The Best Individual Tax Update Course by Surgent

BITU/21/W4

Today's Presenter

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Bob has more than 30 years of experience as a practicing CPA and has worked exclusively with privately held businesses and owners to provide compliance services and sophisticated tax planning strategies including like-kind exchanges, tax efficient workouts and restructurings, reorganizations and estate planning services. He has assisted clients in the development of tax-favored and other retirement plans and has worked with firm partners in developing tax efficient succession transitions, including acquisitions and sales of businesses. He also has extensive experience in dealing with tax authorities at both the federal and state levels.

The Infrastructure Investment and Jobs Act

- The House of Representatives passed the $1.2 trillion infrastructure bill, *The Infrastructure Investment and Jobs Act (IIJA),* on November 5, 2021. President Biden subsequently signed the bill into law on November 15, 2021
- Notable provisions include:
  - **Terminating the Employee Retention Tax Credit** as of October 1, 2021
    - **Exception:** Recovery Startup Businesses may take the Employee Retention Tax Credit for wages paid before January 1, 2022
  - **Increasing cryptocurrency reporting:** The IIJA expands the definition of **brokers** to include *"any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person"*
    - A **digital asset** is *"any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary"*
    - As a result, brokers will have increased reporting requirements for cryptocurrency transactions
    - §6050I(a) is expanded to include digital assets, meaning individuals engaged in a trade or business will be required to report cryptocurrency transactions over $10,000
    - The reporting requirements are effective for transactions entered into as of January 1, 2023
  - **Extending Tolling of time to file a Petition with the Tax Court:** If a filing location becomes inaccessible on the date a petition is due, the IIJA provides that the relevant time period for filing such petition shall be tolled for the number of days within the period of inaccessibility, plus an additional 14 days
  - **Providing authority to postpone certain tax deadlines due to "significant fires,"** defined as any fire with respect to which assistance is provided under §420 of the Stafford Act

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Objectives

- As the COVID-19 pandemic persists throughout 2021, these materials will keep practitioners informed of all the latest legislative initiatives, including the FFCRA, CARES Act, CAA 2021, and ARPA in order to best assist their clients
- Although the primary focus of this course is federal taxation, this course will address certain state tax implications related to the COVID-19 pandemic
- New for 2021: The materials preview the Biden administration's proposed tax reform changes
- These materials are ***continually updated*** so that practitioners are kept abreast of tax law changes necessary for their practice

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Course Overview

Supplement – The Build Back Better Act,
The Infrastructure Investment and Jobs Act, and Other Recent Updates

Chapter 1 – Navigating the New Normal: COVID-19;
Recent Legislation and Updates

Chapter 2 – Miscellaneous Practice and Reporting Issues

Chapter 3 – Individual Taxation Issues

Chapter 4 – Numbers Applicable to Rulings

Chapter 5 – Investments, Retirement, and Miscellaneous

A Quick Word on Policy vs. Politics

Many times when discussing accounting, tax and financial policy issues, it can be difficult to divorce the politics from the policy

Today, when discussing the various issues we will encounter over the next several hours, let's agree to keep our own view of politics out of the application of the policy and focus on doing the very best we can for all our clients

This goes for religious/faith views as well

Supplement

The Build Back Better Act,
The Infrastructure Investment and Jobs Act, and
Other Recent Updates

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The Build Back Better Act

Overview

- On November 15, 2021, President Biden signed into law *The Infrastructure Investment and Jobs Act (IIJA),* containing some important tax-related provisions
- It is important to distinguish the IIJA from the proposed *Build Back Better Act,* both of which have been heavily discussed and debated by Congress over the last quarter of 2021
- The proposed *Build Back Better Act* contains far more tax provisions which will be discussed later in this course

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The Infrastructure Investment and Jobs Act

The Employee Retention Tax Credit

- One of the most notable provisions of the IIJA is the termination of the Employee Retention Tax Credit (ERTC), effective October 1, 2021
- Only recovery startup businesses are eligible to take the ERTC for wages paid before January 1, 2022. (This topic is discussed in further detail later in this course)

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The Infrastructure Investment and Jobs Act

Cryptocurrency Reporting

- The IIJA significantly increases cryptocurrency reporting requirements
- The IIJA expands the definition of **brokers** to include *"any person who (for consideration) is responsible for regularly providing any service effectuating transfers of digital assets on behalf of another person."*
  - A **digital asset** is *"any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary."*
  - Such brokers must report cryptocurrency transactions or any other digital asset transactions on Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*
  - This provision could potentially impact cryptocurrency exchanges, miners, or digital wallet companies

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The Infrastructure Investment and Jobs Act

Cryptocurrency Reporting

- The IIJA expanded §6050I(a) to include digital assets, meaning individuals engaged in a trade or business will be required to report cryptocurrency transactions over $10,000
  - Any person engaged in a trade or business that has a single transaction or related transaction in excess of $10,000 must file Form 8300, *Report of Cash Payments Over $10,000 Received in a Trade or Business*
- The reporting requirements are effective for transactions entered into as of January 1, 2023

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The Infrastructure Investment and Jobs Act

Extension of Certain Deadlines

- **Tolling of time to file a Petition with the Tax Court:** If a filing location becomes inaccessible on the date a petition is due, the IIJA extends the filing deadline and provides that the relevant time period for filing such petition shall be tolled for the number of days within the period of inaccessibility plus an additional 14 days
- **Certain tax deadlines due to significant fires:** If a significant fire occurs, the IIJA provides authority to postpone certain tax deadlines
  - Under §7508A(d), the Treasury may automatically postpone federal tax deadlines for 60 days if a federally declared disaster occurs
  - A **significant fire** is any fire with respect to which assistance is provided under §420 of the Stafford Act

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The Build Back Better Act

Overview

- On November 19, 2021, the House of Representatives passed a smaller, revised $1.6 trillion *Build Back Better Act (BBBA)*
- Prior to this passage, a $3.5 trillion BBBA proposal was released by the House Ways and Means Committee on September 13, 2021, and the *American Families Plan* and *Made in America Tax Plan* were proposed by the Biden administration in the spring of 2021
- Notable provisions of the House-passed November 2021 BBBA will be discussed in the subsequent slides

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The Build Back Better Act

Overview

- Prior to discussing what ***is*** included in the November 2021 House-passed BBBA, it is important to discuss the notably absent provisions
- The following provisions previously included in the September 2021 BBBA were **not included** in the November 2021 House-passed BBBA:
  - An increase in the top individual income tax rate to 39.6%;
  - An increase in the corporate income tax rate to 26.5%;
  - An increase in the top capital gains rate to 25%;
  - A limitation on the deduction of Qualified Business Income for certain high-income individuals;
  - Changes to the rules for partnership interests held in connection with the performance of services (carried interest rules);
  - Changes to valuation rules for certain transfers of nonbusiness assets;
  - Changes to certain tax rules applicable to grantor trusts; and
  - Terminating the temporary increase in the Unified Credit

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The Build Back Better Act – Business Provisions

Corporate Alternative Minimum Tax (Minimum Book Tax)

- The BBBA would impose a 15% minimum tax on adjusted financial statement income for applicable corporations (other than S corporations, RICs, or REITs) with three-year average annual adjusted financial statement income in excess of $1 billion. Corporations under common control are aggregated for purposes of this test
  - The corporation's minimum tax would be equal to the amount by which the tentative minimum tax exceeds the corporation's regular tax for the year
  - **Tentative minimum tax** is equal to 15% of the corporation's adjusted financial statement income for the taxable year (after considering the AMT foreign tax credit and the financial statement net operating losses)
    - **Adjusted Financial Statement Income (AFSI)** is the net income or loss of the taxpayer stated on the taxpayer's applicable financial statement (i.e., 10-K) with certain modifications
  - Corporations continue to remain applicable corporations unless, due to either an ownership change or consistent reduction in AFSI beneath the threshold amounts, the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation
  - This provision would be effective for taxable years beginning after December 31, 2022

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The Build Back Better Act – Business Provisions

Excise Tax on Repurchase of Corporate Stock

- The BBBA would impose a 1% excise tax on a publicly traded U.S. corporation for the value of any of its stock that is repurchased by the corporation during the taxable year
  - "Repurchase" refers to corporate redemptions under §317(b) and can include "economically similar" transactions as determined by the Secretary
    - Presumably, the IRS could assess step-transaction and substance-over-form doctrines to determine a "repurchase" has occurred
  - The repurchases subject to this excise tax are reduced by the value of any new issuance to the public and stock issued to the employees of the corporation
  - Repurchases facilitated through a subsidiary of publicly traded companies would also result in excise tax treatment; a subsidiary is any corporation or partnership which is owned more than 50% directly or indirectly by the covered corporation
  - The following transactions are <u>specifically excluded from excise tax:</u>

• Tax-free reorganizations (§368(a));	• Repurchases contributed to ESOPs or similar plans;
• Aggregate annual repurchases that do not exceed $1 million;	• Repurchases by dealers in securities; and
• Repurchases treated as stock dividends;	• Repurchases by RICs/REITs

- The excise tax would apply to repurchases of stock after December 31, 2021

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The Build Back Better Act – Business Provisions

Limitation on Deduction of Interest Expense

- The BBBA would add §163(n) to limit the amount of net interest expense of certain domestic corporations that are members of an international financial reporting group
  - The business interest expense deduction would be limited to an "allowable percentage" of 110% of the domestic corporation's worldwide net interest expense
  - The new interest limitation would apply only to domestic corporations whose average excess interest expense over interest includible exceeds $12 million over a three-year period
  - The new interest limitation would not apply to small businesses with average earnings over three years of less than $26 million, partnerships, Subchapter S corporations, REITS, or RICs
- The BBBA would modify §163(j)(4) to apply the limitation of deductibility of business interest at the partner or shareholder level, rather than to the partnership or S corporation as an entity
- The BBBA would add §163(o) to allow the carryforward of disallowed interest expense due to §163(j)(1) and §163(n)(1)
  - Taxpayers subject to both §163(j) and §163(n) are eligible to deduct only the lesser of the two limitations in a taxable year
- These provisions would apply to taxable years beginning after December 31, 2022

The Build Back Better Act – Business Provisions

Modifications to Treatment of Certain Losses

- Under current law, if any security becomes **worthless** during the taxable year, the taxpayer may claim a worthless stock loss
  - A "security" for this purpose includes a share of stock in a corporation, a right to receive a share of stock in a corporation, or a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form
  - The loss is treated as occurring on the last day of the tax year
- The proposed legislation would amend §165(g) to provide that losses with respect to securities are treated as realized at the time the identifying event establishing worthlessness occurs, rather than on the last day of the tax year
  - The implementation of this proposal could prove to be difficult, as sometimes a series of events, rather than a sole identifying event, establishes worthlessness. Under this scenario, there could be uncertainty as to the timing of which specific event determined worthlessness
  - The timing change could potentially impact the holding period to determine whether the loss is short-term or long-term

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The Build Back Better Act – Business Provisions

Modifications to Treatment of Certain Losses

- Additionally, the proposed legislation would expand the definition of "security" to include a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a partnership, with interest coupons or in registered form
  - Essentially, the proposal provides that partnership indebtedness is treated in the same manner as corporate indebtedness
- Under the legislative proposals, §165 would be further amended to provide that a loss on a worthless partnership interest would be treated as a loss from the sale or exchange of the interest in the partnership, as provided in §741, at the time of the identifiable event establishing worthlessness
- Lastly, the legislative proposal would change the treatment of taxable liquidations of corporate subsidiaries so that a loss in a taxable liquidation is deferred until the property received in the liquidation is sold to a third party

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The Build Back Better Act – Business Provisions

Adjusted Basis Limitation for Divisive Reorganization

- The proposed legislation would amend §361 to provide that a distributing corporation in a divisive reorganization recognizes gain to the extent of controlled corporation debt securities transferred to the creditors of the distributing corporation in excess of the basis in assets (reduced by amounts paid by the controlled corporation to the distributing corporation) transferred from the distributing corporation to the controlled corporation in the transaction
  - This provision would apply to reorganizations after the date of enactment

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The Build Back Better Act – Business Provisions

Limitation on Certain Special Rules for Section 1202 Gains

- Currently, under §1202, taxpayers other than a corporation can exclude from gross income up to 100% of any gain from the sale or exchange of qualified small business stock held for more than 5 years. The exclusion is limited to the greater of $10 million or 10 times the taxpayer's basis of their initial investment
  - For stock acquired after September 27, 2010, 100% of the gain may be excluded
  - For stock acquired after February 17, 2009, and before September 28, 2010, 75% of the gain may be excluded
  - For stock acquired after August 10, 1993, and before February 18, 2009, 50% of the gain may be excluded
- The proposed legislation states that the 75% and 100% exclusion rates would not apply to taxpayers with AGI of $400,000 or more, as well as trusts and estates. The 50% exclusion rate would remain available for all taxpayers, regardless of when the stock was acquired after August 10, 1993
  - The 50% exclusion would be applied against a 28% rate, and it would remain an AMT preference item
- The proposed legislation would generally apply to sales and exchanges on or after September 13, 2021

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The Build Back Better Act – Business Provisions

Constructive Sales

- Under §1259, if there is a constructive sale of an appreciated financial position, the taxpayer shall recognize a gain as if the position were sold, assigned, or otherwise terminated at its FMV on the date of the constructive sale
  - Taxpayers are treated as having made a constructive sale of an appreciated financial position if they:
    1) Enter into a short sale of the same or substantially identical property;
    2) Enter into an offsetting notional principal contract with respect to the same or substantially identical property;
    3) Enter into a futures or forward contract to deliver the same or substantially identical property; or
    4) In the case of an appreciated financial position that is a short sale or contract described in #2 or #3 above with respect to any property, acquire the same or substantially identical property
- The proposed legislation would include digital assets in the constructive sale rules for taxable years beginning after December 31, 2021
  - The term "**digital asset**" means any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary
- Additionally, the proposed legislation would expand the definition of a constructive sale in #4 above to include entering into a contract to acquire the same or substantially identical property
- The proposal would apply to constructive sales entered into after the date of enactment

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The Build Back Better Act – Business Provisions
Wash Sales

- **Wash Sales** occur when a taxpayer sells securities at a loss and within 30 days before or after the sale either buys *substantially identical* securities, acquires substantially identical securities in a taxable trade, or acquires a contract or option to buy substantially identical securities
  - The wash sale rule prevents taxpayers from claiming tax losses while retaining an interest in the loss asset
  - Any loss that is denied for purposes of the loss sale rule is added to the basis of the acquired stock or options
- Under current law, the wash sale rule only applies to stock or securities, including contracts or options to acquire or sell stock or securities

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The Build Back Better Act – Business Provisions
Wash Sales

- The proposed legislation would *expand* the wash sale rule to include commodities, currencies, and digital assets
- Exceptions would be provided for foreign currency and commodity losses either:
  - Directly related to the business needs of a trade or business of the taxpayer (other than the trade or business of trading foreign currencies or commodities); or
  - Part of a hedging transaction (as defined by §1221(b)(2))
- If enacted, this provision would apply to wash sales occurring in taxable years beginning after December 31, 2021

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The Build Back Better Act – Business Provisions

Modifications to Limitation on Deduction of Excessive Employee Remuneration

- Under §162(m), in the case of a publicly held corporation, a deduction limit of $1 million generally applies to compensation of the principal executive officer or the three most highly compensated officers for the taxable year other than the principal executive officer
- ARPA (discussed later) expanded the applicable employees under §162(m) to include the next five highest-paid employees in addition to the CEO, CFO, and next three highest compensated officers
  - These next five highest-paid employees are to be determined on an annual basis
- The ARPA provision was scheduled to take effect in 2027; however, the BBBA would accelerate ARPA's changes to take effect in tax years beginning in 2022

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The Build Back Better Act – Business Provisions

Termination of Employer Credit for Paid Family and Medical Leave

- Currently, eligible employers may claim a credit equal to 12.5% of the eligible wages paid to qualifying employees during any period such employees are on family and medical leave, if the rate of payment under the program is 50% of the wages typically paid to the employee
  - The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%
  - The maximum amount of family and medical leave that may be taken for any qualifying employee for any taxable year is 12 weeks
  - Eligible employers must have a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and less-than-full-time qualifying employees a commensurate amount of leave
- The Taxpayer Certainty and Disaster Tax Relief Act of 2020 extended the employer credit for paid family and medical leave through December 31, 2025, but the proposed legislation would amend the expiration date of the credit for paid family and medical leave to December 31, 2023

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The Build Back Better Act – Business Provisions

Employer-Provided Childcare Credit

- Currently, employers may claim a tax credit of 25% of qualified childcare expenditures plus 10% of qualified childcare resource and referral expenditures, not to exceed a maximum annual credit amount of $150,000
  - Qualified childcare expenditures include the costs of constructing, acquiring, expanding, or rehabilitating property used as a qualified childcare facility or any costs incurred in operating the facility
  - Qualified childcare facilities must be open to all employees and, if qualified childcare is the principal trade or business of the taxpayer, at least 30% of enrollees must be dependents of employees of the taxpayer
- The BBBA would make the following changes to the employer-provided childcare credit:
  - Increase the credit rate for qualified childcare expenditures from 25% to 50%;
  - Increase the overall annual credit limitation from $150,000 to $500,000; and
  - Limit the amount of qualified childcare resource and referral expenditures to $1.5 million per year
- The BBBA changes would apply to taxable years beginning after December 31, 2021

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The Build Back Better Act – Business Provisions

Miscellaneous Business Provisions

- The BBBA includes certain international provisions and other less commonly applicable provisions, including:
  - Modification of §250 deductions related to FDII and GILTI (Effective 12/31/2022)
    - The provision provides that certain classes of income are excluded from FDII, and therefore, an offsetting deduction is not available
  - Repeal of 1-Month Deferral Election for Taxable Year of Specified Foreign Corporations (Effective after 11/30/2022)
  - Modification to Foreign Tax Credits to Dual Capacity Taxpayers (Effective after 12/31/2021)

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The Build Back Better Act – Business Provisions

