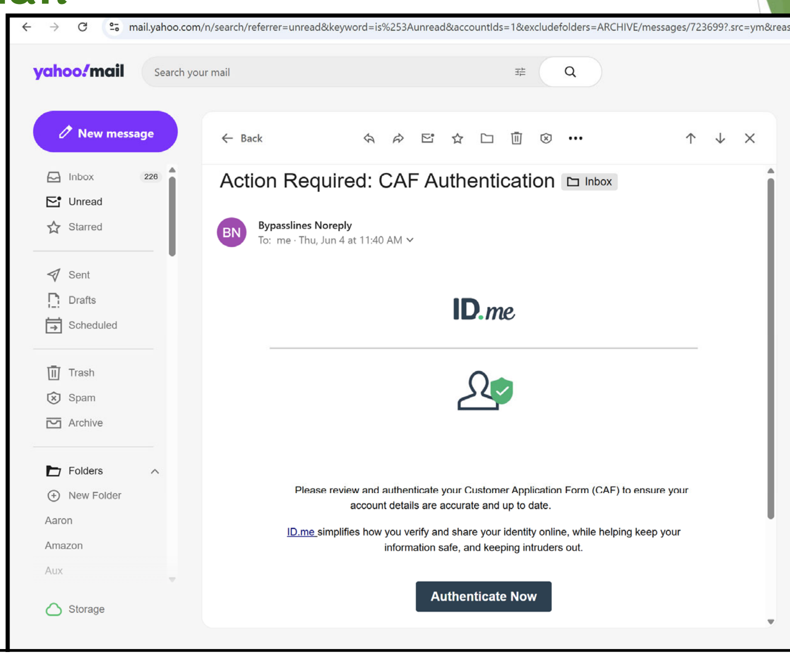
60

Unusual EFIIN Activity

- Software companies are contacting Tax Professionals
- Need to review your EFIN online in E-Services

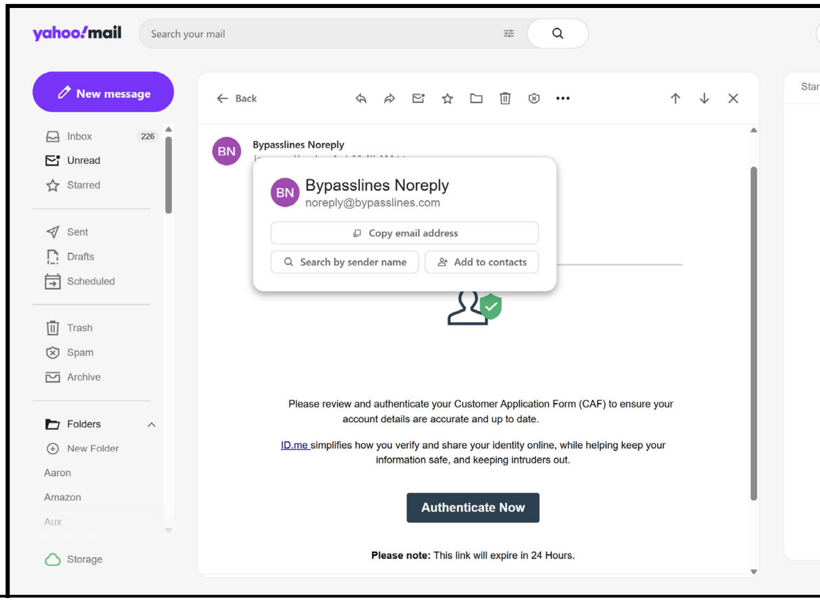
61

Scam email



62

Scam email



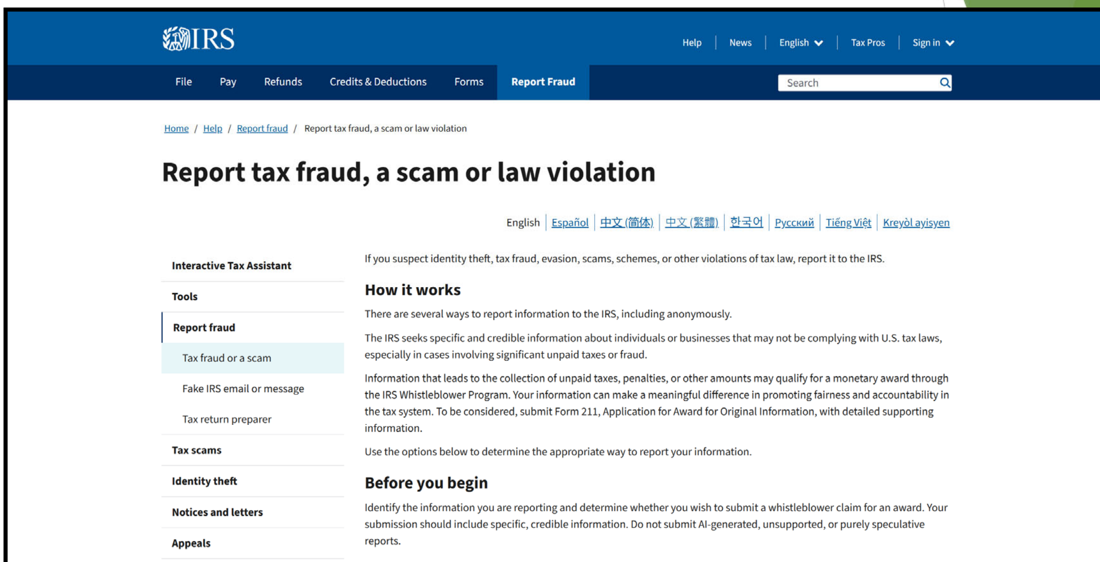
63

Unscrupulous tax return preparers

- Most tax preparers provide outstanding and professional service.
- However, people should be careful of shady tax professionals and watch for common warning signs, including charging a fee based on the size of the refund.
- A major red flag or warning sign is when the tax preparer is unwilling to sign on the dotted line. Avoid these "ghost" preparers, who will prepare a tax return but refuse to sign or include their IRS Preparer Tax Identification Number as required by law.
- Taxpayers should never sign a blank or incomplete return

64

Reporting Fraud to the IRS



IRS

Help | News | English | Tax Pros | Sign in

File | Pay | Refunds | Credits & Deductions | Forms | Report Fraud | Search

Home / Help / Report fraud / Report tax fraud, a scam or law violation

Report tax fraud, a scam or law violation

English | Español | 中文 (简体) | 中文 (繁體) | 한국어 | Русский | Tiếng Việt | Kreyòl ayisyen

- Interactive Tax Assistant
- Tools
- Report fraud
  - Tax fraud or a scam
  - Fake IRS email or message
  - Tax return preparer
- Tax scams
- Identity theft
- Notices and letters
- Appeals

If you suspect identity theft, tax fraud, evasion, scams, schemes, or other violations of tax law, report it to the IRS.

How it works

There are several ways to report information to the IRS, including anonymously.

The IRS seeks specific and credible information about individuals or businesses that may not be complying with U.S. tax laws, especially in cases involving significant unpaid taxes or fraud.

Information that leads to the collection of unpaid taxes, penalties, or other amounts may qualify for a monetary award through the IRS Whistleblower Program. Your information can make a meaningful difference in promoting fairness and accountability in the tax system. To be considered, submit Form 211, Application for Award for Original Information, with detailed supporting information.

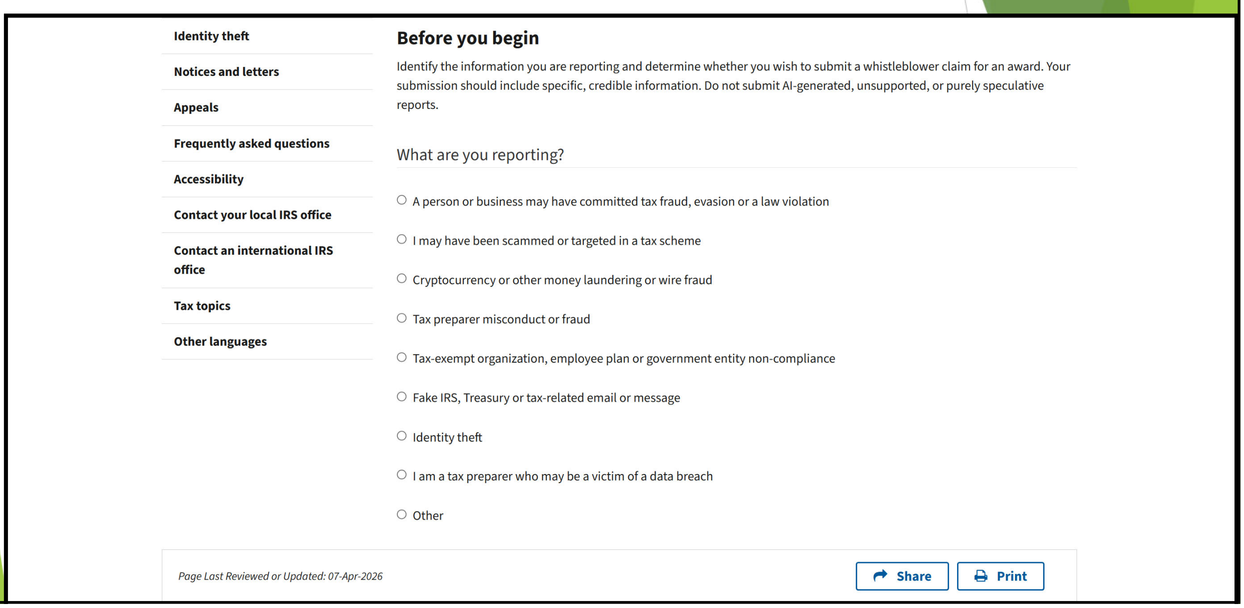
Use the options below to determine the appropriate way to report your information.

