KSCPA 76th Annual Tax Conference 2026

2026 Federal Tax Update - Businesses

What changed, what it means, and what to do next

Speakers

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Overview



- Depreciation: Property Allocations
- QOF 12/31/26 deferred gain recognition.
- SE Tax for Limited Partners and LLC Members
- AI and Tax
- IRS
- Private Jets
- Judicial Doctrines and Economic Substance
- Ethics
- On the Lighter Side

Depreciation: **Property Allocations**



Depreciation: **Property Allocations**

- Purchase of rental or business properties.

  "Slice and dice" property into its components.

  1. **Step 1**: Remove the portion for land.

     There are 6 ways to do this.

  2. **Step 2**: Slice and dice the remainder (improvements) into 3 components:

     Building shell (generally no bonus depreciation).

     Land improvements (**bonus eligible**).

     Personal property (**bonus eligible**).

- **Recent IRS audits**.
  - IRS is taking a **harder line based** on *AmeriSouth XXXII* case. T.C. Memo. 2012-67.
    - **Issue**: Millwork, cabinets, and countertops.
      - **However**, memorandum cases ***don't*** create binding precedent. Nico v. Comm'r, 67 T.C. 647, 654 (1977).
    - And subsequently issued final reg contradicts IRS.

Cost Segregation Studies

- “Questionnaire” Cost Seg study 2020.

Date of Results: 03/19/2020

ALLOCATIONS AFTER STUDY



Total Reclassification	Tax Basis	% allocated
5 Year Property	$26,648	14.25%
15 Year Real Property	$14,684	7.85%
27.5 Year Real Property	$145,667	77.90%

Cost Segregation Studies

- Same “questionnaire cost seg study” shows allocation to **cabinets** and **countertops**.

Other Non-Structural Interiors	Kitchen Cabinets & Countertops	$7,495	5	200%DB
	Kitchen & Appliance Plumbing	$3,087	5	200%DB
	Removable Flooring	$1,602	5	200%DB
	Ceiling Fans & Wiring	$383	5	200%DB
	Carpet	$3,521	5	200%DB
	Appliances	$8,671	5	200%DB
	Blinds & Curtains	$545	5	200%DB
	Appliance Wiring	$1,343	5	200%DB

- Is this a problem?
  - Classification depends on the facts.
    - Example 5 treats hotel cabinets as §1245 property. Treas. Reg. §1.263(a)-3(j)(3), ex. 5.
    - Example 6 assumes a sushi counter and chairs are §1245 property. Treas. Reg. §1.263(a)-3(l)(3), ex. 6.

Cost Segregation Studies

- **Reportedly**, IRS is **allowing** bonus on cabinets (except those which house plumbing) and countertops in **appeals conferences**.
  - Millwork continues to be an issue.
  - However, note that our “questionnaire cost segregation study” did ***not*** allocate to millwork as bonus eligible property.
- Ongoing impact.
  - **Future cost segregation studies *may*** provide a little bit **less bonus depreciation**.

QOF Gain Recognition December 31, 2026



Gain on December 31, 2026

Deferred Qualified Opportunity Fund Gain

- Tax code: Report gain on deferrals on Dec. 31, 2026, *if* no prior inclusion event.
  - Amount to be reported is the *lesser* of:
    1. Deferred gain, *or*
    2. FMV.
  - **Reduce gain** by *permanent exclusion* if eligible (10%/15%).
- There's no *special* FMV definition for QOFs. §1400Z-2(b)(2)(A)(i) and TR 1.1400Z2(b)-1(e)(3).
  - Valuation concepts apply (marketability/minority discounts).
- Most QOF's have performed poorly.
  - **Publicly traded** QOF (OZ) **declined 52%** since issuance.
- Approaches:
  1. Ask QOF for recent sales or valuations?
  2. Book capital account minus 35% (minority/marketability)?
  3. Valuation?

Gain on December 31, 2026

Deferred Qualified Opportunity Fund Gain

Example (based on the tax code)

Description	Valuation	Computation
Original deferred gain		$200,000
FMV of pro rata share of equity	$150,000	
Minority / marketability discount (35%)	($52,500)	
FMV of minority interest		$97,500
Lesser of deferred gain or FMV		**$97,500**
Less: adjusted basis (15% × $200,000)		($30,000)
Gain recognized		**$67,500**

Assumes investment by 12/31/2019, a supportable combined 35% discount, and no other basis adjustments.

- So far, so good.
  - But what do the *regs* say?

Fair Market Value

Code vs. Regulations

FMV in the gain computation

QOF partnerships and S corporations

Code	Regulations
IRC §1400Z-2(b)(2)(A)(i)	Treas. Reg. §1.1400Z2(b)-1(e)(4)
"the **fair market value of the investment** as determined as of the date described in paragraph (1)"	"The **gain** that would be recognized on a **fully taxable disposition** at fair market value of the qualifying investment that gave rise to the inclusion event."
Uses investment FMV in the lesser-of test, then subtracts basis.	Uses gain on a ***hypothetical*** taxable sale at FMV in the lesser-of test.

What's the Difference?

- What's the difference in practical terms?
  - Is this just a matter of "you say puh-TAY-toh, I say "puh-TAH-toh"?
- **No**: ***If*** the partnership has a **typical amount** of **debt**, in essence:
    - **FMV** is effectively ***increased*** by distributions and losses that reduced basis.
    - *Example*
      - FMV (after discounts) = $97,500.
      - The QOF ***partner*** has taken $200,000 in deductions that reduced basis.
        - Why liabilities matter – if there were no liabilities, the deductions wouldn't have reduced basis.
      - The FMV under the regs becomes $297,500.
        - Low FMV provides no benefit.

Gain on December 31, 2026

Deferred Qualified Opportunity Fund Gain

Example: $200,000 of losses

This *assumes* *significant debt*, but slide is *simplified* to make it more understandable

Description	Computation
Original deferred gain	$200,000
Less: 15% basis increase	($30,000)
Deferred gain less basis increase (cap)	**$170,000**
FMV less basis increase ($97,500 − $30,000)	$67,500
Add: prior losses that reduced basis	$200,000
Taxable gain on hypothetical FMV sale ($297,500 – $30,000)	**$267,500**
Gain recognized: lesser of $170,000 or $267,500	**$170,000**

Same $97,500 FMV and 15% basis increase as the prior example.
Debt basis and debt relief offset here. No distributions or other basis changes.

Gain on December 31, 2026

Deferred Qualified Opportunity Fund Gain

Example: $100,000 of losses

This assumes *no debt*, not very likely in real life,
But makes it more understandable

Description	Computation
Original deferred gain	$200,000
Less: 15% basis increase	($30,000)
Deferred gain less basis increase (cap)	**$170,000**
FMV less basis increase ($97,500 − $30,000)	$67,500
Add: prior losses that reduced basis	$100,000
Taxable gain on hypothetical FMV sale	**$167,500**
Gain recognized: lesser of $170,000 or $167,500	**$167,500**

Same $97,500 FMV and 15% basis increase as the prior example. **The only difference between the Statute and the Regulation is the losses which were allocated in this Example**

Treas. Reg. §1.1400Z2(b)-1(e)(4) · December 31, 2026 inclusion

The QOF partnership rule and how to challenge it

Statute · §1400Z-2(b)(2)

Lesser of deferred gain or FMV of the QOF interest, minus basis (zero plus the 10%/15% step-ups)

Regulation · partnership and S corporation QOFs

Lesser of (i) deferred gain less step-ups or (ii) gain on a hypothetical sale: FMV + debt share – actual outside basis

What Treasury aims to stop

- Debt can lower FMV after the investor already benefited
- Borrow and distribute: take cash, then report lower FMV
- Debt-funded losses: deduct the drop, then use it again
- Fix: tax the gain a sale would produce, debt included

The case against the rule

- The statute is a fixed formula; the reg's own (e)(3) follows it
- (e)(4)(ii) swaps in a different measure of gain
- It reaches ordinary depreciation and real economic loss
- After Loper Bright, courts read the text without deference
- IRS reply: §1400Z-2(e)(4) expressly delegates anti-abuse rules

Taking the 8275-R route

- Report the statutory amount; disclose it on Form 8275-R
- Reasonable basis + disclosure: no disregard or understatement penalty
- Expect an exam; litigate in Tax Court or a refund suit
- Lower risk: report per the reg, then claim a refund
- Notice 2026-55 asks about debt-funded losses; comments due 11/23

SE Tax for

Limited Partners and LLC Members



Limited Partners

- In 1977 Congress learned that **super wealthy people** **who'd never worked a day in their *lives*** were buying into limited partnerships.
  - Limited partnerships would allocate self-employment income to people with names like Rockefeller and Astor.
  - The rich people would get large Social Security benefits.
- Congress promptly modified the self-employment tax rules to stop this.
  - **Can't** let limited partners "**shoehorn**" their way into the Social Security benefits system.
  - They really ***just investors***.
    - **Social Security** is for ***working*** **people**

The Code

- §1402(a) (*general* rule)
  - ". . . 'net earnings from self-employment'. . . [includes] his *distributive share* . . . of income or loss . . . from *any* . . . business carried on by a *partnership* of which he is a member."
- Section 1402(a)(13) (exception *limited* partners)
  - "[but *not*] the *distributive share* of . . .of a *limited partner*, *as such*, *other* than *guaranteed payments*. . . for *services* . . ."

