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# IRS Insights

## A closer look

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## Tax Court Grants Taxpayer's Motion for Reconsider Post *Loper*

The Tax Court's recent decision to grant a motion for reconsideration in a hobby-loss case highlights the significant impact of the Supreme Court's *Loper* decision.

### Background

In May 2024, the Tax Court ruled for the IRS in a hobby-loss case.[1] The Tax Court concluded that the petitioners' farming and real estate activities were not a single activity for purposes of section 183 and, when the activities were considered separately, the court concluded that

the petitioners did not have an "actual and honest profit objective." The court applied and relied on Treas. Reg. § 1.183-1(d)(1) and Treas. Reg. § 1.183-2(b). During the case, the petitioners never argued that the Treasury regulations were invalid.

Six weeks after the Tax Court issued its decision, the Supreme Court issued the *Loper* decision which held that courts, not agencies, are responsible for interpreting ambiguous code sections; the decision overturned the forty-year old *Chevron* precedent which held that courts should defer to regulations as long as the regulations were not contrary to the statute and they were reasonable.[2] The taxpayers filed a motion for reconsider with the court alleging that Treas. Reg. § 1.183-1(d) (1) and Treas. Reg. § 1.183-2(b) were invalid under *Loper*.[3]

### Tax Court Order

Over the IRS's objections, the Tax Court granted the motion for reconsideration.[4] The IRS argued against the motion for reconsideration because the taxpayers did not raise any challenge to the regulation and the court's decision did not rely on *Chevron*.[5] The Tax Court said although its decision did not cite *Chevron*, it "does not mean that *Chevron* was not *implicit* controlling law."[6] The court said because it relied heavily on the regulations in this case, a motion for reconsideration was warranted.[7]

### Conclusion

The Tax Court's willingness to reconsider underscores the evolving landscape of a post-*Loper* environment.

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## Tax Court invalidates Treasury Regulation to find petition timely filed

In a recent decision,[8] the Tax Court rejected a taxpayer's attempt to expand the equitable tolling ruling in the Supreme Court case of *Boechler*.

### Background

Although Mr. Applegarth made payments towards his 2014 and 2015 tax liabilities, he did not timely file refund claims for those years. Instead, Mr. Applegarth filed his 2014 return on June 24, 2019 and he sent an unsigned 2015 return to IRS counsel in March 2022.

The IRS issued a notice of deficiency for 2014 and 2015, which asserts that Mr. Applegarth was not entitled to a refund under the statute of limitations in section 6511(b)(2) (addressing ability of IRS to issue a refund based on date of payment) and section 6512(b)(3) (addressing ability of Tax Court to determine an overpayment). Mr. Applegarth agreed those sections applied, but argued they were subject to equitable tolling.

### Tax Court Decision

Relying on the Supreme Court case *Brockamp*,[9] the Tax Court concluded that equitable tolling did not apply to sections 6511(b)(2) and 6512(b)(3). In *Brockamp*, the Supreme Court ruled that section 6511(a) is not subject to equitable tolling because it is written in a "highly detailed technical manner."

The Tax Court rejected Mr. Applegarth's argument that *Brockamp* was diminished by the more recent Supreme Court decision in *Boechler P.C. v. Commissioner*,[10] which held that a 30-day deadline to file a collection-due- process case was subject to equitable tolling. The Tax Court explained that Boechler is not inconsistent with *Brockamp* because the statute in *Boechler* did not contain detailed and technical language. Here, the statutes at issue contained "detailed" and "technical" language that distinguished them from the statute under consideration in *Boechler*.

The court also noted that the enactment of section 6511(h) supports a conclusion that Congress did not intend for there to be a general equitable tolling provision. In 1998, Congress added section 6511(h), which suspends the statute of limitations for the time a taxpayer is unable to manage their affairs by reason of a permanent physical or mental impairment. Thus, Congress chose to add a specific exception instead of providing a general equitable tolling exception.

