Taxation Reporter

Published by the Virginia State Bar Taxation Law Section for its Members Summer 2026

Message from the Chair

By Jake Snow

The Board of Governors of the Taxation Section of the Virginia State Bar is pleased to present this issue of the *Taxation Law Reporter*. This edition features five thoughtful articles.

First, John P. Morgan provides a practical overview of offers in compromise, including key eligibility requirements, filing considerations, and the distinctions among doubt as to liability, doubt as to collectability, and effective tax administration offers.

Next, Karen E. Kelly's article on administration priorities affecting certain Virginia nonprofits examines recent federal enforcement developments and highlights the need for nonprofit organizations and their advisors to pay close attention to compliance, governance, and potential areas of scrutiny.

Bryan Camp then explains how the IRS assesses and collects FBAR penalties, offering a useful reminder that these penalties are not tax penalties and that this distinction has important consequences for practitioners advising clients in this area.

Kelly C. Scanlon's article discusses retirement plan overpayments after SECURE 2.0 and explains how the new rules give plan sponsors additional flexibility while also raising important questions about recoupment, rollover treatment, and plan administration.

We are also pleased to include an article by Michael Wahl, the winner of the Section's 2024–2025 student writing competition. We are grateful for all the submissions we received as part of the 2024-2025 student writing competition.

Looking ahead, we are now launching the Section's 2026-2027 writing competition, and we encourage our members to consider involving their summer associates in the process. The submission deadline for this cycle is January 31, 2027. Winners will be eligible for cash prizes and an opportunity to be published in a future edition of this publication.

We are grateful to the authors for contributing their time and expertise to this edition, and we appreciate the efforts of everyone who helped prepare it for publication. We hope you find these articles useful in your practice, and we welcome your ideas for future topics, authors, and section programming.

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Offers in Compromise: Basics for Practitioners

By John P. Morgan, J.D., CPA, LL.M. (Tax), CFP®

Many taxpayers find themselves owing tax debt they cannot reasonably pay back. For this reason, the IRS processes and, in some cases, accepts offers in compromise. For this reason, Section 7122 of the Internal Revenue Code authorizes the Secretary of the Treasury to accept offers in compromise to settle a taxpayer's debt. In the author's experience, however, settling a tax debt with the IRS had little in common with settling a debt with a private creditor due to the numerous procedural and substantive requirements. This article briefly explores the basics of what practitioners and their individual clients should know about preparing offers in compromise, focusing on situations where there is not a dispute as to the amount of tax debt owed.

Requirements

Requests for offers in compromise are completed using Form 656[1]. Form 656 begins with what is labeled a "warning", with the following text:

> "The attached Form 656 is not a stand-alone form and is intended for tax professional use only. Individuals requesting consideration of an offer must use Form 656-B, Offer in Compromise, which may be found under the Forms and Pubs tab on www.irs.gov. Completed financial statements and required application fee and initial payment must be included with your Form 656. Failure to include the required information will delay consideration of your offer."

Accordingly, only tax practitioners should be preparing Form 656. The IRS has warned of OIC "mills" charging taxpayers fees for offers in compromise that are not properly prepared for evaluation[1]. Only certain types of taxpayers are eligible to file offers in compromise; the Instructions for Form 656 provide that a taxpayer must file all tax returns that are legally required to be filed, must have received a bill for at least one tax debt included in the offer, and must make all required estimated tax payments for the current year. Additionally, a taxpayer in an open bankruptcy proceeding is not eligible to file an offer in compromise, and the Instructions direct taxpayers to resolve any open audit or innocent spouse claim issues before submitting an offer. Finally, the IRS cannot process an offer if the IRS referred the taxpayer's case to the Department of Justice.

Offers in compromise must be accompanied by a fee of $205 unless a taxpayer qualifies for a waiver using Low-Income Certification guidelines, the thresholds for which are set forth on page 2 of Form 656.

Individuals are required to include a financial disclosure through Form 433-A (OIC) with offers in compromise, detailing sources of the taxpayer's income, assets, and liabilities. The completed Form 433-A (OIC) calculates a "minimum offer amount" to include with an offer based on doubt as to collectability. Additionally, the following documentation is required to be attached to Form 433-A (OIC): the most recent paystub or earnings statement; the most recent statement for each investment and retirement account; copies of all documents and records showing digital assets; three most recent months' bank statements; Most recent statement from all other income sources, including pensions, Social Security, rent, interest, dividends, child support, alimony, royalties; lists of accounts and notes receivable; verification of delinquent state/local tax liability; copies of court orders for child support and alimony; and documentation to support any special circumstances that may apply.

Types of Offers in Compromise

There are generally two different types of offers in compromise: those paid on doubt as to liability or doubt as to collectability. Offers based on doubt as to liability can be completed on Form 656-L, which defines doubt as to liability as existing where "there is a genuine dispute as to the existence or amount of the correct tax debt under the law." Filers are instructed not to include any fee with such offer, but generally are required to make an offer for $1 or more, based on what the taxpayer believes to correct amount of tax owed to be. Instead, filers must include an explanation as to why they believe the amount of tax they owe is incorrect. They are not

subject to the broad financial disclosures generally required when Form 656 is filed.

Offers filed with Form 656 are generally made based on doubt as to collectability, which the form defines as the taxpayer not having enough in assets and income to pay the taxpayer's full tax liability.

In the author's experience, it usually takes several months, and sometimes about a year, for the IRS to contact the filer of an offer. At this juncture, the IRS will let the filer know if any additional information or documentation is required for the offer to be processed. This also presents the first opportunity to engage in negotiations with the IRS about what constitutes an acceptable offer. A taxpayer is generally required to submit a minimum offer amount with the offer, constituting the taxpayer's equity in assets (taking into account a 20% discount in the gross value of illiquid assets), plus the taxpayer's "remaining monthly income" over a set period of time, taking into account certain expenses of the taxpayer.

An offer based on doubt as to collectability may offer to pay the offered amount in a lump sum or based on periodic payments, for a period between 6 and 24 months. A lump sum payment requires 20% of the total offer amount to be paid with the offer, with the remaining balance paid in 5 or fewer payments within 5 or fewer months of the date your offer is accepted.

Periodic payments require the taxpayer to make the first payment with the offer and the remaining balance paid in monthly payments within 6 to 24 months, in accordance with the proposed offer terms. Importantly, the taxpayer is required to continue to make monthly payments while the IRS processes and evaluates the offer.

Form 656 also allows a taxpayer to make an offer in compromise based on "effective tax administration." The current version of the Form refers to two different types of effective tax administration – "economic hardship" and "public policy or equity." An economic hardship is defined as a taxpayer having enough in assets and income to pay the full tax liability, but due to special circumstances, requiring full payment would cause an economic hardship. An offer should be made for effective tax administration based on public policy or equity when full collection could be viewed is unequitable. Form 656 gives the example of a payroll service provider misappropriating taxes withheld from the taxpayer's employees.

Taxpayers should be made aware that penalties and interest continue to accrue while an offer in compromise is being processed.

The IRS will accept, reject, or return an offer in compromise. A rejection of an offer can be appealed, but a return of an offer cannot be. Offers that are not accepted generally do not result in a refund to the taxpayer of amounts paid with the offer, but will be applied against the taxpayer's outstanding tax liability.

Conclusion

Offers in compromise are a valuable tool for taxpayers who cannot afford to pay their debt, and in some cases for those who have the ability to pay "on paper" but would suffer undue hardship from paying. It should not be thought of, however, as an expeditious or inexpensive option. Many members of the public believe from advertising they see that offers in compromise can be resolved quickly and based on cost-benefit analyses made by the IRS, similar to negotiating with a private creditor, which does not align with the author's experience.

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End Notes

[1] https://www.irs.gov/pub/irs-pdf/f656.pdf

[1] *IRS warns of "mills" taking advantage of taxpayers with Offer in Compromise program*, September 19, 2024, https://www.irs.gov/newsroom/irs-warns-of-mills-taking-advantage-of-taxpayers-with-offer-in-compromise-program

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Administration Priorities May Threaten Nonprofits in Virginia

By Karen E. Kelly

New developments in the enforcement priorities announced by the Trump Administration should concern members of tax-exempt and nonprofit organizations in Virginia--including individuals, donors, and executives affiliated with the targeted nonprofits. Individuals affiliated with tax exempt organizations should proactively review their compliance policies and procedures and ensure that their tax filings are accurate.

