

Winston & Strawn Tax Impacts Monthly Tax Controversy Update – July 2023

AUGUST 7, 2023

Welcome to the July 2023 edition of the Winston & Strawn Tax Impacts™ *Monthly Tax Controversy* newsletter. This edition highlights some recent decisions and other points of interest in the area of tax controversy and dispute resolution from the month of July. In this installment, we highlight two recent notable court cases, cover recent developments in Washington related to enforcement efforts related to the Employee Retention Credit (ERC), and highlight recent IRS guidance as to the taxation of staking rewards within the cryptocurrency space.

If you have any questions about the matters discussed below, please forward any questions or comments to us via email.

NOT CULPABLE OF NONRECEIPT OF NOTICE? – THIRD CIRCUIT REVERSES TAX COURT AND HOLDS IRC SECTION 6213(A)'S PETITION- FILING DEADLINE TO BE NON-JURISDICTIONAL

In a July 19 opinion in *Culp v. Commissioner*, No. 22-1789 (3d Cir. 2023), the Third Circuit reversed an earlier decision of the Tax Court and determined that the 90-day filing deadline under IRC section 6213(a) for redetermination of a deficiency is not jurisdictional but rather is a claims-processing rule subject to equitable tolling. The Tax Court dismissed the petition for lack of jurisdiction, finding that the petition was untimely because it was not filed within the required 90-day time period from the IRS's mailing of notice to file a petition. In its decision, the Third Circuit cited the recent Supreme Court case *Boechler, P.C. v. Commissioner*, 142 S. Ct. 1493, 1497 (2022), analogizing that the IRC section 6213(a) deadline should not be jurisdictional, like IRC section 6330(d)(1) in the case of *Boechler*. As a non-jurisdictional limitation, the court additionally held that the deadline should be subject to equitable tolling and remanded the case back to the Tax Court to determine whether the taxpayers were entitled to that relief.

The Third Circuit's decision in *Culp* sets up a conflict among the circuits and represents a notable development in the judicial interpretation of jurisdictional limitations in the tax-litigation process. Taxpayers outside the Third Circuit should carefully consider precedent outside the Third Circuit establishing the 90-day rule under IRC section 6213(a) as jurisdictional; on the other hand, taxpayers in the Third Circuit should be able to rely on the result in *Culp*.

EMPLOYEE RETENTION CREDIT GARNERING ATTENTION WITHIN THE BELT

The Oversight Subcommittee of the Committee on Ways and Means conducted a hearing on July 27, 2023, accentuating an unusually busy month of Employee Retention Tax Credit (ERTC)-related activity in Washington and

beyond. The focal topics of the hearing were dissatisfaction with the complexity of the law and lack of available guidance, the significant backlog of unprocessed applications, and a proliferation of unscrupulous promoters offering ERTC refunds that are too good to be true.

The hearing follows on the heels of IRS-published materials addressing each of these in the week prior to the hearing. In a Generic Legal Advice Memorandum (AM 2023-005) issued on July 21, the IRS provided clarification regarding the ability of certain employers to claim eligibility for the ERTC on the basis of supply chain disruptions. The memorandum presents five generic scenarios representing known taxpayer positions and explains why each hypothetical employer is ineligible for the credit. While the memorandum does not present truly new information, it does illustrate the IRS's position that eligibility claims based on supply chain disruptions must be supported by detailed documentation and must satisfy the narrow requirements previously published in IRS Notice 2021-20. The IRS also published finalized regulations (TD 9978) authorizing the assessment of erroneous refunds and clarifying how the IRS will move forward with collecting overpayments of ERTC refunds to employers in the future. Notably, the regulations confirm that erroneous refunds to employers shall be treated as an underpayment of taxes and may be assessed and collected in the same manner (including the potential assessment of penalties).

RESEARCH CREDIT UNDER SECTION 41, FAR FROM A SURE BETZ

On July 6, the U.S. Tax Court released a memorandum opinion in the case of *Betz v. Commissioner*, T.C. Memo 2023-84 (July 6, 2023), holding that shareholders in an S corporation that designs and supplies air pollution control systems were not entitled to claim the section 41 research tax credit. Taxpayers claimed the credit for wages paid to employees for activities performed in connection with 19 purportedly qualifying projects and supply costs associated with the production of systems produced in the Taxpayer's business. Following trial, the Tax Court held that the taxpayers (1) failed to carry their burden of establishing that the products were pilot models, (2) failed to carry their burden of establishing that employee wages were incurred in connection with the performance of qualified services, and (3) failed to retain substantial rights in the results of their research under contracts with contracts, and claimed purported qualified-research expenditures that were not creditable and incurred in connection with funded research within the meaning of IRC section 41(d)(4)(H). Accordingly, the Tax Court held that the taxpayers were not entitled to claim the section 41 research credit and additionally liable for penalties under IRC section 6662(a).

Monthly Spotlight: Cryptocurrency-staking Taxation Takes a Twist

IRS STAKES CLAIM TO CRYPTOCURRENCY REWARDS UNDER REVENUE RULING 2023-14

On July 31, the IRS issued Revenue Ruling 2023-14, setting forth its position that certain staking "rewards" are taxable income. The revenue ruling framed the principal issue as whether a cash-method taxpayer staking cryptocurrency native to a proof-of-stake blockchain and receiving additional units of cryptocurrency as rewards when validation occurs must include the value of the rewards in gross income. In support of its position, the revenue ruling delineates the fundamental rule for gross income under IRC section 61(a), providing that "instances of undeniable accession to wealth" require inclusion in gross income. Following the principles of that rule, the ruling culminates with the holding that cash-method taxpayers receiving additional units of cryptocurrency as rewards when validation occurs should include the fair market value of validation rewards received in the taxable year when the taxpayer gains dominion and control over the validation rewards. The ruling notes that the fair market value of the validation reward should be determined as of the date and time that the taxpayer gains dominion and control over the validation rewards.

The ruling represents a further articulation of the IRS's position just days after the taxpayers in the case *Jarrett v. United States*, No. 22-6023 (6th Cir. 2023), sought to keep their lawsuit on proof-of-stake taxation alive and force a judicial decision on the matter.

4 Min Read

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