LAW360 Tax Authority

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Top Federal Tax Cases Of 2021

By **David van den Berg**

Law360 (December 22, 2021, 7:13 PM EST) -- In 2021, the U.S. Supreme Court declined to review an IRS summons seeking the identities of a law firm's clients, while federal courts rebuffed constitutional challenges to passport revocations and issued other noteworthy tax-related rulings.

Here, Law360 looks back at some of the most significant federal tax decisions of the year.

IRS Client Privilege Row

In October, the Supreme Court **declined to review** a Fifth Circuit ruling allowing the Internal Revenue Service to proceed with a John Doe summons for the identities of a Texas law firm's clients who may have used the firm's advice to stash money abroad.

Among the top federal tax decisions of the year was the Supreme Court declining to take up a Fifth Circuit ruling allowing the IRS to proceed with a John Doe summons for the identities of clients of Taylor Lohmeyer Law Firm PLLC who may have used the firm's advice to stash money abroad. (AP Photo/J. Scott Applewhite)

The high court's rejection left in place an **April 2020 decision** by a three-judge panel to allow the IRS to enforce the summons. The agency pursued the identities of clients of Taylor Lohmeyer Law Firm PLLC **after investigating** a hedge fund manager who failed to report about $5 million of offshore income while using the firm's advice.

The Fifth Circuit ruling went against a prior standard that law firm clients' identities were protected from a summons if revealing them would likely show the reason they initially sought advice from the firm, said Laura Gavioli of Alston & Bird LLP. The panel narrowed the attorney-client privilege by requiring a stricter connection between a client's identity and the way they received the advice in order for the identity to be shielded, Gavioli said.

The case is probably causing the most significant discussion about privilege the legal community has had in a long time, said Joshua Smeltzer of Gray Reed & McGraw LLP. Tax professionals may need to change their delivery of advice from the outset of the client relationship and consider whether that advice will be protected if the IRS later pursues a John Doe summons, Smeltzer said.

"I think all tax practitioners now, knowing the Taylor Lohmeyer decision, you have to consider privilege from the very get-go," he said.

The Taxpayer First Act, the 2019 IRS overhaul law, bars the agency's use of John Doe summonses unless they meet certain standards, including that the information sought is narrowly tailored. Still, the summonses are an effective tool, and the agency will likely continue using them unless they become less effective or if more restrictions are added, Smeltzer said. If Congress increases the agency's enforcement funding as planned, that would also likely lead to the issuance of more John Doe summonses by the IRS, he said.

"The IRS is also investing pretty heavily in analytics to just sort and organize the data they already have," Smeltzer said. "That investment will probably yield more potential John Doe summons opportunities."

For her part, Gavioli said the Supreme Court's decision may empower the IRS to increase its use of John Doe summonses on professionals offering tax advice.

"It's definitely a tool the IRS is using more, and the Taylor Lohmeyer decision really enables the IRS to potentially go after law firms and accountants more than they might have in the past," she said. "It seems to narrow the circumstances where law firms and other tax advisers could withhold client names under these types of summonses."

The case is Taylor Lohmeyer Law Firm PLLC v. U.S., case number 20-1596, in the U.S. Supreme Court.

Passport Denial Program

A program in which the U.S. State Department can deny passports to taxpayers with tax debts certified as seriously delinquent by the IRS survived multiple constitutional challenges in federal courts in 2021.

The Tenth Circuit **threw out** a constitutional challenge to the program by Coloradoan Jeffrey T. Maehr in July. The IRS had certified Maehr's $250,000 tax debt as seriously delinquent in 2018, resulting in the revocation of his passport. A lower court found in 2020 that Maehr failed to prove the government's revocation of his passport was unconstitutional, which the Tenth Circuit affirmed.

With one appellate court upholding the constitutionality of the statutory scheme for passport revocations, Bruce McGovern of the South Texas College of Law Houston said he thinks the issue has been resolved "for now."

However, he said, "We could see a different court of appeals disagreeing with certain aspects of the opinion in Maehr and potentially reaching a different result."

The Tenth Circuit decision **followed the** U.S. Tax Court's March rejection of a California doctor's challenge to the constitutionality of Internal Revenue Code Section 7345 , which permits the agency to certify tax debts as delinquent. Dr. Robert Rowen had failed to pay tax debts for more than 20 years, racking up nearly $500,000 in unpaid liabilities, and the IRS certified his debt as seriously delinquent under Section 7345 in 2018.