2026 Summary: Self-Employment Tax and LPs

- *Lots* of activity.
- New appellate court decisions issued:
  - Soroban 2026 (CA2) 2026 WL 2751819
  - K Alain (formerly Sirius), 2026 (CA5)
    - 1st decision – paying self-employment tax would have been optional.
    - 2nd decision – Panic at consequences of 1st decision.
      - Issued new decision.
- Tax Court decision appealed.
  - Denham Capital (CA1)

What's Really Going On? SE Tax Limited Partners

- Large hedge fund, private equity, and consulting firms said:
  - We're "limited partners," we ***don't have*** to **pay** self-employment tax.
    - **Tax Court** previously ***rejected*** this. *Soroban Capital Partners*, T.C. Memo. 2025-52.
- Big picture: Partners who run or manage the business generally owe self-employment tax on their share of ordinary business income (K-1 Box 1).
  - "Pay up!"
- Soroban, 2026 WL 2751819 (CA2) ***hinted*** at the **reason** for its decision:
  - "[S]elf-employment income taxes are then used to fund our Medicare and Social Security systems."
  - Social Security is a "comprehensive national insurance system that provides benefits for **retired** workers, **disabled workers**, **unemployed workers**, and their **families." Indeed, part of Social Security's purpose** is to ensure "the **decent support** of **elderly workmen** who have **ceased** to **labor**."

Is Significant Capital Required? SE Tax Limited Partners

- Soroban (2025)
  - The Tax Court considered the small investment relative to earnings as evidence that the income came from the partners' work.
    - Not conclusive but can *weigh* against taxpayers.
  - One contributed $4 million. All three worked full time and managed the business.
- Soroban (2026) appellate case.
  - Considered contributed capital.
    - The holding imposes no separate minimum capital contribution.
    - Capital ***wasn't*** mentioned in the Court's holding.
- K Alain (formerly Sirius) (2026)
    - The majority's holding does ***not*** impose a separate capital threshold.

Are LLC Members Covered? SE Tax Limited Partners

- Soroban (2025)
  - Didn’t address, but *prior* decisions make it **clear that LLC members can qualify as limited partners.**
    - And therefore, could avoid SE tax in the right circumstances.
- Soroban (2026)
  - Didn’t address LLC members.
    - But its literal definition of “limited partner” would include LLC members.
      - They could potentially avoid SE tax in the right circumstances.
- K Alain (formerly Sirius) (2026).
  - Didn’t address LLC members.
    - But its literal definition of “limited partner” would include LLC members.
      - They could potentially avoid SE tax in the right circumstances.

Which Services Are Disallowed? SE Tax LPs

- Soroban (2025)
  - Can't be involved in "running the business."
  - Overall requirement to ***avoid*** SE tax: Are you really just a passive investor?
- Soroban (2026)
  - ***Can't*** run, manage or control the business.
    - If you want to avoid SE tax.
- K Alain (formerly Sirius) (2026)
  - Can't play a "*significant* role in managing or running a business."

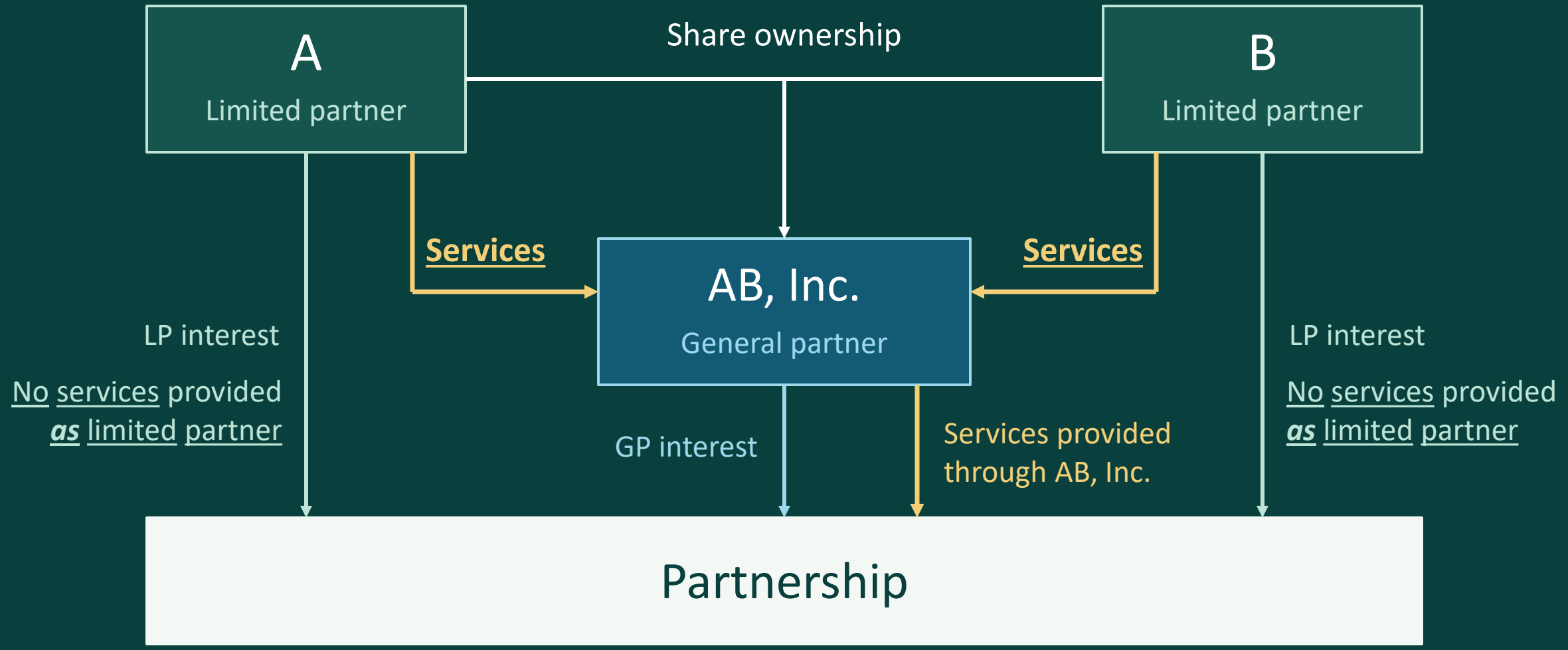
How Much Service Is Acceptable? SE Tax LPs

- Soroban (2025)
  - Some services are okay, but overall test is whether you are a passive investor.
- Soroban (2026)
  - *Can't* provide services constituting "controlling, managing, or running" business.
    - Doesn't limit other types of services.
- K Alain (formerly Sirius) (2026)
    - Services running the business must be insignificant.
      - *Other* services appear to be okay *even if more* than insignificant.

Can **Proper Structuring** Avoid the Problem? SE Tax LPs

- This involves routing your services through a corporate general partner.
  - And no services in your role as a limited partner.
    - Example – Bob contractually works for general partner, no work in capacity of LP.
- Soroban (2025)
  - Tax Court disparaged the idea that routing services through general partner would work.
- Soroban (2026)
  - Not addressed.
- K Alain (formerly Sirius) (2026)
  - Not addressed.

Limited Partnership Structure Services through General Partner



Can an **LLC Manager** Qualify? SE Tax LPs

- Soroban (2025)
  - Appears to be okay.
- Soroban (2026)
  - Appears to be okay, provided not actually running the business.
    - Unexercised powers (e.g., to contract on behalf of LLC) seem to be okay.
- K Alain (formerly Sirius) (2026)
  - Appears to be okay, as long as don’t exercise significant authority in running business.

Can a Spouse's Separate Property Interest Avoid SE Tax?

- None of the cases address this directly.
  - But CCA 201640014 seems to support testing spouses separately.
  - And the statute *doesn't* have an "attribution rule" that imputes other spouse's services to non-working spouse.
- Soroban (2025)
  - Doesn't address.
- Soroban (2026)
  - Doesn't address.
- K Alain (formerly Sirius) (2026)
  - Doesn't address.

