IRS Insights

A closer look

In this issue:

Tax Court Reaffirms Its View that the IRS Lacks Authority to Assess Penalties for the Failure to File Form 5471

In mid-November of last year, the Tax Court reaffirmed its view that the IRS lacks authority to assess penalties under section 6038(b)(1) when it issued its decision in *Mukhi v. Commissioner,* 162 T.C. No. 8 (Nov. 18, 2024) (*"Mukhi 2"*). With this holding, the Tax Court reaffirmed its decision in *Farhy v. Commissioner* and rejected the reasoning of the DC Circuit, which had reversed *Farhy* on appeal.

In *Mukhi v. Commissioner*, 162 T.C. No. 8 (Apr. 9, 2024) ("Mukhi 1"), the IRS assessed penalties for the taxpayer's failure to file Forms 5471, *Information Return of US Persons with Respect to Certain Foreign Corporations*, for three foreign corporations. The taxpayer argued that the IRS lacked authority to assess section 6038(b) penalties, and the Tax Court, relying entirely on its previous decision in *Farhy,* agreed with the taxpayer. In *Farhy*, the Tax Court had held that the plain language of section 6038 required the IRS to pursue civil action rather than administrative assessment and collection procedures to enforce section 6038(b) penalties.

The IRS appealed *Farhy* to the DC Circuit, and the court ultimately reversed the Tax Court's decision and held that the text, structure, and function of section 6038 supported the IRS's position that it has authority to assess penalties under section 6038. Following the DC Circuit's ruling, the IRS filed a motion for reconsideration of *Mukhi 1*, which was granted by the Tax Court.

As part of its motion for reconsideration, the IRS argued that if it cannot assess the section 6038 penalty, it cannot determine whether the taxpayer has reasonable cause for their failure to file. The Tax Court rejected this argument and noted that the determination of reasonable cause could be made before referring the matter to the Department of Justice. Adhering to the doctrine of *stare decisis*, the Tax Court reaffirmed its decision in *Farhy* and held that the argument that a prior case was incorrectly decided is not sufficient justification—on its own—to warrant reconsideration. Additionally, the Tax Court noted *Mukhi 1* was appealable to the Eighth Circuit as opposed to the DC Circuit. Thus, under the *Golsen* rule, the Tax Court was not constrained by precedent of the DC Circuit.

IRS Acquiesces to Eleventh Circuit Court Decision Regarding Reportable Transactions

In *Green Rock LLC v. IRS*, [1] the Eleventh Circuit Court upheld the district court's ruling that the Internal Revenue Service (IRS) violated the Administrative Procedure Act (APA) by issuing Notice 2017-10 without abiding by the APA's notice-and-comment procedures. In December 2024, the IRS announced that it will now follow the Eleventh Circuit opinion and will no longer defend the notice.

Background on Reportable Transactions and Notice 2017-10

To enact regulations that have the force of the law, the APA's notice-and-comment procedures generally require that federal agencies publish a notice with the proposed regulation and offer the public an opportunity to comment, before promulgating the final regulation as the law. Congress may, under the "express-exemption rule", choose to exempt an agency from complying with the notice-and-comment requirement by plainly and expressly communicating its congressional intent to deviate from the APA's procedural requirements.

Treas. Reg. § 1.6011-4 was enacted by the IRS in 2003, implementing the reportable transactions regime by providing the "rules relating to the disclosure of reportable transactions" and the process for identifying listed transactions. Specifically, the regulation states that the IRS may identify reportable transactions "by notice, regulation, or other form of published guidance." Section 6707A, enacted by the American Jobs Creation Act of 2004, established civil penalties to support the reportable transaction regime set forth in the existing Treas. Reg. § 1.6011-4.

The IRS published Notice 2017-10 to "designate certain conservation easement transactions as presumptively tax-avoidant listed transactions." The designation of a listed transaction "triggers significant reporting and recordkeeping requirements" for taxpayers and material advisors that participate in those transactions. Notice 2017-10 was published in the Internal Revenue Bulletin, the IRS's "authoritative instrument for announcing [its] official rulings and procedures", without undergoing notice and comment.