Tax Court Judge Emin Toro said Section 7345 can't violate the Fifth Amendment because all it does is establish the process for the IRS to send certifications of seriously delinquent tax debts to the State Department.

Under Section 7345, the IRS **can certify** tax debts as seriously delinquent if they top $50,000. The decision whether to deny passport applications **rests with** the State Department under a law enacted in 2015.

The Maehr and Rowen cases weren't the only constitutional challenges to the program. A Georgia federal judge found **in March** that Section 7345 is constitutional. The taxpayer who brought that case, Craig Thomas Jones, later dropped his appeal to the Eleventh Circuit.

The cases are Jeffrey T. Maehr v. U.S. Department of State, case number 20-1124, in the U.S. Court of Appeals for the Tenth Circuit; Robert Rowen v. Commissioner, docket number 18083-18P, in the U.S. Tax Court; and Craig Jones v. Steven Mnuchin et al., case number 1:19-cv-00222, in the U.S. District Court for the Southern District of Georgia.

Donor-Advised Funds

Two federal courts issued decisions in 2021 that sided with donor-advised funds over their handling of gifts made by donors.

Donor-advised funds are separately identified funds or accounts operated by organizations governed by Section 501(c)(3) of the Internal Revenue Code. Once the donor makes a gift to the donor-advised fund, the sponsoring organization legally controls it, though donors or their representatives retain advisory privileges regarding the distribution of funds and investment of assets in the account.

A California federal judge in June **dismissed a suit** against Schwab Charitable Fund from a donor who sued on behalf of himself and other donors. He had argued the organization benefited Charles Schwab & Co. to the detriment of the donor-advised fund, leaving less money in donor accounts for donations.

The suit claimed Schwab Charitable breached its fiduciary duty and violated California law because it could've used market power to negotiate more favorable rates for custodial and brokerage services Charles Schwab provided. However, the judge ruled the donor ceded control of his donation and lacked a property interest establishing legal standing.

In February, a California federal magistrate judge **found** a couple failed to come close to proving the Fidelity Investments Charitable Gift Fund breached a standard of care in liquidating the couple's $100 million stock donation. The couple argued the organization made false promises to get them to donate their stock and sold all of it in three hours on the last trading day in 2017, hurting the stock price and cutting their tax deduction.

The cases were a positive development for donor-advised funds as a business, even if they suggest that donors have a problematic understanding of their interest in the funds, said Philip Hackney of the University of Pittsburgh School of Law.

"It's going to be hard for donors to actually argue that they have any property interest at all in a donor-advised fund, which I think means the position of these donor-advised funds is pretty strong in terms of how they are seen in the law," he said.

The cases are Pinkert v. Schwab Charitable Fund et al., case number 20-cv-07657, and Fairbairn et al. v. Fidelity Investments Charitable Gift Fund, case number 3:18-cv-04881, in the U.S. District Court for the Northern District of California.

Section 280E

In April, a three-judge Ninth Circuit panel **rebuffed** a California marijuana business's constitutional challenge to Section 280E , which bars marijuana businesses from taking business deductions other than for their cost of goods sold.

The Ninth Circuit panel declined to consider the argument from Patients Mutual Assistance Corp., which **does business** as Harborside Health Center, that Section 280E violated the 16th Amendment. That argument wasn't presented before the Tax Court, the panel said.

The Ninth Circuit's decision followed a U.S. Tax Court judge denying charitable contribution and depreciation deduction claims by medical marijuana business San Jose Wellness **in February**. Judge Toro said that the IRS correctly denied the deductions and that the company was liable for about $4.2 million in taxes.

Judges have **repeatedly upheld** the code provision and said it can be enforced against businesses operating in states where marijuana is legal.

Annette Nellen of San Jose State University said court interpretations of Section 280E appear consistent.

"Basically, they're saying go see Congress," she said.

The cases are Patients Mutual Assistance Corp.v. Commissioner of Internal Revenue, case number 19-73078, in the U.S. Court of Appeals for the Ninth Circuit, and San Jose Wellness v. Commissioner of Internal Revenue, docket numbers 12313-15, 12353-15 and 15714-18, in the U.S. Tax Court.

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