Summary: Limited Partner Status

Question	Soroban (2025) Tax Court	Soroban (2026) Second Circuit	K Alain (formerly Sirius) 2026, Fifth Circuit
Overall test	Overall role generally resembles passive investment.	Limited liability. Does not run, manage, or control the business.	Limited liability. No significant role managing or running the business.
Capital contribution	Small investment relative to earnings weighed against these partners.	Court mentioned contributions but not included in Court's holding.	Court never mentioned capital contributions as a relevant factor.
LLC members	Prior cases allow qualifying LLC members.	Definition would include qualifying LLC members.*	Definition would include qualifying LLC members.*

*LLC coverage follows the appellate definitions. Neither appeal directly decided an LLC member's claim.

Summary: Services and Management

Question	Soroban (2025) Tax Court	Soroban (2026) Second Circuit	K Alain (formerly Sirius) 2026, Fifth Circuit
Services outside management	Possible if the overall role remains that of a passive investor.	Permitted if they do not control, manage, or run the business.	Permitted. No significant role in managing or running the business.
Fixed hours limit?	None established.	None established.	None established.
LLC manager with unused powers	Potentially, under the passive investor analysis.*	Potentially, if not running, managing, or controlling the business.*	Potentially, if no significant management role.*

*The manager conclusions are inferences. None of these cases directly decided unused LLC management powers.

Summary: Structuring and Outcomes

Question	Soroban (2025) Tax Court	Soroban (2026) Second Circuit	K Alain (formerly Sirius) 2026, Fifth Circuit
Services through a general partner	Rejected the argument that management work counted only through the general partner.	Not separately analyzed.	Not addressed.
Nonworking spouse	Not addressed.	Not addressed.	Not addressed.
Case outcome	Partners owed SE tax on their distributive shares.	Affirmed the Tax Court's decisions.	Vacated and remanded. Individual partners' eligibility remains undecided.

CCA 201640014 supports separate testing of a nonworking spouse. Guaranteed payments for services remain subject to SE tax.

SE Tax and Limited Partners

- Minimal services by limited partners appear to be okay.
  - Can still avoid SE tax on ordinary income.
- LLC members can qualify as limited partners.

  Example
    - Bob is a member in ABC, **LLC**.
    - He provides minimal services that ***don't*** include managing or running the business.
      - 100-500 hours.
    - There's support for treating bob as a limited partner.
      - And avoiding SE tax on ordinary income (K-1, box 1).
    - Even if Bob is involved in managing or running the business, if his spouse has a separate property interest and doesn't work in the business.
      - Spouse should be treated as a limited partner.
- Still evolving area.
  - More appellate circuits will weigh in.

Reporting Self-Employment Income

Example

- Mary (50%) and Judy (50%) are members of an LLC.
  - Mary is ***treated*** as a general partner (manager, not investor, etc.).
  - Judy qualifies as a limited partner (non-manager, mere investor, etc.).
- The LLC has $5,000 of ordinary income.
  - We'll check the box that Mary is "General partner or LLC member-manager".
    - Mary will have $2,500 of self-employment income.
  - We'll check the box that Judy is a "Limited partner or other LLC member".
    - Judy will have $0 of self-employment income.

K-1s

Self-employment Tax Reporting

-
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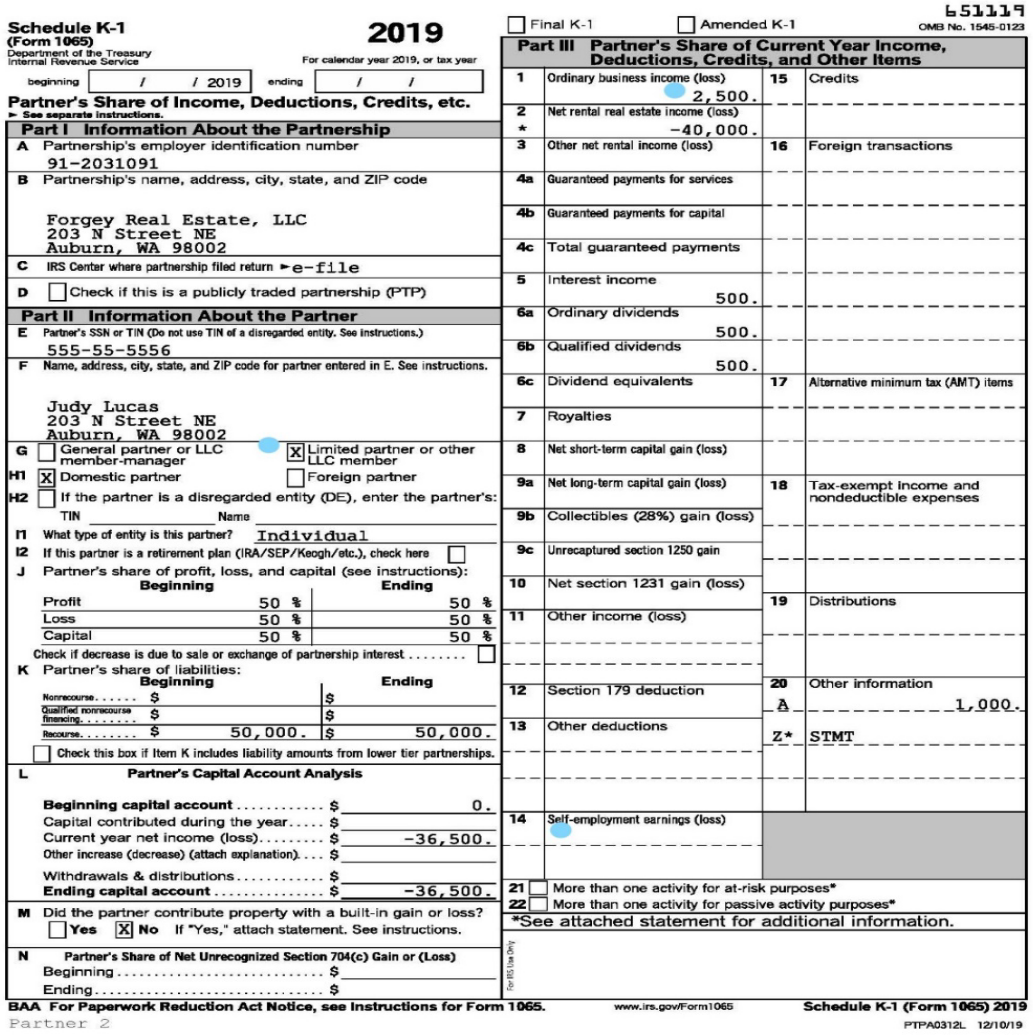


Schedule K-1 (Form 1065) — Department of the Treasury, Internal Revenue Service — **2019** — For calendar year 2019, or tax year beginning / / 2019 ending / /

Partner's Share of Income, Deductions, Credits, etc. ► See separate instructions.

☐ Final K-1 ☐ Amended K-1 — 651119 — OMB No. 1545-0123

Part I Information About the Partnership

A Partnership's employer identification number: 91-2031091

B Partnership's name, address, city, state, and ZIP code:
Forgey Real Estate, LLC
203 N Street NE
Auburn, WA 98002

C IRS Center where partnership filed return: e-file

D ☐ Check if this is a publicly traded partnership (PTP)

Part II Information About the Partner

E Partner's SSN or TIN (Do not use TIN of a disregarded entity. See instructions.): 555-55-5556

F Name, address, city, state, and ZIP code for partner entered in E. See instructions.
Judy Lucas
203 N Street NE
Auburn, WA 98002

G ☐ General partner or LLC member-manager ☒ Limited partner or other LLC member

H1 ☒ Domestic partner ☐ Foreign partner

H2 ☐ If the partner is a disregarded entity (DE), enter the partner's: TIN _____ Name _____

I1 What type of entity is this partner? Individual

I2 If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here ☐

J Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	50 %	50 %
Loss	50 %	50 %
Capital	50 %	50 %

Check if decrease is due to sale or exchange of partnership interest ☐

K Partner's share of liabilities:

	Beginning	Ending
Nonrecourse	$	$
Qualified nonrecourse financing	$	$
Recourse	$ 50,000.	$ 50,000.

☐ Check this box if Item K includes liability amounts from lower tier partnerships.

L **Partner's Capital Account Analysis**

Beginning capital account	$ 0.
Capital contributed during the year	$
Current year net income (loss)	$ -36,500.
Other increase (decrease) (attach explanation)	$
Withdrawals & distributions	$
Ending capital account	$ -36,500.

M Did the partner contribute property with a built-in gain or loss? ☐ Yes ☒ No If "Yes," attach statement. See instructions.