Miscellaneous Provisions

- The BBBA includes certain international provisions and other less commonly applicable provisions, including (cont'd):
  - Modifications to Foreign Tax Credit (FTC) Limitations (Effective after 12/31/2022)
    - Require country-by-country reporting of FTCs
    - Repeal the carryforward limitations related to GILTI FTCs (5-yr carryforward to 2030; 10-yr carryforward 2030 and beyond)
    - Restrict deductions in GILTI Basket of FTCs to only those directly allocable to GILTI income including the GILTI §250 deduction
    - Require FTCs related to covered stock transactions be applied with the principles of §338(h)(16)
  - Modifications to Foreign Oil Related Income (Effective after 12/31/2021)
  - Modifications to GILTI (Effective after 12/31/2022)
    - Require application of GILTI on a country-by-country regime
    - Allow carryover of country-specific net CFC tested losses
    - Modify net deemed tangible return from 10% of QBAI to 5% of QBAI
    - Include foreign oil and gas extraction income in GILTI calculation

The Build Back Better Act – Business Provisions

Miscellaneous Provisions

- The BBBA includes certain international provisions and other less commonly applicable provisions, including (cont'd):
  - Modifications of Deemed Paid Foreign Taxes Related to GILTI from 80% to 95% (Effective after 12/31/2022)
  - Modifications to Foreign Source Dividend deductions under §245A and adding §951B related to downward attribution of foreign persons (Effective after date of enactment)
  - Modifications on Foreign Base Company Sales and Services Income (Effective after 12/31/2021)
  - Modifications to BEAT Tax Rates (Effective after 12/31/2021)
    - 1/1/2022 – 12/31/2022: 10%
    - 1/1/2023 – 12/31/2023: 12.5%
    - 1/1/2024 – 12/31/2024: 15%
    - 1/1/2025 and beyond: 18%

The Build Back Better Act – Business Provisions

Miscellaneous Provisions

- The BBBA includes certain international provisions and other less commonly applicable provisions, including (cont'd):
  - Limitations on the Credit for Clinical Testing of Orphan Drugs (Effective after 12/31/2021)
  - Exclusions of Prison Facility Rents for Purposes of REIT Income Tests (Effective after 12/31/2021)
  - Modifications of Portfolio Interest Exemptions (Effective after date of enactment)
  - Enact Dividend Treatment under §871(m) with respect to payments of notional principal contracts and similar payments for PTPs (Effective 12/31/2022)
  - Adjustments to E&P of CFCs (Effective after 12/31/2021)
  - Treatment of certain CFC dividends as Extraordinary Dividends (Effective after date of enactment)
  - Clarification of the meaning of trade/business for purposes of §52(b) aggregation rules (Effective after 12/31/2021)
  - Modification to delay amortization requirements of Research and Experimental Expenditures to taxable years after 12/31/2025

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The Build Back Better Act – Business Provisions

Miscellaneous Provisions

- The BBBA includes certain international provisions and other less commonly applicable provisions, including (cont'd):
  - Modifications to Deductibility of Certain Qualified Sound Recording Productions under §181 (Effective date of enactment)
  - Payroll Credits for Local News Journalist Compensation (Effective calendar quarters after date of enactment)
  - Increase in Research Credit Against Payroll Tax for Small Businesses (Effective after 12/31/2021)

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The Build Back Better Act – Individual Provisions

Application of NIIT to Trade or Business Income of Certain High-Income Individuals

- Under current law, §1411 imposes a Net Investment Income (NII) tax of 3.8% on certain individuals, estates, and trusts
- The 3.8% NII tax for individuals is imposed on the lesser of:
  - Net Investment Income for such taxable year; or
  - The excess (if any) of the Modified AGI for such taxable year over the threshold amount
    - The threshold amount is $250,000 for married filing jointly taxpayers or surviving spouses
    - The threshold amount is $200,000 for head of household and single taxpayers
    - The threshold amount is $125,000 for married individuals filing separate returns
- The 3.8% NII tax for trusts and estates is imposed on the lesser of:
  - Undistributed Net Investment Income for such taxable year; or
  - The excess (if any) of the adjusted gross income for such taxable year over the threshold amount, which is the dollar amount at which the highest estate or trust income tax bracket begins ($13,450 for 2022)
- Typically, the NII tax applies for passive activities, not activities in which the taxpayer materially participates

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The Build Back Better Act – Individual Provisions

Application of NIIT to Trade or Business Income of Certain High-Income Individuals

- The proposed legislation would apply the NII tax to certain high-income taxpayers, regardless of whether they materially participate
  - For individuals, the expanded NII tax would apply to the greater of “specified net income” (a new term), or net investment income, as defined by current law
  - For trusts and estates, the expanded NII tax would apply to the greater of:
    - “Undistributed specified net income” (new term) or undistributed net investment income, as defined by current law; or
    - The excess (if any) of the adjusted gross income for such taxable year over the threshold amount, which is the dollar amount at which the highest estate or trust income tax bracket begins ($13,450 for 2022)
- For purposes of the proposed, expanded NII tax, “**specified net income**” is “income derived in the ordinary course of a trade or business without regard to the current limitation that the trade or business is a passive activity with respect to the taxpayer or consists of trading financial instruments or commodities”
  - Specified net income is specified income reduced by deductions allocable to such income
  - Specified income includes gross income from interest, dividends, annuities, royalties, rents, other gross income derived from a trade or business, and net gain attributable to the disposition of property

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The Build Back Better Act – Individual Provisions

Application of NIIT to Trade or Business Income of Certain High-Income Individuals

- The expanded NII tax would cover Net Investment Income derived in the ordinary course of a trade or business for the following income brackets:
  - $500,000 for married filing jointly taxpayers or surviving spouses;
  - $400,000 for head of household or single taxpayers; and
  - $250,000 for married individuals filing a separate return
- Under the proposal, the increase in tax is phased in based on the ratio of:
  - The excess of the taxpayer's modified AGI over the applicable threshold amount, to
  - $100,000 for all taxpayers other than married individuals filing a separate return, in which case this amount is $50,000
  - *Example:* Married taxpayers Jon and Carol have $540,000 of modified AGI. The increase in NII tax under the proposal is limited to 40% (($540,000 - $500,000))/$100,000)
- The NII proposal would keep the current threshold amounts above which the NII tax applies
- The proposal clarifies that the expanded NII tax is not assessed on wages on which FICA is already imposed
- This proposal would apply to taxable years beginning after December 31, 2021

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The Build Back Better Act – Individual Provisions

Limitations on Excess Business Losses of Noncorporate Taxpayers

- Under current law, for taxable years beginning after December 31, 2020, and before January 1, 2027, §461(l) disallows the excess business loss of noncorporate taxpayers
  - An **excess business loss** is the excess (if any) of the aggregate deductions of the taxpayer for the taxable year that are attributable to the trades or businesses of such taxpayer, over the sum of the aggregate gross income or gain of the taxpayer for the taxable year that is attributable to such trades or businesses, plus a threshold amount
    - In 2021, the threshold amount is $262,000 ($524,000 for married filing jointly taxpayers)
  - The aggregate deductions taken into account to determine the taxpayer's excess business loss are determined without regard to the limitation of the provision, and without regard to any NOL deduction or §199A deduction
  - The excess business loss limitation applies after the basis limitations for partners and S corporation shareholders, the §465 at-risk limitations, and the §469 passive loss limitations
  - The disallowed excess business loss is suspended and carried over to the following tax year as an NOL

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The Build Back Better Act – Individual Provisions

Limitations on Excess Business Losses of Noncorporate Taxpayers

- The proposed legislation would make permanent the limitation on any excess business loss of a noncorporate taxpayer
- Any disallowed loss for a particular year would be carried forward to the next taxable year and treated as a deduction attributable to trades or businesses of the taxpayer in that year
  - As it would not be considered an NOL carryforward, the loss would be considered as part of the aggregate deductions under §461(l) for the next taxable year, and therefore may be subject to the excess business loss limitation in that year
    - This provision may limit or delay the ability of the taxpayer to utilize the benefit of such losses
- This provision would apply to taxable years beginning after December 31, 2020

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The Build Back Better Act – Individual Provisions

Surcharge on High-Income Individuals, Trusts, and Estates

- The proposed legislation would create a new five-percent income tax surcharge on modified AGI of an individual, estate, or trust, above the following amounts:
  - $10 million for married filing jointly taxpayers, surviving spouses, head of household filers, and single taxpayers;
  - $5 million for married individuals filing separate returns; and
  - $200,000 for estates and trusts
- An additional, new three-percent income tax surcharge (for a total of eight percent) on modified AGI of an individual, estate, or trust, would be applied above the following amounts:
  - $25 million for married filing jointly taxpayers, surviving spouses, head of household filers, and single taxpayers;
  - $12.5 million for married individuals filing separate returns; and
  - $500,000 for estates and trusts

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The Build Back Better Act – Individual Provisions

Surcharge on High-Income Individuals, Trusts, and Estates

- For purposes of the new income tax surcharges, an individual's modified AGI is the taxpayer's AGI reduced by any deduction (not taken into account in determining adjusted gross income) allowed for investment interest
- The new income tax surcharge would not be treated as income taxes paid for purposes of the AMT
- This provision would be effective for tax years beginning after December 31, 2021

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The Build Back Better Act – Individual Provisions

Child Tax Credit

- ARPA significantly expanded the Child Tax Credit (CTC) for the 2021 tax year by increasing the maximum CTC amount, creating advanced CTC payments, and making the CTC fully refundable (details discussed in later slides)
- The BBBA would provide a one-year extension of the expanded CTC and advanced payments
  - Advanced payments would be equal to 100% of the estimated 2022 CTC and would be made in 12 monthly payments
  - Advanced payments made to joint return filers would treat half of each payment as being made to each spouse
  - Taxpayers may elect a "look-back rule" to use their 2021 MAGI to determine their 2022 CTC and advance payment amount
  - The Secretary would be able to consider any information known when determining eligibility and the amount of advanced CTC payments. Prior to this change, the Secretary was only permitted to use an individual's prior year return information to determine eligibility and payment amount
- The BBBA would make the CTC fully refundable for tax year 2021 and tax year 2022 forward

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The Build Back Better Act – Individual Provisions

Child Tax Credit

- Under current law, taxpayers may only receive the CTC for an eligible child if they provide such child's SSN. This SSN must be associated with work authorization in order to qualify for CTC eligibility
  - The BBBA would ***repeal*** the work-authorized SSN requirement and allow taxpayers with eligible children with ITINs to claim the CTC, provided that all other eligibility requirements are met
- Currently, ARPA provides a repayment safe harbor so that taxpayers who receive excess advance payments may be protected from repayment. Currently, the maximum safe harbor amount for 2021 is $2,000, multiplied by the difference in the number of qualifying children between 2021 and 2020
  - The BBBA **increases** the maximum safe harbor amount for 2022 to be $3,600, multiplied by the number of children under age 6 considered for advanced payments and not claimed on 2022 returns, plus $3,000, multiplied by the number of children over age 6 considered for advanced payments and not claimed on 2022 returns

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The Build Back Better Act – Individual Provisions

Earned Income Tax Credit

- ARPA significantly expanded eligibility for the Earned Income Tax Credit (EITC) for the 2021 tax year by lowering the minimum age requirement, eliminating the maximum age requirement, increasing the maximum credit amounts, increasing the phaseout percentages, and increasing the income thresholds (details discussed in later slides)
- The BBBA would extend the expanded EITC through tax year 2022 and allow taxpayers to elect to use prior year income to compute their EITC

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The Build Back Better Act – Individual Provisions

Premium Tax Credit

- ARPA changed the affordability percentages used for premium tax credits (PTC) for 2021 and 2022 to increase credits for individuals eligible for assistance and provide credits for taxpayers with income over 400% of the FPL. Additionally, ARPA did not require taxpayers to repay excess advance PTC payments in 2020 (details discussed in later slides)
- Currently, the PTC is available to individuals who cannot obtain affordable minimum coverage through their employer, defined as contributing no more than 9.5% (9.83% in 2021) of household income toward health insurance premiums
- The BBBA would implement the following changes to the PTC:
  - Extend PTC eligibility for taxpayers with income over 400% of the FPL through 2025
  - Modify the definition of affordable minimum-based coverage through an employer to be 8.5% of household income through 2025

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The Build Back Better Act – Individual Provisions

Premium Tax Credit (Cont'd)

- The BBBA would implement the following changes to the PTC (cont'd):
  - Eliminate the requirement that taxpayers must include lump-sum Social Security benefits in household income in the year awarded when determining PTC eligibility for tax years beginning after December 31, 2021
    - Previously, any large lump sum payment could have eliminated an individual's PTC or required them to repay advance PTCs
  - Exclude certain dependent income (up to $3,500, to be indexed for inflation) from the calculation of household income for purposes of determining the PTC amount through 2026
  - Allow taxpayers with household incomes below 100% of the FPL to be eligible for PTCs, effective through December 31, 2025
  - Extend the ARPA provision that individuals receiving unemployment compensation are treated as if their income is no higher than 150% of the FPL
    - This provision would be effective through December 31, 2022
  - Make the health coverage tax credit permanent and increase the amount of the qualified health insurance premium covered by the credit from 72.5% to 80%

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The Build Back Better Act – Individual Provisions

State and Local Tax Deduction

- The TCJA notoriously limited the itemized deduction for state and local taxes (SALT deduction) to $10,000 for all taxpayers other than estate, trust, or married filing separately taxpayer subject to a $5,000 limitation
- The BBBA would increase the SALT deduction from $10,000 to $80,000 for all taxpayers other than estates, trusts, and married filing separately taxpayers, which would be entitled to a deduction of $40,000
- The BBBA SALT provision would be effective for tax years 2021 through 2030
- The SALT deduction effective from the TCJA would revert to the $10,000/$5,000 limitation for tax year 2031 before all limitations expire in 2031

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The Build Back Better Act – Individual Provisions

Pell Grants

- Under current law, if an individual receives a scholarship, including a Pell Grant, that covers room and board or other living expenses, such scholarship or Pell Grant is **taxable**
  - Only the portion of the scholarship or Pell Grant that is used to pay for qualified tuition and fees is **excludable** from income
- The BBBA would provide that any amount received from a Pell Grant is **excludable** from income, including any portion of the grant used to pay for room and board or other living expenses
- Additionally, the BBBA would not reduce expenses eligible for education tax credits by any amount of a Pell Grant
- The BBBA changes applicable to Pell Grants would apply to grants received after December 31, 2021 and before January 1, 2026

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The Build Back Better Act – Individual Provisions

New Above-the-Line Deductions

- **Union Dues:**
  - The BBBA would provide an above-the-line deduction for union dues, up to $250, consisting of the performance of services by the taxpayer as an employee
  - This above-the-line deduction is available to union dues paid in any taxable year beginning after December 31, 2021, and before January 1, 2026
- **Employee Uniforms:**
  - The BBBA would create a new, above-the-line deduction, up to $250, for employee uniforms
  - The uniform must be a condition of the taxpayer's employment and unsuitable for everyday wear
  - This above-the-line deduction is available for expenses paid in any taxable year beginning after December 31, 2021, and before January 1, 2025
- As an above-the-line deduction, these deductions are available to all taxpayers, regardless of whether they itemize or take the standard deduction

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The Build Back Better Act - Retirement Plans

Contribution Limit for IRAs of High-Income Taxpayers with Large Account Balances

- There are two main types of IRAs:
  - **Traditional IRAs:** Eligible individuals may deduct pre-tax contributions made to the traditional IRA, and any distributions are includible in gross income to the extent of any deductible contributions and earnings on the account. Individuals may make both deductible and nondeductible contributions
  - **Roth IRAs:** Eligible individuals may make after-tax contributions to the Roth IRA. Since all contributions are after-tax, the contributions are nondeductible and all qualified distributions and earnings on the account are not includible in gross income
- An annual contribution limit applies to contributions to both traditional and Roth IRAs. In 2021, the maximum contribution is the lesser of:
  - $6,000 ($7,000 for those age 50 or older before the end of the taxable year); or
  - The individual's compensation
- Additional AGI limitations apply to deductible contributions to traditional IRAs and nondeductible contributions to Roth IRAs
  - Individuals who make contributions to an IRA in excess of the contribution limits are subject to an excise tax of 6% of the excess amount contributed. The excise tax continues to apply until the excess amount is distributed

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The Build Back Better Act - Retirement Plans

Contribution Limit for IRAs of High-Income Taxpayers with Large Account Balances

- Under the BBBA, if the total value of an applicable individual's IRA and defined contribution plan exceeds $10 million as of the end of the prior taxable year, the individual would be prohibited from making further contributions to a Roth or traditional IRA for the taxable year
- **Applicable individuals** are defined as taxpayers whose adjusted taxable income for the taxable year exceeds:
  - $450,000 for Married Filing Jointly or a Surviving Spouse;
  - $425,000 for Head of Household; and
  - $400,000 for Single or Married Filing Separately Taxpayers
- Both the account limit and adjusted taxable income limits would be adjusted for inflation beginning in 2023

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The Build Back Better Act - Retirement Plans

Contribution Limit for IRAs of High-Income Taxpayers with Large Account Balances

- Additionally, under the BBBA, certain IRAs with high account balances would be subject to additional reporting requirements
- If as of the end of any plan year, one or more participants in an applicable retirement plan has a vested account balance of at least $2.5 million for the plan year, the plan administrator would be required to file a statement including the following information:
  - The name and identifying number of each such participant; and
  - The amount to which each participant is entitled
- The enhanced reporting requirements would be effective tax years beginning after December 31, 2028

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The Build Back Better Act - Retirement Plans

Increase in RMDs for High-Income Taxpayers with Large Retirement Account Balances

- The proposed legislation would require certain taxpayers to take a minimum distribution in the year following the year in which their combined traditional, Roth IRA, and defined contribution account balances exceed $10 million as of the end of the taxable year
  - The increased minimum required distribution would generally equal:
    - The excess of the sum of 100% of the "applicable Roth excess amount" (note: this is generally Roth amounts in excess of $20 million) plus 50% of the "excess aggregate vested retirement plan balance" that exceeds $10 million reduced by the applicable Roth excess amount; over,
    - The sum of the minimum required distributions, determined without regard to the proposed legislation, for all such plans
  - Only taxpayers with taxable incomes above the following thresholds would be required to take a minimum distribution:
    - $450,000 for Married Filing Jointly or a Surviving Spouse;
    - $425,000 for Head of Household; and
    - $400,000 for Single or Married Filing Separately Taxpayers
  - Any minimum required distributions made as a result of this proposal would be exempt from the §72(t) 10% early distribution penalty and such minimum required distributions would be subject to 35% withholding
- The proposed legislation would be effective for tax years and plan years beginning after December 31, 2028