Before you begin

Identify the information you are reporting and determine whether you wish to submit a whistleblower claim for an award. Your submission should include specific, credible information. Do not submit AI-generated, unsupported, or purely speculative reports.

65

Answer the question



- Identity theft
- Notices and letters
- Appeals
- Frequently asked questions
- Accessibility
- Contact your local IRS office
- Contact an international IRS office
- Tax topics
- Other languages

Before you begin

Identify the information you are reporting and determine whether you wish to submit a whistleblower claim for an award. Your submission should include specific, credible information. Do not submit AI-generated, unsupported, or purely speculative reports.

What are you reporting?

- A person or business may have committed tax fraud, evasion or a law violation
- I may have been scammed or targeted in a tax scheme
- Cryptocurrency or other money laundering or wire fraud
- Tax preparer misconduct or fraud
- Tax-exempt organization, employee plan or government entity non-compliance
- Fake IRS, Treasury or tax-related email or message
- Identity theft
- I am a tax preparer who may be a victim of a data breach
- Other

Page Last Reviewed or Updated: 07-Apr-2026

Share | Print

66

Answers will direct you to correct form

Tax preparer misconduct or fraud

Fraud or misconduct by a paid tax preparer or tax preparation business can include:

- Stealing or embezzling a refund
- Not filing a return as agreed
- Filing a return without your consent
- Falsifying information on a return
- Misrepresenting credentials
- Not complying with tax law on their own return

Do you want to submit a whistleblower claim for award? To be considered, you'll need to provide your contact information.

Yes No

Do you have specific and credible information about tax law violations or other laws the IRS is authorized to administer, enforce or investigate?

This includes:

- Specific and credible facts that may lead to collected proceeds
- The identity of individuals you believe have failed to comply with internal revenue laws
- Substantive information, including all available documentation, that supports your allegations

Yes No

Are you a current employee of the Department of Treasury?

Yes No

67

Whistleblower Form 211

IRS File Pay Refunds Credits & Deductions Forms **Report Fraud** Search

Yes No

Are you a current employee of the Department of Treasury?

Yes No

Are you willing to provide information about yourself and sign under penalty of perjury?

Yes No

You qualify to submit a whistleblower claim for award

Follow the steps in Form 211, Application for Award for Original Information.

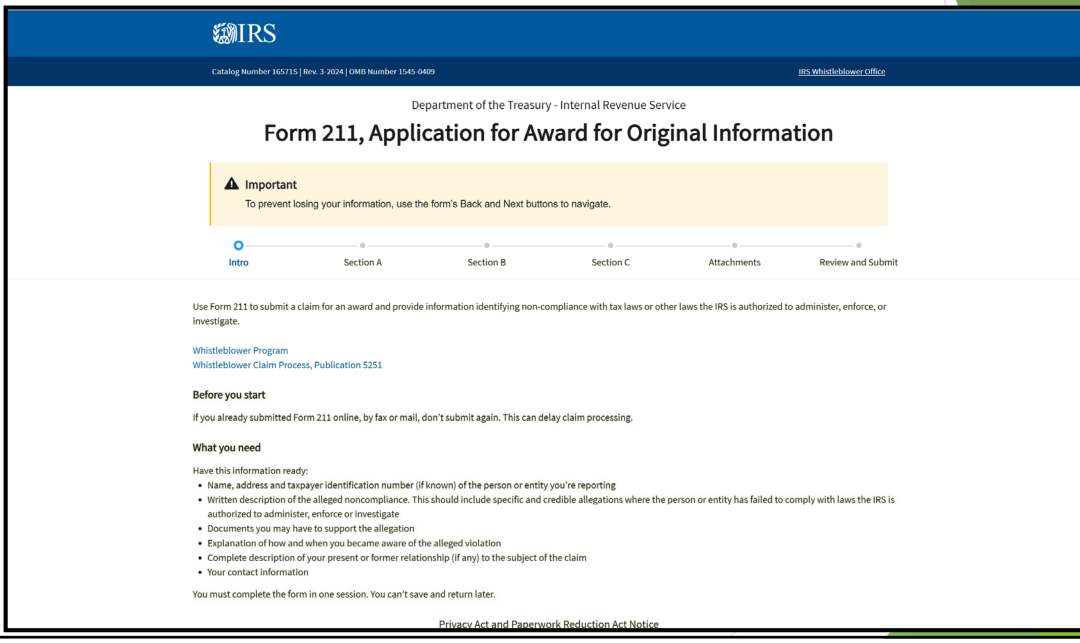
Submit a whistleblower claim for award

Report your information and submit a claim for award.

Submit Form 211

68

Online completion of form


IRS

Catalog Number 16571S | Rev. 3-2024 | OMB Number 1545-0409

IRS Whistleblower Office

Department of the Treasury - Internal Revenue Service

Form 211, Application for Award for Original Information

Important
To prevent losing your information, use the form's Back and Next buttons to navigate.

Intro · Section A · Section B · Section C · Attachments · Review and Submit

Use Form 211 to submit a claim for an award and provide information identifying non-compliance with tax laws or other laws the IRS is authorized to administer, enforce, or investigate.

Whistleblower Program
Whistleblower Claim Process, Publication 5251

Before you start

If you already submitted Form 211 online, by fax or mail, don't submit again. This can delay claim processing.

What you need

Have this information ready:

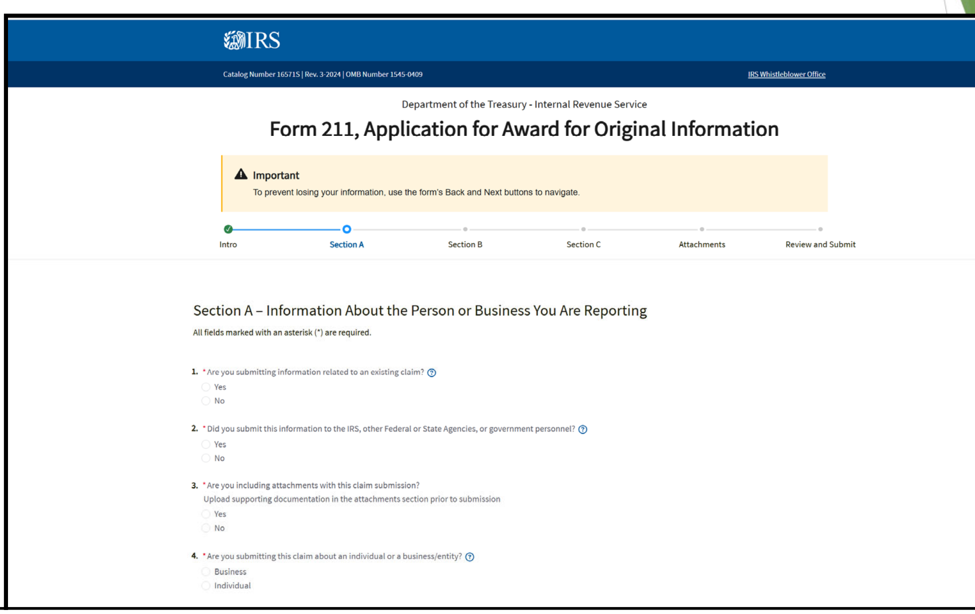
- Name, address and taxpayer identification number (if known) of the person or entity you're reporting
- Written description of the alleged noncompliance. This should include specific and credible allegations where the person or entity has failed to comply with laws the IRS is authorized to administer, enforce or investigate
- Documents you may have to support the allegation
- Explanation of how and when you became aware of the alleged violation
- Complete description of your present or former relationship (if any) to the subject of the claim
- Your contact information

You must complete the form in one session. You can't save and return later.

Privacy Act and Paperwork Reduction Act Notice

69

Answer question to completion


IRS

Catalog Number 16571S | Rev. 3-2024 | OMB Number 1545-0409

IRS Whistleblower Office

Department of the Treasury - Internal Revenue Service

Form 211, Application for Award for Original Information

Important
To prevent losing your information, use the form's Back and Next buttons to navigate.

Intro · Section A · Section B · Section C · Attachments · Review and Submit

Section A – Information About the Person or Business You Are Reporting

All fields marked with an asterisk (*) are required.

1. *Are you submitting information related to an existing claim?
   - Yes
   - No
2. *Did you submit this information to the IRS, other Federal or State Agencies, or government personnel?
   - Yes
   - No
3. *Are you including attachments with this claim submission?
   Upload supporting documentation in the attachments section prior to submission
   - Yes
   - No
4. *Are you submitting this claim about an individual or a business/entity?
   - Business
   - Individual

70

Submit Form 14157

IRS | File | Pay | Refunds | Credits & Deductions | Forms | Report Fraud | Search

○ Other

Tax preparer misconduct or fraud

Fraud or misconduct by a paid tax preparer or tax preparation business can include:

- Stealing or embezzling a refund
- Not filing a return as agreed
- Filing a return without your consent
- Falsifying information on a return
- Misrepresenting credentials
- Not complying with tax law on their own return

Do you want to submit a whistleblower claim for award? To be considered, you'll need to provide your contact information.