N **Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)**
Beginning $ _____
Ending $ _____

Part III Partner's Share of Current Year Income, Deductions, Credits, and Other Items

1	Ordinary business income (loss) 2,500.	15	Credits
2 *	Net rental real estate income (loss) -40,000.		
3	Other net rental income (loss)	16	Foreign transactions
4a	Guaranteed payments for services		
4b	Guaranteed payments for capital		
4c	Total guaranteed payments		
5	Interest income 500.		
6a	Ordinary dividends 500.		
6b	Qualified dividends 500.		
6c	Dividend equivalents	17	Alternative minimum tax (AMT) items
7	Royalties		
8	Net short-term capital gain (loss)		
9a	Net long-term capital gain (loss)	18	Tax-exempt income and nondeductible expenses
9b	Collectibles (28%) gain (loss)		
9c	Unrecaptured section 1250 gain		
10	Net section 1231 gain (loss)	19	Distributions
11	Other income (loss)		
12	Section 179 deduction	20	Other information A 1,000.
13	Other deductions	Z*	STMT
14	Self-employment earnings (loss)		

21 ☐ More than one activity for at-risk purposes*
22 ☐ More than one activity for passive activity purposes*
*See attached statement for additional information.

For IRS Use Only

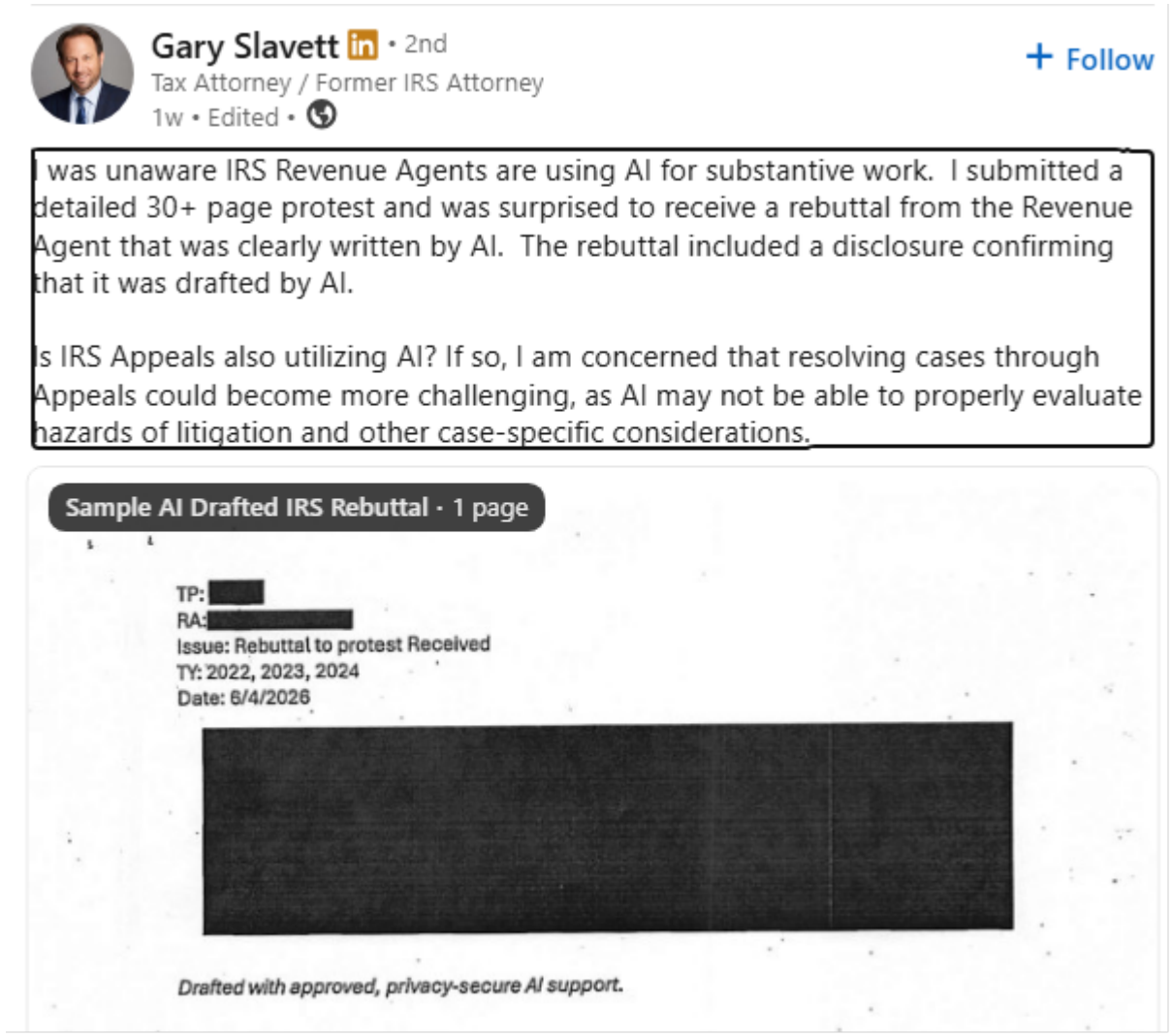
BAA For Paperwork Reduction Act Notice, see Instructions for Form 1065. www.irs.gov/Form1065 Schedule K-1 (Form 1065) 2019

Partner 2 PTPA0312L 12/10/19

AI and Tax



IRS Agents Are Using AI



Gary Slavett • 2nd
Tax Attorney / Former IRS Attorney
1w • Edited •
+ Follow

I was unaware IRS Revenue Agents are using AI for substantive work. I submitted a detailed 30+ page protest and was surprised to receive a rebuttal from the Revenue Agent that was clearly written by AI. The rebuttal included a disclosure confirming that it was drafted by AI.

Is IRS Appeals also utilizing AI? If so, I am concerned that resolving cases through Appeals could become more challenging, as AI may not be able to properly evaluate hazards of litigation and other case-specific considerations.

Sample AI Drafted IRS Rebuttal · 1 page

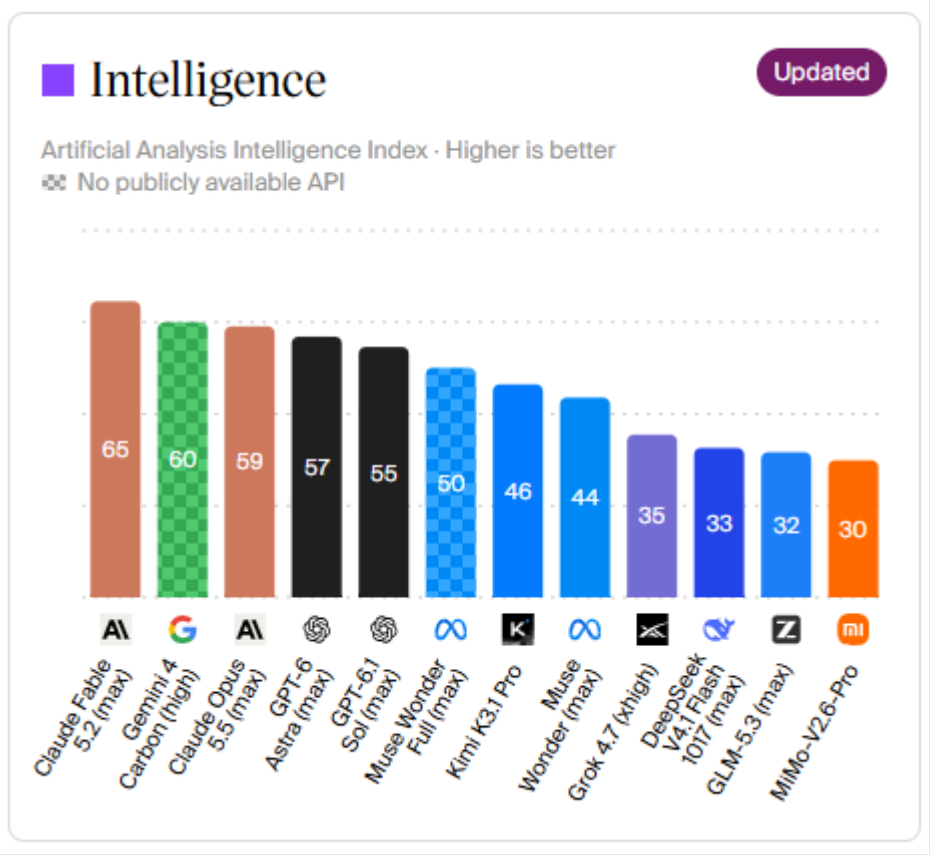
TP: [redacted]
RA: [redacted]
Issue: Rebuttal to protest Received
TY: 2022, 2023, 2024
Date: 6/4/2026

[redacted]

Drafted with approved, privacy-secure AI support.