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The Build Back Better Act - Retirement Plans

Tax Treatment of Rollovers to Roth IRAs and Accounts

- Currently, taxpayers may convert any amount in a traditional IRA to a Roth IRA by making a distribution from the traditional IRA and making a rollover to a Roth IRA
  - The taxpayer pays income tax on such distribution as if a withdrawal was made, but the §72(t) 10% early distribution penalty does not apply
- §401(k), §403(b), and §457(b) plans that maintain a Roth contribution program may allow amounts not held in designated Roth accounts to be converted, and such amounts would be included in the gross income of the taxpayer as if distributed
- The BBBA would eliminate traditional IRA to Roth IRA conversions for "**applicable taxpayers**," defined as those whose adjusted taxable income for the taxable year exceeds:
  - $450,000 for Married and Filing a Joint Return or Surviving Spouse;
  - $425,000 for Head of Household; and
  - $400,000 for Single or Married Filing Separately
  - This provision would apply to distributions, transfers, and contributions made in taxable years beginning after December 31, 2031

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The Build Back Better Act - Retirement Plans

Tax Treatment of Rollovers to Roth IRAs and Accounts

- Under the BBBA, applicable taxpayers could no longer convert non-Roth funds in §401(k), §403(b), and §457(b) plans to a designated Roth account for distributions, transfers, and contributions made in tax years beginning after December 31, 2031
- Lastly, the BBBA would prohibit all after-tax amounts held in non-Roth accounts in an employer-sponsored retirement plan or a traditional IRA from being converted to a Roth IRA or a designated Roth account for distributions, transfers, and contributions made after December 31, 2021, for all taxpayers, regardless of income level

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The Build Back Better Act - Retirement Plans

Statute of Limitations with Respect to IRA Noncompliance

- The proposed legislation would extend the statute of limitations for IRA noncompliance related to valuation-related misreporting and prohibited transactions from 3 years to 6 years to help the IRS pursue violations that may have originated outside the current statute’s 3-year window
- This provision would apply to taxes to which the current 3-year period ends after December 31, 2021

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The Build Back Better Act - Retirement Plans

IRA Owners Treated as Disqualified Persons for Purposes of Prohibited Transaction Rules

- If an IRA engages in certain prohibited transactions with a disqualified person, it ceases to be an IRA
- A disqualified person includes:
  - A fiduciary of the plan;
  - A person providing services to the plan;
  - An employer with employees covered by the plan;
  - An employee organization any of whose members are covered by the plan;
  - A direct or indirect owner of an interest of 50% or more in the employer or employee organization; or
  - A corporation, partnership, or trust or estate of which (or in which) an interest of 50% or more is held directly or indirectly by a person described above

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The Build Back Better Act - Retirement Plans

IRA Owners Treated as Disqualified Persons for Purposes of Prohibited Transaction Rules

- The BBBA would *modify* the definition of a disqualified person for purposes of the prohibited transaction rules to include IRA owners as a disqualified person with respect to the IRA
- The following would also be considered disqualified persons under the proposal:
  - A family member of the IRA owner;
  - A corporation, partnership, or trust or estate in which an interest of 50% or more is held directly or indirectly by the IRA owner; and
  - A 10% or more (in capital or profits) partner or joint venturer of the IRA owner
- The proposal would apply to transactions occurring after December 31, 2021

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The Build Back Better Act – Taxpayer Compliance

Funding the IRS and Backup W/H with Respect to Third-Party Network Transactions

- The BBBA would add to the list of reportable payments any payments in settlement of third-party network transactions
- A reportable payment will trigger a backup withholding requirement if:
  - The aggregate amount of such payment and all previous payments made by the third-party settlement organization to the participating payee during the calendar year equals or exceeds $600; or
  - The third-party settlement organization was required under §6050W to file an information return for the preceding calendar year with respect to payments to the participating payee
- This proposal would apply to calendar years beginning after December 31, 2021
- A transition rule for 2022 adds the requirement that the aggregate number of annual transactions between the third-party settlement organization and the payee must exceed 200 transactions

The Build Back Better Act – Social Provisions

Childcare and Universal Preschool

- The BBBA would establish a new childcare and early learning entitlement program to provide quality, affordable childcare for eligible children from birth up to age five who have not yet started kindergarten. Additionally, it would increase wages for early childhood care providers and invest in childcare quality
  - Payments for childcare would be capped at a maximum of 7% of a family's income based on a sliding scale system
  - Families earning under 75% of their State Median Income (SMI) would pay nothing for childcare
  - After a three-year phase in period, families with parent(s) engaged in an eligible activity earning no more than 250% of SMI would be eligible for childcare assistance through a childcare subsidy or grant fund
    - Eligible activities include employment, job searches, educational or training programs, or family leave
- In addition to expanded early childhood care, the BBBA would establish universal preschool for eligible children ages three to four

The Build Back Better Act – Social Provisions

Comprehensive Paid Leave

- The BBBA creates four weeks of comprehensive paid leave benefits for both full-time and part-time workers in the public and private sectors
  - This paid leave program is more expansive than current FMLA leave, as it applies to nearly all employers, self-employed individuals, and employees regardless of employer size or employee classification
- The Weekly Benefit Amount is calculated as follows:

$$Weekly\ Benefit\ Amount = Weekly\ Benefit\ Rate\ \times \frac{Caregiving\ hours\ in\ a\ workweek}{Regular\ workweek\ hours}$$

  - The number of caregiving hours per workweek may not exceed the number of regular workweek hours
  - The initial weekly benefit rate in 2024 is the sum of:
    - 90.138% x (the first $15,080 of annual earnings) ÷ 52 weeks
    - 73.171% x (the portion of annual earnings between $15,081 and $34,248) ÷ 52 weeks
    - 53.023% x (the portion of annual earnings between $34,249 and $62,000) ÷ 52 weeks
  - Utilizing this formula, the maximum weekly benefit rate is $814.10 in 2024

The Build Back Better Act – Social Provisions

Comprehensive Paid Leave

- The weekly benefit rate would increase according to the growth in the national average wage index for years after 2024
- Under the BBBA, comprehensive paid leave benefits provided to individuals are excluded from gross income
- The new paid leave provision is effective as of January 1, 2024

Other Recent Updates

IRS New FAQ Process

- The Internal Revenue Bulletin is the authoritative instrument of the IRS to announce official rulings and procedures, and for publishing Treasury Decisions, Executive Orders, Tax Conventions, Court Decisions, Legislation, or any other important items
  - **Final and Temporary Treasury Regulations** may be relied on by taxpayers. Proposed regulations may be relied on if the regulations explicitly state that
  - **Revenue Rulings** provide the IRS's interpretation of the law to facts in the specific ruling. Taxpayers may rely on these rulings if their specific facts and circumstances are substantially the same as the revenue ruling. Revenue rulings have a lower level of authority than Treasury Regulations
  - **Revenue Procedures** are official statements of IRS procedure and administrative practices. Taxpayers may rely on this guidance if their specific facts and circumstances are substantially the same as the revenue procedure. Revenue procedures have a lower level of authority than Treasury Regulations
  - **Frequently Asked Questions (FAQs)** provide the IRS's responses to general inquiries rather than a specific set of facts and circumstances

Other Recent Updates

IRS New FAQ Process

- On October 15, 2021, the IRS announced that it will update its process for Frequently Asked Questions (FAQs) on new tax legislation and will address concerns of those who rely on such FAQs
- The IRS will announce future significant FAQs on newly enacted tax legislation, as well as any updates or revisions, in a news release. These FAQs will also be posted as a dated Fact Sheet on the IRS.gov website
  - Prior versions of such fact sheets will be maintained, so if any FAQs are later changed, taxpayers can easily determine which dated version was used
- The IRS clarified that if a taxpayer *reasonably relies* on any FAQ (even those released prior to October 15, 2021) in good faith, they will have a "reasonable cause" defense against any negligence or accuracy-related penalty if the FAQ is later determined to be an incorrect statement of the law as applied to the taxpayer's particular facts
  - **Prior to this release, FAQs that had not been published in the Bulletin could not be relied on**

Other Recent Updates

Sneak Peak at 2022 Inflation-Adjusted Figures

- In November 2021, the IRS released annual inflation adjustments
- The standard deduction amounts in 2022 are as follows:
  - $25,900 for married filing jointly filers;
  - $19,400 for head of household filers; and
  - $12,950 for single and married filing separately filers
- The contribution limit for employees participating in 401(k) plans increases to $20,500 in 2022
- The limit on annual contributions to an IRA remains unchanged at $6,000
- The annual exclusion for gifts increases to $16,000 in 2022 and the federal estate tax exclusion increases to $12,060,000 in 2022

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Other Recent Updates

New Foreign Reporting Requirements: Schedules K-2 and K-3

- For tax year 2021, Schedules K-2 and K-3 replace foreign reporting lines previously included on Schedules K and K-1
  - For partnerships, lines 16 and 20 are replaced by completing Schedule K-2 and K-3 and providing it to partners
  - For S corporations, the schedules replace lines 14 and certain items of line 17
- The new schedules are provided to partners/shareholders to provide greater clarity on how to determine their U.S. income tax liability with respect to certain items of international relevance, particularly items of deduction and credit

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Other Recent Updates

Form 7203 – S Corporation SH Stock and Debt Basis Limitations

- For 2021, Form 7203 will be required of S corporation shareholders if any of the following apply:
  1) A shareholder is claiming a deduction for their share of an aggregate loss from an S corporation;
  2) A shareholder received a non-dividend distribution from an S corporation during the tax year;
  3) A shareholder disposed of stock in an S corporation during the tax year; or
  4) A shareholder received a loan repayment from an S corporation during the tax year
- Given the above list, for all intents and purposes, basis will be reported on this form and attached to Form 1040 for all S corporation shareholders

Practice Note: It may be beneficial for shareholders to complete and retain Form 7203 even for years it is not required to be filed, as this will ensure their bases are consistently maintained year after year

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Chapter 1

Navigating the New Normal: COVID-19; Recent Legislation and Updates

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II. COVID-19 Legislative Updates

- Over the past year, significant legislation has been enacted to provide relief amidst the COVID-19 pandemic, including:
  - ***The Families First Coronavirus Response Act (FFCRA)***, March 2020
    - This bill established mandated paid leave for employees affected by COVID-19 and provided employers with tax credits to offset the financial burden of providing the paid leave
  - ***The Coronavirus Aid, Relief, and Economic Security (CARES)* Act**, March 2020
    - This $2 trillion stimulus bill created the Paycheck Protection Program, expanded unemployment benefits, established the Employee Retention Tax Credit, and amended certain areas of the tax code to provide relief to taxpayers during a time of economic uncertainty
  - ***The Consolidated Appropriations Act of 2021 (CAA 2021)***, December 2020
    - Note: ***The COVID-related Tax Relief Act of 2020*** **(COVIDTRA)** was included in CAA 2021
    - Year-end appropriations bills are typically signed into law each December; however, the CAA 2021 went beyond renewing tax extenders and provided additional COVID-19 relief to taxpayers
  - ***The American Rescue Plan Act (ARPA) of 2021***, March 2021
    - ARPA extended popular CARES Act provisions that were set to expire and established new provisions to provide economic relief during the COVID-19 pandemic

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II. Individual COVID Relief Efforts

1. Economic Impact Payments (Stimulus Checks)

- First and second round economic impact payments (EIP1 and EIP2) were sent to taxpayers in 2020 and were considered advanced payments of the recovery rebate credit
  - Using the new 2020 tax return data, the taxpayer re-computed his or her recovery rebate credit and compared it to the amount he or she actually received
  - The taxpayer did not have to pay back the EIPs if the recovery rebate credit amount that the taxpayer qualified for in 2020 was less than what the taxpayer received. This is because the 2020 credit could not be reduced below zero
- Most recently, ARPA established a **third round** of economic impact payments (EIP3) as part of a continued relief effort during the COVID-19 pandemic
  - Similar to the first (EIP1) and second round (EIP2) of economic impact payments, the ARPA recovery rebates are an advanced rebate payment of a 2021 credit
  - Unlike EIP1 and EIP2, qualifying children and qualifying relatives, including dependent college students, dependent disabled adult children, and dependent adult parents qualified for the EIP3 additional dependent payment

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II. Individual COVID Relief Efforts

1. Economic Impact Payments (Stimulus Checks)

- The IRS noted that if they process a taxpayer's 2020 return and determine that there is a **mistake** with the credit amount on Line 30 of Form 1040, the IRS will calculate the correct amount, make the correction, and continue processing the return
- The IRS cautions that if a correction is needed, there may be a slight delay in processing the return, and the IRS will notify the taxpayer of any changes made
- Common 2020 recovery rebate credit corrections that the IRS encounters include:
  - The individual did not provide an SSN
  - The individual was claimed as a dependent on another taxpayer's 2020 tax return
  - The qualifying child that was claimed for purposes of EIP1 or EIP2 was age 17 or older as of January 1, 2020
  - Various math errors related to calculating AGI and EIP1 or EIP2 amounts already received
- The IRS urges taxpayers **not** to file an amended return if they believe that they made a mistake in calculating their 2020 Recovery Rebate Credit, as the IRS will calculate the correct amount of the credit, make the correction, and continue processing the return
- It is important to note that the IRS **will not** calculate the taxpayer's 2020 Recovery Rebate Credit if he or she did not enter any amount on his or her original return
- If the taxpayer was eligible for a 2020 Recovery Rebate Credit but did not claim it on their 2020 tax return, they need to file Form 1040-X in order to claim the credit
  - The taxpayer may be able to e-file Form 1040-X, provided the original Form 1040 was e-filed and other conditions are met

II. Individual COVID Relief Efforts

2. Federal Pandemic Unemployment Compensation

- The CARES Act created a temporary ***Pandemic Unemployment Assistance*** through December 21, 2020 for workers affected by the COVID-19 pandemic who are ineligible for traditional unemployment benefits
  - This unemployment compensation was fully funded through the federal government
  - Eligible workers include, but are not limited to, self-employed individuals, independent contractors, and workers with limited work history
  - In order to qualify, individuals had to be unable to work as a direct result of COVID-19
  - A temporary $600 per week supplemental benefit was provided for up to 4 months
  - The CAA 2021, and later ARPA, extended the PUA program and provided an additional $300 of weekly benefits (half of the CARES Act $600 weekly benefits) to recipients through September 6, 2021

II. Individual COVID Relief Efforts

2. Federal Pandemic Unemployment Compensation

- Unemployment compensation is generally fully taxable to recipients
- Under ARPA, for tax year 2020, a taxpayer could ***exclude up to $10,200*** of unemployment compensation received from gross income, provided his or her AGI was less than $150,000
  - The same $150,000 limit applied to returns filed jointly, as head of household, or single status
  - In the case of a joint return, the $10,200 exclusion applied separately to each spouse, meaning that each spouse was eligible for the $10,200 exclusion (maximum $20,400 total)
  - There was **no income phase-out** provided for the exclusion, so if the taxpayer's AGI exceeded $150,000, the exclusion would not apply, and all of the individual's unemployment compensation would be included in gross income

SURGENT ACCOUNTING & FINANCIAL EDUCATION

II. Individual COVID Relief Efforts

2. Federal Pandemic Unemployment Compensation

- Taxpayers and practitioners alike were concerned that if they already filed a 2020 income tax return and paid taxes on unemployment compensation that is now excludable from income, they would have to file an amended tax return in order to receive a refund
  - On March 18, 2020, IRS Commissioner Chuck Rettig stated that such taxpayers **should not** file an amended return, as the IRS planned to automatically issue refunds associated with the unemployment compensation exclusion
  - On March 31, 2021, the IRS released IR-2021-71, stating that the IRS would **recalculate** taxes on unemployment benefits for those who already filed their 2020 tax return
- The IRS noted that they will determine the *correct* taxable amount of unemployment compensation for any taxpayers who have already filed their returns and calculated their tax liability based on the full amount of unemployment compensation
  - Any overpayment will either be **refunded or applied to outstanding tax owed**

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II. Individual COVID Relief Efforts

2. Federal Pandemic Unemployment Compensation

- ***Thinking Ahead***
- Although ARPA made up to $10,200 of unemployment compensation excludable from income for certain taxpayers, this provision was only in effect for tax year 2020
- **Unemployment benefits received in 2021 are fully taxable**
- It would be wise for taxpayers who continue to receive unemployment compensation in 2021 to **withhold taxes** from benefits received to help prevent owing taxes when they file their 2021 tax return
  - Federal law allows all recipients to choose to have a flat 10 percent withheld from their benefits to cover part or all of their tax liability
  - Recipients must fill out Form W-4V, *Voluntary Withholding Request*, and provide it to the agency paying the benefits if they wish to withhold federal tax from their benefits
  - It is possible that future legislation may allow taxpayers to exclude a similar amount of benefits from their 2021 tax returns, but to err on the side of caution, it is best to withhold taxes to avoid any surprises when the 2021 federal tax return is due

II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Expanded Eligibility***
- For tax year 2021, the CTC expands the definition of a qualifying child to include a child who has not turned age 18 by the end of 2021
- As a result, 17-year-old children are qualifying children for purposes of the CTC in the 2021 tax year
- ***Increased Credit Amount***
- ARPA increases the CTC to $3,000 per child, or $3,600 for children under age 6 as of the end of the tax year
- A phaseout applies to the temporarily increased amounts for 2021, meaning:
  - The $1,600 amount per child under age 6 ($3,600 increased CTC amount in 2021 less $2,000 "normal" CTC amount); or
  - The $1,000 amount per child age 6 or older ($3,000 increased CTC amount in 2021 less $2,000 "normal" CTC amount)