Yes | No

Report tax preparer misconduct or fraud

Report your information with Form 14157, Return Preparer Complaint.

Submit Form 14157

71

Online Form 14157

IRS | File | Pay | Refunds | Credits & Deductions | Forms | Report Fraud | Search

Form 14157

(Rev. June 2018)

Return Preparer Complaint

OMB Number 1545-2168
Catalog Number 55242M

1 Instructions — 2 Pre Screening — 3 Review — 4 Submitted/ Download

Instructions

Important Things You Should Know

- **General Instructions**
- **What's New:** Several questions were added about the fee for the tax preparation services. Questions were added to help tax return preparers self-report issues with compromised PTINs, data breaches/security incidents, return count discrepancies or if someone used their identity to obtain a PTIN.
- **Purpose of Form:** Use Form 14157 to file a complaint against a tax return preparer or tax preparation business. Tax professionals can use this form to report events that impact their PTIN or business.
- Individuals who are paid to prepare federal tax returns must follow ethical standards and guidelines as established in Treasury Department Circular 230. For more information on requirements for paid tax return preparers, view Circular 230 at www.irs.gov/taxpros.
- **Where to Send This Form:** The completed form along with all supporting information can be filed by fax or regular mail.
- If faxing Form 14157 send to: 855-889-7957
- If mailing Form 14157 send to: Attn: Return Preparer Office, 401, W. Peachtree Street NW, Mail Stop 421-D, Atlanta, GA 30308
- If a tax return preparer filed a return or altered your return without your consent and you are seeking a change to your account, complete Form 14157-A, Tax Return Preparer Fraud or Misconduct Affidavit, in addition to Form 14157. Submit both forms along with

72

Taxpayer Advocate

73

The Advocate's Mission

- **Independent Advocacy**
  - The Taxpayer Advocate Service (TAS) is an independent organization within the IRS, led by the National Taxpayer Advocate (NTA), ensuring a fair and just tax system
- **Strategic Reporting**
  - The NTA is required by law to submit annual reports directly to the House Ways and Means and Senate Finance Committees without prior IRS or Treasury review.

74

Executive Overview

- A summary of 71 key legislative recommendations presented to Congress to reform tax laws and protect individual rights.
- The #1 Priority in the 2026 report is the full modernization of IRS online accounts. Taxpayers and professionals deserve digital functionality that mirrors top-tier banks
- This includes the ability to view all relevant notices, conduct secure transactions, and resolve issues without long phone wait times.

75

Most serious taxpayer problems

- Refund delays and unclear and confusing disallowance notices harm taxpayers and jeopardize their rights to administrative and judicial review.
- Outdated paper processes and procurement delays harm taxpayers.
- The IRS does not accurately measure the quality of its telephone service.

76

Other problems identified in the report

- The independence of the IRS's Independent Office of Appeals;
- the limited functionality of online accounts used by tax professionals;
- IRS delays in responding to Freedom of Information Act requests submitted by taxpayers to obtain their own tax records;
- deficient procedures for maintaining the IRS's Centralized Authorization File for tax practitioners;
- misinformation about tax compliance on social media;
- compliance challenges faced by U.S. taxpayers living abroad; and
- the ineffectiveness of IRS processes designed to offer taxpayers relief from international withholding requirements.

77

Key Legislative Priorities

- **Preparer Standards**
  - Establishing minimum standards for federal tax return preparers to protect the public from unethical actors.
- **Court Access**
  - Expanding Tax Court jurisdiction to allow taxpayers to litigate refund claims in their preferred forum.
- **Refund Timelines**
  - Requiring the IRS to act on refund claims within one year to prevent administrative limbo for taxpayers.

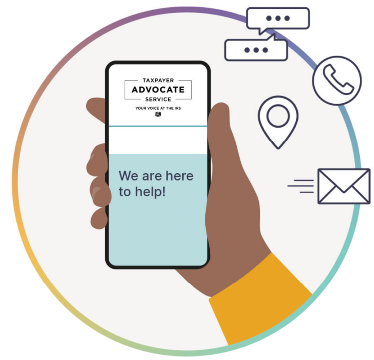
78

Can TAS help me with my tax issue?

Can TAS help me with my tax issue?

Generally, the Taxpayer Advocate Service (TAS) helps taxpayers whose tax issues fall into one of these main categories. Select the topic below to learn more:

- Financial Hardship
- IRS System Issue
- Fair & Equitable Treatment



Note: While the results of the TAS qualifier tool may indicate if TAS can help you with your tax issue, the final determination will be made by one of our Advocates after you **Submit a Request for Assistance**.

However, TAS is taking internal measures to help taxpayers who have experienced significant delays. We've made changes to the types of cases we can currently accept. Learn how TAS is assisting taxpayers in requesting help. Read the updated **FAQs** to help you determine if TAS can help you with your tax issue.

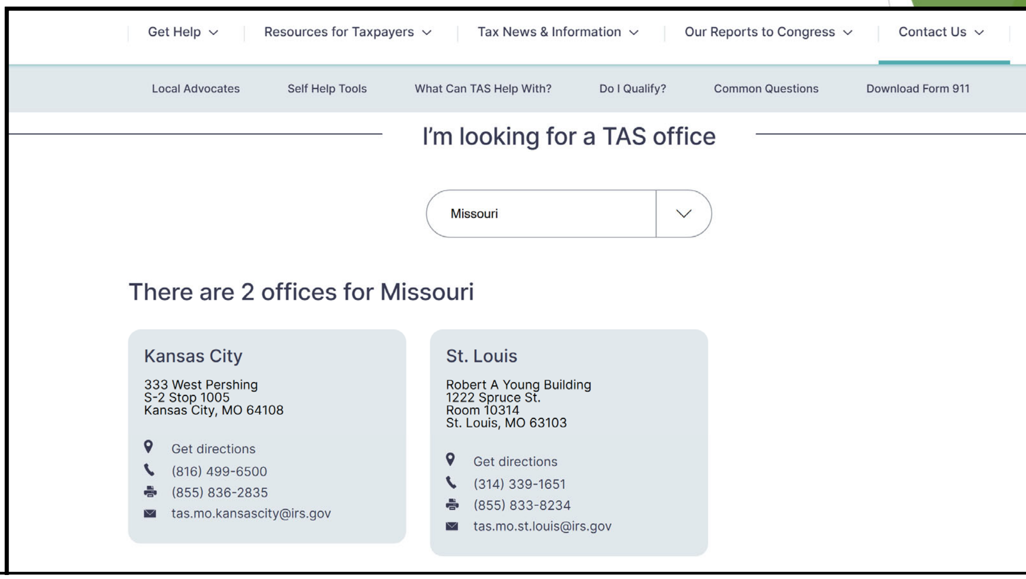
79

IRS System Issue

- An IRS System Issue is also known as Systemic Burden which could include:
  - Do you have a delay more than 30-days after regular processing time to resolve an IRS tax-related problem? Has the IRS not taken action to resolve your tax related problem after sending multiple interim letters stating to give them more time?
  - Has the IRS not responded to you or not resolved your tax related problem by a specific date?
  - Has an IRS system or procedure failed to operate as intended, or failed to resolve your tax related problem or dispute with the IRS?
- If you answered yes to any of these questions, you may qualify for assistance and TAS may be able to help you.

80

Your Local Taxpayer Advocate(LTA)



81

Recent events with Taxpayer Advocate

- May 19th in St Louis.
  - Sheila Gurley, Local Taxpayer advocate, came with case advocates
  - Day for working with the local tax professionals.
  - LTA determined our local tax professionals needed more time with her case advocates
  - Starting a monthly call-in to work cases with TAS.

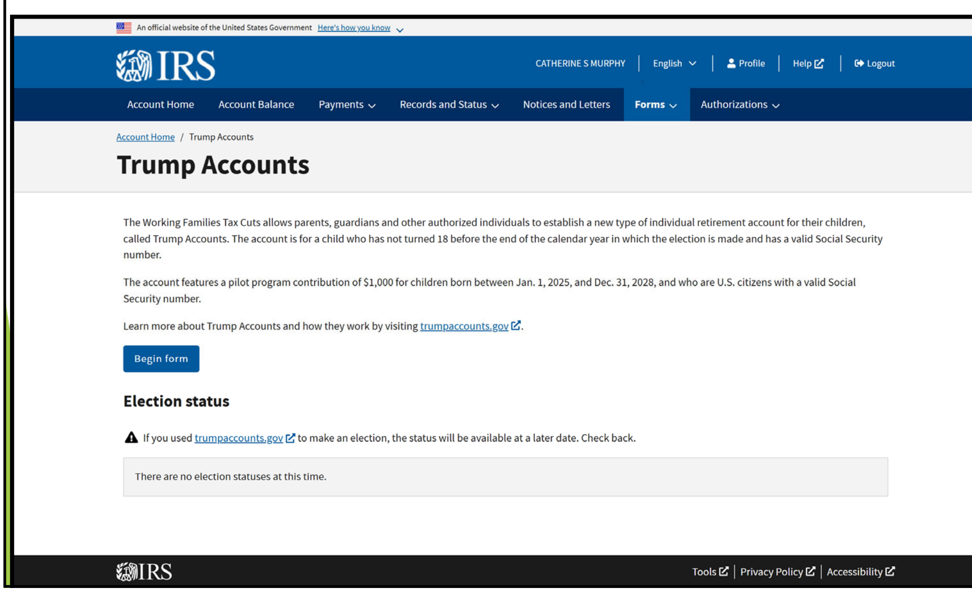
82

Trump accounts

- Through IRS Individual Account, taxpayers can securely access their tax information and complete common tasks online, including:
  - View the latest submission status of their Form 4547, Trump Account Election(s), including next steps.
  - Submit Form 4547, Trump Account Election(s), electronically.