Top Performing AI Models

- Evaluations of most intelligent models.



Use ***both*** Claude ***and*** ChatGPT

https://artificialanalysis.ai/models

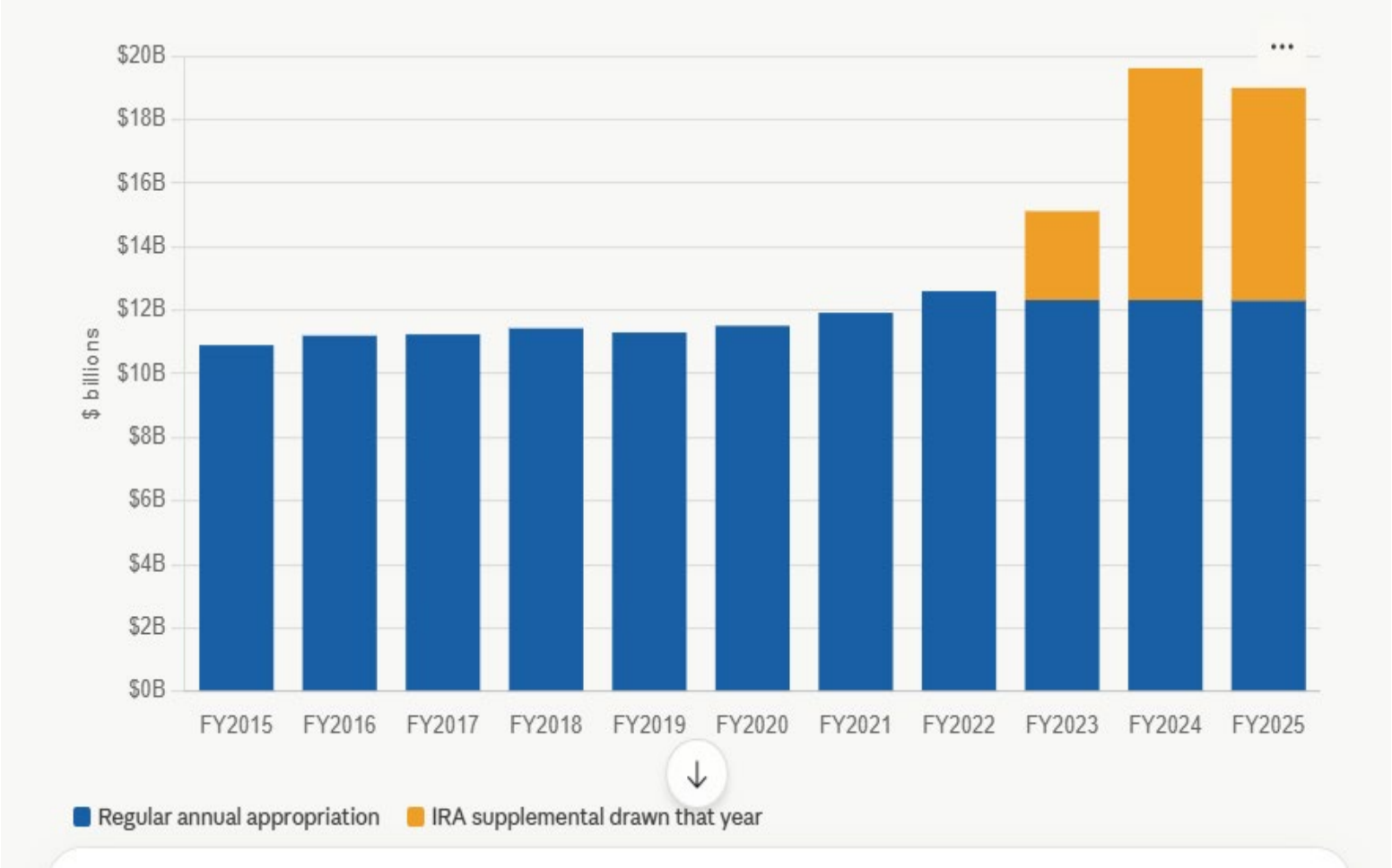
IRS



IRS Total Spending

- IRS spending increased significantly over the last few years.

  Using 2022 Inflation Reduction Act funds.



IRS Number of Employees

Almost Identical to October 2021.

- Number of IRS employees.
  Increased after the Inflation Reduction Act.
  It's **back** to **October 2021 staffing levels**.

Figure 2: Staffing in Key IRS Programs as of October 2025 is Generally at Pre-Inflation Reduction Act Levels

Key Program Areas	Employees as of October 2021	Employees as of October 2024	Employees as of October 2025
Overall IRS	**81,492**	**100,435**	**81,456**
Key Filing Season Programs			
Accounts Management	17,326	23,773	19,354
Field Assistance	2,621	3,477	2,852
Information Technology	7,091	8,504	7,135
Media and Publications	597	620	557
Return Integrity and Compliance Services	1,855	1,923	1,642
Submission Processing	9,401	9,320	7,775
Total Key Filing Season Program	**38,891**	**47,617**	**39,315**

Source: IRS Human Capital Office reports for employees on roll for the week ending October 9, 2021; October 5, 2024; and October 4, 2025.

Source: TIGTA, Jan. 26, 2026, Audit No. 2026400002.
Staffing figures are as of October 2025.

Automatic Penalty Abatement

IR-2026-83

- Automatic Exemption from Penalty (AEP)
- Eligible 2025 annual and 2026 quarterly original returns.
- Replaces FTA for eligible original returns due on or after Jan. 1, 2027.
- Compliance history: prior 3 years or 12 consecutive quarters.
- File within 3 years of the original due date.
- Relief: failure to file, pay or deposit.
- Eligible forms: 1040, 1065, 1120, 1120-S; 940, 941, 943, 944, 945; CT-1 (manual consideration).
  - Not estate and gift tax returns.
- During transition, contact IRS if qualifying relief is missed.