II. Individual COVID Relief Efforts
3. Child Tax Credit Expansion

- ***Increased Credit Amount***
- The increased CTC is phased out at a rate of $50 for each $1,000 of modified AGI over the threshold as follows:
  - At modified AGI over $75,000 for single filers;
  - At modified AGI over $112,500 for head of household filers; and
  - At modified AGI over $150,000 for married filing joint filers and surviving spouse filers
- As a result, the CTC is subject to **two sets** of phaseout rules for the 2021 tax year
  - A taxpayer eligible for the temporary increase in CTC first applies the phaseout rules above
  - Next, the taxpayer applies the phaseout rules under existing law (modified AGI in excess of $400,000 for joint filers and $200,000 for all other filers)

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II. Individual COVID Relief Efforts
3. Child Tax Credit Expansion

- ***Refundability***
- Prior to ARPA, the $2,000 CTC was partially refundable to the extent of 15% of the taxpayer's earned income exceeding $2,500
  - The maximum refundable portion of the CTC prior to ARPA was $1,400
- ARPA makes the CTC ***fully refundable*** in 2021 for a taxpayer with a principal place of abode in the U.S. for more than one-half of the tax year, or for a taxpayer who is a bona fide resident of Puerto Rico for the tax year
- The refundability is determined *without regard* to earned income, meaning the $2,500 earned income requirement does not apply in 2021
  - The partial $500 CTC for dependents other than qualifying children **remains nonrefundable**

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Advanced Payments***
- ARPA directed the IRS to establish a program to make monthly, periodic advanced payments starting July 15, 2021, through December 2021
- In total, the advanced payments should equal 50% of the IRS's estimate of the eligible taxpayer's 2021 CTC
  - The IRS's estimate is to be based on the taxpayer's "reference year," meaning either 2019 or 2020 tax return information (if filed)
- If paid on a monthly basis, each payment would represent one-twelfth of an annual advance amount for the calendar year
  - If the IRS determines that it is unable to deliver the payments on a monthly basis, it will issue the payments as frequently as possible

II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Advanced Payments***
- The taxpayer's CTC claimed on the 2021 tax return is reduced by the aggregate of advance payments paid by the IRS
- If a taxpayer receives advance CTC payments from the IRS in excess of the allowable CTC for the 2021 tax year, the taxpayer generally must repay the excess amount on his or her 2021 tax return
  - ***Exception:*** If the taxpayer's modified AGI is below certain threshold amounts, the payments received in excess of the allowable CTC may be reduced by a full repayment protection amount of $2,000. The income threshold amounts are as follows:
    - $40,000 for Single filers;
    - $50,000 for Head of Household filers; and
    - $60,000 for Married Filing Jointly filers
- The full repayment protection amount is equal to $2,000, multiplied by the number of qualifying children that the IRS took into account in determining the IRS's initial estimate of the taxpayer's advance CTC payments, less the number of qualifying children properly taken into account in determining the allowed CTC amount on the 2021 tax return

II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Advanced Payments***
- Taxpayers with income below the threshold amounts are protected from repaying up to $2,000 in overpayments per child that were incorrectly claimed
- This repayment protection amount decreases to $0 as the taxpayer's income rises to double the threshold amount
- This safe harbor full repayment protection amount limits the amount by which the taxpayer would have to increase his or her tax liability and allows the taxpayer to **keep** a portion of the excess CTC payment
- If taxpayers received an overpayment of the CTC due to a child for whom the advance was paid in 2021, when in fact the child was no longer that taxpayer's dependent, there is *no requirement* to repay the payment to the IRS

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Advanced Payments***
- In January 2022, the IRS will send Letter 6419 to taxpayers
  - This letter will provide the total amount of advance CTC payments that were distributed to the taxpayer during 2021
  - The advance CTC only covers half of the total 2021 CTC, so Letter 6419 will be used to calculate any remaining CTC amount due on the taxpayer's 2021 Form 1040
  - Taxpayers should keep this letter with their records in order to reconcile their advance CTC payments with the CTC they claim on their 2021 tax return
- Per IRS guidance, advance CTC payments ***may not be counted as income*** for purposes of determining whether a taxpayer is eligible for benefits assistance under any federal program, or any state or local program financed in whole or in part with federal funds
- Advance CTC payments will not be offset for overdue taxes from previous years, federal or state debts, or past-due child support. However, advance CTC payments are subject to garnishment by state, local government, and private creditors

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Online Child Tax Credit Update Portal***
- To assist with the administration of the advanced CTC payments, ARPA directed the IRS to create an **online portal, known as the Child Tax Credit Update Portal,** which allows taxpayers to:
  - Elect out of advanced monthly payments; or
  - Update information relevant to calculating the CTC, such as changing the number of qualifying children, changing the taxpayer's filing or marital status, changing the taxpayer's income, managing bank account information, and any other factors as determined by the IRS
- The IRS will issue payments to the bank account that was listed on the taxpayer's 2019 or 2020 tax return, or an account known to the federal government, such as an account where Social Security benefits are deposited
- If the taxpayer wishes to change their bank account information or mailing address, he or she may do so by using the Child Tax Credit Update Portal

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Online Portal***
- If taxpayers opt to elect out of monthly payments, they must unenroll by the unenrollment deadline shown below:

Payment Month	Unenrollment Deadline	Payment Date
July	6/28/2021	7/15/2021
August	8/2/2021	8/13/2021
September	8/30/2021	9/15/2021
October	10/4/2021	10/15/2021
November	11/1/2021	11/15/2021
December	11/29/2021	12/15/2021

- It takes the IRS up to seven calendar days to process a taxpayer's unenrollment. Taxpayers are not required to unenroll each month
- Unenrollment applies on an *individual basis*, meaning if a taxpayer unenrolls but his or her spouse does not unenroll, they will receive half of the joint payment they were supposed to receive
- **There is no option to re-enroll at this time**

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Online Portal***
- The advance CTC payments will occur on the 15th of each month for the rest of 2021 unless the taxpayer elects to unenroll
- Taxpayers who receive an advance child tax credit and wish to return the payment may follow the following instructions:
  - **Payment Received by Paper Check**: If a taxpayer received the advance CTC by paper check, he or she should write "void" in the endorsement section on the back of the check, include a brief explanation for why the check is being returned, and mail the check and explanation to the appropriate IRS location
  - **Payment Received by Direct Deposit or Cashed Paper Check**: If a taxpayer received the advanced CTC by direct deposit or cashed a payment received by paper check, he or she should submit a personal check or money order to the appropriate IRS location. The taxpayer should make the check payable to "U.S. Treasury," write "2021 advance CTC" and include his or her SSN or TIN and include a brief explanation for why the check is being returned

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II. Individual COVID Relief Efforts

3. Child Tax Credit Expansion

- ***Online Portal***
- On September 1, 2021, a new online tool called the "GetCTC Portal" was launched by Code for America Labs Inc. in collaboration with the U.S. Department of Treasury and the Biden administration
- The new GetCTC Portal improved upon the shortcomings of the IRS Online Child Tax Credit Update Portal by offering additional features such as mobile device access and multilingual (English / Spanish) capabilities
- The new Code for America GetCTC Portal tool is available at www.GetCTC.org; however, the IRS Online Child Tax Credit Update Portal remains available for use on the IRS webpage
- Individuals who believe that they qualify for advance CTC payments should check the Online Portal to determine their eligibility
  - Certain individuals may have a "pending" eligibility status, meaning that the IRS is still determining whether the individual is eligible for advance CTC payments. The advance CTC will only be issued once the IRS confirms the individual's eligibility
- If the IRS issued a payment but the individual did not receive the payment, they may file Form 3911, *Taxpayer Statement Regarding Refund*, to request a payment trace to track the payment
- Per a September 2021 statement by the Department of Treasury, eligible individuals that did not sign up in time to receive the first round of the advance CTC may be eligible to receive increased monthly payments ("catch-up payments") for the previous months they were eligible for the advance CTC but did not receive any payment

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II. Individual COVID Relief Efforts

4. Earned Income Tax Credit Expansion

- An earned income tax credit (EITC) is available for low- and moderate-income taxpayers.
- **Age Requirement**:
  - ARPA *reduces* the applicable minimum age for the credit from 25 years old to 19 years old, unless the individual is a specified student or qualified former foster youth or qualified homeless youth (special rules apply)
  - ARPA also eliminates the maximum age limit of 65, meaning there is *no maximum age limit* in 2021 for purposes of claiming the EITC
- **Increase in the Childless EITC Amount:**
- ARPA makes the following changes to the childless EITC amount for the 2021 tax year:
  - Raises the credit percentage and phaseout percentage from 7.65% to 15.3%
  - Raises the income at which the maximum EITC is reached to $9,820
  - Raises the income at which phaseout begins to $11,610 for Single, HOH, or Surviving Spouse filers (filers other than married filing jointly filers)
  - Raises the income at which phaseout begins to $17,550 for MFJ filers
  - As a result of these changes, the maximum childless EITC amount in 2021 is increased from $543 to $1,502

II. Individual COVID Relief Efforts

4. Earned Income Tax Credit Expansion

- **Identification Requirement:**
- Prior to ARPA, a taxpayer was **required** to provide a qualifying child's name, age, and taxpayer identification number in order to claim the qualifying child when determining the amount of the EITC
  - If the taxpayer was unable to provide the qualifying child's name, age, and taxpayer identification number, he or she was ***ineligible*** to claim the EITC as an eligible individual with no qualifying children
- ARPA removes this requirement and allows an eligible individual who has qualifying children, but cannot provide the necessary identification for such children, to claim the EITC as an eligible individual with no qualifying children
- This provision is effective for tax years beginning after December 31, 2020

II. Individual COVID Relief Efforts

4. Earned Income Tax Credit Expansion

- **Investment Income Requirement:**
- For purposes of the EITC, certain types of "disqualified income" may cause an individual to be ineligible for the EITC
  - **Disqualified income** consists of certain types of investment income, including dividends, royalties and rental income from personal property, capital gain net income, certain passive activities, and interest income
- Prior to ARPA, individuals who had disqualified investment income over $3,650 per year were unable to claim the EITC
- ARPA raises the disqualified investment income amount from $3,650 to $10,000
- Similar to prior law, the new ARPA amount will be indexed for inflation for tax years beginning after 2021. This provision is effective for tax years beginning after December 31, 2020

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II. Individual COVID Relief Efforts

4. Earned Income Tax Credit Expansion

- **Filing Status Requirement:**
- Prior to ARPA, married taxpayers were **required** to file a joint return in order to claim the EITC. Married individuals were **not permitted** to file separate returns
- ARPA loosens this restriction and creates new code §32(d)(2)(A) which states that an individual will not be treated as married for EIC purposes if the individual is:
  - Married under §7703(a);
  - Does not file a joint return for the tax year;
  - Lives with his or her qualifying child for more than half of the tax year; and,
  - Either: 1) During the last six months of the tax year, does not have the same principal place, or 2) has a decree, instrument, or agreement with regard to his or her spouse and is not a member of the same household of his or her spouse by the end of the tax year

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II. Individual COVID Relief Efforts

4. Earned Income Tax Credit Expansion

- **Filing Status Requirement:**
  - Provided the requirements are met, ARPA allows a separated individual to *file a separate tax return* and claim the EITC
  - This provision is effective for tax years beginning after December 31, 2020
- **Temporary Special Rule:**
  - ARPA establishes a temporary special rule for determining earned income for purposes of the EITC
  - ARPA allows taxpayers to **substitute** their 2019 earned income for their 2021 earned income for purposes of determining the EITC if their 2021 earned income was **less than** their 2019 earned income
  - For joint returns, the taxpayer's earned income for 2019 is the sum of each spouse's earned income for 2019

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II. Individual COVID Relief Efforts

5. Enhanced Child and Dependent Care Credit

- Certain taxpayers may be eligible to claim the child and dependent care credit.
- ***Refundability***
- Prior to ARPA, the child and dependent care credit was **nonrefundable**
- ARPA makes the child and dependent care credit **refundable** for taxpayers who have a principal place of abode in the U.S. for more than one half of the tax year
- In the case of a joint return, either spouse must have a principal place of abode in the U.S. for more than one-half of the tax year
  - For purposes of this requirement, the taxpayer's main home is any location where he or she regularly lives, including a house, apartment, shelter, mobile home, or temporary housing. A taxpayer's main home *need not be the same physical location throughout the entire tax year*

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II. Individual COVID Relief Efforts

5. Enhanced Child and Dependent Care Credit

- ***Increased Expense Limits***
- The total deduction for the child and dependent care credit is required to be less than the dollar limitation for qualifying expenses
- ARPA ***increases*** the dollar limitation for qualifying expenses from $3,000 to $8,000 for one qualifying individual, and from $6,000 to $16,000 for two or more qualifying individuals
- Prior to ARPA, the credit was equal to 35% of employment-related expenses for taxpayers whose AGI was $15,000 or less
  - The maximum credit was $1,050 ($3,000 x 35%) for one qualifying individual and $2,100 ($6,000 x 35%) for two or more qualifying individuals

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II. Individual COVID Relief Efforts

5. Enhanced Child and Dependent Care Credit

- ***Increased Expense Limits***
- ARPA increases the applicable credit percentage from 35% to 50% for taxpayers whose AGI is $125,000 or less
  - The 50% applicable credit percentage amount is decreased by one percentage point for each $2,000 of additional AGI until it is reduced to 20% for taxpayers whose AGI is $183,000
  - A 20% applicable credit percentage amount applies to taxpayers with AGI greater than $183,000 but not greater than $400,000
  - If a taxpayer’s AGI is above $400,000, the 20% applicable credit percentage decreases by one percentage point for every $2,000 of additional AGI until it is completely phased out for taxpayers with AGI greater than $438,000

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II. Individual COVID Relief Efforts

5. Enhanced Child and Dependent Care Credit

- ***Increased Expense Limits***
- As a result of the new ARPA provisions, taxpayers with one qualifying individual and whose AGI is $125,000 or less can receive a maximum credit amount of $4,000 ($8,000 dollar expense limitation x 50% applicable credit percentage amount)
- Taxpayers with two or more qualifying individuals and whose AGI is $125,000 or less can receive a maximum credit amount of $8,000 ($16,000 dollar expense limitation x 50% applicable credit percentage amount)

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II. Individual COVID Relief Efforts

6. Premium Tax Credit

- The premium tax credit, often referred to as the “PTC,” is a refundable credit available to eligible taxpayers who purchase health insurance on the Health Insurance Marketplace
- Generally, the PTC is available to taxpayers with household income between 100% and 400% of the federal poverty line (FPL)
  - The PTC is limited to the excess of the premiums for the applicable benchmark plan covering the taxpayer’s family over the taxpayer’s contribution amount. This **contribution amount** is equal to the taxpayer’s household income multiplied by an applicable percentage based on the taxpayer’s income in relation to the federal poverty line
- ARPA changed the affordability percentages used for premium tax credits for 2021 and 2022 to **increase** credits for individuals eligible for assistance and provide credits for taxpayers with income *over* 400% of the FPL
  - All individuals with premiums **in excess of 8.5% of their household income** are eligible for the PTC in 2021 and 2022

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II. Individual COVID Relief Efforts

6. Premium Tax Credit

- Prior to ARPA, taxpayers who were enrolled in an exchange-purchased qualified health plan could receive an **advance** of the PTC, payable directly to the insurer
  - This advanced payment was an estimate based on information from prior year tax returns
  - Taxpayers were required to reconcile any advanced PTC payments received with the PTC for which they were actually eligible
  - If the taxpayer's advanced payments exceeded the calculated PTC, the excess would be assessed as an additional income tax subject to a repayment cap based on income
- For 2020, ARPA changed the repayment obligations for taxpayers receiving excess advance premium tax credits so such payments are not subject to recapture
- On April 9, 2021, the IRS released IR-2021-84, stating that taxpayers with excess advanced payments of the PTC were ***not required*** to file Form 8962, *Premium Tax Credit*, or report an excess advance PTC repayment on their 2020 Form 1040
  - Taxpayers claiming a net PTC were still required to file Form 8962 when filing their 2020 tax return
  - Taxpayers who reported and paid excess advance PTC on their 2020 tax returns before the ARPA legislation was signed into law are **not required** to file an amended return to receive a refund
- Lastly, ARPA provided advanced premium tax credits as if the taxpayer's income were no higher than 133% of the federal poverty line (FPL) for individuals receiving unemployment compensation
  - This provision increases the amount of a taxpayer's PTC and applies to tax years beginning after December 31, 2019 and before January 1, 2022

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II. Individual COVID Relief Efforts

7. Student Loan Discharges

- Generally, if a taxpayer receives cancellation of debt (COD) income, he or she must report it as taxable income on the tax return during the year the cancellation occurs
  - Although COD income is generally taxable, certain canceled debt is *specifically excluded* from taxable income
- ARPA expands the student loan debt exclusion to exclude from gross income certain partial or full discharges of student loans after December 31, 2020, and before January 1, 2026
- The expanded student loan discharge exclusion applies to:
  1) Private education loans
  2) Loans provided expressly for postsecondary educational expenses, regardless of whether provided through the educational institution or directly to the borrower, if such loan was made, insured, or guaranteed by the United States, a state or local governmental entity, or an eligible educational institution
  3) Loans made by an educational organization qualifying as a 50% charity
  4) Loans made by an educational organization qualifying as a 50% charity or by a tax-exempt organization to refinance a loan to an individual to assist the individual in attending any educational organization but only if the refinancing loan is under a program of the refinancing organization that is designed as described in bullet point (3) above
- If a student loan is discharged for any of these reasons, it will **not** result in discharge of indebtedness income to the borrower
  - The discharge of a loan made by either an educational institution or a private education lender is *not excluded* under the expanded ARPA rules if the discharge is on account of services performed for either the organization or for the private education lender

SURGENT ACCOUNTING & FINANCIAL EDUCATION

II. Individual COVID Relief Efforts
8. Student Loan Relief

- Traditionally, an employee's gross income does not include up to $5,250 of employer payments made under an educational assistance program for the employee's education
  - Under the CARES Act, employers can contribute up to **$5,250 annually** toward an employee's student loans, which were previously not considered educational payments
  - Eligible student loan repayments are payments by the employer, whether paid to the employee or a lender, of principal or interest on any qualified higher education loan
- The CAA 2021 extends the exclusion of employer payments of student loans from an employee's gross income through 2025