Administration Priorities

On September 25, 2025, President Trump issued National Security Presidential Memorandum 7 (NSPM-7) "Countering Domestic Terrorism and Organized Political Violence" that directed the Department of Justice, Treasury, and Homeland Security, to identify and investigate entities, including nonprofits, that could be designated "domestic terrorist organizations" under the Administration's broad new definition. NSPM-7 identified common recurrent motivations and indicia that united "terroristic activities under the umbrella of self-described "anti-fascism."" These activities included "extremism on migration, race, and gender; and hostility towards those who hold traditional American views on family, religion, and morality."[1] The Memo called for the designation of such groups as domestic terrorist organizations and for the National Joint Terrorism Task Force and its local offices (JTTFs) to investigate them. The Memo directed the IRS to take action to ensure that "no tax-exempt entities are directly or indirectly financing political violence or domestic terrorism." And the IRS was directed to refer such organizations, employees, and officers of such organization to the Department of Justice for investigation and possible prosecution.

In response to NSPM-7, on December 4, 2025, Attorney General Pam Bondi issued an internal directive (The Directive) to the Department of Justice to prioritize and implement NSPM-7 using a whole of government approach. The Directive reiterated the grave threats posed by "sophisticated, organized campaigns of targeted intimidation, radicalization, threats, and violence designed to silence opposing speech, limit political activity, change or direct policy outcomes, and prevent the functioning of a democratic society." The Directive identified "Antifa-aligned extremists" as those that adhere to "extreme viewpoints on immigration, radical gender ideology, and anti-American sentiment" and pose a "domestic terrorism threat."[2] These groups were identified as those that use violence or the threat of violence "to advance political and social agendas, including opposition to law and immigration enforcement; extreme views in favor of mass migration and open borders; adherence to radical gender ideology, anti-Americanism, anti-capitalism, or anti-Christianity; support for the overthrow of the United States Government; hostility towards traditional views on family, religion, and morality; and an elevation of violence to achieve policy outcomes." Zealously investigating and prosecuting these groups, along with culpable participants—including organizers and funders—is an Administration priority. Indeed, Bondi's Directive sets out a five year look back and mandatory reporting requirements and mandatory timelines for law enforcement to refer matters of suspected domestic terrorism to the Joint Terrorism Task Forces (JTTFs) for an "exhaustive investigation."

As part of this exhaustive investigation, the Attorney General directed federal law enforcement and the Department of Justice (DOJ) to consider any "applicable tax crimes in cases in which extremist groups are suspected of defrauding the Internal Revenue Service. As it receives referrals for violations of tax obligations, the DOJ should investigate, and where appropriate, prosecute those responsible."[3]

What This Means for Targeted Nonprofits

The potentially broad scope of these documents underscore that the federal government is paying outsized attention to certain nonprofit groups.[4] Individuals, donors, funders, and organizations whose advocacy - including immigration, the LGBT community, and other potentially politically sensitive issues - should be on notice and prepare for significant scrutiny from the federal government.

Indeed, all nonprofit organizations, not just those involved in issues targeted by the administration, should be prepared for the prospect of increased enforcement actions. The Directive puts strong emphasis

on criminal investigations and encourages the government to conduct intrusive grand jury investigations and issue criminal indictments where the evidence supports it. The consequences of a criminal investigation can be dire. Not only is the existence of the nonprofit jeopardized, but the individuals affiliated with the nonprofit can face prison time and fines.

It is not exceptional for the Department of Justice to investigate and prosecute nonprofits. In the early 2000s, Care International, Inc., which was a nonprofit based in Massachusetts, was investigated and prosecuted. On its Form 1023 submitted to the IRS it represented its charitable purpose as assisting victims of natural and man-made disasters and orphans. However, the entity also published a newsletter that promoted jihad. Three leaders of the organization, Emadeddin Muntassser, Samir Almonla, and Muhamed Mubayyid, were convicted of crimes including conspiring to defraud the IRS, false statements, and causing the filing of false tax returns due to their omissions on filed Form 1023 and Forms 990.[5] Another example is the case against former Pennsylvania State Senator Vincent J. Fumo who was convicted for fraud, tax evasion, and obstruction of justice for using a nonprofit, Citizens Alliance for Better Neighborhoods, for his political and personal benefit. He used the organization for his benefit through spending on cars, furnishings and office refurbishing. At his direction, the nonprofit also donated $60,000 to a group which sought to prevent sand dune construction near Fumo's beach house, which he feared would block his view of the ocean.[6] More recently, in 2019, an exempt organization called Preferred Family Healthcare Inc. was investigated by the DOJ due to unreported payments to executives affiliated with the nonprofit and for unreported political contributions. Leaders in the organization, including Tommy and Bontiea Goss, eventually pleaded guilty to charges that included tax fraud.[7] These cases provide a sampling of grand jury investigations of nonprofits that resulted in the dissolution of the entity and significant financial and personal harm to the individual defendants. Certainly, the majority of nonprofits are, presumably, not involved in nefarious conduct. However, regardless of the severity of the crime, organizations involved in nonprofit investigations can face revocation of tax-exempt status and substantial penalties, fines and excise taxes. More importantly, individuals involved in these investigations face serious personal jeopardy, including financial penalties and possible prison time.

Why Virginia?

These days it appears that one loci of this Administration's investigative priorities is Virginia. Specifically, the Eastern District of Virginia (EDVA) appears to be a favored venue, which may raise alarms for Virginia nonprofits. The attention and pressure of the federal government increase the risk for organizations with offices in Virginia to face federal investigations.[8]

Nonprofits in Virginia Must Act Now

Individuals involved with nonprofits in Virginia, particularly nonprofits involved with issues this Administration has expressed an intention to target, need to ensure their taxes and finances are in compliance with federal and state statutes. You can't stop trouble from coming, but you don't have to give it a chair to sit on. Prepare for trouble by conducting your own audit of your entities' compliance program, review your tax and public filings, review and update donor lists, funding sources and think about strategic planning. Now is the time to use your donor list to communicate with your supporters to educate them about the present atmospherics. Now is the time to prepare for a civil audit and a criminal investigation. Review with your team the possibilities of an investigation and best practices. Remind the individuals involved with your nonprofit that they can become subjects or targets in an investigation and that they need to review their personal tax filings.

In sum, individuals involved in nonprofits should preemptively look for and, if present, correct any irregularities in their taxes and governance. They should also seek to resolve any outstanding tax liabilities and delinquencies. High-profile organizations and individuals or organizations with sophisticated tax issues should obtain professional assistance. Individuals involved in certain nonprofits in Virginia must be prepared for invasive and extensive federal investigations. Before investigations begin in earnest,

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now is the time to ensure compliance—an ounce of prevention is worth a pound of cure.

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End Notes

1 National Security Presidential Memorandum-7, 90 Fed. Reg. 47225 (Sep. 25, 2025).

2 Jacob Knuston & Matthew Kupfer, Leaked Memo: DOJ To List, Target Anti-Trump Activists as 'Domestic Terrorists', Democracy Docket (Dec. 8, 2025), https://www.democracydocket.com/news-alerts/leaked-memo-bondi-doj-list-target-anti-trump-activists-domestic-terrorists/.

3 Id.

4 A proposed IRS overhaul to more easily investigate "left leaning" groups highlight the high likelihood of imminent nonprofit investigations. See Brian Schwartz et. al., Trump Team Plans IRS Overhaul to Enable Pursuit of Left-Leaning Groups, WALL STREET JOURNAL (Oct. 15, 2025), https://www.wsj.com/politics/policy/trump-irs-investigations-left-leaning-groups-democratic-donors-612a095e.

5 Melissa Wiley & Karen Kelly, IRS Vow to Amp Up Audits Puts Tax-Exempt Entities in Crosshairs, BLOOMBERG TAX (Nov. 5, 2025), https://news.bloombergtax.com/tax-insights-and-commentary/irs-vow-to-amp-up-audits-puts-tax-exempt-entities-in-crosshairs.

6 Id.; Press Release, U.S. Dep't of Just., State Senator Vincent Fumo Indicted Along With Three Aides (Feb. 6, 2007), https://www.justice.gov/archive/usao/pae/News/2007/feb/FumoPressRelease2.6.07.pdf.