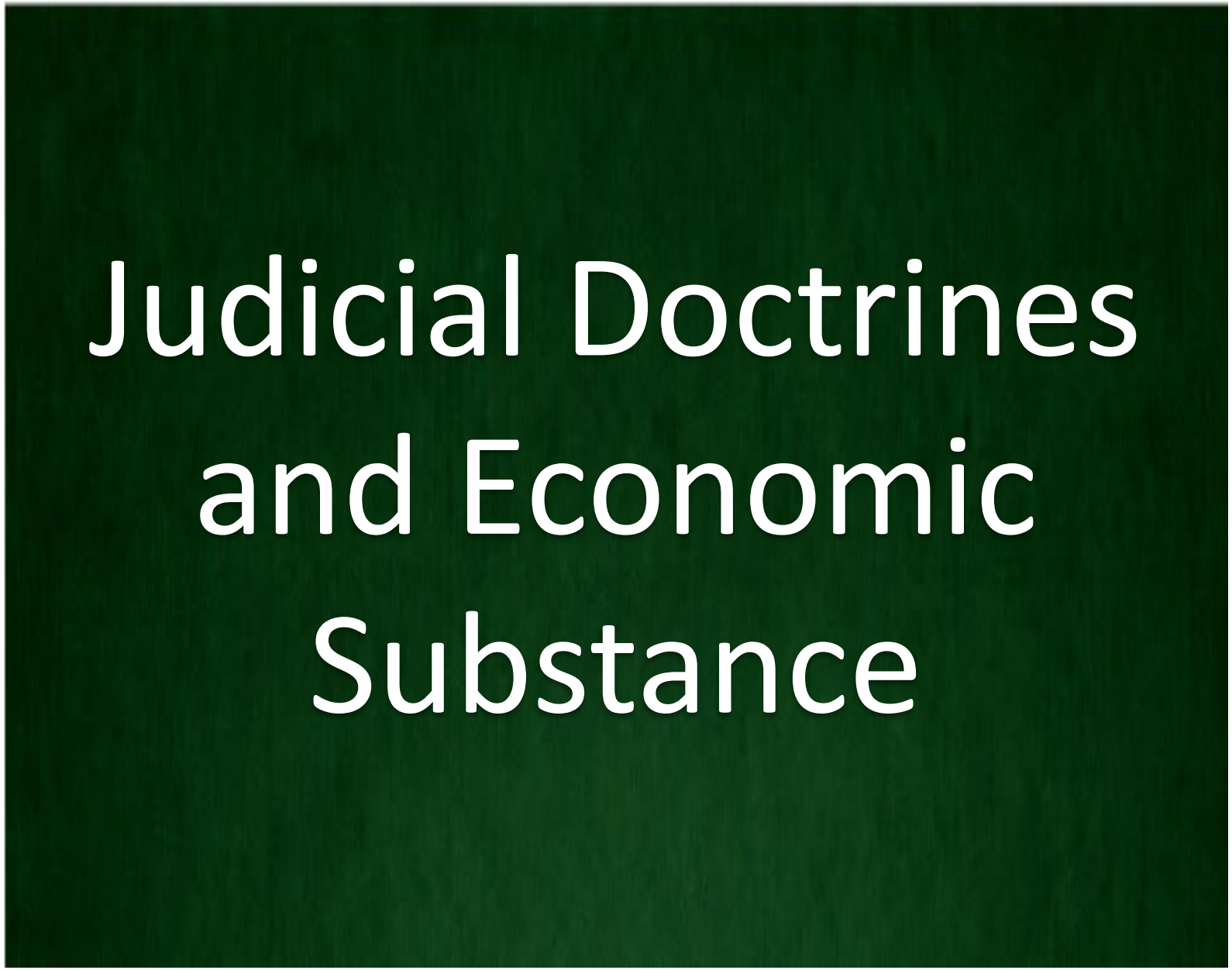
Private Jets



Private Jets and SIFL

- Executives who use a corporate-owned jet for *personal* purposes.
  - Get a special deal.
    - Eligible personal flights may use a special valuation method *instead* of comparable charter value.
    - The “Standard Industry Fare Level” (SIFL) formula may be used when its requirements are met.
- Democratic senators asked Treasury to change the rules and close this “loophole.”
  - Treasury declined the request.
  - If presidency flips in 2028, “loophole” might well be closed.

Judicial Doctrines and Economic Substance



Economic Substance Doctrine

- Economic substance test - **Flurry** of **activity**
  - Government victories on the tax merits: Patel, Liberty Global and Otay.
  - Otay applied the common-law doctrine.
- **Tests – *If* the doctrine is relevant, taxpayer must clear both hurdles**
  1. **Transaction changes** in a meaningful way (apart from federal taxes) the **taxpayer's economic position, *and***
  2. **Taxpayer has a substantial *non-tax* purpose** for entering into the transaction. §7701(o)(1)
- Penalty: 20% of the underpayment; 40% if not adequately disclosed.
- IRS is using this doctrine to shut down tax-motivated **tax shelters**.

Economic Substance Doctrine

Patel v. Comm’r, 165 T.C. No. 10 (2025)

- His businesses paid just over **$4.5 million** to two family-controlled captives during 2013–2016.
- Commercial premiums also paid: about **$68,000–$106,000** annually. This was not a quote for equivalent coverage.
- **Did the arrangement meaningfully change his economic position?**
- The court found circular flows of funds back to the family-controlled captives.
- **Was there a substantial nontax purpose?**
- No. Emails and premium pricing showed a tax-driven arrangement.

Patel, 165 T.C. No. 10, pp. 7–9 and 28–30.

Economic Substance Doctrine

- Wait a second!
  - What about S corp elections?
  - Roth conversions?
  - Like-kind exchanges?
- Economic substance only applies if *relevant*.
  - Not to tax benefits Congress clearly intended.
    - Ordinary statutory choices generally are not the target. Related steps still require analysis.
- Dr. Patel argued Congress *intended* small insurers to get special tax benefits.
  - No tax on income except investment income. §831(b)
  - Tax Court: Congress *wasn't* trying to provide benefits for payments that *weren't* in substance insurance!
    - The premiums were tax driven, not supported by a genuine insurance need.

Economic Substance Doctrine

- Be wary of “too good to be true” tax shelters.
- Penalty: 20% of the attributable tax underpayment.
  - 40% if the transaction is not adequately disclosed.
- **Disclosure reduces the rate; it does not eliminate the penalty.**
- Patel: 40% for the 2014 and 2015 tax years.
- Related topic: “tax-aware strategies” in Part 1.

IRC §6662(a), (b)(6), (i).

Ethics



OPR Guidance on AI Use

- OPR issued guidance on AI use. https://www.irs.gov/pub/opr-taxpros/issue-number-2026-19-introductory-guidelines-for-responsible-ai-use-in-federal-tax-practice.pdf
  - OPR oversees and enforces Circular 230.
    - Investigates misconduct, suspends practitioners.
- OPR noted AI-related mistakes in a Deloitte Australia report.
  - The report contained invented quotes, fake source references and misattributed authorship.
- OPR covered 6 ethical areas. We'll cover 5:
  1. Due diligence (§10.22)
  2. Fees (§10.27)
  3. Competence (§10.35).
  4. Procedures to ensure compliance (§10.36).
  5. Ensuring confidentiality.

OPR Guidance on AI Use

Due Diligence

- "When using GAI, practitioners must thoroughly review all AI-created documents and language incorporated into writings *before* delivery to a client or submission to the IRS."
- "Due diligence requires verifying the accuracy of facts, *citations*, and *calculations* produced by AI."
- "Practitioners cannot rely solely on AI; human scrutiny and editing are essential to ensure correctness and compliance with IRS expectations."
- My comments:
  1. Citations: Even *without* this guidance, **we know** we should check citations.
     - If the AI answer doesn't provide citations, ask for them.
  2. Computations: Ask for a spreadsheet showing inputs and formulas. Independently check the tax rule, assumptions, inputs and key computations.

OPR Guidance on AI Use

Fees

- “AI can reduce research and drafting time, such that billing clients for manual labor or time that was not actually spent *or* double billing for AI-assisted tasks may violate § 10.27, depending on the facts (e.g., a noticeable pattern across clients or the size of the billing differentials).”
- “Cost savings should be *passed on openly*, with billing practices that reflect the efficiencies gained from the use of GAI. Practitioners should not only disclose, in general or specific terms as needed, the AI activities performed, but also fairly credit to the client’s account any cost reductions.”
- My comment: I think a typical response might be to raise hourly rates (rather than overstating time). You can always take a write-off if needed.

OPR Guidance on AI Use

Competence

- “Practitioners must understand both the law and the technology used in their representation of clients before the IRS, including AI systems’ operational mechanics, limitations, and risks.”
- “They must understand how AI develops content, recognize the potential for bias or errors, and be able to evaluate whether AI outputs are suitable for use in IRS matters.”
- “Lack of technological competence could lead to improper advice or flawed filings.”

OPR Guidance on AI Use

Procedures to Ensure Compliance

- "Firms must deploy internal policies and *procedures* for compliance with Circular 230 **in the AI space**, with coverage that includes:
  - Staff
    - Comprehensive training on use of AI (the risks – technological and other – and the requirements).
  - Rules applicable internally (within the firm)
    - Established protocols for secure data handling, AI accuracy monitoring, etc.
  - Contracting with external providers
    - Outsourced or third-party AI tools should be vetted. And all steps and processes documented."
- **My comment**: This is a good idea. Implement before next busy season?