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II. Individual COVID Relief Efforts
9. FSA and Dependent Care Assistance

- The CAA 2021 made temporary changes to FSA rules
  - It provides that health and dependent care FSAs may carry over unused benefits *up to the full annual amount* from 2020 to 2021 and from 2021 to 2022
    - Notice 2021-26, released May 10, 2021, confirmed that amounts carried over to 2021 or 2022 or made available under an extended claims period are excluded from income if used by the participant for dependent care purposes
  - It provides a **12-month grace period** for any unused benefits or contributions for 2020 and 2021 plan years, meaning those who were terminated or otherwise ceased participation in a dependent care FSA could continue to apply unused FSA amounts
  - It *extends* the maximum age of eligible dependents for dependent care FSAs from age 12 to age 13 for the 2020 plan year, and any unused amounts from the 2020 plan year may be **carried over** to the 2021 plan year
  - It permits plans to make a **prospective change** in election amounts for health and dependent care FSAs for plan years ending in 2021
    - Prior to the CAA 2021 being enacted into law, an employee's FSA election was **irrevocable** for the entire plan year, unless there was a change in status

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II. Individual COVID Relief Efforts

9. FSA and Dependent Care Assistance

- A **Dependent Care Assistance Plan** (DCAP) allows an employee to be reimbursed for eligible dependent care expenses so that the employee and his or her spouse may work, look for work, or attend school full time
- The employer sets the minimum and maximum an employee contributes, subject to an annual limitation
  - Prior to ARPA, employer-provided contributions to FSAs for dependent care assistance were limited to $5,000 per year for married couples filing jointly, $2,500 for married couples filing separately
  - ARPA increases the dollar limit for employer-provided dependent care FSA contributions for tax year 2021 only to $10,500 for married couples filing jointly and $5,250 for married couples filing separately
  - Any employer-provided assistance above the annual maximum amounts is **included** in taxable income
  - Employers are ***not required*** to implement the increased limitations but are allowed to do so by the last day of the plan year

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II. Individual COVID Relief Efforts

10. COBRA Premium Subsidy

- In 1985, the **Consolidated Omnibus Budget Reconciliation Act (COBRA)** was established, providing workers who lose their health benefits with the right to continue group health benefits provided by their group health plan for limited periods of time under *extenuating circumstances* such as job loss, reduction in work hours, transition between jobs, death, divorce, or other life events
- Generally, employers who had 20 or more employees in the prior year and sponsor a group health plan are required to offer employees and their families the opportunity for a temporary extension of health coverage (called **continuation coverage**) in certain circumstances where the plan coverage would otherwise end
- COBRA coverage generally lasts for an 18-month period

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II. Individual COVID Relief Efforts

10. COBRA Premium Subsidy

- ARPA established that **Assistance Eligible Individuals (AEIs)** may receive a 100% subsidy for COBRA premiums paid during any period of COBRA coverage during the period beginning on April 1, 2021, and ending on September 30, 2021 (“**subsidy period**”)
  - In other words, ARPA provided up to **six months** of free COBRA coverage to AEIs during the subsidy period beginning on April 1, 2021
  - This subsidy is **non-taxable** to the AEI recipient
- An individual is considered an AEI if:
  1. He or she is enrolled in COBRA coverage during the subsidy period due to a qualifying event;
  2. He or she did not have a COBRA election in effect on April 1, 2021, but would be an AEI if he or she did; or
  3. He or she elected but discontinued COBRA coverage before April 1, 2021 and is still within his or her maximum period of coverage
  4. He or she was ***involuntarily terminated***. Individuals who voluntarily terminate their employment are **not** considered AEIs
- ARPA allowed AEIs who were not currently enrolled in COBRA as of April 1, 2021 to make a COBRA election during the period beginning on April 1, 2021 and ending 60 days after they are provided required notification of the extended election period
  - This **special extended election enrollment period** applies to AEIs described in points 2 and 3 on the prior slide
- AEIs who enrolled during the special enrollment period were eligible for the COBRA subsidy starting April 1, 2021 through the *earlier* of:
  1. The ending date of the AEI's original maximum period of coverage;
  2. The date the beneficiary becomes eligible for coverage under another group health plan or Medicare; or
  3. September 30, 2021

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II. Individual COVID Relief Efforts

10. COBRA Premium Subsidy

- Employers were ***required*** to take certain actions regarding the new COBRA premium subsidy, including:
  - Notifying all AEIs who were eligible to elect COBRA prior to April 1, 2021 about the subsidy and special enrollment period by May 31, 2021;
  - Updating the typical required COBRA paperwork provided to individuals who become AEIs to explain new ARPA rights; and
  - Notifying AEIs no less than 15, and no more than 45 days, before their subsidies end, unless the subsidy ends because the AEI has obtained other group health plan coverage
    - ***Note:*** The AEI is required to timely notify the plan administrator that he or she became eligible for other coverage. Failure to notify the plan administrator results in the AEI receiving **a $250 penalty**
- Employers were *permitted,* but **not** *required*, to allow AEIs to enroll in a different type of medical coverage than they previously had within 90 days from receiving the notice
  - The premiums for any newly elected coverage must have been equal to or less than the premiums for the coverage that the individual would have had at the time of the original COBRA qualifying event
- The new ARPA provisions applied to all group health plans that are subject to federal or state COBRA obligations

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II. Individual COVID Relief Efforts

12. Payroll Tax Executive Memorandum

- Per former President Trump's Executive Memorandum, issued on August 8, 2020, employers were able to **defer withholding of the employee share** of Social Security taxes from September 1, 2020, through December 31, 2020
  - The employee deferral applied to individuals with less than $4,000 in wages every two weeks, or an equivalent amount for other pay periods
  - The employee deferral was optional for most employers, but it was mandatory for federal employees and military service members
- Employers were to increase withholding and pay the deferred amounts ratably from wages and compensation paid between January 1, 2021, and April 30, 2021, with penalties and interest on the deferred unpaid tax liability beginning to accrue on May 1, 2021
- The CAA 2021 **extended** the timeframe to repay the deferred unpaid payroll tax liability **through December 31, 2021**. Penalties and interest on deferred unpaid tax liability will not begin to accrue until January 1, 2022

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II. Individual COVID Relief Efforts

12. Payroll Tax Executive Memorandum

- On March 10, 2021, the IRS issued a "COVID Tax Tip," providing guidance regarding how employers can pay any deferred payroll taxes pursuant to former President Trump's Executive Order
- Per the IRS guidance, employers can make employee deferral payments through the Electronic Federal Tax Payment System (EFTPS)
  - Employers should select the newly added "deferral payment" option as the tax type
  - After the employer selects deferral payment, they will enter the applicable tax period for the payment
  - If the employer chooses not to use EFTPS, they may make deferral payments using credit or debit card, check or money order, or electronic funds withdrawal
  - The IRS emphasizes that the deferral payments **must be made separately** from other payments, to ensure that they are correctly applied to the deferred payroll tax balance
    - Currently, the IRS's system will be unable to recognize the amount of the deferral payment if it is combined with any other tax payments or sent as a tax deposit
  - Lastly, the IRS states that if an employee whose Social Security tax was deferred no longer works for the employer, the employer is responsible for repayment of the *entire* deferred amount

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II. Individual COVID-19 Relief Efforts
13. Charitable Contributions

- Taxpayers may deduct up to $300 of cash contributions made to qualified charitable organizations as an above-the-line deduction if the taxpayer *does not* itemize deductions for tax years beginning after December 31, 2019
  - The $300 deduction was ***per return*** in 2020
  - The CAA 2021 extends the $300 above-the-line deduction through 2021. The maximum deduction amount is increased to $600 for married filing joint taxpayers beginning in 2021
- Prior to the CARES Act, taxpayers who **itemized** their returns were allowed a deduction on Schedule A for cash contributions made to certain qualified charitable organizations, up to 60% of their AGI
  - The CARES Act waives the 60% of AGI limit for cash charitable contributions made in 2020, and instead allows for cash charitable contributions of up to 100% of AGI. The CAA 2021 extends this limit through 2021

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III. Business COVID-19 Relief Efforts
1. FFCRA Emergency Family and Medical Leave Expansion Act

- The FFCRA established the Emergency Family and Medical Leave Expansion Act (EFMLEA) and the Emergency Paid Sick Leave Act (EPSLA), requiring certain employers to provide paid sick and family medical leave due to COVID-19
- Although mandatory EFMLEA and EPSLA leave has expired as of December 31, 2020, ARPA extended the credits for sick and family leave (discussed later) through September 30, 2021
  - Wages paid after September 30, 2021, may be qualified leave wages under ARPA, provided that the wages are paid with respect to leave taken by employees beginning on April 1, 2021, through September 30, 2021

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III. Business COVID-19 Relief Efforts

3. FFCRA Tax Credits for Paid Sick and Paid Family and Medical Leave

- To counter the costs associated with the FFCRA paid sick and family medical leave, employers are eligible for refundable tax credits
- A self-employed individual is eligible for the FFCRA credits if he or she would have been entitled to receive paid family or sick leave himself or herself under EFMLEA or EPSLA if the individual were an employee of an employer other than himself or herself
- Eligible employers are able to retain an amount of payroll taxes equal to the amount of qualifying sick and child care leave that they paid the affected employee, rather than depositing the amount with the IRS
- Employers cannot receive these credits if they are also receiving the payroll tax credit for paid family and medical leave under §45S

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III. Business COVID-19 Relief Efforts

3. FFCRA Tax Credits for Paid Sick and Paid Family and Medical Leave

- The CAA 2021 extended the FFCRA refundable payroll tax credits for paid sick and family leave through March 31, 2021, and ARPA further extended these credits through September 30, 2021
  - FFCRA mandatory leave provisions **were not extended** past December 31, 2020, meaning that employers are no longer required to provide EFMLEA or EPSLA leave
  - Employers who *voluntarily* offered such leave were able to take advantage of the FFCRA credits through September 30, 2021
  - Wages paid after September 30, 2021, may be qualified leave wages under ARPA, provided that the wages were paid with respect to leave taken by employees beginning on April 1, 2021, through September 30, 2021
- Employers had to report amounts of qualified sick and family leave wages paid to employees on either Form W-2, Box 14, or on a separate statement

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III. Business COVID-19 Relief Efforts

3. FFCRA Tax Credits for Paid Sick and Paid Family and Medical Leave

- In addition to extending the credits for paid sick and family leave through September 30, 2021, ARPA made other changes, including:
  - Increasing the amount of wages for which an employer may claim the paid family credit in a year from $10,000 to $12,000 per employee
  - Increasing the number of days for which a self-employed individual can claim the paid family leave credit from 50 days to 60 days
  - Permitting employers to be eligible for the paid sick and family leave credit if they provide employees paid time off to receive the COVID-19 vaccination or recover from an illness related to the immunization
  - Resetting the 10-day limitation on the maximum number of days for which an employer can claim the paid sick leave credit with respect to wages paid to an employee
    - In other words, ARPA provided employees with a new 10-day limit of employer paid sick leave, without regard to any paid sick leave used prior to April 1, 2021
  - Establishing a non-discrimination requirement, meaning no FFCRA credits would be permitted to an employer who discriminated by providing leave only to highly compensated individuals, full-time employees, or employees on the basis of employment tenure. In order to receive FFCRA credits, the employer had to offer leave to all employees
- The new ARPA provisions were effective April 1, 2021 through September 30, 2021

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- The CARES Act established a new program, called the **Paycheck Protection Program**, offering loans to small businesses, including any business, private nonprofit organization, or public nonprofit organization with less than 500 employees
- The *initial round* of PPP loan funding has ended
- The *second round* of PPP loans established by the CAA 2021 was open to **first-time borrowers** with 500 or fewer employees. Sole proprietors, not-for-profits, veterans organizations, tribal concerns, self-employed individuals, and independent contractors were also eligible first-time borrowers for a PPP loan
- Small business borrowers were eligible to apply for a **second** PPP loan, provided they met the following requirements:
  - Had 300 or fewer employees;
  - Experienced a decline in gross receipts of at least 25% during 2020 compared to the same quarter in 2019; and
  - Used or will use the full amount of the first PPP loan for authorized uses

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- Arguably the greatest benefit of the Paycheck Protection Program loans is that they can be **forgiven** if the proceeds were spent on eligible expenses, including at least 60% of such proceeds being spent on payroll costs
  - The borrower's loan forgiveness amount *may be reduced* if the borrower reduces its workforce during the covered period
  - If the payroll percentage is less than the 60% threshold, there is a proportionate reduction in loan forgiveness
- PPP borrowers may **deduct** expenses paid for with PPP loan proceeds
- Any amount of the loan that is forgiven and results in cancellation of debt income is ***specifically excluded*** from the borrower's income
  - In the case of an eligible recipient that is a partnership or S corporation, any amount excluded from income shall be treated as tax-exempt income for purposes of §705 and §1366
  - Except as provided by the Secretary of the Treasury, any increase in the adjusted basis of a partner's interest in a partnership under §705 shall equal the partner's distributive share of deductions resulting from costs giving rise to forgiveness

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- S corporations have a *positive basis adjustment* for forgiven PPP loan proceeds, since these proceeds are tax-exempt income
- Both taxable and tax-exempt income are *positive adjustments* to basis of S corporation shareholders
- Deductible expenses paid with the PPP loan proceeds *reduce* the shareholder's basis in stock
- If a shareholder took a distribution in 2020, the PPP loan year, the distribution *could be taxable* due to lack of basis in S corporation stock

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- Unlike S corporations, a partner in a partnership receives a *positive basis adjustment* for a PPP loan when the loan proceeds are received, equal to the partner's allocable share of the liability
- Section 752 provides that a PPP loan creates basis for the partners by each partner's allocable share of the PPP loan
- **No partner is personally liable for any portion of a PPP loan**, and as such, the §465 at-risk rules provide that the PPP loan amount is not at risk
- As a result, losses resulting from spending PPP loan proceeds are ***suspended*** due to lack of amounts at risk
- If a partner took distributions in 2020, the PPP loan year, the distribution *could be taxable* due to a reduction in the amount at risk for the partner

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- On April 22, 2021, the IRS issued Rev Proc. 2021-20, providing a **safe harbor** to taxpayers who received a PPP loan, and based on guidance prior to the enactment of COVIDTRA, did not deduct otherwise deductible expenses paid for with PPP loan proceeds during their taxable year ending after March 26, 2020, and on or before December 31, 2020, that resulted in, or were expected to result in, forgiveness of the PPP loan
- The safe harbor provided in this notice allows such taxpayer to elect to deduct these expenses on their timely filed original federal income tax return or information return, as applicable, for their *first taxable year following their 2020 taxable year* rather than filing an amended return or an AAR for their 2020 taxable year in which the expenses were paid or incurred

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III. Business COVID-19 Relief Efforts
4. Paycheck Protection Program

- In order to be eligible for the Rev Proc. 2021-20 safe harbor, the taxpayer must:
  - Be a **covered taxpayer**, defined as a taxpayer that:
    - Received an original PPP covered loan,
    - Paid or incurred original eligible expenses during their 2020 taxable year,
    - On or before December 27, 2020, timely filed, including extensions, a federal income tax return or information return, as applicable, for the taxpayer's 2020 taxable year; and
    - On the taxpayer's federal income tax return or information return, as applicable, the taxpayer did not deduct the original eligible expenses because:
      - The expenses resulted in forgiveness of the original PPP loan; or
      - The taxpayer reasonably expected at the end of the 2020 taxable year that the expenses would result in such forgiveness
  - Make the election by the **election deadline**, by attaching a statement to their timely filed, including extensions, federal income tax return or information return, as applicable, for the first taxable year following their 2020 taxable year in which the original eligible expenses were paid or incurred
    - The statement must contain certain information, such as a list detailing the descriptions and amounts of the original eligible expenses paid or incurred by the taxpayer during their 2020 taxable year

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III. Business COVID-19 Relief Efforts
4. Paycheck Protection Program

- On November 18, 2021, the IRS issued three revenue procedures, providing long-awaited guidance on certain PPP loan issues
- Rev Proc. 2021-48 addresses the timing and reporting of PPP loan forgiveness. Specifically, Rev. Proc. 2021-48 provides that taxpayers may treat tax-exempt income in connection with the forgiveness of PPP loans as received or accrued:
  - As eligible expenses are paid or incurred. Taxpayers who relied on the Rev. Proc. 2021-20 safe harbor will be treated as if they paid eligible expenses in the tax year following the year in which the expenses were actually paid;
  - When an application for PPP loan forgiveness is filed; or
  - When PPP loan forgiveness is granted
- Rev. Proc. 2021-48 is effective for any taxable year in which a taxpayer paid or incurred eligible expenses, any taxable year in which the taxpayer applied for forgiveness of a PPP Loan, or any taxable year in which the taxpayer's PPP Loan forgiveness is granted

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- Rev. Proc. 2021-48 provides that if a taxpayer receives PPP loan forgiveness for an amount *less than* what was previously treated as tax-exempt income, such taxpayer must make adjustments on an amended return or AAR as applicable for the taxable year(s) in which the taxpayer treated tax-exempt income from the forgiveness of such PPP loan as received or accrued
- Similarly, partners and shareholders that receive amended Forms K-1 must file amended returns, information returns, or AARs, as applicable, consistent with the Forms K-1 received

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- Rev. Proc. 2021-49 provides guidance for partnerships and consolidated groups regarding tax-exempt income and deductions related to PPP loan forgiveness
- If a partnership received a PPP loan and received partial or complete forgiveness of such PPP loan, the IRS will treat the taxpayer's allocation of tax-exempt income from PPP loan forgiveness and allocation of deductions in accordance with §704(b)
- Under §705(a), partners *increase* their basis by their distributive share of PPP tax-exempt income and *decrease* their basis by their distributive share of deductions