### Conclusion

The Tax Court's decision emphasizes the difficulties taxpayers face when challenging the strict application of statute of limitations. Taxpayers should confirm their refund claims comply with the statute of limitations.

## Tax Court Applies Functional Analysis to NESE Limited Partner Exception

Recently, the Tax Court considered whether taxpayers were limited partners for purposes of the net earnings from self-employment (NESE) limited partner exception.

### NESE Tax Background

Generally, the Internal Revenue Code taxes NESE.[11] However, limited partners are exempted from this rule.[12] In recent years, there has been a lot of focus on which taxpayers are limited partners for NESE purposes, and, therefore, can exclude their partnership distributions from NESE tax.

In Soroban v. *Commissioner*, the Tax Court ruled that the designation of "limited partner" under state law does not determine if the NESE limited partner exception applies.[13] Instead, the Tax Court held that a functional analysis must be done to determine whether the partner truly is a limited partner.

*Denham* is the first post-Soroban case where a court had to determine whether the partners were limited partners under a functional analysis test for purposes of the NESE limited partner exception.

### Tax Court in *Denham*

The Tax Court began its analysis by noting that it is required to construe exceptions to NESE narrowly to achieve Congress's goal of optimizing the number of people eligible for Social Security (limited partners do not earn Social Security on the income exempt from NESE tax).

The Tax Court rejected the taxpayers' attempt to overturn or distinguish *Soroban*. The Tax Court said it was bound by stare decisis to follow the Tax Court's prior decisions.

The Tax Court identified the following factors for evaluating whether a partner is a limited partner: sources of partnership's income; the partner's role in generating the income; and the relationship between the partner's distributive shares and capital contributions.

When applying these factors, the Tax Court concluded the taxpayers in *Denham* were not limited partners for purposes of the NESE exception. Some of the facts the Tax Court relied on in reaching its conclusion include: the partnership's income was derived solely from fees in exchanges for services provided; the partners' time, skills, and judgement were essential to the services provided; the partnership carried a life insurance policy on of the partners; some of the partners did not make any capital contributions in exchange for their interest so distributions were not a return on capital; distributions were multiple times higher than guaranteed payments and no explanation was provided for how guaranteed payments were determined; the partnership agreement required partners to devote substantially all of their time and attention to the partnership (i.e., it was the partners' full-time employment); the partners participated in the management of the partnership; clients were allowed to leave the partnership if partners left; and marketing of the partnership focused on the partners.

### Conclusion

The *Denham* opinion demonstrates the Tax Court's commitment to its holding in Soroban. Unless a circuit court rules contrary to the Tax Court, taxpayers should expect the IRS to continue to narrowly apply the NESE limited partner exception.

## Final Regulations Providing Guidance on Appeals Resolution Process Finalized

The Treasury Department issued final regulations (T.D. 10030) providing guidance on the resolution of Federal tax controversies by the Independent Office of Appeals, including twenty-four exceptions to a taxpayer's general right to go to Appeals.

### Background

On January 15, 2025, Treasury promulgated final regulations (T.D. 10030) under section 7803(e) providing guidance on the Appeals resolution process. The Taxpayer First Act of 2019 renamed the IRS Office of Appeals as the IRS Independent Office of Appeals and provided taxpayers

a general right to go to Appeals. In October 2022, Treasury and IRS proposed regulations which, among other things, provided exceptions to the general right to Appeals. The final regulations generally follow the proposed regulations, with a few differences and clarifications. The regulations are effective as of January 15, 2025 and apply to all requests for Appeals' consideration received on or after February 14, 2025.

### Final Regulations

The final regulations provide twenty-four exceptions to the general rule that Appeals resolution is available to all taxpayers to resolve Federal tax controversies. The final regulations also address procedural and timing rules that must be met before Appeals consideration is available. Appeals cannot consider a matter until the originating IRS office (e.g., exam) makes a final determination on the controversy or proposing an administrative decision.