7 Wiley & Kelly, supra note 4.

8 The Eastern District of Virginia includes Alexandria, Arlington County, Fairfax County, Loudon County, Newport News, Norfolk, Virginia Beach, and Richmond among other cities and counties in the eastern portion of Virginia. See Eastern District of Virginia Jurisdiction, E.D. VA., https://www.vaed.uscourts.gov/eastern-district-virginia-jurisdiction.

How The IRS Assesses and Collections FBAR Penalties

By Brian Camp

Introduction

Just because the IRS assesses and collects a liability does not make it a *tax* liability. The penalty for failure to properly comply with the Foreign Bank and Financial Accounts (FBAR) reporting requirements is a good illustration. When helping clients contest assertions of FBAR penalties, it can be important to remember that these are not tax penalties. That is mostly good news, as I hope to explain in this article, using a recent Tax Court case as an illustration.

Background on FBAR

We often talk about "the IRS" as if it were a person (or animal!). Or we talk about the "Treasury Department" doing this or that. But agencies are legal fictions. As Edward Thurlow, 1st Baron Thurlow pointed out way back in the 18th century, corporate entities have no body to kick, no soul to damn. They operate only through a work process done by actual people.

Thus when you read statutes that Congress writes, you see that Congress generally grants powers not to the agency but instead to just a *single person*, generally "the Secretary" of a department. That person then delegates the powers to other specific categories of people within the relevant agency. And those folks often then re-delegate their powers to yet other groups of folks. It's a trail of delegations.

Specifically, Congress empowers one single person, the Secretary of the Treasury, to perform a lot of functions. Some of those functions relate to revenue collection. Others involve matters about the federal government's finances and budget. Whenever someone at the IRS does something, they must have authority to do it and that authority must trace up to the authority Congress has given the "Secretary." You do this tracing by looking at all the delegation orders collected in the Internal Revenue Manual (IRM) 1.2.2, that is: Part 1 (Organization , Finance, and Management); Chapter 2 (Service-wide Policies and Authorities); Section 2 (Service-wide Delegations of Authority). [1]

Congress has also loaded responsibilities other than tax collection on the Secretary of Treasury. Thus, if

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you title 31 of the United States Code you will see, repeatedly, that "the Secretary" is charged (and empowered) to deal with all sorts of other matters involving money, the federal budget, and the management of the federal government's finances.

So it is in title 31 of the United States Code—and not title 26—that Congress tells "the Secretary" to collect information about the foreign financial holdings of certain groups of people. Specifically, 31 U.S.C. §5314 provides that "*the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.*"

The statute goes on to empower the Secretary of Treasury to issue regulations.

You find those regulations in 31 CFR Subpart C - Subpart C ("Reports Required To Be Made"). Among the reports required to be made are the FBARs, as described in 31 CFR 1010.350 ("Reports of foreign financial accounts").

To enforce this reporting requirement, 31 U.S.C. §5321 authorizes, again, "the Secretary" to "impose a civil money penalty on any person who violates, or causes any violation of, any provision of section 5314." And, again, the regulations delegate that authority to the Commissioner of IRS. 31 CFR 1010.810(g).

The penalty amount for non-willful violations is a flat $10,000 per violation. The Supreme Court has recently interpreted that to mean a maximum of $10,000 per FBAR because the *"statutory obligation is binary. Either one files a report in the way and to the extent the Secretary prescribes, or one does not." Bittner v. United States*, 598 U.S. 85 (2023) (internal quote marks omitted).

The Secretary has delegated to IRS officials the responsibly for assessing and collecting taxes. But the Secretary has also delegated to the same IRS folks the responsibility for assessing and collecting certain non-tax liabilities, such as the penalty for failing to submit a proper Report of Foreign Bank and Financial Accounts (FBAR).

Assessment And Collection of FBAR Penalties

Taxpayers make their FBAR reports on Form 114 and submit them electronically to the Financial Crimes Enforcement Network (FinCEN), which is an organization within the Department of Treasury, just like the IRS. Only FinCEN is much smaller! It has only about 300 employees, according to its website.

The relative size may be part of why the Secretary of Treasury has delegated power to enforce the FBAR reporting requirement to the Commissioner of the IRS who has re-delegated them to various IRS employees. *See* IRM 1.2.2.15.13. To help monitor FBAR reporting, the IRS requires taxpayers to disclose their FBAR reporting requirement on various tax reporting forms, such as Schedule B (question 7a) on the famous Form 1040.

Assessing the FBAR penalty is straightforward. If and when the IRS detects a violation of the FBAR reporting requirements, it has authority to assess the penalty, but again that authority trickles down the delegation trail from title 31, specifically §5321. Details on how the IRS performs the assessment function are found in IRM 4.26.17.

Collecting the FBAR penalty is not so straightforward, precisely because the IRS does not treat it as a tax. The IRS has more limited authority to collect non-tax debts than it has to collect taxes.

To collect *taxes*, title 26 creates a lien in favor of the government (§6321) and gives the IRS the ability to seize any property or rights to property of the taxpayer (§6331). Actually, again, the statutes give authority to "the Secretary" who has then delegated that authority to the Commissioner who has redelegated it to various IRS personnel, *see* IRM 1.2.2.6.3 (11-08-2007).

To collect *non-tax* debts, the IRS generally has two options: First, it can refer the debt to the Department of Justice to file a collection suit. This first option is sometimes problematic. One problem is that the Department of Justice is not always willing or able to file collection actions. The amount to be collected must be large enough to justify the time and effort. A second problem is that even when it acts, it can take years to get a final judgment that can be collected. During those years the debtors do not fear the reaper. Those years give debtors time to engage in "asset protection"

measures to defeat collection. An example is *United States v. Brandt*, 2018 WL 1121466 (S.D. Fla. 2018). There Mr. Brandt failed to file FBARS in 2006 and it took until 2018 for the U.S. to even secure a default judgment against him. Sure, it's a judgment for over $3 million, but that delay gave Mr. Bandt, who lived in Switzerland, about a dozen years to protect his assets from eventual collection. For a more recent example, see *United States v. Koluk*, 2024 WL 4373414 (S.D. Fla. 2024) (another default judgment granted, in 2024, for FBAR penalties related to years 2016, 2017 and 2018). For information on protection strategies *see* Bryan Camp, Protecting Trust Assets from the Federal Tax Lien, 1 Estate Planning and Community Property Law Journal 295 (2009).

The second option for the IRS to collect non-tax penalties is offset. The IRS has a statutory power offset in §6402. The statute permits offset only of tax liabilities. However, the federal government *also* has a common law power to offset *non-tax* debts owed to the federal government against payment obligations owed by the government to the debtor. *See In re Chateaugay Corp*. 94 F.3d 772 (2nd Cir. 1996) (IRS has common law right to offset non-tax debts against tax refunds). To collect non-tax debts the government uses the Treasury Offset Program, managed by a different part of the Treasury Department, the Bureau of Fiscal Services (BFS). After sending notice of the FBAR penalty assessment and the amount due to the person against whom the assessment was made, the IRS refers FBAR penalty assessments to the BFS. See IRM 4.26.17.4.4(3), (6), and (7); *see also* 31 U.S.C. §3711(g)(1) and (4).

Illustration

A recent Tax Court case helps us understand how FBAR penalties are collected and why they are not taxes. In *Jenner v. Commissioner*, 163 T.C. No. 7 (Oct. 22, 2024), Mr. and Ms. Jenner failed to comply with their FBAR reporting requirements between 2006 and 2009. Apparently between 2009 and 2022 nothing happened to collect those penalties. The Jenners did not fear the reaper.

But in November of 2022 each of the Jenners received a letter from the Bureau of Fiscal Services telling them that *"funds may be withheld from your social security benefit payment"* through the Treasury Offset Program to pay the FBAR penalties. So now the Jenners had something to be collected. They feared the reaper.

In response to these letters the Jenners inexplicably attempted to invoke §6330 and requested a Collection Due Process (CDP) hearing. I say "inexplicably" for reasons I will explain below. The IRS sent them a letter explaining why they were not entitled to a CDP hearing and in response they, again inexplicably, petitioned the Tax Court.

The Jenners' argument on why they were entitled to a CDP hearing stood on two shaky legs. First, they had to argue that the SSA offsets were really levies. Remember that CDP rights are triggered only when the IRS either proposed to levy a taxpayer's assets (§6330) or files a Notice of Federal Tax Lien (§6320). So the Jenners had to argue that the offsets were really levies. The second leg of their argument was that the FBAR penalties were taxes. Again, when you read the CDP provisions, you see they are triggered only when the taxpayer wants to dispute the collection of "an unpaid tax." §6330(a)(3).