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- In light of the changes caused by Rev. Proc. 2021-48 and Rev. Proc. 2021-49, Rev. Proc. 2021-50 permits partnerships subject to the centralized partnership audit regime to file amended partnership returns and furnish amended Schedules K-1 in lieu of filing an AAR
- This relief is eligible for tax years ending after March 27,2020 and before the issuance of Rev. Proc. 2021-50
  - The amended return must be filed, and Schedules K-1 must be furnished, on or before December 31, 2021

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- On July 28, 2021, the SBA issued a final interim rule, streamlining the forgiveness process for second draw PPP loans of $150,000 or less for which a lender has not issued a loan forgiveness decision
- The new interim final rule established an online platform as an alternative form of revenue reduction confirmation for borrowers of second draw PPP loans of $150,000 or less who did not submit documentation of revenue reduction at the time of the loan application
  - An independent third-party SBA contractor developed a **COVID Revenue Reduction Score** based on a variety of inputs including industry, geography, and business size. The platform will assign a COVID Revenue Reduction Score to each second draw PPP loan borrower with loans $150,000 or less
    - Lenders will be able to see this score on the online platform, and they will be able to use this score as an optional alternative to document revenue reduction
    - If the borrower’s COVID Revenue Reduction Score meets or ***exceeds*** the value required for validation of revenue reduction, it will satisfy the requirement for the borrower to document revenue reduction
    - If the borrower’s COVID Revenue Reduction Score ***does not meet*** the value required for validation of revenue reduction, and the borrower has not provided documentation to the lender to validate revenue reduction, the borrower must either provide documentation directly to the lender or upload such information to the online platform

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III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- Additionally, the new interim final regulations directed the SBA to implement a direct borrower forgiveness process for PPP lenders, integrating the streamlined forgiveness application for loans of $150,000 or less. This platform will serve as a single secure location for borrowers with loans of $150,000 or less to apply for forgiveness
  - Lenders will receive notification when a borrower has applied for forgiveness, and lenders will review the loan forgiveness application on the platform and have the ability to issue a forgiveness decision to the SBA within the platform
- During the transition period after the launch of the direct borrower forgiveness process, lenders that opt-in to the platform must finish processing forgiveness applications already submitted by borrowers, and they must inform such borrowers not to submit a duplicate loan forgiveness application through the platform
- After the launch of the direct borrower forgiveness process, borrowers will still be able to submit loan forgiveness applications to their lenders rather than through the platform, provided any of the following circumstances apply:
  - The PPP lender did not opt-in to use the direct borrower forgiveness process;
  - The borrower's PPP loan amount was greater than $150,000;
  - The borrower does not agree with the SBA's data on record or cannot validate their entity in the platform; or
  - The borrower's submission is rejected for any other reason

III. Business COVID-19 Relief Efforts

4. Paycheck Protection Program

- The PPP Direct Borrower Forgiveness Portal officially launched on August 4, 2021. Since that time, ***over one million PPP loan forgiveness applications*** were submitted to the portal for borrowers seeking forgiveness of loans $150,000 or less
  - This represents roughly 91% of all 2020 PPP loans eligible for direct forgiveness, with over 1,400 lenders participating in the program
  - Approximately 65% of all 2021 PPP loans eligible for direct forgiveness have been submitted to the PPP Direct Borrower Forgiveness Portal
- Borrowers can complete and submit their SBA applications to the PPP Direct Borrower Forgiveness Portal using their smartphone
- It takes roughly six minutes for borrowers to complete and submit their forgiveness applications using the portal
- The forgiveness decision is usually made within a week from the submission date

III. Business COVID-19 Relief Efforts

5. Economic Injury Disaster Loans ("EIDLs")

- **Economic Injury Disaster Loans** ("EIDLs") are SBA's disaster assistance loans
- The CARES Act established initial EIDL loans, providing borrowers with a **$10,000 emergency advance** within 3 days of submitting the application. This advance is not required to be repaid
- The initial EIDL loans were available through December 31, 2020
- The CAA 2021 allocated an additional $20 billion for EIDL grants
- The additional EIDL funding was available to covered entities that:
  - Are located in a low-income community;
  - Suffered an economic loss of at least 30%; and
  - Employ 300 employees or fewer
- If a covered entity previously received an EIDL grant through the CARES Act, the maximum grant they were eligible to receive is the difference between $10,000 and the amount previously received
- The CAA 2021 repealed the requirement that PPP borrowers deduct the amount of any EIDL advance from their PPP forgiveness amount

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III. Business COVID-19 Relief Efforts

5. Economic Injury Disaster Loans ("EIDLs")

- ARPA allocated an additional $15 billion in aid for the EIDL program, including $10 billion to the Targeted EIDL Advance program and $5 billion for the new Supplemental Targeted EIDL Advance program
- Businesses that received a previous EIDL advance in an amount *less than* $10,000 had **first priority** to receive a Targeted EIDL advance
  - These businesses may only apply when they receive an invite from the SBA
- The **second priority** group included any businesses and nonprofit organizations that applied for EIDL assistance prior to December 27, 2020 but did not receive an EIDL advance due to exhausted funding
- Under the new ***Supplemental Targeted EIDL Advance program***, businesses with 10 or fewer employees were eligible to receive supplemental payments of $5,000 if they suffered economic losses of more than 50% during the covered period

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III. Business COVID-19 Relief Efforts

5. Economic Injury Disaster Loans ("EIDLs")

- On September 9, 2021, the SBA announced new changes to the COVID EIDL Program for small businesses impacted by the COVID-19 pandemic and ongoing Delta variant. Major changes to the EIDL Program include:
  - **Increasing the maximum EIDL amount from $500,000 to $2,000,000**: These funds can be used for expenses such as payroll, operating expenses, working capital, paying debt, and purchasing equipment
  - **Implementing a Deferred Payment Period**: Borrowers may defer repayment of the COVID EIDL until two years after the loan origination date
  - **Establishing a 30-Day Exclusivity Window**: There will be a 30-day exclusivity window of approving and disbursing funds for loans of $500,000 or less. Any approval or disbursement of loans over $500,000 will occur after the initial 30-day exclusivity window, on October 8, 2021
  - **Expanding the Eligible Use of Funds**: Borrowers may use the COVID EIDL for additional purposes, such as to prepay commercial debt and pay federal business debt
  - **Simplifying Affiliation Requirements**: The COVID application process will have more simplified affiliation requirements

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III. Business COVID-19 Relief Efforts

5. Economic Injury Disaster Loans ("EIDLs")

- Under the COVID-19 EIDL Program, borrowers seeking loans of $25,000 or less will pay **no fees** if applying directly through the SBA, and **no collateral** is required
- Loans greater than $25,000 will have certain fees associated with them and will require collateral
- Personal guaranty is required for loans greater than $200,000
- These loans will have a term of 30 years at a fixed rate of 3.75% for business and 2.75% for private nonprofit organizations
- There is no penalty for prepayment

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III. Business COVID-19 Relief Efforts

6. Restaurant Revitalization Fund (RRF) Grants

- ARPA provided additional relief to struggling restaurant businesses by allocating $28.6 billion for **Restaurant Revitalization Grants** to be administered by the SBA
  - The funding was divided into government-funded grants with a maximum of $10 million per restaurant group or $5 million per individual restaurant location
  - Of the $28.6 billion of funding, $5 billion was allocated specifically to provide RRFs to businesses with 2019 gross receipts of less than $500,000
- The Restaurant Revitalization Grants can be used for certain purposes, including payroll costs, rent, utilities, mortgage payments, supplies, maintenance expenses, food and beverage expenses, operational expenses, covered supplier costs, paid sick leave, and any other expense determined to be essential to maintaining the business
  - If funds are used for eligible expenses by March 11, 2023, the recipient is not required to repay the grant
  - If the business **fails** to use the grant funds on these allowable expenses, the grant funds must be **returned** to the SBA
  - If the business goes out of business prior to using all of the grant funds or fails to use all of the grant funds before December 31, 2021 or within two years of March 11, 2021, the entity must **return** the grant funds to the SBA
- There was an unprecedented amount of demand for the RRF grants, and as a result, the SBA closed the RRF program as of July 2, 2021. It is possible that Congress will replenish the RRF through future legislation due to ongoing demand

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- The CARES Act created a refundable **employee retention credit** for employers subject to closure due to COVID-19
  - Under the CARES Act, the ERTC was equal to 50% of qualified wages, up to $10,000, for qualified wages paid or incurred after March 12, 2020 and before January 1, 2021
    - In other words, the ERTC was worth up to $5,000 per employee in 2020
- The Consolidated Appropriations Act of 2021 (CAA 2021) **extended** the ERTC through June 30, 2021 and implemented other changes related to the ERTC, including:
  - Increasing the credit from 50 percent to **70 percent** of qualified wages in 2021
  - Expanding the credit eligibility threshold for "the significant decline in gross receipts" from a 50-percent decline in year-over-year gross receipts to a 20-percent decline in year-over-year gross receipts
    - It establishes a **safe harbor**, allowing employers to use prior quarter gross receipts to determine eligibility

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- ***CAA 2021 Updates Cont'd:***
- Increasing the wage limit on a per-employee basis from $10,000 per year to **$10,000 per quarter in 2021**
  - (i.e., $10,000 for the first quarter of 2021 and $10,000 for the second quarter of 2021)
- Increasing the 100 or fewer employee wage base to 500 or fewer employees
- Removing the 30-day wage limitation and allowing employers to claim the credit on bonus pay to essential workers
- Allowing businesses with 500 or fewer employees to **advance the credit** at any point during the quarter based on wages paid in the same quarter in a previous year
- Allowing certain employers who were **not in existence** for all or part of 2019 to claim the credit
- Allowing all wages of employers with 500 or fewer full-time-equivalent employees to qualify

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- **ARPA** originally extended the ERTC from June 30, 2021 through December 31, 2021, and implemented the following provisions:
- Maintained the credit at **70 percent** of qualified wages in 2021
- Maintained the wage limit on a per-employee basis of **$10,000 per quarter** in 2021
- Established that the ERTC in any calendar quarter *may not exceed* the applicable employment taxes, reduced by any credits allowed under §§3131 and 3132 for qualified sick leave and family leave, on the wages paid with respect to the employment of all the employees of the eligible employer
  - However, if the amount of the ERTC exceeded this limitation for any calendar quarter, the excess was treated as an overpayment and was refunded to the employer under IRC §§6402 and 6413

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III. Business COVID-19 Relief Efforts
7. Employee Retention Tax Credit

- ***ARPA Provisions Cont'd:***
  - Created a limitation for the credit for **recovery startup businesses**, defined as employers who: (i) began operations after February 15, 2020; (ii) who have average annual gross receipts for a three-taxable-year period ending with the taxable year which precedes such quarter not in excess of $1,000,000; and (iii) is not otherwise an eligible employer due to a full or partial suspension of operations or a decline in gross receipts
- Such recovery startup businesses are limited to a credit of **$50,000 per calendar quarter for each of the third and fourth calendar quarters of 2021**. Businesses that meet the definition of a recovery startup business are neither required to meet the gross receipts test nor have been subject to a government shutdown in order to claim the credit
  - **Note**: The determination of whether an employer is a recovery startup business is made separately for each calendar quarter

III. Business COVID-19 Relief Efforts
7. Employee Retention Tax Credit

- ***ARPA Provisions Cont'd:***
- Provided special rules for **severely financially distressed employers**, defined as an employer who has suffered a decline in quarterly gross receipts of *90% or more* compared to the same calendar quarter in 2019 (or 2020 if the employer did not exist in 2019)
  - These financially distressed employers are able to treat **all wages paid** during those quarters (subject to the limitation) as qualified wages, rather than only wages paid to employees when they do not provide services
  - Additionally, Notice 2021-49 clarified that employers may claim the ERTC for qualified wages paid in the same quarter the credit is being claimed
- Created a new provision for employers not in existence in 2019 by allowing such employers to define qualified wages by substituting 2019 with 2020

III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- The Infrastructure Investment and Jobs Act (IIJA), signed into law on November 15, 2021, **terminated** the ERTC as of September 30, 2021
  - As discussed, the ERTC was originally intended to run through December 31, 2021
  - Recovery Startup Businesses are *exempt* from this provision and can continue to take the Employee Retention Tax Credit through December 31, 2021
- As a result of this change, the maximum ERTC per employee in 2021 is $21,000 ($10,000 wage limitation per quarter x 70% credit x 3 quarters), instead of $28,000
- The IRS issued Notice 2021-65, clarifying that employers that reduced deposits on or before Dec. 20, 2021, for wages paid during the fourth calendar quarter of 2021 in anticipation of the ERTC, will not be subject to a failure to deposit penalty with respect to the retained deposits, provided that:
  - The employer reduced deposits in anticipation of the ERTC consistent with the rules provided in Notice 2021-24;
  - The employer deposits the amounts initially retained in anticipation of the ERTC on or before the relevant due date for wages paid on December 31, 2021; and
  - The employer reports the tax liability resulting from the termination of the employer's ERTC on the applicable employment tax return or schedule that includes the period from October 1, 2021, through December 31, 2021
- Notice 2021-65 also clarifies that employers who are no longer eligible for the ERTC in the fourth quarter of 2021 but received advance payments for fourth quarter wages of 2021 will avoid failure to pay penalties if they repay such amounts by the due date of their applicable employment tax return that includes the fourth calendar quarter of 2021

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- Prior to Rev. Proc. 2021-33, it was uncertain whether PPP loan forgiveness in 2021 was required to be included in gross receipts when measuring a 20% decline for ERTC purposes
- Rev. Proc. 2021-33 created a safe harbor, clarifying that the following amounts may be ***excluded*** in calculating gross receipts for purposes of the ERTC:
  - Forgiveness of a Paycheck Protection Program Loan;
  - Shuttered Venue Operators Grants under the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act; and
  - Restaurant Revitalization Grants under the American Rescue Plan Act of 2021
- Rev. Proc. 2021-33 requires employers to apply the safe harbor consistently for determining eligibility for the ERTC
- An employer is not required to apply this safe harbor, and the safe harbor does not permit the exclusion of these amounts from gross receipts for any other federal tax purpose

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- A "**significant decline of gross receipts**" is determined to have occurred in **2020** by identifying the first calendar quarter in 2020 (if any) in which an employer's gross receipts are less than 50% of its gross receipts for the same calendar quarter in 2019
  - The period during which there is a significant decline in gross receipts ends with the earlier of January 1, 2021, or the calendar quarter that follows the first calendar quarter in which the employer's 2020 quarterly gross receipts are *greater than 80%* of its gross receipts for the same calendar quarter in 2019
- A "**significant decline of gross receipts**" is determined to have occurred in **2021** by identifying a decline of at least 20% of the employer's gross receipts when compared to the same calendar quarter in 2019
  - Alternately, the employer can use the previous quarter's gross receipts compared to the same quarter in 2019
  - The determination of whether an employer is an eligible employer based on a decline in gross receipts is made separately for each calendar quarter

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- On April 2, 2021, the IRS issued an advance version of Notice 2021-23, detailing how employers could take advantage of the ERTC in 2021
  - In 2020, there were **no restrictions** on claiming the ERTC in advance nor a maximum amount of credit advance that could be obtained
- **All** employers could claim the ERTC in the first and second quarters of 2021 prior to filing their employment tax returns by reducing employment tax deposits in anticipation of the employee retention credit
- However, only **small eligible employers** could elect to receive an *advance payment* of the ERTC in an amount not to exceed 70 percent of the average quarterly wages paid in calendar year 2019. This is also referred to as "**the 70 percent advance rule**"
  - **Small eligible employers** are defined as employers with an average of 500 or less full-time employees in 2019
  - For purposes of the 70 percent advance rule, "**average quarterly wages**" is the average of wages or compensation determined without regard to the Social Security wage base, paid in each calendar quarter in 2019
  - Small eligible employers were still required to reduce deposits in anticipation of the ERTC before requesting an advance

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- The CARES Act initially provided that an eligible employer that received a PPP loan would not be eligible for the ERTC
  - The CAA 2021 *retroactively amended* the CARES Act and provided that employers who receive a PPP loan are still eligible to claim the ERTC for wages paid for funds other than those used to obtain PPP loan forgiveness
    - The same is true if the business used funds forgiven under another recovery relief provision, such as a restaurant revitalization grant
  - Notice 2021-20 provided guidance, stating that employers can elect out of claiming the ERTC so that the wages can count towards PPP loan forgiveness

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- Per Notice 2021-20, an eligible employer generally makes the election by not claiming the ERTC for those qualified wages on Form 941
  - Notice 2021-20 is taxpayer friendly in that it allows the taxpayer to pick and choose which wages are reported on the PPP forgiveness application
- Additionally, an eligible employer that received a PPP loan is deemed to have made the election for the amount of qualified wages included in the amount reported as payroll costs on the PPP loan forgiveness application, up to (but not exceeding) the **minimum amount** of payroll costs, together with any other eligible expenses reported on the PPP Loan Forgiveness Application
- An eligible employer is *not deemed to have made an election* for any qualified wages paid by the eligible employer that are not included in the payroll costs reported on the PPP Loan Forgiveness Application
- The ERTC *does not apply* to the qualified wages for which the election or deemed election is made

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- Lastly, Notice 2021-20 clarifies that if an eligible employer reports any qualified wages as payroll costs on a PPP Loan Forgiveness Application, but the loan amount is **not forgiven**, those qualified wages may be considered for purposes of the ERTC
- If an eligible employer obtains forgiveness of only a portion of the PPP loan amount, then the employer is deemed to have made an election for the **minimum amount** of qualified wages included in the payroll costs reported on the PPP Loan Forgiveness Application *necessary to obtain the forgiveness* of that amount of the PPP loan
- If a taxpayer qualified for the ERTC in 2020 and did not claim the ERTC on its original Form 941, the taxpayer can file a Form 941-X for each qualifying quarter

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III. Business COVID-19 Relief Efforts

7. Employee Retention Tax Credit

- The IRS issued Notice 2021-49 on August 4, 2021, clarifying many aspects regarding the ERTC, but also creating a predicament for many majority owners of corporations
- Per the Notice, any wages paid to a majority owner or his or her spouse are not eligible for the ERTC due to attribution rules if they have any living related family members, including:
  - A child or a descendant of a child;
  - A brother, sister, stepbrother, or stepsister;
  - A father or mother, or an ancestor of either;
  - A stepfather or stepmother;
  - A niece or nephew;
  - An aunt or uncle; or
  - A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law
- In other words, wages paid to a majority owner of a corporation will only be considered qualified wages for purposes of the ERTC if such majority owner has no living family relatives