83

Trump accounts with online account



84

Officials consider adding citizenship question to tax forms

- Officials are reportedly weighing a revised Form 1040 featuring a checkbox for non-US or dual citizens.
- Tax advisers warn fears over immigration enforcement could reduce compliance rates
- Filings among immigrant groups - more than $300 bn
  - Reuters

85

Kwong vs. US – Relief of penalties and Interest

- Found that certain tax deadlines were automatically postponed for the entire COVID-19 disaster period plus 60 days.
- This will provide a refund opportunity for taxpayers who paid interest and penalties related to tax deadlines that fell within this period. This means the 2019, 2020, 2021, and 2022 tax filings for businesses and individuals.
- A Claim for Refund must be filed before July 10, 2026 to seek these refunds by filing Form 843 – Claim for Refund and Request for Abatement.
- You will need to review your clients' transcripts to see if they actually paid any penalties and interest. If not, there is no refund claim.

86

Sign up for automatic email updates

- The IRS e-News subscription service sends tax information by email for many different audiences, including:
- **IRS Outreach Connection** – Up-to-date materials for tax professionals and partner groups inside and outside the tax community. Subscribers can easily share the material with their clients or members through email, social media and the web
- **IRS Tax Tips** – Tips in plain language on a wide range of general interest tax topics for taxpayers
- **IRS Newswire** – News releases on tax issues from breaking news to details on legal guidance
- **IRS News in Spanish** - Noticias del IRS en Español – IRS news releases, tax tips and updates in Spanish
- **e-News for Small Businesses** – Tax information for small businesses and self-employed individuals
- **e-News for Tax Professionals** – A roundup of news releases and legal guidance for tax professionals

87

IRS Outreach Connection

- Find useful information and materials you can share with clients, employees, customers, constituents, partners and even families. This monthly subscription provides tax-related information for groups inside and outside the tax community including:
- Important tax tips and information that may affect your audience.
- Ready to use information suitable for sharing, using internal newsletters or posting on your website.
- The latest in social media involving taxes, including X, Instagram and YouTube
- Informational flyers and graphics
- Webinars and events

88

Questions

- Cathy Murphy. CPA
- cath225@gmail.com

89

Internal Revenue Service
United States Department of the Treasury

Handout 1

This Product Contains Sensitive Taxpayer Data

Form 1040A Account Transcript

Request Date:	05-27-2026
Response Date:	05-27-2026
Tracking Number:	110521025090

Form Number:	1040A
Report for Tax Period Ending:	12-31 2022
Taxpayer Identification Number:	XXX

POWER OF ATTORNEY/TAX INFORMATION AUTHORIZATION (POA/TIA) ON FILE

— Any minus sign shown below signifies a credit amount —

Account balance:	$8,525.96		
Accrued interest:	$296.52	As of:	06-08 2026
Accrued penalty:	$0.00	As of:	06-08 2026
Account balance plus accruals (this is not a payoff amount):	$8,822.48		

**** Information from the return or as adjusted ****

Exemptions:	01
Filing status:	Single
Adjusted gross income:	$0.00
Taxable income:	$0.00
Tax per return:	$0.00
SE taxable income taxpayer:	$0.00
SE taxable income spouse:	$0.00
Total self employment tax:	$0.00
Return due date or return received date (whichever is later):	04-01-2025
Processing date:	04 28-2025

TRANSACTIONS

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Substitute tax return prepared by IRS 11210-887-00015-5	20251505	04-28 2025	$0.00
140	Inquiry for non-filing of tax return		07-10 2024	$0.00
971	Notice issued CP 0059		07 29 2024	$0.00
960	Appointed representative		01-16 2025	$0.00
494	Final notice before tax is determined by IRS		02 04 2025	$0.00
495	Resolved tax determination		04-01 2025	$0.00
595	Account referred for review		04 08 2025	$0.00
570	Additional account action pending		04 28 2025	$0.00
610	Payment with return 00		05 06 2025	-$6,418.00
270	Penalty for late payment of tax	20254705	12 08 2025	$822.12
170	Penalty for not pre-paying tax 12 08 2035	20254705	12 08 2025	$207.30
160	Penalty for filing tax return after the due date 12 08 2035	20254705	12-08-2025	$1,422.90
196	Interest charged for late payment	20254705	12 08-2025	$2,545.64
971	Notice issued CP 0022		12-08 2025	$0.00
670	Payment 00		01-12-2026	-$1,500.00
470	Claim pending		05 04-2026	$0.00

Internal Revenue Service
United States Department of the Treasury

This Product Contains Sensitive Taxpayer Data

Form 1040 Tax Return Transcript

Request Date:	05 27 2026
Response Date:	05 27-2026
Tracking Number:	110521025090

SSN provided:	XXX XX [redacted]
Report for Tax Period Ending:	12-31-2023

The following items reflect the amount as shown on the return, and the amount as adjusted, if applicable. They do not show subsequent activity on the account.

SSN:	XXX XX [redacted]
Spouse SSN:	

[redacted]

Filing status:	Single Taxpayer
Form number:	1040
Cycle posted:	20251205
Received date:	03-11-2025
Payment:	$0.00
Exemption number:	01
Other dependent credit total eligible per computer:	0
Other dependent credit total eligible verified:	0
PTIN:	XXX-XX1289
Preparer EIN:	XX-XXX9184

Income

Total wages:	$0.00
Form W 2 wages:	$0.00
Taxable interest income (Schedule B):	$478.00
Tax exempt interest:	$0.00
Ordinary dividend income (Schedule B):	$1,019.00
Qualified dividends:	$20.00
Refunds of state/local taxes:	$0.00
Alimony received:	$0.00
Business income or loss (Schedule C):	$0.00
Business income or lose (Schedule C) per computer:	$0.00
Capital gain or loss (Schedule D):	$0.00
Capital gains or loss (Schedule D) per computer:	$448.00
Other gains or losses (Form 4797):	-$448.00
Total IRA distributions:	$0.00
Taxable IRA distributions:	$0.00
Total pensions and annuities:	$9,416.00
Taxable pension/annuity amount:	$0.00
Additional income:	$58,083.00
Additional income per computer:	$0.00
Refundable credits per computer:	$0.00
Refundable education credit per computer:	$0.00
Qualified business income deduction:	$0.00
Rent/royalty/partnership/estate (Schedule E):	$0.00
Rent/royalty/partnership/estate (Schedule E) per computer:	$0.00
Rent/royalty income/loss per computer:	$0.00
Estate/trust income/loss per computer:	$0.00
Partnership/S-Corp Income/loss per computer:	$0.00
Farm income or loss (Schedule F):	$0.00
Farm income or loss (Schedule F) per computer:	$0.00
Unemployment compensation:	$0.00
Total Social Security benefits:	$0.00
Taxable Social Security benefits:	$25,224.00
Taxable Social Security benefits per computer:	$21,440.00
Other income:	$21,440.00
Schedule EIC Selfemployment income per computer:	$0.00
	$0.00

Schedule EIC earned income per computer:	$0.00
Schedule EIC disqualified income per computer:	$0.00
Excess advance child tax credit per computer:	$0.00
Primary economic impact payment 2:	$0.00
Secondary economic impact payment 2:	$0.00
Primary advanced child tax credit payments:	$0.00
Secondary advanced child tax credit payments:	$0.00
Additional child tax credit earned income:	$0.00
EIC prior year earned income:	$0.00
Qualified business income deduction:	$0.00
Form 8995 qualified business income deduction computer:	$0.00
Form 8995 net capital gains computer:	$0.00
Primary economic impact payment:	$0.00
Secondary economic impact payment:	$0.00
Scholarship/Fellowship grant:	$0.00
Total income:	$89,988.00
Total income per computer:	$89,988.00