Judge Foley does not address the first leg of the argument, aside from calling it "specious." It's not, actually, although it is extraordinarily weak. When I was in Chief Counsel we had robust debates about whether the collection of payments that another component of the federal government owed a taxpayer who owed taxes were offsets or levies. We eventually concluded they were offsets but the matter was not entirely free from doubt. And for those of you who practice government contracts you probably know that a boilerplate provision in many such contracts is that the government's payment obligations under the contract will not be subject to offset.

Judge Foley, however does not need to address the levy-vs-offset issue because he cuts off the second leg of the argument: FBAR penalties are not taxes subject to the CDP rules.

"A necessary component of any determination made pursuant to section 6330 is that it relate to an unpaid tax. We have previously explained that the tax making up the underlying liability is the amount a taxpayer owes pursuant to the tax laws that are the subject of the Commissioner's collection activities. The

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statutes creating the 'collection due process' procedures, and the statutes creating the lien and levy collection mechanisms reviewed by those procedures, all explicitly pertain to 'tax'"

"Because FBAR penalties are not imposed pursuant to Title 26, they "are not subject to the various statutory cross-references that equate 'penalties' with 'taxes.'" In addition, nothing in 31 U.S.C. §5321(a) provides that an FBAR penalty is deemed a tax or that it is required to be assessed or collected "in the same manner as a tax."

Op. at 4-5 (citations omitted).

Comment: The Good News For Taxpayers

There are several reasons why it is not really bad news, and may actually be good news for most taxpayers, that FBAR penalties are not tax assessments.

1. Easier To Avoid Collection

Since the FBAR penalties are not taxes that mean means the IRS cannot use its lien and levy powers to administratively collect the penalties. So the IRS cannot seize their bank accounts, or investment accounts, or other property. As I explain above, the IRS has only two collection options: filing suit (if it can convince the Department of Justice to do so), or offset. Even better, it means taxpayers do not have to fully pay the assessment to get judicial review. This is why I said above that it was inexplicable to me that the Jenners wanted to get to Tax Court. They had a perfectly good route to judicial review through the U.S. Court of Federal Claims. The Tucker Act, 28 U.S.C. §1491 gives the Court of Federal Claims jurisdiction *"to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort."*

In other words, as the former Claims Court put it, the Court has jurisdiction over any complaint from a citizen that the federal government has their money in its pocket and needs to give it back. The seminal case remains *Eastport S.S. Corp. v. United States*, 372 F.2d 1002 (1967).

As I read the record in Jenner, their complaint was that the IRS missed the limitation period for assessing the FBAR penalties. After that period had expired, the IRS somehow persuaded the Jenners to sign retroactive consents extending the limitation period, seemingly as a condition to participate in the offshore voluntary disclosure program ("OVDP"). When that process failed, the taxpayers apparently wanted to contest the validity of their consents. That seems the basis for their assertion that the FBAR assessment was really a FUBAR assessment.

They can do that in Court of Federal Claims. Other folks have done exactly that. An example is *Jarnagin v. United States*, 134 Fed.Cl. 368 (Ct. Fed. Claims 2017). There, the Jarnagins claimed the FBAR penalty assessment was unlawful because they had reasonable cause for failing to file an FBAR and the IRS misapplied the statute in finding otherwise. The Court of Federal Claims held that *"because the Jarnagins claim that the penalty was exacted in contravention of that statute, the Jarnagins' claim is one for an illegal exaction and the Court has subject matter jurisdiction over it."*

But wait, it gets better! If FBAR penalties *were* taxes, then the Jenners would not be able to access either the Court of Federal Claims or any District Court until they jumped through two major hoops: (a) they would have to fully pay the assessment and (b) they would need to make an administrative claim for refund before they could sue. *Flora v. United States*, 357 U.S. 63 (1958). But they don't have to do any of that when suing on a *non-tax* claim in the Court of Federal Claims. They can just pay a little bit of the penalty (which apparently they have been doing through the SSA offsets) and just go directly to the Court of Federal Claims to challenge what they will claim is an illegal exaction.

Again, taxpayers have done exactly that. In *Mendu v. United States*, 153 Fed.Cl. 357 (2021), Mr. Mendu was assessed an FBAR penalty of over $750,000. He paid $1,000 and filed suit in Court of Federal Claims. Naturally the government counter-claimed for the unpaid penalty but the critical lesson is that the Court held that because the FBAR penalties were not taxes, then the *Flora* full payment rule did not apply and the Court had jurisdiction over Plaintiff's claim (and the counterclaim). But you do need to be

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careful what you ask for. Apparently, Mr. Mendu changed his mind about wanting judicial review and tried to voluntarily dismiss his case after the government counterclaimed. That's how the issue arose. Too late!

2. Avoid Passport Restrictions

Another reason why it may be better for taxpayers that FBAR penalties are not taxes is because that means the penalties do not count towards passport restrictions. That is, as another method to encourage payment of tax debts, Congress has authorized the Department of State to withhold passport approval or renewal when the IRS sends a notice that a taxpayer has a "seriously delinquent tax debt." §7345(b)(1). For details see Bryan Camp, Lesson From The Tax Court: *The Limited Review Of Passport Revocation Certifications*, TaxProf Blog (Feb. 21, 2023).

But the IRS takes the position that FBAR penalties do not count towards determining whether a taxpayer has a "seriously delinquent tax debt." Chief Counsel Notice 2018-005 (Apr. 5, 2018) (and neither do criminal restitution or past-due support payments).

Comment: Some Non-Tax Penalties Are Subject to CDP Rules

Congress often delegates responsibility to the IRS to assess or collect other liabilities that are not taxes. In such cases, however, Congress often explicitly provides that such liabilities are to be assessed and collected as if they were taxes. The most obvious example are all the assessable penalties (47 of them?) listed in Chapter 68, Subchapter B, which §6671 says are to be assessed and collected in the same manner as tax and explicitly directs that *"any reference in this title to "tax" imposed by this title shall be deemed also to refer to the penalties and liabilities provided by this subchapter."* So that means the IRS can use its full administrative collection powers and also means that taxpayer get the (questionable) benefit of CDP.

Other examples of non-tax penalties subject to CDP include: the power to assess and collect past-due child support, §6305(a) and the power to assess and collect criminal restitution obligations, §6201(a)(4). Notice those latter amounts also do not count for passport revocation, even though they are treated as taxes for CDP purposes.

Conclusion:

FBAR penalties are not tax penalties and are not collected like taxes. While that shuts off the CDP route to judicial review, it really may not be such bad news because when one door closes another opens, here the door to the Court of Federal Claims.

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End Notes

[1] Note that whenever the IRS reorganizes, it is useful to review the delegation orders to make sure they have been properly revised to reflect the organizational changes. You can sometimes get a quick win by finding an IRS foot-fault.

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Retirement Plan Overpayments After SECURE 2.0

By Kelly C. Scanlon

The SECURE 2.0 Act of 2022 (SECURE 2.0), which was included as part of the larger year-end budget bill, is a sweeping piece of legislation that changed many of the tax rules applicable to employee benefit plans (and has kept those of us practicing benefits law busy for the past few years). The regulatory agencies have released a stream of subsequent guidance; years later, plan administrators and recordkeepers are still implementing these changes. The way retirement plans manage overpayments is one of the areas that was changed.

Prior to SECURE 2.0, when a mistake resulted in a benefit being paid to a participant or beneficiary that was more than the amount owed under the terms of the plan, some retirement plans would try to get the overpayment amount back from the participant or beneficiary. This practice resulted in situations where a retiree on a fixed income was asked to return money or told that their future pension benefit payments would be decreased despite the individual being unaware of the error. Congress recognized that adjustments for even small overpayment amounts could create hardships for retirees and thus created new rules under the Internal Revenue Code (Code) and the Employee Retirement Income Security Act of 1974 (ERISA) to provide plans with additional flexibility when correcting these types of overpayments. The Internal Revenue Service (IRS) issued subsequent guidance in the form of Q&As to help clarify these new requirements.