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III. Business COVID-19 Relief Efforts

8. Charitable Contributions

- Corporate charitable contribution deductions cannot exceed 10% of taxable income prior to the contribution or any dividends received deduction
  - Similar to individuals, if a corporation has charitable contributions in excess of the 10% limit, the excess is allowed as a charitable contribution deduction over the next five years
- The CARES Act **temporarily increases** the 10% corporate limitation to 25% for contributions made in 2020
  - CAA 2021 extends the corporate limitation of 25% through 2021
- The CARES Act also increases the limitation for contributions of food inventory from 15% to 25% of taxable income
- The CARES Act does not specify that charitable contributions must be made for COVID-19 relief efforts, so the taxpayer may choose to take advantage of higher percentage limitations to **any qualified** charity of its choosing

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III. Business COVID-19 Relief Efforts

9. Payroll Tax Deferral

- The CARES Act allows employers and self-employed individuals to **defer payment** of the employer share of the payroll tax that they are otherwise responsible for paying to the federal government with respect to their employees
- The deferred payment must be paid over the following two years:
  - Half of the total deferred payment is to be paid by December 31, 2021;
  - The remaining half of the deferred payment is to be paid by December 31, 2022
- Any taxpayer who has SBA Paycheck Protection Program loan indebtedness forgiven through the CARES Act is eligible for payroll tax deferral

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III. Business COVID-19 Relief Efforts

10. Modification of NOL Carryback

- The TCJA provided that NOL carryovers were allowed for a taxable year up to the lesser of the carryover amount or 80 percent of taxable income determined without regard to the deduction for NOLs. NOL carrybacks of post-2017 tax years were eliminated
- The CARES Act amended the TCJA and allowed NOLs arising in a tax year beginning after December 31, 2017 and before January 1, 2021 to be **carried back to each of the five tax years** preceding the tax year of such loss
  - NOL carryforwards provide a future tax benefit, contingent upon future income for the NOL deduction to offset
  - NOL carrybacks provide an **immediate** benefit to taxpayers

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III. Business COVID-19 Relief Efforts

10. Modification of NOL Carryback

- The CARES Act also temporarily suspended the taxable income limitation in the TCJA to allow an NOL to **fully offset** income for taxable years beginning before 2021
  - For taxable years beginning before 2021, taxpayers were eligible for an NOL deduction equal to 100% of taxable income
  - For taxable years beginning after 2021, the taxpayer will be eligible for a 100% deduction of NOLs arising in tax years prior to 2018 and will be eligible for a deduction limited to 80% of modified taxable income for NOLs arising in tax years after 2017

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III. Business COVID-19 Relief Efforts

10. Modification of NOL Carryback

NOL Generated in Tax Years	Eligible for Carryback	Eligible for Carryforward	Eligible to Offset % of Taxable Income
Beginning on or before 12/31/17	2 tax years	20 tax years	• 100% of taxable income
2018-2020	5 tax years	Indefinite	• 100% of taxable income prior to 2021 • 80% of taxable income after 2020
2021 and beyond	Generally no carryback	Indefinite	• 80% of taxable income

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III. Business COVID-19 Relief Efforts

10. Modification of NOL Carryback

- A taxpayer had the option to elect to forgo the 5-year carryback of NOLs arising in tax years beginning in 2018 and 2019
  - Per Notice 2020-24, taxpayers could make the election by preparing a statement stating, “Taxpayer is electing to apply section 172(b)(3) under Rev. Proc. 2020-24 for [tax year]”
  - The election was required to have been made by the due date (including extensions) for filing the taxpayer’s return for the first tax year ending after March 27, 2020, the date the CARES Act was signed into law
  - The election statement can be made for either or both tax years, but the election to forgo the 5-year NOL carryback period is irrevocable

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III. Business COVID-19 Relief Efforts

11. Modification of Excess Business Losses

- For taxable years beginning after December 31, 2017 and before January 1, 2026, the TCJA provided that "excess business losses" of a taxpayer other than a corporation are not allowed for the taxable year. ARPA extends this provision for one year, to include tax years beginning before January 1, 2027
  - An "excess business loss" is defined as the excess of aggregate deductions of the taxpayer attributable to trades or businesses over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount ($250,000 for individuals or $500,000 for joint filers, as not indexed for inflation)
- The CARES Act temporarily modified the loss limitation for noncorporate taxpayers set forth in the TCJA and allows them to deduct excess business losses arising in a tax year beginning after December 31, 2017 and before January 1, 2021
- As a result, taxpayers who had a limited loss in either 2018 or 2019 could file an amended return and receive a refund
  - Taxpayers who had large losses in 2018 or 2019 resulting from the TCJA's 100% bonus depreciation provision would especially benefit from the CARES Act excess business loss modification, as they may be able to deduct these large losses that would otherwise be limited

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III. Business COVID-19 Relief Efforts

12. Modification of 163(j)

- TCJA §2306(a) amended §163(j) to reflect a limitation on the deduction for business interest expense for certain taxpayers in tax years beginning after 2017
  - Per the TCJA rules, if §163(j) applies to a business, an interest expense deduction is allowed for the tax year limited to the sum of business interest income, 30% of the adjusted taxable income ("ATI"), and floor plan financing interest expense
  - Any amount of business interest expense that was not allowed as a deduction under §163(j) for the tax year was carried forward to the following year as a disallowed business interest expense carryforward that could be carried forward indefinitely
- The CARES Act temporarily amended the TCJA §163(j) limitation by ***retroactively increasing*** the limitation on the deductibility of interest expense from 30% to 50% for tax years beginning after December 31, 2018 and before January 1, 2021
- In the event that the business did not have taxable income in 2020, such business could elect to use its 2019 adjusted taxable income in computing its 2020 limitation

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

12. Modification of 163(j)

- The CARES Act provided a special carve out rule for partnerships so that a partnership may not use the increased limitation in 2019, thereby deferring any potential benefits from the 50% threshold to 2020
- Any interest disallowed at the partner level was treated under applicable 2019 law
  - The 50% suspended interest frees up in 2020 and become fully deductible
  - The remaining 50% is suspended until the partnership allocates interest income or excess taxable income to the partner
- A partnership could elect, at the partnership level, to use 2019 adjusted taxable income (ATI) in computing its 2020 limitation. Partnerships could also elect out of §163(j) at the partnership level

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III. Business COVID-19 Relief Efforts

13. Qualified Improvement Property Technical Correction

- Qualified improvement property ("QIP") is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service
- The TCJA did not reflect the intended 15-year recovery period for QIP due to a drafting error, and instead assigned it a tax life of 39 years
  - As such, QIP was ineligible for bonus depreciation as it was not considered 15-year property
- The CARES Act reclassifies QIP as 15-year property (20-year ADS life) and allows businesses to **immediately** write off costs associated with QIP instead of depreciating the improvements over a 39-year life
- The CARES Act QIP fix is effective for property placed in service after December 31, 2017

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

13. Qualified Improvement Property Technical Correction

- On September 21, 2020, the IRS and Department of Treasury released the second round of §168(k) bonus depreciation final regulations (T.D. 9916), addressing the CARES Act QIP fix
  - The CARES Act stated that the improvement must be "made by the taxpayer"
  - The final regulations clarify that an improvement is made by a taxpayer if the taxpayer makes, manufactures, constructs, or produces the improvement for itself, or if the improvement is made, manufactured, constructed, or produced for the taxpayer by another person under a written contract
  - If a taxpayer acquired nonresidential property in a taxable transaction, and such property had an existing improvement placed in service by the seller, the existing improvement is **not** considered to have been made by the taxpayer

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

14. Business Meals Deduction

- The CAA 2021 ***temporarily increases*** the 50% limit on the business meals deduction to 100%
- To qualify for the increased deduction, expenses must be paid or incurred in 2021 and 2022 for business meal food and beverage expenses, including delivery and carry-out meals, **provided by a restaurant**
- Final §274 regulations confirm that the food and beverage expenses include the full cost of the meal, including any delivery fees, sales tax, or tips

SURGENT ACCOUNTING & FINANCIAL EDUCATION

III. Business COVID-19 Relief Efforts

14. Business Meals Deduction

- On April 8, 2021, the IRS issued Notice 2021-25, clarifying when the increased 100% deduction applies
- Notice 2021-25 defines a "**restaurant**" as "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises"
- A restaurant *does not include* a business "that primarily sells pre-packaged food or beverages not for immediate consumption, such as a grocery store; specialty food store; beer, wine, or liquor store; drug store; convenience store; newsstand; or a vending machine or kiosk"
  - For such businesses, a 50% deduction continues to apply
- Lastly, Notice 2021-25 clarifies that an employer *may not* treat as a restaurant:
  - An eating facility located on the business premises of the employer and used in furnishing meals excluded from an employee's gross income; or,
  - Any employer-operated eating facility treated as a de minimis fringe benefit, even if such eating facility is operated by a third party under contract with the employer

III. Business COVID-19 Relief Efforts

15. Executive Compensation

- Prior to ARPA, the deduction for executive compensation was capped at $1 million for certain covered employees of publicly traded companies, including the CEO, CFO, and next three highest compensated officers
- ARPA modifies §162(m) by capping the deduction at $1 million for *the next five highest-paid employees* in addition to the CEO, CFO, and next three highest compensated officers
  - These next five highest-paid employees are to be determined on an **annual basis**
- As a result of this new modification, companies with highly paid non-officer employees may be subject to a disallowed deduction
- This provision takes effect in 2027, providing companies with adequate time to prepare for the change

Chapter 2

Miscellaneous Practice and Reporting Issues

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

1. Introduction to Cryptocurrency and Key Terms

- ***Virtual Currency*** is defined by the IRS as "a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value"
  - ***Convertible Virtual Currency*** is virtual currency that has an equivalent value in real, tangible currency
- ***Cryptocurrency*** is a specific type of virtual currency that uses "cryptography" to validate and secure transactions that are digitally recorded on a distributed ledger or record keeper

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
1. Introduction to Cryptocurrency and Key Terms

- A ***Blockchain*** is a type of virtual currency that uses “cryptography” to validate and secure transactions that are digitally recorded on a distributed ledger or record keeper
  - Individual ***blocks*** make up the blockchain and contain information about transactions including the date, time, and dollar amount of the transaction
  - Individual ***blocks*** also contain information about the parties participating in the transaction via unique digital signatures
  - A single ***block*** can hold up to a few thousand transactions

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
1. Introduction to Cryptocurrency and Key Terms

- Cryptocurrency transactions are ***pseudonymous*** and not connected to individual identities. One cannot easily connect the identity of a user with an address or transaction
- Each transaction must be confirmed by a ***miner*** who solves a cryptologic puzzle in order to validate the transaction
  - Once a miner successfully solves the cryptologic puzzle and confirms the transaction, he or she is rewarded with a specific amount of cryptocurrency. This is an incentive for solving the problem and verifying the transaction
  - The entire legitimacy of the cryptocurrency network depends on the underlying blockchain

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

1. Introduction to Cryptocurrency and Key Terms

- In order to send or receive cryptocurrency, an individual must have a ***wallet.*** The wallet stores the individual's public, and possibly private, keys that are used to send or receive cryptocurrency
  - The **public key** provides a public address that is capable of receiving cryptocurrency transactions, and acts as the spot where funds are deposited
  - The corresponding **private key** is unique to an individual user. Without the private key, the individual won't be able to withdraw any cryptocurrency
- Unlike a traditional wallet that one uses to hold cash or credit cards, the cryptocurrency wallet does not hold the actual cryptocurrency. The cryptocurrency is stored and maintained on the blockchain

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

2. Chronology of Cryptocurrency

- In January 2009, Satoshi Nakamoto (pseudonym) launched the first units of virtual cryptocurrency, called ***Bitcoins***
- Nakamoto created the Bitcoin to create digital cash on a **decentralized network**
  - Cryptography and the underlying math problems secure the network
- In November 2019, the IRS discussed virtual currency for the first time, posting on their website that virtual currency transactions could potentially be considered taxable income or gain

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

2. Chronology of Cryptocurrency

- Throughout 2012, major companies such as Microsoft, Expedia, and Newegg began to accept payment in Bitcoin, legitimizing cryptocurrency as having real, tangible value
- In May 2013, the GAO issued its first report on cryptocurrency, indicating the various ways that virtual currency exchange could produce taxable income

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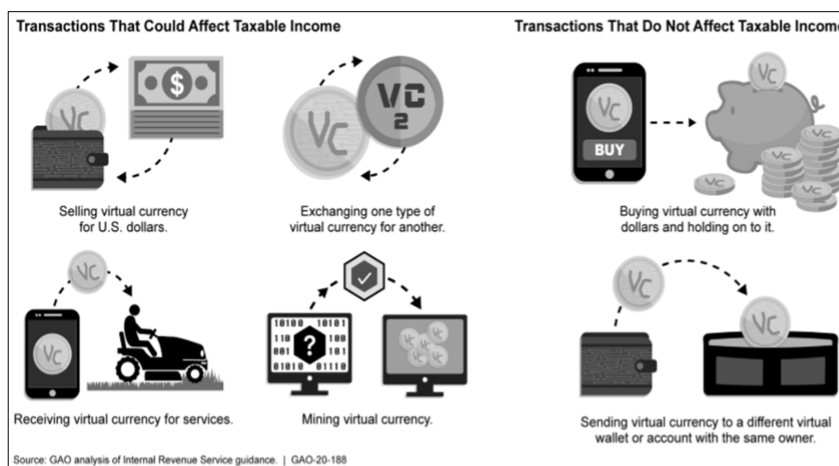
I. Advanced Practice Issues

2. Chronology of Cryptocurrency



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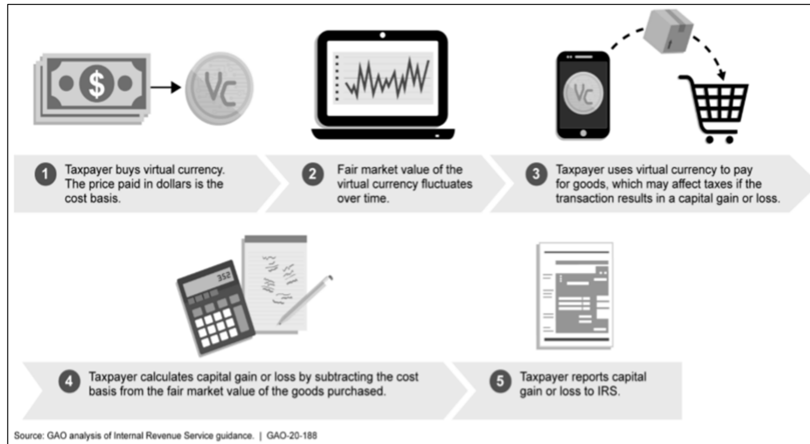
I. Advanced Practice Issues

2. Chronology of Cryptocurrency



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I. Advanced Practice Issues

2. Chronology of Cryptocurrency

- In March 2014, the IRS issued Notice 2014-21 in the form of a FAQ document for taxpayers
- Established cryptocurrency as ***property*** for federal tax purposes, and as such is subject to general tax principles applicable to property transactions
  - As such, it is critical for individuals to track the underlying basis of each unit of cryptocurrency in order to correctly calculate any potential gain or loss triggered upon sale or transfer

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
2. Chronology of Cryptocurrency

- In November 2016, the IRS became involved in the prolific "Coinbase" court case. The IRS was granted permission to serve a "John Doe" administrative summons on Coinbase, Inc. (Coinbase)
  - A "John Doe" summons is a request that does not specifically identify any one person, but rather a group or class of person(s) based on their activities
  - The Court allowed the IRS to obtain information on any U.S. person who was involved in virtual currency transactions between 1/1/2013 and 12/31/2015 in excess of $20,000 (USD equivalent) in any one transaction, who was not issued a Form 1099-K, and whose identity was already known by the IRS
  - More than 14,000 Coinbase customers were involved in transactions in excess of $20,000 during the time period in question, but only around 800-900 of these customers reported the information to the IRS. Ultimately, Coinbase complied with the request, and in March 2018 notified the customers in question that they would be turning over information to the IRS

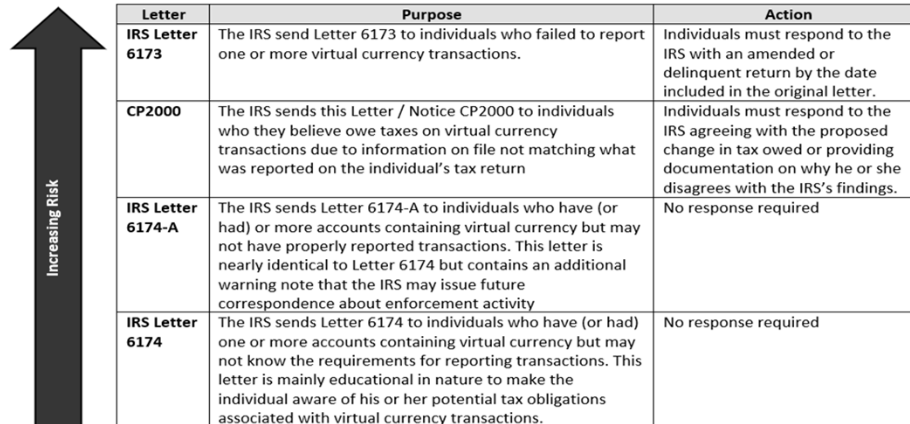
I. Advanced Practice Issues
2. Chronology of Cryptocurrency

- In July of 2018, the IRS's Large Business and International Division announced a *Virtual Currency Compliance* campaign addressing virtual currency noncompliance and urged taxpayers to correct their returns and report previously unreported virtual currency, as the IRS would **not** create a voluntary disclosure program for such transactions
- In July 2019, the IRS announced that it has begun sending letters to taxpayers who completed virtual currency transactions but potentially failed to report income and pay the resulting tax from virtual currency transactions or did not report their transactions properly for tax years 2013 through 2017
  - By the end of August 2019, more than 10,000 taxpayers received these letters
    - As a result of sending these letters, the IRS reported that taxpayers filed amended returns and reported virtual currency transactions for the tax years in question, resulting in more than $13.1 million in assessments

I. Advanced Practice Issues

2. Chronology of Cryptocurrency

- There are four variations of IRS correspondence: Letter 6173, Notice CP2000, Letter 6174, or Letter 6174-A



Letter	Purpose	Action
IRS Letter 6173	The IRS send Letter 6173 to individuals who failed to report one or more virtual currency transactions.	Individuals must respond to the IRS with an amended or delinquent return by the date included in the original letter.
CP2000	The IRS sends this Letter / Notice CP2000 to individuals who they believe owe taxes on virtual currency transactions due to information on file not matching what was reported on the individual's tax return	Individuals must respond to the IRS agreeing with the proposed change in tax owed or providing documentation on why he or she disagrees with the IRS's findings.
IRS Letter 6174-A	The IRS sends Letter 6174-A to individuals who have (or had) or more accounts containing virtual currency but may not have properly reported transactions. This letter is nearly identical to Letter 6174 but contains an additional warning note that the IRS may issue future correspondence about enforcement activity	No response required
IRS Letter 6174	The IRS sends Letter 6174 to individuals who have (or had) one or more accounts containing virtual currency but may not know the requirements for reporting transactions. This letter is mainly educational in nature to make the individual aware of his or her potential tax obligations associated with virtual currency transactions.	No response required

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

A. Virtual Currency Update

- ***Letter 6173***

  - This form of the letter requires a response by the taxpayer. The heading includes a "respond by" date; however, the taxpayer may send a request for a 30-day extension.

