



IRS Insights

A closer look

In this issue:

Tax Court finds economic substance doctrine must be “relevant” to a transaction	1
A copy of a tax return provided to the IRS as proof of filing purports to be a valid return, IRS attorney says in email advice.....	2
Fifth Circuit held limited partner exception applies to any partner that has limited liability under state law, regardless of how active the partner is in the partnership	3
Court of Federal Claims finds section 7508A COVID-19 disaster relief period ran from January 20, 2020 until July 10, 2023.....	4

Tax Court finds economic substance doctrine must be “relevant” to a transaction

In a recent decision,¹ the Tax Court unanimously held that the economic substance doctrine may only be considered when it is “relevant” to a transaction, rejecting the decision reached in other cases that there is no threshold relevancy inquiry.

Background

In *Patel*, the IRS argued that the petitioners' paid insurance premiums to captive insurance companies were not insurance premiums for federal income tax purposes. As such, the petitioners' deductions for those payments were challenged by the IRS.

The Tax Court sided with the IRS in a 2024 decision,² denying the deduction of the purported premiums. The decision did not require a determination on economic substance, and the Tax Court requested briefing from the parties on two issues: 1) whether the economic substance doctrine under section 7701(o) requires a threshold relevancy determination and 2) the circumstances in which the economic substance doctrine is relevant.

Tax Court decision

The Tax Court unanimously held that under the statutory language of section 7701(o), the economic substance doctrine requires a threshold "relevancy" determination. Because "the statute says so, right there on its face," a relevancy determination is required. The legislative history of the statute supports that the economic substance doctrine was meant to apply only in circumstances where it was historically proper to disregard tax-motivated structures.

This approach conflicts with two other cases,³ where two district courts found that relevance should be assumed whenever a transaction fails the two-prong statutory test. This allows the IRS to proceed to the two-prong test without first demonstrating relevancy. The Tax Court in *Patel* took a more restrictive approach, limiting the economic substance doctrine to transactions in which it passes the threshold relevancy determination.

Conclusion

The Tax Court's decision emphasizes that not all tax-motivated transactions are automatically subject to the economic substance doctrine. This decision provides taxpayers with insights regarding IRS assertions of the economic substance doctrine.

A copy of a tax return provided to the IRS as proof of filing purports to be a valid return, IRS attorney says in email advice

In recently published [email advice](#), the IRS Chief Counsel's office concluded that when a taxpayer provided the IRS a copy of their tax return to prove they had filed a return, they were filing a valid return.

Background

When the IRS sent Taxpayers a notice that it had not received their tax return, Taxpayers provided a photocopy of the first two pages of their signed Form 1040 that had been filed, which was marked "COPY." The IRS then requested Taxpayers to provide the remaining pages of the Form 1040, including additional supporting schedules and forms.

The "copy" return, signed by Taxpayers, had a married filing jointly (MFJ) status. After providing that copy to the IRS, Taxpayers decided they wanted to file their return for that year as married filing separate (MFS). However, Taxpayers cannot change from MFJ to MFS on an amended return.⁴ As such, Taxpayers took the position that the "copy" they provided to the IRS did not constitute a return and that they could file a "new" return with MFS status.

Issue

When Taxpayers submitted a copy of their Form 1040, did they file a valid tax return?

Chief Counsel analysis

In a published email advice,⁵ the IRS Chief Counsel attorney advised that the "copy" return did constitute a return under the *Beard* test.⁶

The *Beard* test is a long-established test for determining whether a document constitutes a valid return. Under the test, a document is a return if: (1) the document has sufficient data to calculate the tax liability, (2) the document purports to be a return, (3) taxpayer made an honest and reasonable attempt to satisfy the requirements of the tax law, and (4) taxpayer executed return under penalties of perjury.⁷

The Chief Counsel attorney concluded that three of the four prongs were “easily” met. First prong: The copy of the first two pages of the return had sufficient information to allow the IRS to compute Taxpayers’ tax liability. Third prong: After the IRS sent a notice that they did not file their return, Taxpayers sent the copy as proof of timely filing. Fourth prong: The copy was signed by Taxpayers.

As for the second prong, the Chief Counsel attorney noted that was a more complex analysis—there is an argument that the copy did not purport to be a tax return because it was marked “COPY.” After analyzing *Kestin v. Commissioner*,⁸ the Chief Counsel attorney concluded that the copy did purport to be a return.

In *Kestin*, the taxpayer filed a frivolous amended return. When the IRS refused to issue her refund, the taxpayer sent six letters to the IRS with a copy of her frivolous amended return; each time the copy was clearly marked “copy.” The IRS assessed seven section 6703 frivolous tax return penalties against the taxpayer—one for the frivolous amended return and six for each time she sent a copy of the return to the IRS. The Tax Court concluded that, for purposes of section 6703, the copies did not purport to be returns because they were labeled copies. Accordingly, the IRS could assess only one section 6703 penalty.