Overpayments Before SECURE 2.0: IRS Employee Plan Compliance Resolution System

Retirement plans offer many tax advantages. In order to maintain that tax-favored status, a plan must be operated in accordance with the applicable tax rules and plan terms. Unintentional errors are such a part of plan administration, the IRS developed the Employee Plans Compliance Resolution System (often referred to by its acronym EPCRS) in order to help retirement plans correct mistakes and stay compliant.

Prior to SECURE 2.0, plan sponsors relied on the guidance set forth in EPCRS when determining how to correct overpayments made from both qualified retirement plans and section 403(b) plans (e.g., a retirement plan offered by public schools). EPCRS included various methods for correcting overpayments. These include corrective payments made to the plan either by recouping the overpayment from the participant or beneficiary, or from contributions made by other specified parties such as the plan sponsor (e.g., employer). This guidance also provided additional correction methods for defined benefit plans that reduced the need for corrective contributions if the plan met specified funding levels.

In certain cases, a plan sponsor could adopt a retroactive amendment that would align plan terms with plan operations as a means of correcting the overpayment, but these amendments were subject to conditions and the approach was not always available. EPCRS further specified that if the overpayment was not corrected by plan amendment, then that overpayment portion of the benefit payment was not eligible for tax-free rollover. This created tax reporting issues with respect to the benefit payments that included overpayment amounts and also resulted in plan administrators asking for overpayments to be disgorged from tax-favored accounts.

A Partial Solution: New Code Sections 414(aa) and 402(c)(12)

To help ease some of the resulting inequities and administrative burden, two new Code sections were included in SECURE 2.0 that addressed how overpayments from retirement plans should be defined and administered. These new provisions generally preempt the guidance previously provided under EPCRS and give plans additional flexibility when managing benefit overpayments.

New Code section 414(aa) introduced the term "inadvertent benefit overpayment" into the conversation and provides, generally, that a retirement plan will not fail to satisfy the tax qualification rules under section 401(a) of the Code (or the rules under section 403 of the Code, if applicable) merely because the plan fails to recoup payment from any participant, beneficiary, employer, plan sponsor, fiduciary, or other party on account of an inadvertent benefit overpayment.

However, the term "inadvertent benefit overpayment" was not defined in the legislation.

The IRS, in Notice 2024-77, picked up the mantle and defined "inadvertent benefit overpayment" as an overpayment that, despite the existence of established practices and procedures, either exceeds the amount payable under the plan terms or a statutory benefit limitation (although relief is limited here) or is made before a distribution is permitted under the plan terms. Inadvertent benefit overpayments do not include failures that are egregious, related to the diversion or misuse of plan assets, and that are directly or indirectly related to an abusive tax avoidance transaction. Essentially there is now recognition of, and relief for, overpayments that are caused by unintentional mistakes despite controls being in place. The IRS did clarify that an inadvertent benefit overpayment does not include overpayments made to a disqualified person or owner-employee as such terms are defined in the Code. Inadvertent benefit overpayments can include payments made from both defined benefit and defined contribution plans.

In the case of an inadvertent benefit overpayment, there generally is no strict requirement to seek recoupment from the overpayment recipient. However, plan sponsors are still permitted to do so and perhaps even should in certain situations. For example, in the case of fraud against the plan or in the case of a participant who received an overpayment by virtue of misrepresentation of information, omission of information, or has awareness that they were overpaid, then recoupment of the overpayment may be proper and needed to satisfy fiduciary obligations. And, importantly, while recoupment of overpayments is not necessarily required, the employer is not relieved of its obligation to meet any applicable funding obligations, or to restore amounts that may have been impermissibly forfeited from the plan. The limitations under other sections of the Code that apply to benefit payments must still be observed and, as described below, specialized notices to individuals may be required if these limits are violated.

New Code section 402(c)(12) eased administration of these inadvertent benefit overpayments. It provides that if recoupment of an inadvertent benefit overpayment is not sought, then that overpayment will be treated as having been paid in an eligible rollover distribution if the payment would have been eligible for rollover but for being an overpayment. To rephrase, unless a recoupment effort is made by a plan, an overpayment amount included in a benefit payment that was otherwise eligible for tax-free rollover won't necessarily change the treatment of the entire payment. This means, among other things, that it is okay for that extra amount to also be treated as rollover eligible, and an IRA provider or employer plan that may have received the inadvertent benefit overpayment is not forced to distribute it as an excess contribution.

There are limits to this relief. For example, if an inadvertent benefit overpayment is caused by a failure to observe the statutory limits under section 401(a)(17) or section 415, then the plan sponsor is required to notify the individual that the overpayment is not eligible for tax-free rollover. Further, if an inadvertent benefit overpayment is caused by a section 401(a)(17) or section 415 failure and the overpayment is not recouped from the individual, then a corrective payment must be made to the plan (by the plan sponsor or another party) under the same circumstances that apply to an overpayment under EPCRS.

Restrictions on Recoupment Efforts

If, after all of the details described above are thought through, a plan determines that recoupment from the overpayment recipient is warranted because the overpayment was not "inadvertent", then SECURE 2.0 amended ERISA to add restrictions that would apply to a recoupment effort. Notably, these conditions do not apply if the participant was "culpable" meaning that the participant was responsible or should have otherwise known that the payment was too large. The Department of Labor (DOL) has jurisdiction over these restrictions and has yet to release guidance that expands these concepts particularly with respect to participant culpability. The IRS made it clear in its guidance that it was not addressing the issues under the DOL's jurisdiction.

These restrictions specify that no interest, earnings, and fees may be charged on the overpayment and that recoupment efforts cannot be made through collection agencies or accompanied by a threat of litigation. Additionally, if the inadvertent benefit

overpayment was made to a participant, no recoupment of that overpayment may be sought from a spouse or beneficiary of that participant. There is a timing restriction as well. Recoupment may not be sought if the first overpayment occurred more than three years before the participant was notified in writing of the overpayment, except in cases of fraud or misrepresentation. Additionally, in the case of on-going annuity payments being made from a defined benefit plan that are more than what is owed under the terms of the plan, future payments can only be adjusted subject to certain parameters surrounding the amount of the future reduction. For instance, if the plan chooses to adjust future annuity payments, the annual recovery cannot exceed 10% of the overpayment and the reduction cannot reduce the monthly payment by more than 10%.

Bottom Line

SECURE 2.0 introduced important new methods that retirement plans can use to manage overpayments, particularly in the case of inadvertent benefit overpayments. Determining when an overpayment is inadvertent seems like it should be straightforward, but plan administration is complex and challenging factual situations arise. The main thing to remember is that while recoupment of an overpayment from a participant or beneficiary may be warranted in some cases (such as when there was a bad actor involved), the changes made by SECURE 2.0 clarify that trying to collect on an overpayment from a participant or beneficiary should not be an automatic or default course of action. Instead, there are other avenues available that a plan sponsor can consider for purposes of ensuring retirement plans stay in compliance with the applicable tax rules when managing overpayments.

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The Losing War on Wealth: Why a Federal Wealth Tax is Unlikely to Survive After *Moore v. United States*

By Michael Wahl, Regent University School of Law
Winner of the Section's 2024–2025 student writing competition.

Abstract

Moore v. United States *was poised to be a landmark ruling on whether the tax principle of realization—that income cannot be taxed until the taxpayer receives some actual gain from the disposition of an asset—was constitutionally required by the Sixteenth Amendment. Instead, the majority in* Moore *sidestepped the realization question and narrowed its ruling to the constitutionality of the mandatory repatriation tax at issue in the case. The Court's hesitance to enshrine realization into the Constitution may leave advocates of a federal wealth tax hopeful. Wealth taxes are an increasingly popular proposed remedy to income inequality in the United States, outlining a plan to tax exceedingly rich taxpayers on their unrealized economic gains using an accretion-based tax model. Proponents of accretion taxes—which tax unrealized appreciation in assets rather than realized gain—have long criticized the realization requirement and feared that* Moore *would preempt a national wealth tax and other accretion-based tax proposals by only constitutionally allowing taxes on realized, as opposed to accrued, gains. But even as the possibility for a wealth tax survives, the language of the Justices in* Moore*—particularly Justice Barrett's concurrence, Justice Thomas's dissent, and even Justice Kavanaugh's various pre-opinion comments and qualifications of the majority opinion—indicates that the Supreme Court will rule that realization is constitutionally required before taxation of income can occur if the question is inescapably before the Court again.*