Adjustments to Income

Educator expenses:	$0.00
Educator expenses per computer:	$0.00
Reservist and other business expense:	$0.00
Health Savings Account deduction:	$0.00
Health Savings Account deduction per computer:	$0.00
Moving expenses (Form 3903):	$0.00
Self employment tax deduction:	$0.00
Self employment tax deduction per computer:	$0.00
Self-employment tax deduction verified:	$0.00
Keogh/SEP contribution deduction:	$0.00
Self-employment health insurance deduction:	$0.00
Early withdrawal of savings penalty:	$0.00
Alimony paid SSN:	
Alimony paid:	$0.00
Scholarship/Fellowship excluded:	$0.00
IRA deduction:	$0.00
IRA deduction per computer:	$0.00
Student loan interest deduction:	$0.00
Student loan interest deduction per computer:	$0.00
Student loan interest deduction verified:	$0.00
Total other payment refundable credit per computer:	$0.00
Total other payment refund verified:	$0.00
Other adjustments:	$0.00
Archer MSA deduction:	$0.00
Archer MSA deduction per computer:	$0.00
Total adjustments:	$0.00
Total adjustments per computer:	$0.00
Adjusted gross income:	$89,988.00
Adjusted gross income per computer:	$89,988.00

Tax and Credits

65 or over:	Yes
Blind:	No
Spouse 65 or over:	No
Spouse blind:	No
Standard deduction per computer:	$13,850.00
Additional standard deduction per computer:	$1,850.00
Tax table income per computer:	$74,288.00
Exemption amount per computer:	$0.00
Taxable income:	$74,288.00
Taxable income per computer:	$74,288.00
Total positive income per computer:	$90,436.00
Tentative tax:	$11,648.00
Tentative tax per computer:	$11,648.00
Form 8814 additional tax amount:	$0.00
Tax on income less Social Security income per computer:	$6,329.00
Form 6251 alternative minimum tax:	$0.00
Form 6251 alternative minimum tax per computer:	$0.00
Foreign tax credit:	$0.00
Foreign tax credit per computer:	$0.00
Foreign income exclusion per computer:	$0.00
Foreign income exclusion tax per computer:	$0.00
Excess advance premium tax credit repayment amount:	$0.00
Excess advance premium tax credit repayment verified amount:	$0.00

Child & dependent care credit:	$0.00
Child & dependent care credit per computer:	$0.00
Credit for elderly and disabled:	$0.00
Credit for elderly and disabled per computer:	$0.00
Education credit:	$0.00
Education credit per computer:	$0.00
Gross education credit per computer:	$0.00
Retirement savings contribution credit:	$0.00
Retirement savings contribution credit per computer:	$0.00
Total retirement savings contribution (Form 8880 computer):	$0.00
Residential clean energy credit:	$0.00
Residential clean energy credit per computer:	$0.00
Child and other dependent credit:	$0.00
Child and other dependent credit per computer:	$0.00
Adoption credit (Form 8839):	$0.00
Adoption credit per computer:	$0.00
Form 8396 mortgage certificate credit:	$0.00
Form 8396 mortgage certificate credit per computer:	$0.00
Total other non refundable credit:	$0.00
Form 3800 general business credits:	$0.00
Form 3800 general business credits per computer:	$0.00
Prior year minimum tax credit (Form 8801):	$0.00
Prior year minimum tax credit (Form 8801) per computer:	$0.00
Earlier year income repayment credit:	$0.00
Clean vehicle credit:	$0.00
Clean vehicle credit per computer:	$0.00
Refundable Adoption Credit Verified Amount:	$0.00
Sick family leave credit:	$0.00
Non-itemized charitable contribution deduction:	$0.00
Non itemized charitable contribution per computer:	$0.00
Refundable child care credit:	$0.00
Sick family leave credit after 3 31 21:	$0.00
Refundable child care credit verified:	$0.00
Recovery rebate credit:	$0.00
Recovery rebate credit per computer:	$0.00
Health coverage tax credit (Form 8885):	$0.00
Recovery rebate credit verified:	$0.00
Other credits:	$0.00
Total credits:	$0.00
Total credits per computer:	$0.00
Income tax after credits per computer:	$11,648.00
Advanced manufacturing credit per computer:	$0.00
Advanced manufacturing invest credit per computer:	$0.00
Clean hydrogen production credit per computer:	$0.00
Carbon oxide sequestration credit per computer:	$0.00
Energy efficient home credit per computer:	$0.00
Energy efficient home credit:	$0.00
Pre-owned clean vehicle credit per computer:	$0.00
Pre owned clean vehicle credit:	$0.00
Pre-owned clean vehicle verified:	$0.00
New clean vehicle bus credit per computer:	$0.00
New clean vehicle bus verified:	$0.00
Commercial clean vehicle credit per computer:	$0.00
Commercial clean vehicle verified:	$0.00
Clean vehicle credit verified:	$0.00

Other Taxes

Self employment tax:	$0.00
Self employment tax per computer:	$0.00
Social Security and Medicare tax on unreported tips:	$0.00
Social Security and Medicare tax on unreported tips per computer:	$0.00
Tax on qualified plans Form 5329 (PR):	$0.00
Tax on qualified plans Form 5329 per computer:	$0.00
Individual Retirement Account File (IRAF) tax per computer:	$0.00
Taxpayer tax figures (reduced by IRAF) per computer:	$11,648.00
Individual Master File (IMF) total tax (reduced by IRAF) per computer:	$11,648.00
Total other taxes per computer:	$0.00
Unpaid Federal Insurance Contributions Act (FICA) on reported tips:	$0.00
Form 8959 additional Medicare tax:	$0.00
Form 8960 net investment income tax:	$0.00
Interest on deferred tax:	$0.00
Total other taxes:	$0.00
Recapture tax (Form 8611):	$0.00
Household employment taxes:	$0.00

Household employment taxes per computer:	$0.00
Interest due on installment:	$0.00
Schedule 8812 additional tax computer:	$0.00
Refundable child care computer:	$0.00
Health coverage recapture (Form 8885):	$0.00
Excess Social Security tax withheld verified:	$0.00
Excess Social Security tax withheld per computer:	$0.00
Total additional taxes:	$0.00
Total assessment per computer:	$11,648.00
Total tax liability taxpayer figures:	$11,648.00
Total tax liability taxpayer figures per computer:	$11,648.00

Payments

Federal income tax withheld:	$4,730.00
Schedule 8812 additional tax:	$0.00
Estimated tax payments:	$0.00
Other payment credit:	$0.00
Refundable education credit:	$0.00
Refundable education credit per computer:	$0.00
Refundable education credit verified:	$0.00
Refundable credits:	$0.00
Earned income credit:	$0.00
Earned income credit per computer:	$0.00
Nontaxable combat pay:	$0.00
Excess Social Security & Railroad Retirement Tax Act (RRTA) tax withheld:	$0.00
Schedule 8812 additional child tax credit:	$0.00
Schedule 8812 additional child tax credit per computer:	$0.00
Schedule 8812 additional child tax credit verified:	$0.00
Amount paid with Form 4868:	$0.00
Form 2439 regulated investment company credit:	$0.00
Form 4136 credit for federal tax on fuels:	$0.00
Form 4136 credit for federal tax on fuels per computer:	$0.00
Section 965 tax installment:	$0.00
Section 965 tax liability:	$0.00
Premium tax credit amount:	$0.00
Premium tax credit verified amount:	$0.00
Primary NAP first time home buyer installment amount:	$0.00
Secondary NAP first time home buyer installment amount:	$0.00
First time homebuyer credit repayment amount:	$0.00
Form 5405 total homebuyers credit repayment per computer:	$0.00
Small employer health insurance per computer:	$0.00
Small employer health insurance per computer (2):	$0.00
Total other payments refundable:	$0.00
Total payments:	$4,730.00
Total payments per computer:	$4,730.00

Refund or Amount Owed

Amount you owe:	$7,216.00
Estimated tax credit applied to next year:	$0.00
Estimated tax penalty:	$298.00
Tax on income less state refund per computer:	$0.00
Balance due/overpayment using taxpayer figure per computer:	$7,216.00
Balance due/overpayment using computer figures:	$7,216.00
Form 8888 total refund per computer:	$0.00

Third Party Designee

Third party designee ID number:	x0101
Authorization indicator:	Yes
Third party designee name:	CATH S MURP

Schedule D - Capital Gains and Losses

Short Term Capital Gains and Losses

Short term basis no adjustments sale amount:	$0.00
Short term basis no adjustments cost amount:	$0.00
Short term basis sale amount:	$12.00
Short term basis cost amount:	$183.00
Short term basis adjustments:	$0.00
Short term no basis sale amount:	$0.00
Short term no basis cost amount:	$0.00
Short term no basis adjustments:	$0.00

Short term no 1099-B sale amount:	$0.00
Short term no 1099 B cost amount:	$0.00
Short term no 1099 B adjustments:	$0.00
Short term Schedule K 1 amount:	$0.00
Net short-term gain/loss:	-$171.00
Form 8949 Y qualified opportunity funds short term investments:	No
Form 8949 Y qualified opportunity funds short term EIN:	
Form 8949 Y qualified opportunity funds short term sold date:	00-00 0000
Form 8949 Y qualified opportunity funds short term deferred:	$0.00
Form 8949 Z qualified opportunity funds short term adjustments:	$0.00
Form 8949 Z qualified opportunity funds short term investments:	No
Form 8949 Z qualified opportunity funds short term EIN:	
Form 8949 Z qualified opportunity funds short term acquired date:	00-00-0000