District Court Opinion

Green Rock LLC ("Green Rock") is an Alabama-based company that historically complied with the disclosure and reporting requirements related to its role as a material advisor for syndicated conservation easement reportable transactions. In 2021, however, Green Rock filed suit to set aside Notice 2017-10 as an improper legislative rule, issued in violation of the APA's notice-and-comment procedures.[2]

The district court granted summary judgement for Green Rock, reasoning that Congress had not expressly exempted listed transactions from complying with the APA's notice-and-comment procedures. It set the notice aside and made it clear that its order was "binding only on the parties to this case."

Eleventh Circuit Court Decision

On appeal, the Eleventh Circuit Court affirmed the district court's ruling that section 6707A did not expressly exempt the IRS from abiding by the APA's notice-and-comment procedures when identifying listed transactions and that, absent an express exemption, Notice 2017-10 was not binding on Green Rock.[3]

In reviewing the district court's ruling, the Eleventh Circuit determined that section 6707A lacks an "explicit reference to notice and comment, the Administrative Procedure Act, or procedural requirements" and that the Code does not "expressly or otherwise exempt the listing of transactions from the Administrative Procedure Act".[4]

The IRS argued that "through a series of statutory cross-references" Congress must have intended to ratify the language in Treas. Reg. § 1.6011, including the notice-listing process, because Congress was aware of the regulation and adopted parts of its language in section 6707A, and that this would "suggest that Congress knew of the Service's listing process and of existing listed transactions".[5] The Eleventh Circuit, however, disagreed with this argument based on its reading of the statutory text.

IRS Action on Decision 2024-1

In response to the Eleventh Circuit Court's ruling in Green Rock LLC, and similar Sixth Circuit and Tax Court decisions, the IRS announced that although it disagrees with the Eleventh Circuit's ruling, it will no longer defend post-AJCA reportable transaction notices.[6] The IRS also indicated that it will not enforce disclosure or reporting requirements, or assert penalties under sections 6662A, 6707, 6707A, and 6708 for reportable transactions identified in post-AJCA notices that were issued in violation of the APA's notice-and-comment procedures.[7] For ongoing cases, the IRS will, at the request of the taxpayer, concede or abate penalties asserted under sections 6662A, 6707, 6707A, and 6708 in relation to reportable transactions unlawfully identified in post-AJCA notices.[8]

IRS Publishes Final Regulations Identifying Several Transactions as Reportable Transactions

Since October of last year, the IRS has published final Treasury Regulations identifying different transactions as reportable transactions. Specifically, final regulations were issued identifying syndicated conservation easements (SCE) and certain micro-captive transactions as "listed transactions" and certain other micro-captive transactions and partnership related-party basis shifting transactions as "transactions of interest" (TOIs). The IRS, however, recently announced that it intends to release a notice of proposed rulemaking (forthcoming "NPRM") that will rescind the aforementioned Treasury Regulations applicable to basis shifting transactions.

Syndicated Conservation Easements

On October 8, 2024, the IRS published final regulations identifying certain SCE transactions as listed transactions. *See* Treas. Reg. § 1.6011-9. The final SCE regulations adopt, with minor revisions, the proposed regulations that were originally published in 2022.

Under the final SCE regulations, a syndicated conservation easement transaction is a listed transaction and requires certain disclosures for participants and material advisors. The definition of syndicated conservation easement transaction first published in the now invalid Notice 2017-10 was adopted in the final SCE regulations and includes four parts—(1) taxpayer receives promotional materials promising a charitable contribution deduction equal to or exceeding 2.5 times the taxpayer's investment, (2) taxpayer invests directly or indirectly in a partnership, (3) the partnership contributes the conservation easement to a qualified organization and allocates the charitable contribution deduction to its partners, and (4) taxpayer claims the charitable contributions deduction on their federal income tax return.