A. *Moore v. United States* and the Realization Debate

The Supreme Court declined to use its recent ruling in *Moore v. United States* to settle the constitutionality of a realization requirement for federal income taxes—the basic tax principle that a tax cannot be levied unless

the taxpayer "realizes" or actually acquires some measurable gain or benefit.[i] Although *Moore* ostensibly concerned the legitimacy of a mandatory repatriation tax ("MRT") imposed by the Tax Cuts and Jobs Act of 2017, the tax community—particularly those who wish to see more accretion-based tax procedures worked into the Internal Revenue Code—fretted over the potential enshrining of realization into the Constitution.[ii] Indeed, almost all of the amicus curiae briefs had far less to say about the MRT than they did on realization.[iii] And while the majority opinion punted on the issue, a principal topic of Justice Barrett's and Justice Jackson's concurrences, as well as Justice Thomas's dissent, was whether realization is constitutionally necessary to trigger income taxation.[iv]

The extended discussion surrounding realization by both commentators and the Justices in *Moore* continues the long-held debate on whether a tax system which targets increases in an asset's economic value is preferable to one where assets must be disposed of before taxation can occur. While some of this discussion is rooted in differing interpretations of the Supreme Court's precedents on the issue—most notably *Eisner v. Macomber*—the bulk of the debate stems from policy-based arguments as to what an ideal tax system would look like.[v] In particular, commentators who view the tax code as a vehicle to redress financial inequality tend to champion the relatively greater redistributive effects of a tax system that eschews the realization requirement.[vi] Such beliefs have culminated in popular support for a wealth tax.

B. The Accretion-Based Wealth Tax

Quickly becoming a mainstream progressive talking point since its modern inception, wealth taxes garnered national attention after one such tax was introduced by U.S. Senator Elizabeth Warren in 2019, who made it a centerpiece of her political platform.[vii] Known initially as the "Ultra-Millionaires Tax,"[viii] supporters have continued to frame this wealth tax as a way to force uber-rich Americans to "pay their fair share."[ix] In general, wealth taxes have become an increasingly discussed solution to income inequality in the United States, and have been staunchly defended by those wishing to see a more robustly progressive tax system.[x] In fact, President Biden previously insisted that several of his national spending programs could source their funding from the expected revenue bumps a wealth tax would generate—a proposal which Democratic presidential candidate Kamala Harris has also endorsed.[xi]

Functionally, wealth taxes target taxpayers who technically receive moderate incomes every year yet hold enormous amounts of wealth in assets that currently remain non-taxable due to lack of realization.[xii] Realization protects high net-worth individuals who hold most of their wealth in stocks or property by fending off tax liability until the taxpayer sells the asset and obtains gain from the transaction.[xiii] Until the stock or property is sold, no tax may be imposed. Thus, rich taxpayers whose wealth remains safely cocooned in assets that only grow in value over time can still leverage such assets for wealth-building activity without triggering taxation.[xiv]

A wealth tax presumes that Congress possesses the power tax individuals before realization occurs. The trigger for a wealth tax is the increase in an asset's value and not a disposable gain to the taxpayer once that asset is sold or otherwise disposed. Such congressional power would be foreclosed if the Constitution were read to prevent taxation before realization—the effect of a constitutional realization requirement. Therefore, a wealth tax targeting unrealized gains could not withstand constitutional scrutiny if the Constitution contains a realization requirement.

C. Realization vs. Accretion

Many tax academics and commentators have maligned the realization requirement, which undergirds much of the tax code.[xv] Popularly decried as the "Achilles' Heel" of the Internal Revenue Code, critics of realization only grudgingly accept it as an administrative necessity and oppose efforts to codify it as a constitutional requirement.[xvi] Instead, many such critics desire to see the current realization-based tax system replaced with one based on asset accretion.[xvii] Often described in terms of a "mark-to-market" tax model, an accretion tax would measure the increase of an asset's value during a taxable year and impose a tax based on that increase.[xviii] In other words, a taxpayer's gross income would encompass the appreciation generated by any asset the taxpayer owns.[xix]

Proponents of the accretion tax model acknowledge some of its seemingly insurmountable

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hurdles, including the difficulty of appraising illiquid assets and the taxpayer illiquidity that results from unsold assets being taxed.[xx] Even so, proponents point to certain sections of the tax code that already operate under an accretion-like paradigm, particularly Subpart F of the Internal Revenue Code.[xxi] Additionally, proponents argue that an accretion tax model promotes greater fairness in taxation across income levels, prevents major tax avoidance strategies permitted under a realization regime, and generates greater revenue for the government by opening up previously inaccessible tax streams.[xxii] Indeed, some in the tax community insist that were it not for some practical obstacles of operating an accretion tax system—which others argue can be overcome[xxiii]—an income tax based on accretion rather than realization would be "the ideal income tax."[xxiv]

D. The Supreme Court's Discussion of Realization in *Moore*

By sidestepping the realization issue underlying the controversy in *Moore*, the Supreme Court spared accretion taxes and emboldened advocates of a federal wealth tax.[xxv] But such relief will likely be short lived. Given the views expressed by the concurring and dissenting Justices, any wealth tax legislation that does manage to pass through Congress will face strong headwinds in the Supreme Court. The Court will not so easily brush aside whether the Constitution requires realization if a wealth tax is challenged, a question that the conservative Supreme Court appears poised to answer affirmatively.

Justices Jackson, Barrett, and Thomas spearheaded the realization discussion in *Moore*, arriving at their different conclusions primarily based upon their divergent readings of both the Sixteenth Amendment and the Court's own precedents.[xxvi] In particular, the Justice Jackson split with Justices Barret and Thomas over the binding effect of *Eisner v. Macomber*, which seemingly imposed a realization requirement by defining taxable income as the "'gain derived from capital, from labor, or from both combined,' . . . includ[ing] profit gained through a sale conversion of capital assets."[xxvii]

1) Justice Jackson's Concurrence

For instance, in her brief concurrence, Justice Jackson explicitly rejects a realization requirement, noting that such an "alleged requirement appears nowhere in the text of the Sixteenth Amendment."[xxviii] Instead, Justice Jackson contends that "both before and after the Sixteenth Amendment was adopted, the term 'income' was widely recognized as flexible enough to include both realized and unrealized gains," finding that any such limitation on that expansive definition was a "Court-created limit."[xxix] Likewise, Justice Jackson dismissed *Macomber* as "outmoded, if not overruled," stating that the Court has since limited *Macomber*'s holding to its specific facts.[xxx] In short, Justice Jackson "wrote what is basically a blueprint for government lawyers to defend a potential wealth tax before the court and a legal theory that justices could follow to uphold it."[xxxi]

2) Justice Barrett's Concurrence

Although wealth tax proponents will likely find an ally in Justice Jackson, Justices Barrett and Thomas defended a constitutional realization requirement. Despite agreeing with the Court's approval of the MRT, Justice Barrett, joined by Justice Alito, found that "[t]he Sixteenth Amendment's reference to income 'derived' from any source encompasses a requirement that income . . . must be *realized*."[xxxii] Indeed, Justice Barrett views the Sixteenth Amendment's use of "derive" as synonymous with "realize," recalling past cases which "use 'derived' and 'realized' more or less interchangeably."[xxxiii] As such, Justice Barrett takes a more restrictive reading of "income" than Justice Jackson, declaring that "income includes neither 'a gain accruing to capital' nor 'a growth or increment of value in the income.'"[xxxiv] Likewise, Justice Barrett breaks with Justice Jackson on her reading of *Macomber* by granting its holding greater weight and maintaining that its propounded realization principle has not been undercut by subsequent cases.[xxxv] Justice Barrett's concurrence stands as a firm commitment to realization as a constitutional mandate: "In sum, realization may take many forms, but our precedent uniformly holds that it is required before the Government may tax financial gain."[xxxvi]

3) Justice Thomas's Dissent

Justice Thomas, with whom Justice Gorsuch joined, echoed Justice Barrett's opinion that "Sixteenth Amendment 'incomes' include only incomes realized by the taxpayer."[xxxvii] Once again employing his jurisprudential originalism, Justice Thomas insists that