Long Term Capital Gains and Losses

Long term basis no adjustments sale amount:	$0.00
Long term basis no adjustments cost amount:	$0.00
Long term basis sale amount:	$32.00
Long term basis cost amount:	$309.00
Long term basis adjustments:	$0.00
Long term no basis sale amount:	$0.00
Long term no basis cost amount:	$0.00
Long term no basis adjustments:	$0.00
Long term no 1099 B sale amount:	$0.00
Long term no 1099-B cost amount:	$0.00
Long term no 1099-B adjustments:	$0.00
Long term schedule K 1 amount:	$0.00
Capital gain distributions (PR):	$0.00
Net long-term gain/loss:	-$277.00
Form 8949 Y qualified opportunity funds long term investments:	No
Form 8949 Y qualified opportunity funds long term EIN:	
Form 8949 Y qualified opportunity funds long term sold date:	00 00-0000
Form 8949 Y qualified opportunity funds long term deferred:	$0.00
Qualified opportunity funds disposal:	No box checked
Form 8949 Z qualified opportunity funds long term investments:	No
Form 8949 Z qualified opportunity funds long term EIN:	
Form 8949 Z qualified opportunity funds long term acquired date:	00-000000
Form 8949 Z qualified opportunity funds long term adjustments:	$0.00

Tax Computation Using Maximum Capital Gains Rates

28% rate gain:	$0.00
Unrecaptured section (1250 gain):	$0.00
Schedule D 15% tax computer:	$3.00
Capital gains less invest income per computer:	$0.00
Capital gains per computer:	$20.00
Capital gains tax per computer:	$11,648.00
Capital gains per computer:	$0.00
25% rate capital gains tax per computer:	$0.00
28% rate capital gains tax per computer:	$0.00
Schedule D tax per computer:	$11,651.00

Handout 2

Internal Revenue Service
United States Department of the Treasury

This Product Contains Sensitive Taxpayer Data

Form 1040 Account Transcript

Request Date:	05-12-2026
Response Date:	05-12-2026
Tracking Number:	110418509550

Form Number:	1040
Report for Tax Period Ending:	12 31 2024
Taxpayer Identification Number:	XXXXX [redacted]
Spouse Taxpayer Identification Number:	XXX-XX[redacted]

[redacted]

— Any minus sign shown below signifies a credit amount —

Account balance:	$0.00		
Accrued interest:	$0.00	As of:	04-20-2026
Accrued penalty:	$0.00	As of:	04-20-2026
Account balance plus accruals (this is not a payoff amount):	$0.00		

**** Information from the return or as adjusted ****

Exemptions:	02
Filing status:	Married Filing Joint
Adjusted gross income:	$187,854.00
Taxable income:	$155,554.00
Tax per return:	$0.00
SE taxable income taxpayer:	$0.00
SE taxable income spouse:	$108,260.00
Total self employment tax:	$16,564.00
Return due date or return received date (whichever is later):	09-30 2025
Processing date:	11-03-2025

TRANSACTIONS

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Tax return filed 70205-674-00406-5	20254205	11-03-2025	$0.00
660	Estimated tax payment 00		04-13-2024	$1,000.00
660	Estimated tax payment 00		06-14-2024	-$1,000.00
660	Estimated tax payment 00		09-13-2024	-$1,000.00
660	Estimated tax payment 00		01-11-2025	$1,000.00
460	Extension of time to file tax return		04-11 2025	$0.00
846	Refund issued		11-03 2025	$4,000.00
670	Payment 00		02-20 2026	$45,798.00
570	Additional account action pending		03-16-2026	$0.00
971	Amended tax return or claim forwarded for processing		02-13-2026	$0.00
977	Amended return filed 33277-458-67369-6		02-13-2026	$0.00
960	Appointed representative		02-19 2026	$0.00

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
196	Interest charged for late payment	20261105	04-06-2026	$2,351.60
826	Credit transferred out to 30 20231231		02-20-2026	$958.65
971	Notice issued CP 0021		04 06-2026	$0.00
971	Notice issued CP 0049		04-06-2026	$0.00
570	Additional account action pending		04-06-2026	$0.00
571	Resolved additional account action		04-13-2026	$0.00
846	Refund issued		04-13-2026	$1,606.19
776	Interest credited to your account		04-13-2026	-$10.44

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Handout 3

Internal Revenue Service
United States Department of the Treasury

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Form 1120S Record of Account

Request Date:	05 2 6 2026
Response Date:	05 26-2026
Tracking Number:	110513830408

Form Number:	1120S
Report for Tax Period Ending:	12-31-2024
Taxpayer Identification Number:	XX-[redacted]

[redacted]

**** Any minus sign shown below signifies a credit amount ****

Account balance:	$0.00		
Accrued interest:	$0.00	As of:	06-08-2026
Accrued penalty:	$0.00	As of:	0 3 15-2025
Account balance plus accruals (this is not a payoff amount):	$0.00		

**** Information from the return or as adjusted ****

Net Receipts	$0.00
Total Income	$0.00
Total Deductions	$0.00
Taxable Income	$30,253.00
Corporate Alternative Minimum Tax	$0.00
Current Years Estimated Tax Payments	$0.00
Personal Holding Company Tax	$0.00
Tax Deposited with Form 7004	$0.00
Total Tax per Return	$0.00
Principal Business Activity Code	541213
Return due date or return received date (whichever is later):	0 3 15 2025
Processed date:	0 2 24-2025

TRANSACTIONS

CODE	EXPLANATION OF TRANSACTION	CYCLE	DATE	AMOUNT
150	Tax return filed 93316-035-02860-5	202506	02-24-2025	$0.00

Taxpayer Identification Number:	XX-XXX9184
Report for Tax Period Ending:	12-31-2024
Form:	1120S
Duplicate Amendment Number	0

The following reflects the federal tax information as included with the original tax return for the taxpayer identification number above. A blank field indicates no data on file.

Original Return

[redacted]

Page 1/5

Cycle Posted:	202506
Document Locator Number:	93316035-02860-5
Remittance:	$0.00
Received Date:	02-04-2025

Indicators, Codes, and Miscellaneous Information

Tax Year Beginning:	01 01-2024
Correspondence Received Date:	00-00-0000
Designee Check Box:	1
Designee Phone Number:	XXX XXX 7864
Total Assets at End of Year:	$0.00
Number of Shareholders:	2
Schedule M 2: Balance at Beginning of Tax Year:	$7,581.00
Schedule N Total Estimated Tax Income Exclusion:	$0.00
F8586: Low Income Housing Credit:	$0.00
F8611: Total Recapture Amount:	$0.00
F8825: Total Gross Rents Amount:	$0.00

Income

Gross Receipts:	$82,117.00
Returns and Allowances:	$0.00
Cost of Goods Sold:	$0.00
Gross Profit Per Computer:	$82,117.00
Net Gain or Loss:	$0.00
Other Income:	$10.00
Total Income:	$82,127.00
Total Income Per Computer:	$82,127.00
Merchant Card and Third Party Payment:	$0.00

Deductions

Compensation of Officers:	$26,604.00
Salary and Wages Less Jobs Credit:	$0.00
Repairs and Maintenance:	$0.00
Bad Debts:	$0.00
Rents:	$0.00
Taxes and Licenses:	$4,250.00
Interest:	$0.00
Depreciation (Net):	$30.00
Depletion:	$0.00
Advertising:	$155.00
Pension/Profit Share Plans:	$0.00
Employee Benefit Programs:	$0.00
F7205 Energy Efficient Commercial Building Deduction:	$0.00
Other Deductions:	$20,835.00
Total Deductions:	$51,874.00
Total Deductions Per Computer:	$51,874.00
Ordinary Income/Loss	$30,253.00
Ordinary Income/Loss Per Computer:	$30,253.00

Tax and Payments

Manually Corrected Total Tax:	$0.00
Total Income Tax:	$0.00
Total Income Tax Per Computer:	$0.00
Estimated Tax Credit:	$0.00
Tax Deposited from 7004:	$0.00

Elective Payment Election:	$0.00
Elective Payment Election Verified:	$0.00
Total Payments:	$0.00
Total Payments Per Computer:	$0.00
Overpayment Windfall Profit Tax + Total Gas Tax Per Computer:	$0.00
Tax Shown on Return:	$0.00
Estimated Tax Penalty:	$0.00
Tax Due:	$0.00
Credit Next Year Estimated Tax:	$0.00
Total Tax Settlement Amount Per Computer:	$0.00
Routing Number:	XXXXX0000
Account Number:	
F8996 Qualified Opportunity Fund:	$0.00
International Tax Report Check Box:	0

Schedule A - Cost of Goods Sold

Inventory at Beginning of Year:	$0.00
Inventory at End of Year:	$0.00

Schedule K - Shareholders' Shares of Income, Credits, Deductions, Etc

Portfolio Interest Income:	$0.00
Alcohol Fuels Tax Credit:	$0.00
Total Property Distribution:	$32,464.00
Income (Loss):	$30,253.00

Schedule L - Balance Sheets per Books

Loans to Shareholders End of Year:	$0.00
Total Assets Beginning of Year:	$0.00
Loans for Shareholders End of Year:	$0.00
Capital Stock End of Year:	$0.00
Additional Paid In Capital End of Tax Year:	$0.00
Retained Earnings End of Tax Year:	$0.00

Form 5884B New Hire Retention Credit

Merchant Card Gross Receipts Per Computer:	$0.00
Net Receipts Per Computer:	$82,117.00