OPR Guidance on AI Use

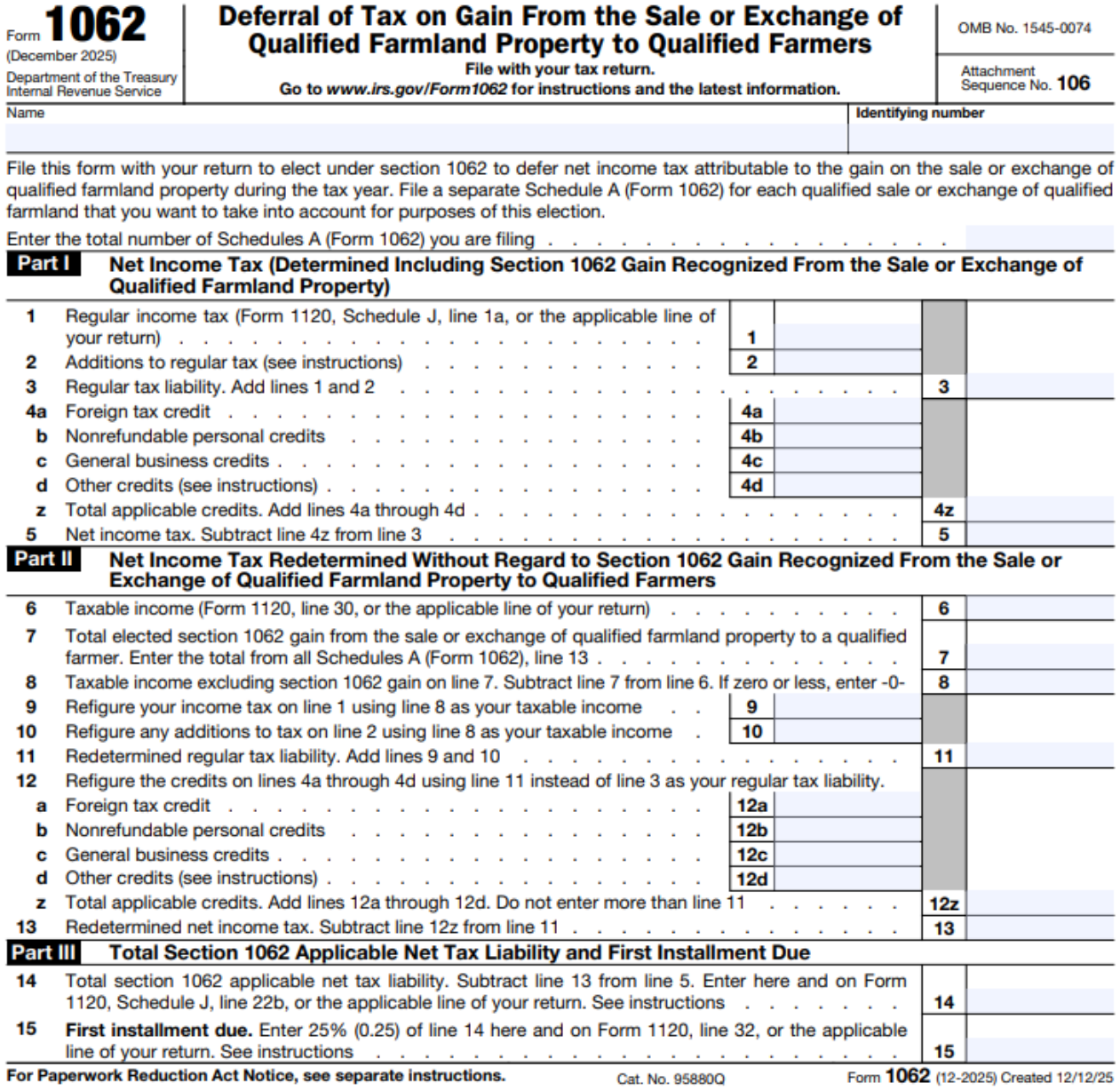
Confidentiality

- “GAI platforms may present risks regarding the unauthorized disclosure of sensitive taxpayer information, especially when data is uploaded to unsecured or public systems.”
- “Practitioners must strictly handle all client data using only secure, enterprise-approved AI. AI systems should be utilized with robust confidentiality safeguards firmly in place. Willful mishandling of taxpayer information through AI may lead to disciplinary actions under Circular 230.”
- My comments:
  - Check for confidentiality provided by tax specific AI.
  - Consider AI plans that provide greater confidentiality.
  - Permanently redact identifying details and verify the resulting file, including text and metadata. Check the applicable disclosure rules before uploading.

Farmland Sales



Form 1062



Form **1062**
(December 2025)
Department of the Treasury
Internal Revenue Service

Deferral of Tax on Gain From the Sale or Exchange of Qualified Farmland Property to Qualified Farmers

File with your tax return.
Go to *www.irs.gov/Form1062* for instructions and the latest information.

OMB No. 1545-0074

Attachment Sequence No. **106**

Name | **Identifying number**

File this form with your return to elect under section 1062 to defer net income tax attributable to the gain on the sale or exchange of qualified farmland property during the tax year. File a separate Schedule A (Form 1062) for each qualified sale or exchange of qualified farmland that you want to take into account for purposes of this election.

Enter the total number of Schedules A (Form 1062) you are filing . . . . . .

Part I **Net Income Tax (Determined Including Section 1062 Gain Recognized From the Sale or Exchange of Qualified Farmland Property)**

1	Regular income tax (Form 1120, Schedule J, line 1a, or the applicable line of your return)	1		
2	Additions to regular tax (see instructions)	2		
3	Regular tax liability. Add lines 1 and 2			3
4a	Foreign tax credit	4a		
b	Nonrefundable personal credits	4b		
c	General business credits	4c		
d	Other credits (see instructions)	4d		
z	Total applicable credits. Add lines 4a through 4d			4z
5	Net income tax. Subtract line 4z from line 3			5

Part II **Net Income Tax Redetermined Without Regard to Section 1062 Gain Recognized From the Sale or Exchange of Qualified Farmland Property to Qualified Farmers**

6	Taxable income (Form 1120, line 30, or the applicable line of your return)			6
7	Total elected section 1062 gain from the sale or exchange of qualified farmland property to a qualified farmer. Enter the total from all Schedules A (Form 1062), line 13			7
8	Taxable income excluding section 1062 gain on line 7. Subtract line 7 from line 6. If zero or less, enter -0-			8
9	Refigure your income tax on line 1 using line 8 as your taxable income	9		
10	Refigure any additions to tax on line 2 using line 8 as your taxable income	10		
11	Redetermined regular tax liability. Add lines 9 and 10			11
12	Refigure the credits on lines 4a through 4d using line 11 instead of line 3 as your regular tax liability.			
a	Foreign tax credit	12a		
b	Nonrefundable personal credits	12b		
c	General business credits	12c		
d	Other credits (see instructions)	12d		
z	Total applicable credits. Add lines 12a through 12d. Do not enter more than line 11			12z
13	Redetermined net income tax. Subtract line 12z from line 11			13

Part III **Total Section 1062 Applicable Net Tax Liability and First Installment Due**

14	Total section 1062 applicable net tax liability. Subtract line 13 from line 5. Enter here and on Form 1120, Schedule J, line 22b, or the applicable line of your return. See instructions		14
15	**First installment due.** Enter 25% (0.25) of line 14 here and on Form 1120, line 32, or the applicable line of your return. See instructions		15

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 95880Q Form **1062** (12-2025) Created 12/12/25

Form 1062

SCHEDULE A (Form 1062)
(December 2025)
Department of the Treasury
Internal Revenue Service

Section 1062 Gain From the Sale or Exchange of Qualified Farmland Property to a Qualified Farmer

File with Form 1062.
Go to *www.irs.gov/Form1062* for instructions and the latest information.

OMB No. 1545-0074

Attachment Sequence No. **106A**

Name | Identifying number

A Check if you are reporting section 1062 gain from a Schedule K-1 from a: **a** ☐ Form 1120-S, **b** ☐ Form 1065, or **c** ☐ Form 8865

B If a box on line A is checked, enter the entity's **(1)** EIN **(2)** name

Part I Qualified Farmland Property Information

		Yes	No
1	Description of the qualified farmland property:		
2	Check if the property was a(n): **a** ☐ Exchange, **b** ☐ Installment Sale, or **c** ☐ Sale		
3	Enter the date of the qualified sale or exchange of the property MM/DD/YYYY		
4	Had you used the property as a farm for farming purposes, or leased the property to a qualified farmer for farming purposes, during substantially all of the 10-year period ending on the date on line 3?	☐	☐
5	Is the property described on line 1 real property located in the United States?	☐	☐
6	Did you make the sale or exchange to a qualified farmer—an individual who is actively engaged in farming?	☐	☐
7	Is the property subject to a covenant or other legally enforceable restriction which prohibits the use of the property other than as a farm for farming purposes for any period before the date that is 10 years after the date on line 3?	☐	☐
8	Are you including with this return a copy of the covenant or other legally enforceable restriction described on line 7?	☐	☐