The Tax Court, however, indicated that it might reach a different conclusion when a taxpayer submits a copy of proof of filing a return: “If the IRS notifies the individual that no return has been received, and if the individual responds with a copy of a purported return that he claims to have previously filed and on which copy he relies to report his income, then we do not rule out the possibility that the copy might constitute a purported return of tax for purposes of imposing a frivolous return penalty.”⁹ A couple years later, in *Smith v. Commissioner*,¹⁰ the Tax Court relied on this language to conclude that a copy of the tax return presented to the IRS to induce a refund payment was a purported return for purposes of the *Beard* test.

Relying on these cases, the Chief Counsel attorney concluded that, here, where Taxpayers provided the copy as proof of filing, the copy purported to be a return. Thus, Taxpayers satisfied the second prong of the *Beard* test. Accordingly, the “copy” was Taxpayers’ original return and they could not file another return changing their filing status from MFJ to MFS.

Fifth Circuit held limited partner exception applies to any partner that has limited liability under state law, regardless of how active the partner is in the partnership

On January 16, 2026, the Court of Appeals for the Fifth Circuit held that “a ‘limited partner’ in section 1402(a)(13) is a limited partner in a state-law limited partnership that is afforded limited liability.”¹¹

NESE tax background

Generally, the Internal Revenue Code taxes net earnings from self-employment (NESE).¹² However, limited partners are exempted from this rule.¹³ In recent years, there has been a focus on which taxpayers are limited partners for NESE purposes and, therefore, can exclude their partnership distributions from NESE tax.

The IRS takes the position that the limited partner exception does not apply to taxpayers who are actively involved in the partnership. The Tax Court has agreed with the IRS. 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.¹⁴ Instead, the court held that a functional analysis must be done to determine whether the partner truly is a limited partner and determined that the partners in *Soroban* were not limited partners for purposes of NESE. In *Denham*, the Tax Court applied the functional analysis that it had set forth in *Soroban*.¹⁵ The court held that, although the partners had limited liability under the state law, the partners were subject to tax on their NESE because the partners were actively involved in the partnership and it was their full-time employment. The taxpayers in *Soroban* and *Denham* have appealed to the Second Circuit and First Circuit, respectively.

Fifth Circuit in *Sirius Solutions LLLP v. Commissioner*

In *Sirius*, the taxpayer and IRS stipulated that if the Tax Court's functional analysis was applied, the partners would not qualify for the limited partner exception. The taxpayer then appealed to the Fifth Circuit, challenging the IRS's functional analysis test.

The Fifth Circuit rejected the Tax Court's functional analysis test and concluded that the limited partner exception applies to any partner that has limited liability under state law, regardless of how active the partner is in the partnership. The Fifth Circuit noted that had Congress intended to create a "passive investor" standard, it could have used the term "passive investor" rather than the commonly used "limited partner" term. The Fifth Circuit also noted that relying on a state law provided certainty rather than requiring taxpayers to apply a functional analysis.

Conclusion

Taxpayers and practitioners are waiting to see if the First and Second Circuits will create a circuit split, which may lead to a Supreme Court case. In the meantime, the Tax Court will likely continue to apply *Soroban's* functional analysis test to cases outside of the Fifth Circuit.

Court of Federal Claims finds section 7508A COVID-19 disaster relief period ran from January 20, 2020 until July 10, 2023

In *Kwong v. USA*, No. 1:2023cv00267, the US Court of Federal Claims declined to defer to an IRS regulation limiting disaster relief extensions to one year. As such, the Court concluded that, as a result of the Federal Emergency Management Agency (FEMA) COVID-19 disaster declaration, the version of section 7508A(d) in effect at the time extended the Taxpayer's deadline for filing a refund suit from January 20, 2020 (the start of the COVID-19 disaster declaration), through May 11, 2023 (the end of the disaster period as determined by FEMA), and for 60 days thereafter, until July 10, 2023.

Statutory background

Section 7508A(a) grants the IRS discretion to postpone certain acts required to be performed by taxpayers and the government if the taxpayer is affected by a Presidentially declared disaster.

Prior to its amendment in 2021, the version of section 7508A in effect during the COVID-19 declaration included subsection 7508A(d) which provided for a mandatory, self-executing minimum postponement period. Specifically, section 7508A(d)(1) stated that the period from the "earliest incident date" to "the date which is 60 days after the latest incident date" shall be disregarded in determining whether certain tax acts were performed on time.

In 2020, the Treasury Department promulgated Treas. Reg. § 301.7508A-1(g)(3)(ii) which interpreted section 7508A(d) such that "In no event will the mandatory 60-day postponement period [under section 7508A(d)] be calculated to exceed one year".

Background

In 2020, the IRS disallowed Taxpayer's refund claims for penalties paid for 2007, 2010, and 2011. After the Taxpayer filed suit in Court of Federal Claims in 2023, the IRS sought to dismiss the refund suit on the basis they were untimely under the two-year statute of limitations in section 6532.