Form 3800 General Business Credit

F7207 Registration Number:	
F7207 Credit Trans Election:	$0.00
F7207 Gross Elective Payment Election:	$0.00
F7207 Net Elective Payment:	$0.00
F7207 Credit:	$0.00
F7207 Gross Minus Net Computer:	$0.00
F3468 Registration Number:	
F3468 Credit Trans Election:	$0.00
F3468 Credit:	$0.00
F8835 Registration Number:	
F8835 Credit Transfer Election:	$0.00
F8835 Credit:	$0.00
F7210 Registration Number:	
F7210 Credit Trans Election:	$0.00
F7210 Gross Elective Payment Election:	$0.00
F7210 Net Elective Payment:	$0.00
F7210 Credit:	$0.00

F7210 Gross Minus Net Computer:	$0.00
F8864 Registration Number:	
F8864 Credit Trans Election:	$0.00
F8864 Credit:	$0.00
F3468 Part 4 Registration Number:	
F3468 Part 4 Gross Elective Payment Election:	$0.00
F3468 Part 4 Net Elective Payment:	$0.00
F3468 Part 4 Credit:	$0.00
F3468 Part 4 Gross Minus Net Computer:	$0.00
F3468 Part 5 Credit Trans Election:	$0.00
F3468 Part 5 Credit:	$0.00
F8911 Registration Number:	
F8911 Credit Trans Election:	$0.00
F8911 Credit:	$0.00
F7211 Registration Number:	
F7211 Credit Trans Election:	$0.00
F7211 Credit:	$0.00
F7213 Registration Number:	
F7213 Credit Transfer Election:	$0.00
F7213 Credit:	$0.00
F7218 Registration Number:	
F7218 Credit Trans Election:	$0.00
F7218 Credit:	$0.00
F8933 Registration Number:	
F8933 Credit Tranafer Election:	$0.00
F8933 Gross Elective Payment Election:	$0.00
F8933 Net Elective Payment:	$0.00
F8933 Credit:	$0.00
F8933 Gross Minus Net Computer:	$0.00
F8936 Part 5 Vehicle Registration Number:	
F8936 Part 5 Credit:	$0.00
F3468 Part 6 Registration Number:	
F3468 Part 6 Credit Transfer Election:	$0.00
F3468 Part 6 Credit:	$0.00
F8835 Part 2 Registration:	
F8835 Part 2 Credit Transfer Election:	$0.00
F8835 Part 2 Credit:	$0.00

Credits

Vehicle 1 Number:	00000000000000000
Placed In Service Date:	00-00 0000
Tentative 1 Credit:	$0.00
Net Business Credit:	$0.00
Net 1 Business Credit Computer:	$0.00
Lesser 1 Part 4:	$0.00
Lesser 1 Part 5:	$0.00
Lesser 1 Part 5 Computer:	$0.00
Vehicle 2 Number:	00000000000000000
Placed In Service Date:	00-00-0000
Tentative 2 Credit:	$0.00
Net Business Credit:	$0.00
Net 2 Business Credit Computer:	$0.00
Lesser 2 Part 4:	$0.00
Lesser 2 Part 5:	$0.00
Lesser 2 Part 5 Computer:	$0.00
Summary Vehicle Validation Credit Verified:	$0.00
More Than 2 Schedule A Indicator:	$0.00

Form 4255 - Recapture of Investment Credit

F7207 Recapture Net Elective Payment Election:	$0.00
F7207 Excess Payment:	$0.00
F7210 Recapture Net Elective Payment Election:	$0.00
F7210 Excess Payment:	$0.00

F3468 Part 4 Recapture Net Elective Payment Election:	$0.00
F3468 Part 4 Excess Payment:	$0.00
F8933 Recapture Net Elective Payment Election:	$0.00
F8933 Excess Payment:	$0.00
Vehicle 1 Validation Number:	0
Vehicle 2 Validation Number:	0
Total Net Elective Pay Computer:	$0.00
Reduction Of CVC Credit Computer:	$0.00

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Personal Financial Planning
University of Missouri

Trump Accounts

Andrew Zumwalt, MS, CFP®
Program Chair
Personal Financial Planning Program
CAFNR

1

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University of Missouri

Disclaimer

This presentation is provided for educational and informational purposes only. Nothing in this presentation should be interpreted as individualized investment, tax, legal, or financial planning advice.

I am not acting as your Investment Adviser Representative, financial planner, tax adviser, or attorney in connection with this presentation. The information discussed is general in nature and may not apply to your specific circumstances.

Before making decisions related to Trump Accounts or any other financial planning strategy, you should consult with qualified investment, tax, legal, and financial planning professionals who can evaluate your individual situation.

2

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Who is this guy?

- Program Chair of the Personal Financial Planning Program
- Associate Teaching Professor
- With MU for 20 years this fall
- With MU Extension for 17 years

3

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Quick Overview

4

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What's the big deal?

- **NEW** OBBBA!
- Intergenerational Wealth Transfer through Retirement
- Time Compounding (60-70 years)
- Tax deferred and tax free (Roth) elements
- Employer fringe benefit opportunities & charitable giving
- More recordkeeping required for basis tracking
- Tracked through the mobile app
- Some issues*

5

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Seems like small change…pt. 1

- Kelly was born Jan 30, 2025
- Receive $1,000 from government (ignore for now)
- Parents contribute $5,000 per year until age 18
- At age 18, account value is $169,995 (7% Rate of Return)
  - $90,000 is basis, $79,995 is tax deferred

6

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Seems like small change…pt. 2

At age 18, Kelly works for a company with a traditional 401k

- Rolls the tax deferred amount into 401k ($79,995)
- Basis of $90,000 rolls into Roth IRA

At age 70 (with 7% return),

- $3+ million in Roth IRA
- $2.7 million in traditional 401k

7

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Eligibility and Creation

8

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Eligibility

- An eligible individual generally must not have attained age 18 before the end of the year and must have a valid Social Security number.

- Growth period
  - "Ends on December 31 of the year in which the child turns age 17."

9

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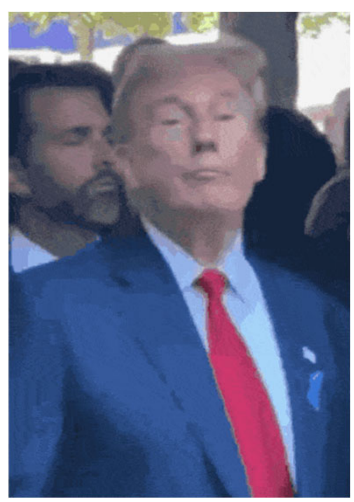
Account creation

- Election on form 4547 ;-)
  - Through tax return or through IRS portal
- Child is the 'beneficiary' or 'bene'
- Adult is the 'owner' *during growth period*
  - Adult has a priority order in order to open
    - Legal guardian, parent, adult sibling, or grandparent
    - Only one per beneficiary
- "Section 530A" accounts



10

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Account creation

- Accounts will be opened at BNY/Robinhood
  - Can be rolled over to other institutions in later years
- Only one account per beneficiary

11

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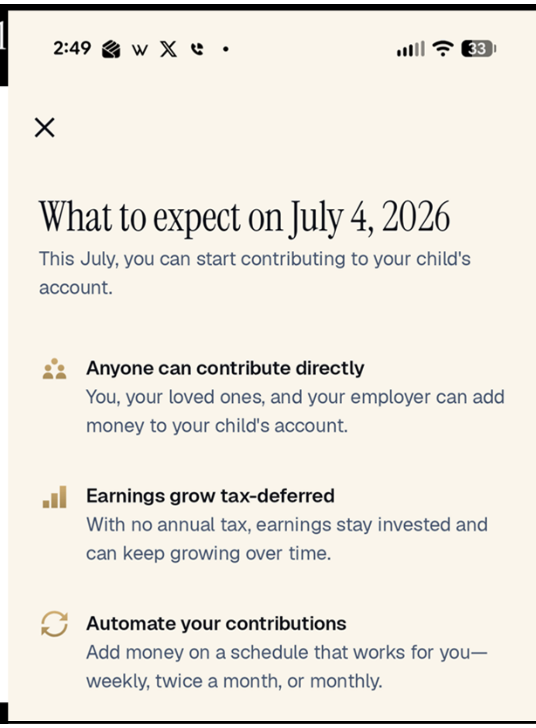

12

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Contributions

13

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Contributions

Two types:

- Basis (after tax):
  - Direct contributions
- Pretax:
  - Charitable contributions
  - Government
  - Employers

14

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Direct contributions

- Anyone can contribute ("loved ones")
- Cap of $5,000, will inflation adjust 2028+
- Shares cap with employer contributions
- Deadline is December 31st (No April 15th tomfoolery)
- After-tax $$$,
  - Must track basis!
  - No tax deduction

15

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Gift tax issues

- Annual exclusion of $19,000 applies to immediate gifts
- Beneficiary can't touch the funds till age 18
- Future gifts require the filing of a 709 gift tax return
- :-(
- Any direct contribution would require form 709
- Workaround: Gift $$$ to child custodial account (savings, brokerage) and then transfer to TA
- IRS knows and will likely, probably fix, pinkie promise