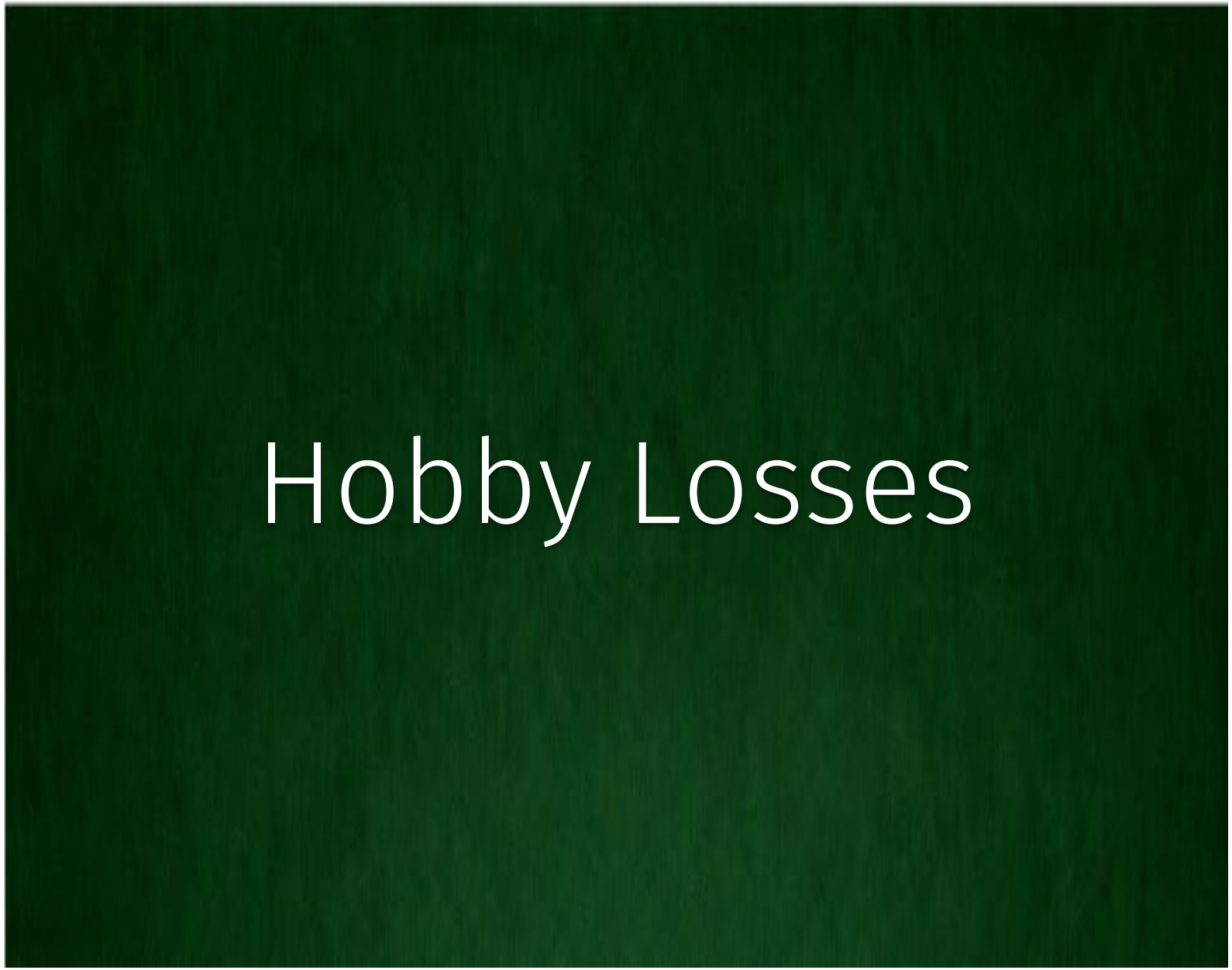
Next: If the answers to the questions on lines 4 through 8 are "Yes," go to Part II. If not, stop here; the disposition of this property does not qualify for the section 1062 deferral of tax.

Part II Recognized Gain on Qualified Farmland Property

9	Gross sales price of the sale or exchange	9		
10	Net sales price of the sale or exchange		10	
11	Unadjusted basis of the qualified farmland property	11		
12	Adjusted basis of the property		12	
13	Recognized (taxable) gain on the qualified sale or exchange of this qualified farmland property		13	

Note: For purposes of lines 4 through 8, property used or leased by a partnership or S corporation is treated as used or leased by each person who holds a direct or indirect interest in the partnership or S corporation.

Hobby Losses



Kolar v. Comm'r.

TC Memo 2026-15

- **Background** – Kenward Kolar
  - **Degrees** in animal science and water supply and wastewater management.
  - His family had owned an 836-acre ranch in Texas since the late 1800s.
  - Ranch also had oil and gas wells - royalties of approx. $400,000/year.
  - Ranch **sold water** from its wells to other farmers and oil/gas companies.
  - His mother managed the ranch until **2016**.
    - He began ranch management - **65 years old**.
    - 2016 - Began to **ramp up** cattle herd (**big loss**).
      - He also had a 2-year-old son.
      - Wanted to run the ranch (later) with his son.

Kolar v. Comm'r.

TC Memo 2026-15

- Law:
  1. §183 **denies losses** from an activity not **engaged** in for **profit**.
     - Expenses otherwise allowed (e.g., RE taxes) may be deducted.
     - The *activity* must be determined. TR 1.183-1(d).
       - Some *interconnected* activities may be *grouped*.
     - **Intent** to make a profit is sufficient, even if not realistic.
       - Of course, ***everyone*** says their ***intent*** was to make a profit.
  2. Regs have a **9-factor test** to determine if taxpayer had intent to make a profit. TR 1.183-2(b).
     - You don't simply see if you won 5 out of 9.
     - There's a ***qualitative*** element.

Kolar v. Comm'r.

TC Memo 2026-15

- What was the activity? Did it include:
  1. Well water –
     - **Yes**, same activity. Used for *both* feeding cattle *and* selling to pecan farmers, etc.
       - So we'll include time spent, profits for the year, etc., combining ranch and well water operations.
       - *Example*
         - If well water activity produced $300,000 for the year, the expenses from ranching ($200,000) would be more than covered, no net loss.
         - ***Actual*** **facts** - **still had** a **loss** on combined activity.
  2. Holding land for appreciation?
     - **No** – Farmers only get to count land appreciation ***if*** farm income > expenses (excluding costs of holding land e.g., RE taxes, interest exp., depreciation). **§**1.183-1(d)(1)
  3. Oil and gas exploration.
     - **No** – too different from ranching.

Kolar v. Comm'r., T.C. Memo. 2026-15

Factor	Facts	Winner
1. Businesslike manner and books and records	• Separate account for ranch business, • No written business plan, **but** he did have an **unwritten** plan (increase herd).	Kenward
2. Taxpayer/adviser expertise	• Worked for decades on ranch, degrees in animal science, water supply	Kenward
3. Time/effort spent	• Spent long hours working on ranch	Kenward
4. Expectation assets ↑ value	• **Couldn't count land appreciation** (farm revenue not > expenses excluding holding costs)	Neutral
5. Success in **other** similar and dissimilar activities	• No evidence provided on other activities	Neutral
6. History of losses in **this** activity	• Focus: 2016 (year before court) – **But** losses in subsequent years considered (2017-2022 gross receipts = $25,874, losses > $2 million).	IRS
7. Occasional profits earned?	• **Lost enormous amounts** in 2016 (year before court) **and** future years.	IRS
8. Taxpayer is wealthy?	• $400,000/year from oil and gas royalties.	IRS
9. Personal pleasure?	• Worked long hours, enjoyed working with son (but this wasn't a problem)	Kenward

Kolar v. Comm'r.

TC Memo 2026-15

- Taxpayers won 4-3.
  - But judge indicated he placed ***most weight*** on:
    - **Favorable** – Lots of reasons he **lost so much money**:
      - Ranch hands died during Covid, Hurricane Harvey, etc.
    - **Unfavorable** – wealth of taxpayer.
- Two of the factors were "**neutral**."
  - Appreciation of land *and* success in other businesses.
    - These often "help, but don't hurt" taxpayers.
- ***Attempt*** to send a message?
  - Watch out if you're wealthy and have consistent losses unless you have really good reasons?

On the Lighter Side



U.S. v. Abramson

CA 7, Oct 8, 2026

- Michael Abramson, Chicago lawyer, paid expenses of his paramour, a dancer, from the mid-1990s through 2014.
  - Expenses included:
    - Luxury condo, luxury vehicles and credit card expenses (luxury trips, spas, fine dining and shopping).
  - He paid these from a company he managed.
  - The company carried the “JT Loan” as a receivable on its books.
- Not good.
  - But I guess this *could be* worse.

U.S. v. Abramson

CA 7, Oct 8, 2026

- It gets worse.
  - In 2014 and 2015, accountants prepared original and amended corporate returns that *deducted* purported commissions to his mistress.
    - Forms 1099 were also issued to her.
- It just can’t get worse than that, right?

U.S. v. Abramson

CA 7, Oct 8, 2026

- IRS discovered deductions for mistress's expenses.
  - He was indicted in 2018.
- Weeks before his trial, he was instructed by the court ***not*** to have unnecessary contact with his accountants, including his bookkeeper.
  - He *nonetheless* approached his bookkeeper and suggested changes to her earlier testimony.
  - Witness tampering.
- Hands down, this is *as bad as it gets*.
  - **Could it possibly get worse?**

U.S. v. Abramson

CA 7, Oct 8, 2026

- It *got* worse.
  - He blamed the error on his unwitting accountants!!
    - They had simply relied on information that he supplied.
- It *really*, *truly*, does *not* get any worse than that!!!

Recap



- Depreciation: Property Allocations
- QOF 12/31/26 gain recognition
- SE Tax for Limited Partners and LLC Members
- AI and Tax
- IRS
- Private Jets
- Judicial Doctrines and Economic Substance
- Ethics
- On the Lighter Side

Thank You