Taxpayer argued that the version of section 7508A in effect at the time the refund claims were filed tolled the time to file the refund suit due to COVID-19 disaster relief. Specifically, the Taxpayer relied on the text of section 7508A(d)(1) which stated that the period from the "earliest incident date" to "the date which is 60 days after the latest incident date" shall be disregarded in determining whether certain tax acts were performed on time. For the COVID-19 pandemic, the President declared a nationwide emergency with a specified start date ("earliest incident date") of January 20, 2020. FEMA later established an end date ("latest incident date") of May 11, 2023. Taxpayer argued that a plain reading of the section 7508A(d) created a mandatory postponement period that ran from January 20, 2020, through July 10, 2023 (60 days after May 11, 2023).

The government argued for a shorter postponement, relying on Treas. Reg. § 301.7508A-1(g)(3)(ii), which stated: “In no event will the mandatory 60-day postponement period [under section 7508A(d)] be calculated to exceed one year”. In addition, the government noted that during the COVID-19 pandemic, the IRS issued Notices 2020-17 and 2021-21, which provided for postponement of the deadline for taxpayers to file federal tax returns for the 2019 and 2020 tax years respectively. As such, the government argued these notices would not have been necessary if the Taxpayer’s reading of section 7508A(d) was correct.

Court of Federal Claims opinion

The Court’s opinion rejected the government’s reliance on Treas. Reg. § 301.7508A-1(g)(3)(ii), deeming the one-year limitation on disaster relief an “unreasonable interpretation” of the statute. Specifically, the Court found the language of the 2019 version of section 7508A(d) to be unambiguous, leaving no room for agency interpretation. Citing the Supreme Court’s 2024 decision in *Loper Bright Enterprises v. Raimondo*, the Court asserted that it must exercise its own independent judgment not simply defer to an agency’s interpretation of an ambiguous statute.

The Court found that Treas. Reg. § 301.7508A-1(g)(3)(ii) conflated the discretionary one-year postponement authority granted to the Treasury in section 7508A(a) with the separate, mandatory, and automatic extension provided by section 7508A(d). The Court held that these two subsections must be read independently such that the discretion granted to the IRS under section 7508A(a) cannot be interpreted to limit the mandatory relief provided under section 7508(d).

The Court noted that Congress amended section 7508A(d) in November 2021 to prevent future open-ended postponements such as occurred during the COVID-19 pandemic. Congress’ non-retroactive amendment of section 7508A(d), which changed the calculation to 60 days from the start of a disaster, implied that the original statute had a different, broader meaning. As such, the Court found that Congress would not have felt impelled to change the 2019 version of section 7508(d) unless it intended to change the limitations of the mandatory relief period.

Conclusion

Although the Court’s holdings are still subject to appeal and litigation in additional venues, taxpayers who had federal tax filing or payment deadlines that fell between January 20, 2020, and July 10, 2023, should consider whether there are potential refund opportunities, including penalties and interest, for any open applicable years.

Endnotes

1. *Patel v. Commissioner*, 165 T.C. No. 10 (Nov. 12, 2025).
2. *Patel v. Commissioner*, T.C. Memo. 2024-34.
3. See *Liberty Glob., Inc. v. United States*, 2023 U.S. Dist. Lexis 209613 (D. Colo. Oct. 31, 2023); *Chemoil Corp. v. United States*, No. 1:19-cv-06314, (S.D.N.Y. Sept. 26, 2023).
4. Treas. Reg. § 1.6013-1(a)(1).
5. CCA_2024091615595818.
6. See *Beard v. Commissioner*, 82 T.C. 766 (1984), *aff’d*, 793 F.2d 139 (6th Cir. 1986).
7. *Id.* at 777.
8. 153 T.C. 14 (2019).
9. *Id.* at *28 n. 6.
10. T.C. Memo. 2021-29, 2021 WL 915611 (Mar. 10, 2021).
11. *Sirius Solutions L.L.P. vs. Commissioner*, 2026 U.S. App. LEXIS 1307.
12. Section 1402(a).
13. Section 1402(a)(13).
14. *Soroban Capital Partners LP v Commissioner*, 161 T.C. 310 (2023).
15. *Denham Capital Management LP v. Commissioner*, T.C. Memo. 2024-114.

Contact us

Matt Cooper

Tax Principal | Tax WNT
Deloitte Tax LLP
mattcooper@deloitte.com

John Diiorio

Tax Managing Director | Tax WNT
Deloitte Tax LLP
jdiiorio@deloitte.com

Teresa Abney

Tax Senior Manager | Tax WNT
Deloitte Tax LLP
tabney@deloitte.com

Juliana Kennedy

Tax Manager | Tax WNT
Deloitte Tax LLP
julkennedy@deloitte.com

Deloitte.

This article contains general information only and Deloitte is not, by means of this article, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This article is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this article.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the “Deloitte” name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.