16

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Employer (ER) contributions

- ERs can contribute $2,500
- Shares cap with Direct contributions ($5,000 total)
- Considered pre-tax (*states may see taxable income*)
- Subject to non discrimination provisions
  - Employers must have non-highly compensated employees!
- ER must have written plan

17

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Qualified general contributions (QCG)

- From charitable organizations or government entities
- No $$$ limit, no shared cap
- Pre-tax dollars (states may see taxable income)
- 'Qualified class' of beneficiaries
  - All beneficiaries <18 (Susan and Michael Dell, $250)
  - Specific geographic area (at least 5,000 beneficiaries)
  - Births in specific years
  - Can tie with median income limits

18

Pilot program

- For kids born between 2025-2028 inclusive
- $1,000 in pre tax dollars from the Federal government
- Does not share cap
- Elected on form 4547, check the box

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Retirement plan limits

- Trump account contributions are not factored into retirement plan contributions in growth period

- Tom is 16 and earns $7,500
- Tom contributes $7,500 to his Roth IRA
- Tom's parents contribute $5,000 to his Trump account
- Tom is a lucky kid

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Post growth period

- Trump account can still exist
  - Some custodians can require rollover to IRA
- Beneficiary becomes Owner with control
  - 18 year old with $100,000+

21

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Investments

22

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Eligible investments: Index mutual funds or index ETFs

- No leverage
- Expenses less than .10% (10 basis points)
- Could be multiple investments
  - No money market funds, limited exception for cash
- Meets other criteria from Secretary of the Treasury
- After age 18, nearly any investment possible (IRA rules)

23

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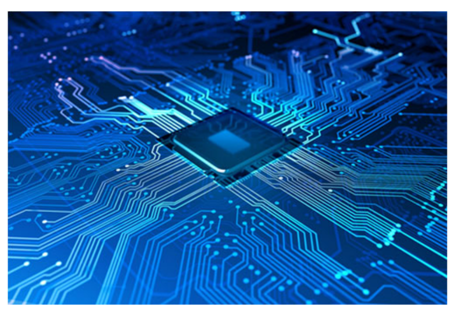
Investments: Must track index

- Either the S&P 500* or an index that primarily invests in 90% US companies and futures contracts are traded on a board or exchange
- No debt, derivatives, or other non-ownership asset
- No specific industry or sector fund allowed



24

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Not your regular tax advantaged account…

- Several states will tax earnings
  - California, Hawaii, Kentucky, Massachusetts, Pennsylvania, South Carolina, and Wisconsin
- Some states are considering exemption
  - Georgia, Maine, Vermont, and Indiana
- Employer, government, and charitable contributions could be taxed by states
- May discourage account creation…

25

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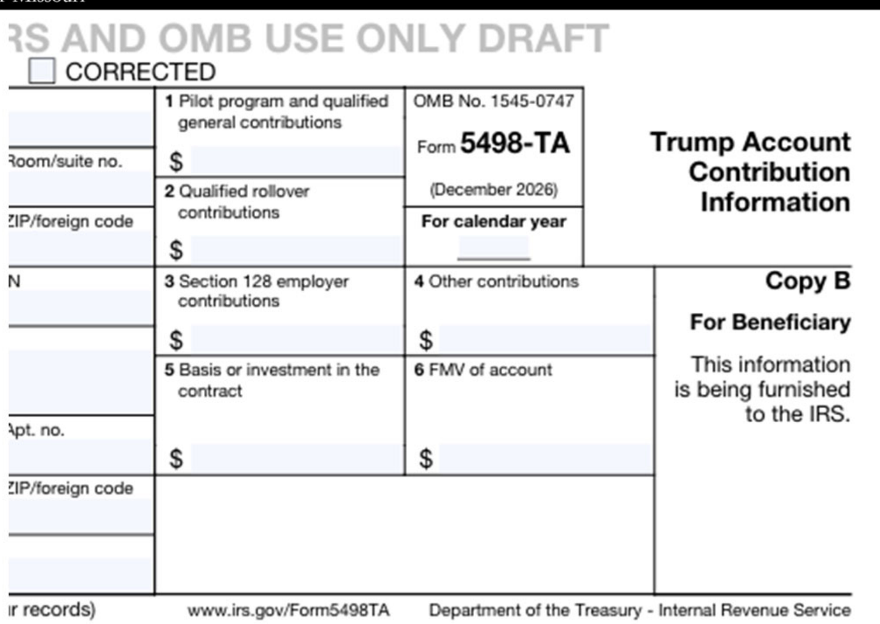
RS AND OMB USE ONLY DRAFT

☐ CORRECTED

Room/suite no.

ZIP/foreign code

N

Apt. no.

ZIP/foreign code

1 Pilot program and qualified general contributions
$

2 Qualified rollover contributions
$

OMB No. 1545-0747

Form **5498-TA**

(December 2026)

For calendar year

Trump Account Contribution Information

3 Section 128 employer contributions
$

4 Other contributions
$

5 Basis or investment in the contract
$

6 FMV of account
$

Copy B

For Beneficiary

This information is being furnished to the IRS.

r records)

www.irs.gov/Form5498TA

Department of the Treasury - Internal Revenue Service

26

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Distributions

27

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Distributions

- No distributions before the first day of the calendar year in which the beneficiary turns 18.
- In post growth period, distributions follow IRA rules
  - Rules on basis, but segregated
  - RMD applies

28

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Exceptions

- Rollover to another Trump account in entirety (trustee to trustee)
  - Only one Trump account at a time
- In the bene's 17th year only, Trump account can roll in entirety to ABLE account (529A)
- Death:
  - In growth period, FMV minus basis is taxable to heir or estate
  - After growth period, regular IRA rules apply
- Excess contributions can be removed; all earnings on excess taxed **100%**

29

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Post growth period distributions

- Withdraw funds and pay taxes and 10% penalty if pre-59.5
- Maintain Trump account status
- Rollover to traditional IRA (with basis)
  - Custodians may require!
  - ...then to Employer plan?
- Convert to Roth IRA

30

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Regular IRA distribution rules

- Earnings and pre-tax contributions are taxable
  - 10% early withdrawal penalty* and income taxes apply
  - *Exceptions apply

- After tax contributions are basis
  - Distributions are pro-rata pre and after tax
  - Trump account basis is segregated from other IRAs
    - Usually we aggregate basis in traditional IRAs

31

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Convert entirety to Roth

- After growth period!
- Pre-tax is taxed; basis rolls tax free
- What could go wrong?

32

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Kiddie Tax: 2026 Rules

- Conversion is unearned income
- First $1,350 is tax free, next $1,350 taxed at child's rates, remaining taxed at parents' rate:
  - All children under age 18 at the end of the year
  - 18 years old, support is more than 2x earned income
  - 19-23 and a full time student, support is more than 2x earned income
- Client also hates charities

33

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Planning Opportunities

34

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Landscape of tax advantaged accounts

35

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Other options for wealth transfer:

- UTMA/UGMA Brokerage
- Trusts
- Child-owned Roth Account
- Inheritable accounts
  - Brokerage
  - Retirement
- Life insurance
- Etc…

36

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Sieve strategy: Post growth period

- Rollover tax deferred into 401k, 403b, 457, etc.
- Roll basis into Roth IRA (start 5 year clock)
  - Can't roll into ER plan…yet
- Convert tax deferred into Roth in low tax years
- Arrive at retirement with options

37

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Trump Accounts = Retirement Accounts for Minors

- Jumpstart Roth IRAs for children
  - Can relieve savings pressure later in life
  - Focus more on saving for education, life events, and other
- Trust 18 yr old with $100,000+?
  - Communication and strategy plan with children
  - Robbing children of the responsibility of saving?
- Many competing options

38

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Trump Accounts = Retirement Accounts for Minors

- Financial Planning Professionals: Meh
  - .10% fee cap, fund or account level, apply to AUM advisor fee?
  - FAFSA ambiguity
  - Accounts may stay outside of AUM umbrella
  - Not very excited about these accounts (Backdoor Roth vibes)
  - See letters from CFP Board, Investment Company Institute, ABA
- Sieve strategy means assets leave AUM

39

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Two dollar summary:

- Take the free money, or
- Max out tax advantaged savings if funds available, or
- Pick and choose the best tax advantaged strategy
  - blend of Roth IRA, 529, Trump Account, etc.

40

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Questions

ZumwaltA@missouri.edu

Handouts/Link
s

41

2026 Upcoming MU Tax Education

Extension
University of Missouri

MU Fall Tax Schools

Columbia – Oct. 26 & 27 (Mon. & Tues.)

Springfield area – to be determined*

Online - to be determined*

* All locations and dates will be decided by early August.

All schools will be using the **National Income Tax Workbook™** compiled and produced by the Land Grant University Tax Education Foundation. Participants will receive online access to the past 10 years of workbooks.

IRS CPE credit planned: 2 hrs. federal tax law update and 6 hrs. federal tax.
Day 2 schools: 2 hrs. ethics, 2 hrs. federal tax update and 4 hrs. federal tax

Schools are approved for CFP credit (16 hrs. - must attend both days). Schools will be submitted for CLE credit through the Missouri Bar. Schools are designed to meet IRS requirements for continuing education credit.