"[t]he text and history of the [Sixteenth] Amendment make clear that it requires a distinction between 'income' and the 'source' from which that income is 'derived.' And, the only way to draw such a distinction is with a realization requirement."[xxxviii] After a lengthy historical analysis, Justice Thomas explains that "economic income" is not the kind of income which Congress is empowered to tax, contrary to what accretion-tax proponents argue.[xxxix] Instead, Justice Thomas approves of *Macomber*'s definition of income, agreeing that taxable income must be "*received* or *drawn* by the recipient (the taxpayer) for his *separate use*."[xl] Likewise, Justice Thomas agreed with Justice Barrett that "realize" is "the near-synonym [of] 'derived'" as used in the Sixteenth Amendment.[xli]

E. The *Moore* Majority and the Future of Realization Post-*Moore*

This debate over the constitutionality of a realization requirement starkly contrasts the majority's single footnote long discussion of the topic, which favored neither side.[xlii] At first glance, the majority's restraint on the issue suggests an unknowable ruling on the realization requirement should it ever return to this iteration of the Supreme Court. If predictions are correct that Justices Kagan and Sotomayor would side with Justice Jackson in any such dispute,[xliii] as their comments in *Moore*'s oral arguments indicate they would,[xliv] then the Court is split 4-3 in favor of realization. The deciding votes therefore rest with Justices Roberts and Kavanaugh. Justice Roberts, who habitually attempts to steer the Court away from sweeping and controversial constitutional enactments, may again call for restraint if the realization requirement is ever before the Court again. But Justice Kavanagh's majority opinion and comments during oral arguments in *Moore* suggests he is much more inclined to rule with his fellow conservatives on this issue.

True enough, Justice Kavanaugh's stance on the issue is well-veiled behind his contemplation of several unknown variables that could influence how a wealth tax is received by the Court, such as the Government's suggestion that wealth taxes could be characterized as property rather than income taxes.[xlv] Moreover, Justice Kavanaugh resisted the idea of "render[ing] vast swaths of the Internal Revenue Code unconstitutional" by ruling against the MRT and related tax provisions like Subpart F, warning that such a ruling "would deprive the U.S. Government and the American people of trillions in lost tax revenue."[xlvi] While wealth tax advocates can and have celebrated such language,[xlvii] they should also heed the quiet urging for "Congress [to] consider amending existing tax provisions or write future tax legislation so that taxes are based on realization."[xlviii]

For one, the majority largely justified its avoidance of the realization question on the fact that the income at issue was realized, if undistributed, in this case, meaning the Court did not treat the MRT as a specialized accretion tax.[xlix] As such, none of Justice Kavanaugh's reasoning would apply to an unambiguous tax on unrealized gains.[l] Justice Kavanaugh himself said as much during oral arguments, responding to the Government's claim that there is no realization requirement in the Constitution by observing, "We don't have to agree with you on that for you to prevail."[li] Similarly, Justice Kavanaugh mused that had a tax without historical precedent come before the Court—perhaps something like a wealth tax solely targeting high-net worth taxpayers—that the "lack of historical support would at least be a strike against it."[lii] In seeking to find a limit on the Government's ability to define and tax income,[liii] Justice Kavanaugh appears more likely to side with Justice Barrett and Justice Thomas's definition of Sixteenth Amendment income, consistent with "his philosophy . . . that the text of a statute generally has a plain meaning and that the same term used in different provisions of the code should ordinarily have the same meaning."[liv]

F. Conclusion

Admittedly, Supreme Court tea-leaf reading can be a futile exercise, and the majority's repeated refusals to entertain a debate on whether a realization requirement is a constitutional requirement throws doubt on any prediction for how the Justices would rule if the issue became unavoidable. Indeed, when critics warn that a constitutional realization requirement portends a grim future,[lv] such predictions may be unwelcome for some.

But in the face of four Justices resoundingly in support of a realization requirement being read into the Sixteenth Amendment, and the majority's heavily

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narrowed and qualified ruling, *Moore* should hardly be taken as the Court greenlighting an accretion-based wealth tax.[lvi] Coming off a Supreme Court term which featured historic curtailments of federal power,[lvii] the idea of this Court constitutionally blessing an expansive federal tax is ill-founded, as evidenced by the opinions and concerns expressed against taxes on unrealized gains by the Justices in *Moore*.

Undoubtedly, the debate over whether Congress should implement more accretion-based mechanics into the Internal Revenue Code will continue, even if the possibility of such a reform becomes constitutionally or administratively obstructed. So too will the political discourse surrounding the wisdom of a wealth tax continue. But *Moore* serves as a sobering reminder to the tax community that ultimately there are only nine opinions that will matter most.

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[i] *See* 144 S. Ct. 1680, 1691 n.3 (2024).

[ii] *Id*. at 1686; *See,* Alan D. Viard, *The Supreme Court Should Not Enshrine the Realization Tax Principle in the Constitution*, AEI (Sept. 12, 2023), https://www.aei.org/economics/the-supreme-court-should-not-enshrine-the-realization-tax-principle-in-the-constitution/ (framing the debate over the MRT's constitutionality as one that will require a decision on whether to enshrine the realization requirement as a constitutional requirement); Loren Naldoza, *Moore v. United States: The Constitutionality of the Taxation of Unrealized Gains*, 28 LEWIS & CLARK L. REV. 333, 351 (2024) (noting several pieces of pending accretion-based tax legislation that would be rendered preemptively unconstitutional if the Court in *Moore* ruled for the petitioners).

[iii] *See, e.g.*, Brief of *Amici Curiae* Former Att'y Gen. Edwin Meese III et al. Supporting Petitioners, Moore v. United States, 144 S. Ct. 1680 (2024) (No. 22-800) (framing the constitutional question as whether Congress can tax unrealized sums and answering in the negative); Brief of John R. Brooks & David Gamge as Amici Curiae in Support of Respondent, Moore v. United States, 144 S. Ct. 1680 (2024) (No. 22-800) (dedicating their arguments entirely towards the meaning of "income" under the Sixteenth Amendment and why a realization requirement is not implicitly contained in that meaning).

[iv] *See Moore*, 144 S. Ct. at 1697–99 (Jackson, J., concurring); *Id*. at 1699–1709 (Barrett, J., concurring); *Id*. at 1709– 27 (Thomas, J., dissenting).

[v] *See, e.g.*, David M. Schizer, *Realization as Subsidy*, 73 N.Y.U.L. REV. 1549, 1575 (1998) (arguing that while *Macomber* did impose a constitutional realization requirement, subsequent decisions have eroded the holding such that "[c]ommentators almost universally agree that realization is not constitutionally required."); David J. Shakow, *Taxation Without Realization: A Proposal for Accrual Taxation*, 134 U. PA. L. REV. 1111, 1114–15 (1986) (arguing that a tax system based on accretion of economic gain rather than realization would be more efficient, fair, and simple); *see also* Eisner v. Macomber, 252 U.S. 189, 207 (1920) (interpreting the definition of "income" used by the Sixteenth Amendment as containing a realization requirement).

[vi] *See, e.g.*, Timothy Hurley, *"Robbing" the Rich to Give to the Poor: Abolishing Realization and Adopting Mark-to-Market Taxation*, 25 T.M. COOLEY L. REV. 529, 548–49 (2008) (arguing that an accretion-based tax system will prevent wealthy taxpayers from avoiding tax liability and thus create a system where "total utility will increase due to the redistribution of capital income from the wealthy to the poor.").

[vii] Sahil Kapur & Laura Davison, *Elizabeth Warren's Tax Proposal Aims at Assets of Wealthiest Americans*, BLOOMBERG (Jan. 24, 2019, 7:29 PM), https://www.bloomberg.com/news/articles/2019-01-25/senator-warren-proposes-ultra-millionaire-tax-of-as-much-as-3; Ultra-Millionaire Tax, WARREN FOR SENATE (2024), https://elizabethwarren.com/plans/ultra-millionaire-tax.

[viii] *Senator Warren Unveils Proposal to Tax Wealth of Ultra-Rich Americans*, ELIZABETH WARREN (Jan. 24, 2019), https://www.warren.senate.gov/newsroom/press-releases/senator-warren-unveils-proposal-to-tax-wealth-of-ultra-rich-americans [hereinafter *Proposal to Tax Wealth*]; Ultra-Millionaire Tax Act of 2021, S.510, 117th Cong. (2021).

[ix] *Proposal to Tax Wealth*, *supra* note viii.

[x] *See, e.g.*, Emmanuel Saez & Gariel Zucman, *Progressive Wealth Taxation*, BROOKINGS PAPERS ON ECON. ACTIVITY 2–3 (2019), https://www.brookings.edu/articles/progressive-wealth-taxation/.