The final regulations define "Federal tax controversy" as a dispute over an administrative determination made by the IRS with respect to a taxpayer in administering or enforcing the internal revenue laws that arises out of the examination, collection, or execution of other activities concerning the amount or legality of the taxpayer's tax liability, a penalty, or an addition to tax under the internal revenue laws.

The final regulations clarified, but did not substantially change, the twenty-four exclusive exceptions to Appeals review. Under the final regulations, Appeals cannot hear a taxpayer's constitutional challenges to statutes or challenges to Treasury regulations. In addition, Appeals cannot consider issues that the IRS has designated for litigation. Other exceptions also include, among others: challenges to IRS decision not to issue closing agreement, challenges to decision not to issue letter rulings and the content of the rulings, whistleblower awards, frivolous positions, administrative determinations made by other agencies, erroneous return or rejection of an offer in compromise, and criminal prosecution pending against a taxpayer.

### Conclusion

When seeking access to Appeals, taxpayers should be mindful of these exceptions in light of the new regulations and should consider all appropriate avenues for resolution.

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## IRS Expands Alternative Dispute Resolution (ADR) Programs

In January 2025, the IRS announced test pilot programs with three changes to its existing ADR programs. The IRS said the changes are to help taxpayers resolve issues without litigation as effectively and efficiently as possible.

### Fast Track Settlement

In Fast Track Settlement (FTS), an IRS Appeals Officer mediates disputes between the taxpayer and Exam while the case is still in Exam's jurisdiction. In the announced pilot program, the IRS will test changes meant to encourage access to FTS. Under the pilot program, if the IRS wants to deny a taxpayer's request for FTS, then a first-line IRS executive must review the denial and the IRS has to provide the taxpayer a reason for denial. In another change, the IRS will now offer FTS on an issue-by-issue basis (previously, if the taxpayer had an ineligible issue, it could not go to FTS even for the eligible issues).

In addition, the IRS announced a "Last Chance FTS" pilot for the IRS's Self- Employed/Small Business division. In this program, Appeals Officers will contact taxpayers after a protest is filed to inform the taxpayer of their eligibility for FTS.

### Post-Appeals Meditation

The IRS also offers Post-Appeals Meditation (PAM). However, PAM involves a meditation between Appeals and taxpayer. Like the changes to FTS, the IRS pilots include changes to expand access to PAM. As with the FTS pilot, in the PAM pilot, the IRS cannot deny a taxpayer's request for PAM without first-line executive review. The IRS must provide a reason whenever a taxpayer's PAM request is denied.

Perhaps the most significant change, the IRS is allowing taxpayers to participate in PAM even if they previously participated in FTS for the same matter.

### Conclusion

Taxpayers looking to resolve controversies with the IRS, even single issues, should consider the IRS's ADR programs.

## Endnotes

1. *Schwarz v. Comm'r*, T.C. Memo. 2024-55.
2. *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024).
3. *Scwarz v. Comm'r* Docket No. 1247-20, Order November 5, 2024.
4. *Scwarz v. Comm'r,* Docket No. 1247-20, Order November 5, 2024.
5. *Scwarz v. Comm'r* Docket No. 1247-20, Order November 5, 2024.
6. *Scwarz v. Comm'r*, Docket No. 1247-20, Order November 5, 2024.
7. *Scwarz v. Comm'r*, Docket No. 1247-20, Order November 5, 2024.
8. *Applegarth v. Commissioner*, Nos. 3178-20, 3972-20, 2024 Tax Ct. Memo LEXIS 110, at *18 (T.C. Dec. 10, 2024).
9. *United States v. Brockamp*, 519 U.S. 347, 350 (1997).
10. *Boechler, P.C. v. Commissioner*, 596 U.S. 199, 202 (2022).
11. Section 1402(a).
12. Section 1402(a)(13).
13. 161 T.C. 310 (2023).

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