Following the publication of the final SCE regulations, participants who had previously filed an income tax return reflecting participation before October 8, 2024, were required to report such participation on Form 8886, *Reportable Transaction Disclosure Statement*, to Office of Tax Shelter Analysis (OTSA) for any year in which the period of limitations for assessment of tax had not ended. These disclosures were due to OTSA on January 6, 2025. Additionally, participants will be required to attach Form 8886 to their federal income tax return for each year going forward in which they participate in the transaction.

Material advisors who made tax statements (that is, any statement, oral or written, that relates to a tax aspect of a transaction that causes the transaction to be a reportable transaction) with respect to transactions covered by the final SCE regulations before October 8, 2024 were also required to disclose any such tax statements made during the six years immediately preceding October 8, 2024. Moreover, material advisors who make tax statements with respect to transactions covered by the final SCE regulations after publication are required to make disclosures in accordance with section 6111 and maintain an investor list pursuant to section 6112. The material advisor disclosure is made on Form 8918, *Material Advisor Disclosure Statement*.

Micro-captive Transactions

On January 14, 2025, the IRS published final regulations identifying certain micro-captive transactions as listed transactions and certain other micro-captive transactions as a TOI. *See* Treas. Reg. § 1.6011-10 and Treas. Reg. § 1.6011-11, respectively.

Both sets of final micro-captive regulations cover certain micro-captive insurance transactions designed to take advantage of the section 831(b) election to be taxed on investment income only as originally outlined in Notice 2016-66. In these transactions, a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, related persons, or both, using contracts that the parties treat as insurance contracts and a related party that the parties treat as a captive insurance company. The captive insurance company elects under section 831(b) to be taxed only on its investment income and excludes the payments directly or indirectly received under the contracts from its taxable income. The final micro-captive regulations for the listed transactions require that both a financing element and specific average loss ratio condition be satisfied. The final micro-captive regulations define a listed transaction as a transaction with a loss ratio of less than 30% and define a TOI as transaction with a loss ratio of less than 60%.

In connection with the publication of the final micro-captive regulations, the IRS issued Rev. Proc. 2025-13, which permits taxpayers seeking to revoke their section 831(b) election, for the current or preceding year, to do so in writing before the extended due date of their tax return.

Similarly to participants in SCE transactions discussed above, participants who previously filed an income tax return reflecting participation in certain micro-captive transactions before January 14, 2025, are required to report such participation on Form 8886 to OTSA for any year in which the period of limitations for assessment of tax had not ended. Additionally, material advisors who made tax statements with respect to transactions covered by the final micro-captive regulations before January 14, 2025, are required to disclose any such tax statements made during the preceding six years. While such disclosures are generally due 90 days after the finalization of the regulations, the IRS issued Notice 2025-24 extending the due date to July 31, 2025. And, as with all reportable transactions, participants and material advisors will be required to disclose their participation on Form 8886 or Form 8918, as applicable, in accordance with the reportable transaction regulations on a going forward basis.

"Basis Shifting" Transactions

On January 14, 2025, the IRS also published final regulations identifying certain partnership related-party "basis shifting" transactions as a TOI. *See* Treas. Reg. § 1.6011-18.

As expected, the final basis shifting regulations require participants and material advisors to disclose prior participation and any future participation in accordance with the reportable transaction regulations. However, on April 17, 2025, the IRS published Notice 2025-23 announcing that they intend to publish an NPRM proposing to remove Treas. Reg. § 1.6011-18.

Notice 2025-23 also provides immediate relief from any penalties applicable to participants and material advisors that fail to disclose their participation in or tax statements made with respect to this TOI, which practically removes the need for participants and material advisors to file Forms 8886 and 8918 for this particular type of transaction.

Tax Court Finds Equitable Tolling Applies to Redetermination of Employment Status

In a recent decision,[9] the Tax Court held that the 90-day deadline for redetermination of employment status is subject to equitable tolling.