[xi] *See* Josh Boak, *What's the So-Called 'Wealth Tax' in Biden's Proposed Bill, and How Would It Work?*, PBS (Oct. 27, 2021, 1:21 PM), https://www.pbs.org/newshour/nation/whats-the-so-called-wealth-tax-in-bidens-proposed-bill-and-how-would-it-work; Garret Watson & Erica York, *Analysis of Harris's Billionaire Minimum Tax on Unrealized Capital Gains*, TAX FOUNDATION (Sept. 4, 2024),

https://taxfoundation.org/blog/harris-unrealized-capital-gains-tax/.

[xii] Suez & Zucman, *supra* note x, at 2 (describing a wealth tax as increasing "the tax rate of wealthy families who can currently escape progressive income taxation by realizing little income relative to their true economic income.").

[xiii] Ilan Benshalom & Kendra Stead, *Realization and Progressivity*, 3 COLUM. J. TAX L. 43, 45 (2011); Gabriel Zucman, *It's Time to Tax the Billionaires*, N.Y. TIMES (May 3, 2024), https://www.nytimes.com/interactive/2024/05/03/opinion/global-billionaires-tax.html.

[xiv] Zucman, *supra* note xiii.

[xv] *See e.g.*, Hurley, *supra* note vi, at 530 ("[R]ealization creates economic distortion, creates inequity, and allows taxpayers to manipulate their tax status"); Schizer, *supra* note v, at 1551 (reporting that "most scholars believe [realization] to be the most intractable problem in the income tax"); Cecily W. Rock & Daniel N. Shaviro, *Passive Losses and the Improvement of the Net Income Measurement*, 7 VA. TAX REV. 1, 29–30 (1987) ("[T]he realization requirement can permit the avoidance of all tax liability, no matter how substantial are one's other sources of taxable income."). *But see* Hurley, *supra* note 6, at 530 ("Realization is one of the most well-established, constant, and powerful elements of an ever-changing income-tax code.").

[xvi] Benshalom & Stead, *supra* note xiii, at 45; Rock & Shaviro, *supra* note xv, at 13 ("The realization requirement, while yielding a less accurate measurement of economic income than would a system of accrual taxation, has generally been viewed as administratively necessary to avoid the problems of both valuation and taxpayer liquidity.").

[xvii] *See, e.g.*, Shakow, *supra* note v, at 1113; Hurely, *supra* note vi, at 531.

[xviii] *See, e.g.*, Hurely, *supra* note vi, at 530–31.

[xix] *See* Benshalom & Stead, *supra* note xiii, at 51 (explaining that "assets [must] appreciate in value for the [accretion] tax to be triggered," contrasting a realization paradigm where "a transaction [must have] occurred and gains [must have been] realized.").

[xx] *See id.* at 53 ("Realization's endurance is generally explained in terms of two tax-administration concerns: problems of low taxpayer liquidity and the technical difficulty of valuing assets."); Shakow, *supra* note v, at 1113 (noting that "the accrual system has never attracted a large group of adherents because its twin problems of valuation (How can all assets be valued every year?) and liquidity (How can taxpayers pay taxes if they do not sell their assets?) have never been solved.").

[xxi] *See, e.g.*, David Kamin et. al., *New Supreme Court Case Could Unsettle Large, Longstanding, Parts of the Tax Code Built on a Bipartisan Basis Over Decades and Give a Windfall to Multinational Corporations*, MEDIUM (June 26, 2023) (arguing that Subpart F imposes a tax on owners of foreign corporations even when only the entity, and not the taxpayer, realized the income through "constructive realization.").

[xxii] *See* Hurley, *supra* note vi, at 544; Shakow, *supra* note v, at 1114–15.

[xxiii] *See* Hurley, *supra* note vi, at 552–53 (arguing that the issues of asset valuation and taxpayer liquidity are not sufficient reasons for resisting a transition to an accretion-based tax system).

[xxiv] Benshalom & Stead, *supra* note xiii, at 46; Rock & Shaviro, *supra* note xv, at 2.

[xxv] *See* Jim Tankersley, *Democrats' Dream of a Wealth Tax Is Alive. For Now.*, N.Y. TIMES (June 20, 2024), https://www.nytimes.com/2024/06/20/us/politics/democrats-wealth-tax-supreme-court.html.

[xxvi] *See generally* U.S. CONST. amend. XI.

[xxvii] Eisner v. Macomber, 252 U.S. 189, 207 (1920).

[xxviii] Moore v. United States, 144 S. Ct. 1680, 1698 (2024) (Jackson, J., concurring).

[xxix] *Id.* at 1698–99.

[xxx] *Id.* at 1698.

[xxxi] Tankersley, *supra* note xxv.

[xxxii] *Moore*, 144 S. Ct. at 1701 (Barrett, J., concurring).

[xxxiii] *Id.*

[xxxiv] *Id.* at 1702.

[xxxv] *Id.* at 1706.

[xxxvi] *Id.* at 1704.

[xxxvii] *Id.* at 1709 (Thomas, J., dissenting).

[xxxviii] *Id.*

[xxxix] *Compare id.* at 1721–22 (asserting that the term "income" as used "purely in an economic sense" is not within the Sixteenth Amendment's definition of taxable income), *with* Benshalom & Stead, *supra* note xiii, at 50 (claiming that "[i]t is widely accepted among economists and tax professionals that taxpayers' economic incomes" should serve as the "relevant benchmark for taxation.").

[xl] *Moore*, 144 S. Ct. at 1709 (Thomas, J., dissenting).

[xli] *Id.* at 1722.

[xlii] *Id.* at 1691 n.3 (majority opinion).

[xliii] Tankersley, *supra* note xxv.

[xliv] Transcript of Oral Argument at 12, Moore v. United States, 144 S. Ct. 1680 (2024) (No. 22-800) (reflecting Justice Sotomayor's comments that the Sixteenth Amendment "does not reference realization" and that if the amendment's drafters had intended realization to be a constitutional requirement, the term would have been explicitly included); *id.* at 37–38 (reflecting Justice Kagan's comment that the Court "left behind" the realization requirement imposed by *Eisner v. Macomber*'s definition of income).

[xlv] *Moore*, 144 S. Ct. at 1697.

[xlvi] *Id.* at 1696.

[xlvii] *See* Tankersley, *supra* note xxv (reporting that wealth tax advocates "celebrated the victory" of avoiding a constitutional realization requirement).

[xlviii] JUSTIN C. CHUNG, CONG. RSCH. SERV., LSB11185, SUPREME COURT DECLINES TO DECIDE WHETHER SIXTEENTH AMENDMENT REQUIRES "REALIZATION" TO TAX INCOME 3 (2024).
[xlix] *See Moore*, 144 S. Ct. at 1688 (holding that "the MRT does tax realized income.").
[l] *See id*. at 1697 ("To decide this case, we need not resolve that disagreement over realization. Those are potential issues for another day, and we do not address or resolve any of those issues here.").
[li] Transcript of Oral Argument at 65, Moore v. United States, 144 S. Ct. 1680 (2024) (No. 22-800).
[lii] *Id*. at 126–27.
[liii] *Id*. at 129.
[liv] Mary Monahan & Bradley Seltzer, *A Federal Tax Perspective on Judge Kavanaugh*, LAW360 (July 16, 2018, 10:40 PM), https://www.law360.com/articles/1063740/a-federal-tax-perspective-on-judge-kavanaugh.
[lv] *See e.g.*, Viard, *supra* note ii (warning that "many of the provisions [of the tax code] might eventually be struck down, resurrecting abusive tax strategies and economic distortions" if realization were to be constitutionally mandated); Jonathan D. Grossberg et al., *Moore v. United States and The Original Public Meaning of "Taxes on Incomes"*, ABA (Jan. 14, 2024), https://www.americanbar.org/groups/taxation/resources/tax-times/2023-fall/moore-v-united-states-original-public-meaning-taxes-incomes/ (arguing that a constitutional realization requirement "would be deeply unsettling to the framework established by the Sixteenth Amendment and create chaos for the administration of the income tax laws.").
[lvi] *See* Tankersley, *supra* note xxv.
[lvii] *See e.g.*, Loper Bright Enterprises v. Raimondo, 603 U.S. ___ (2024) (overturning the decades-long "Chevron Deference" in which courts would defer to federal agencies in interpreting ambiguous agency-empowering statutes).