Background

The IRS issued to Belagio Fine Jewelry Inc. a notice of employment tax determination under section 7436. Four days before the expiration of the 90-day period to file a petition for redetermination, Belagio's attorney mailed the petition to the Tax Court via a service that was not an IRS designated private delivery service. The petition arrived at the Tax Court one day after the 90-day deadline. The timely mailing rule under section 7502 did not apply because the attorney did not mail the petition via an IRS designated private delivery service (as required by section 7502(f)).

The IRS filed a motion to dismiss for lack of jurisdiction because the petition was filed one day late. Belagio argued that the 90-day deadline is a claim-processing rule, subject to equitable tolling.

First Tax Court Decision[10]

On June 25, 2024, the Tax Court held that the 90-day deadline was a nonjurisdictional claim-processing rule and denied the IRS's motion. The court reserved judgment on whether the 90-day deadline is subject to equitable tolling until the issue was properly presented.

The Tax Court found that Congress did not intend the 90-day deadline to be jurisdictional because nothing in the text of the statute restricts the Court's ability to hear the case, consider pleadings, or act upon motions. The statute refers "only to a consequence to a taxpayer for failure to comply with the 90-day deadline" and the text of the statute "does not clearly indicate that the 90-day deadline is jurisdictional." The Court also noted that the historical treatment of similar statutes did not support a jurisdictional reading.

Second Tax Court Decision

On April 15, 2025, the Tax Court held that the nonjurisdictional 90-day deadline in section 7436(b)(2) is subject to equitable tolling. Relying on the Supreme Court case *Boechler*, [11] the Tax Court concluded that equitable tolling applies to section 7436(b)(2). In *Boechler*, the Supreme Court held that a 30-day deadline to file a collection-due-process case was subject to equitable tolling.

The Tax Court stated that nonjurisdictional deadlines are presumptively subject to equitable tolling, and it distinguished the deadline in section 7436(b)(2) from the deadline to file a refund lawsuit under section 6511, which the Supreme Court in *United States v. Brockamp*[12] held was not subject to equitable tolling because it was "highly detailed" and "technical."

The Tax Court further noted that the text of section 7436(b)(2) is not "highly detailed or technical" and that the 90-day deadline is a purely procedural limitation not tied to substantive rights. The taxpayer, however, did not benefit from this ruling because it did not meet the two-pronged test of demonstrating (1) that it pursued its rights diligently and (2) that extraordinary circumstances outside of its control prevented it from filing on time.

The Tax Court found Belagio did not satisfy the two part test because (1) it did not "pursue its rights diligently" because it did not follow up with its attorney to ensure the timely filing of the petition and (2) the "garden-variety negligence" of the attorney's legal staff in selecting a non-designated private delivery service did not constitute "extraordinary circumstances outside the Petitioner's control." Thus, Belagio was not entitled to equitable tolling.

Conclusion

Although the Tax Court's finding that equitable tolling applies to employment status redeterminations is taxpayer favorable, the bar for obtaining equitable tolling relief remains high. Mere administrative errors are unlikely to succeed in equitable tolling arguments, adherence to deadlines and proper mailing procedures should be strictly followed.

As always, it is critical that taxpayers and tax advisors adhere to Internal Revenue Code deadlines and use proper mailing services because, as *Belagio* indicates, courts will apply equitable tolling sparingly.

Endnotes

1. *Green Rock LLC v. IRS*, 104 F.4th 220 (11th Cir. 2024)
2. Id. at 225
3. Id. at 229
4. Id. at 227
5. Id.
6. Internal Revenue Bulletins, IRS, https://www.irs.gov/irb/2024-52_IRB (last updated Dec. 20, 2024) ("This AOD does not apply to pre-AJCA notices.")
7. id
8. id
9. *Belagio Fine Jewelry, Inc. v. Commissioner*, 164 T.C. No. 7 (2025).
10. *Belagio Fine Jewelry Inc. v. Commissioner*, 162 T.C. 243 (2024).
11. *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493, 1500 (2022)
12. 519 U.S. 347, 354 (1997).

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