- ***Notice CP2000***

  - This notice requires a response by the taxpayer.
  - The taxpayer must agree with the IRS's proposed change in tax owed or provide documentation on why he or she disagrees with the IRS's findings.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
A. Virtual Currency Update

- ***Letters 6174 and 6174-A***

- Taxpayer does not need to respond to these letters.
- The difference in the two letters is one additional sentence **added to the 6174-A letter**……:
  - ***Note, however, we may send other correspondence about potential enforcement activity in the future.***
- Read into that additional sentence? Forewarned is Forearmed.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
A. Virtual Currency Update

- Taxpayers who do not properly report the income tax consequences of virtual currency transactions are, when appropriate, liable for tax, penalties, and interest
- In some cases, taxpayers could be subject to criminal prosecution

Caution:

Not to insinuate all cases qualify; however, practitioners must remember virtual currency is an ongoing focus area for IRS Criminal Investigation. **Should practitioners find themselves dealing with a Criminal Investigation case**, **they should seek proper legal counsel**.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

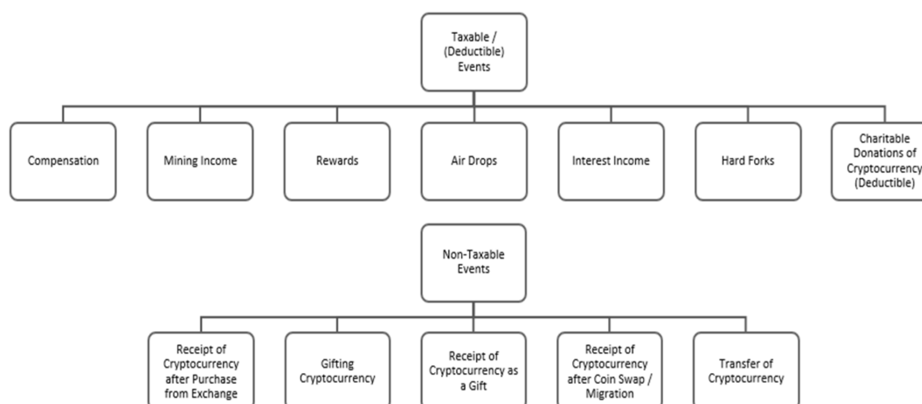
2. Chronology of Cryptocurrency

- On October 9, 2019, breaking nearly five years of silence, the IRS released additional guidance on the tax treatment of virtual currency and reporting obligations. The "Frequently Asked Questions" addresses 45 common questions about cryptocurrency transactions, such as gain/loss recognition, basis, and recordkeeping
- Revenue Ruling 2019-24 addresses the tax treatment of cryptocurrency "hard forks" and "airdrops," and distinguishes that not every hard fork should be treated as an airdrop
- Notice 2014-21 and Revenue Ruling 2019-24 established that cryptocurrency is subject to taxation
- In a broad sense, cryptocurrency can be taxed as either capital gain/loss or ordinary income/loss

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation



SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- Unlike certain stock market investors who are issued a 1099-B for tax reporting purposes, there is very little regulation in the cryptocurrency community
  - Some US taxpayers may receive a 1099-K, *Payment Card and Third Party Network Transactions*, from an exchange
  - ARPA amended the de minimis threshold for Form 1099-K reporting. Through December 31, 2021, a two-step de minimis standard exists, in which Third Party Settlement Organizations are required to report third party network transactions of a participating payee on Form 1099-K if:
    - The amount that would otherwise be reported exceeds $20,000; and
    - There were over 200 transactions

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- ARPA amends the two-step de minimis standard and instead creates a single standard with a **single $600 reporting threshold beginning in 2022**. In other words, beginning on January 1, 2022, Third Party Settlement Organizations will be required to file a Form 1099-K for participating payees receiving over $600
  - This new change mirrors the Form 1099-MISC and Form 1099-NEC reporting requirements for payments of compensation of $600 or more
- For purposes of this change, a reportable payment transaction is any payment card transaction and any third-party network transaction
- Transactions meeting the $600 aggregate payment de minimis standard **must be reported to all payees** who accept payment from a third-party settlement organization

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- Although only a small portion of the population currently receives a Form 1099-K for their cryptocurrency activity, many more taxpayers could receive this form beginning in 2023
- Taxpayers who receive a 1099-K have an ***increased risk*** of receiving a CP2000 Notice from the IRS
  - As discussed earlier, a CP2000 Notice is sent to taxpayers when the information the IRS has on file does not match the information reported on an individual's tax return
- Other exchanges, such as Coinbase, issue Form 1099-MISC to certain individuals
  - Starting in tax year 2020, Coinbase stated that they would issue Form 1099-MISC instead of Form 1099-K to certain U.S. customers who earned $600 or more in cryptocurrency in 2020. Prior to this change, Coinbase sent Form 1099-K to certain customers

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Compensation**
  - As with any other form of compensation, any individual who receives compensation in the form of cryptocurrency must include the compensation on Form 1040, taxed at ordinary rates
  - This applies to both employees (W-2), contractors (Form 1099), or any other individual receiving compensation
  - Even if the employer does not issue a W-2 or Form 1099, the individual receiving compensation in the form of cryptocurrency must report it at the FMV at the time of receipt

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Mining Income**
- Cryptocurrency miners verify and authenticate cryptocurrency transactions in exchange for cryptocurrency
  - **Professional miners** conduct mining activity as part of a §162 trade or business. Professional miners must include the FMV of the mined cryptocurrency as part of their ordinary income. Additionally, as with any §162 trade or business, professional miners can deduct mining-related expenses on Schedule C
  - **Hobby miners** may mine cryptocurrency in their spare time, but it is not their main source of income. Hobby miners must include the FMV of the mined cryptocurrency in their gross income. Since the hobby does not rise to the level of a §162 trade or business, hobby miners cannot deduct mining-related expenses

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Rewards**
- Staking rewards are earned by individuals who hold a cryptocurrency for a specified period of time
- The individual who earns a staking reward should include the FMV of the cryptocurrency reward at the time of receipt in their taxable income
- Similarly, if an individual receives a “reward” in the form of cryptocurrency while shopping on an online platform, the individual should err on the side of caution (no clear IRS guidance exists) and include the FMV of the cryptocurrency reward received in taxable income

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
5. Virtual Currency Taxation

- **Airdrops**
- The IRS guidance (Rev. Rul. 2019-24) confirms that individuals are liable for taxes on cryptocurrencies resulting from an airdrop, regardless of whether or not the cryptocurrency is actually received
- Airdrops occur when a company distributes cryptocurrency to an individual's wallet, usually free of charge, to promote a new cryptocurrency or draw awareness
  - Sometimes airdrops are unsolicited, and other times individuals may complete small tasks (like sending a tweet) in exchange for the airdrop
- The IRS defines an airdrop as "a means of distributing units of a cryptocurrency to the distributed ledger addresses of multiple taxpayers"
- Individuals should recognize ordinary income at the FMV of the airdropped cryptocurrency at time of receipt

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
5. Virtual Currency Taxation

- **Interest Income**
- Some cryptocurrency platforms allow users to generate interest income on the cryptocurrency held
- Individuals receiving interest income should report the amount as interest income on Form 1040

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Hard Fork**
- Similar to how computers require software updates or phones require app updates, cryptocurrency networks also require updates in order to improve performance and resolve any known issues
- This "update" is often referred to as a "**fork**" in the cryptocurrency community. Forks arise when there are two different blocks in the same blockchain that have an identical set of blocks preceding it

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Hard Fork**
- In Rev. Rul. 2019-24, the IRS defines a "hard fork" as "unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. Following a hard fork, transactions involving the new cryptocurrency are recorded on the new distributed ledger and transactions involving the legacy cryptocurrency continue to be recorded on the legacy distributed ledger"

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Hard Fork**
- Hard forks arise if a software or network update is not backwards-compatible with the previous non-updated software
- If buyer A purchases 100 units of cryptocurrency X using non-updated software, the transaction would not be recognized by the updated software. Similarly, if buyer A purchases 100 units of cryptocurrency X using updated software, the transaction would not be recognized by the non-updated software
- In the event a hard fork results in the creation of a new cryptocurrency, all transactions involving the old ("legacy") cryptocurrency remain recorded on the legacy cryptocurrency ledger, but all new cryptocurrency transactions are recorded on the new cryptocurrency ledger

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Hard Fork**
- Sometimes an airdrop occurs after the hard fork, distributing the new cryptocurrency to the individual who owned the original ("legacy") cryptocurrency
- The IRS clarifies that if an individual receives an airdrop of new cryptocurrency resulting from a hard fork and has complete control over the new cryptocurrency, the individual must include the FMV of the new cryptocurrency in ordinary income
- If an individual does not receive units of a new cryptocurrency through an airdrop following a hard fork, there is ***no*** taxable event

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
5. Virtual Currency Taxation

- **Hard Fork**
- Revenue Ruling 2019-24 outlined a scenario in which an airdrop followed a hard fork, but this caused some confusion amidst the cryptocurrency community, as airdrops do not always follow hard forks
- A legal memorandum, released by the IRS on April 9, 2021, clarified that "the specific means by which the new cryptocurrency is distributed or otherwise made available to a taxpayer following a hard fork does not affect the Revenue Ruling's holding"

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
5. Virtual Currency Taxation

- **Charitable Donations of Cryptocurrency**
- An individual who donates cryptocurrency to a qualified charitable organization will not recognize income, gain, or loss from the donation
- If the individual held the cryptocurrency for more than a year, the amount of the charitable deduction is equal to the FMV of the cryptocurrency at the time of donation
- If the individual held the cryptocurrency for less than a year, the amount of the charitable deduction is equal to the lesser of the basis in the cryptocurrency or the FMV of the cryptocurrency at the time of donation

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Crowdsourcing**
- An IRS legal memorandum, dated June 29 and released August 28, states that taxpayers who receive convertible virtual currency in exchange for performing a **microtask** through a crowdsourcing platform have received consideration that is taxable as ordinary income
- Crowdsourcing involves outsourcing various assignments, usually small tasks, to a large group of individuals
- Examples of microtasks include processing data, reviewing images, downloading apps and leaving positive reviews, downloading games to unlock a certain level, completing online surveys or quizzes, and registering accounts with various service providers

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Receipt of Cryptocurrency after Purchase from Exchange**
- If an individual purchases a cryptocurrency on an exchange, it is **not** a taxable event. However, this purchase will be helpful for calculating basis

- **Gifting Cryptocurrency**
- The gifting of cryptocurrency is **not** a taxable event

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Receipt of Cryptocurrency as a Gift**
- Receiving cryptocurrency as a gift does **not** constitute a taxable event
- The recipient must note the FMV of the cryptocurrency on the date the gift was made as well as the donor’s basis in the gifted cryptocurrency. These items are critical for future basis calculations

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

5. Virtual Currency Taxation

- **Receipt of Cryptocurrency after Coin Swap / Migration**
- Coin swaps function similarly to stock splits and thus are **not** considered a taxable event. However, the individual should allocate basis among the new coins in order to properly calculate basis going forward

- **Transfer of Cryptocurrency**
- The transfer of cryptocurrency between exchanges or wallets is not a taxable event

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I. Advanced Practice Issues

5. Virtual Currency Taxation

- Below is a table summarizing some of the forms and schedules that taxpayers involved with cryptocurrency should consider when reviewing cryptocurrency compliance obligations

Cryptocurrency Compliance

Form 1040	Schedule 1	Schedule A	Schedule B	Schedule C	Schedule D	Form 8949

• "Check the box" question on page 1 of Form 1040
• Report Ordinary Income (Wages / Compensation)
  • Line 1
• Report Capital Gains / Losses
  • Line 6
	• Report Ordinary Income (Other Income)
	  • Line 8
		• Report Charitable Deductions of cryptocurrency donations
		  • Line 12
			• Report Interest Income
			  • Part I
			• Report Rewards (Staking)
			  • Part I
				• Report income generated as part of §162 trade or business
				  • Line 1
				• Deduct any expenses associated with §162 trade or business
				  • Part 2
					• Summarize cryptocurrency Capital Gains / Losses from Form 8949	• Report cryptocurrency gains and losses

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I. Advanced Practice Issues

6. IRS Form 1040 – Virtual Currency Question

- The 2020 IRS Form 1040 included an update to the cryptocurrency question. Instead of including the "check the box" question on Form 1040, Schedule 1, the Form 1040 for 2020 incorporated the cryptocurrency question at the **top of page one**
- The wording of the question is unchanged, but its new placement at the beginning of Form 1040 under the name and address field indicates that the IRS has an ***increased focus*** on cryptocurrency activities
- Not all taxpayers are required to file Schedule 1, so by moving the cryptocurrency question to page one of the 1040, **all taxpayers** will be required to disclose whether they engaged in a transaction involving cryptocurrency

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I. Advanced Practice Issues

6. IRS Form 1040 – Virtual Currency Question

- The virtual currency question remains on page 1 of the 2021 draft Form 1040, but the wording of the question has changed
  - The 2020 Form 1040 virtual currency question asked, ***"At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in virtual currency?"***
  - The draft 2021 Form 1040 slightly modified this question, asking ***"At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency?"***
- The new question posed on the draft 2021 Form 1040 focuses on taxable transactions and provides that if a taxpayer purchased a virtual currency with real currency and had no other virtual currency transactions during the year, he or she is not required to answer yes to the Form 1040 question
  - Similarly, the 2021 virtual currency question does not ask about "sending" virtual currency

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I. Advanced Practice Issues

7. Cryptocurrency Like-Kind Exchange Treatment

- The IRS released a legal memorandum on June 8, 2021 (ILM 202124008), clarifying whether certain exchanges of cryptocurrency qualified for §1031 like-kind exchange treatment
- Specifically, the legal memorandum addresses the following question: ***"If completed prior to January 1, 2018, does an exchange of (i) Bitcoin for Ether; (ii) Bitcoin for Litecoin; or (iii) Ether for Litecoin qualify as a like-kind exchange under §1031 of the Code?"***
  - **Short Answer: No**
- Per IRC §1031(a)(1), "No gain or loss may be recognized on the exchange of property held for productive use in a trade or business or for investment if such real property is exchanged solely for real property of like kind which is to be held either for productive use in a trade or business or for investment"

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I. Advanced Practice Issues

7. Cryptocurrency Like-Kind Exchange Treatment

- Essentially, under a §1031 like-kind exchange, the taxpayer's economic situation prior to and after the exchange is the same. Like-kind property is similar in nature or character, and as a result, different classes of property *cannot* be exchanged in a §1031 exchange
  - Prior to the TCJA, §1031 like-kind exchange treatment could apply to the exchange of personal property, but since the enactment of the TCJA, it only applies to exchanges of real property held for use in a trade or business
- In 2016 and 2017, Bitcoin and Ether were considered to be *substantially different* from other types of cryptocurrencies, such as Litecoin, as referenced in the legal memorandum
  - If an individual was interested in investing in Litecoin, they likely had to first acquire Bitcoin or Ether
  - If an individual was interested in liquidating their Litecoin holdings, they likely had to first exchange the Litecoin for either Bitcoin or Ether
  - As such, the IRS determined that both Bitcoin and Ether were ***fundamentally different*** from Litecoin, and therefore, **neither** Bitcoin and Litecoin nor Ether and Litecoin qualify as like-kind property for purposes of §1031

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I. Advanced Practice Issues

7. Cryptocurrency Like-Kind Exchange Treatment

- Additionally, both Bitcoin and Ether differ from each other in that the Bitcoin network is a payment network where Bitcoin essentially acts as a unit of payment; whereas the Ethereum network acts as a payment network and platform for other applications, with Ether being the "fuel" for these features
- Both Bitcoin and Ether can be used for payment purposes, but Ether offers *additional functionality features*, and as such, Bitcoin and Ether are not considered like-kind property for purposes of §1031
- The chief counsel advice rendered in ILM 202124008 only applies to an exchange of Bitcoin for Ether, Bitcoin for Litecoin, or Ether for Litecoin, and may not be used or cited as precedent

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I. Advanced Practice Issues
Harper v. Rettig

- Various court cases have begun to arise as a result of the Coinbase lawsuit
- James Harper filed a lawsuit on July 15, 2020 with the U.S. District Court for the District of New Hampshire, stating that his constitutional rights were violated when the IRS likely obtained his account information via John Doe summonses issued to Coinbase, Abra, and Uphold
- Harper opened his first account with Coinbase in 2013 and deposited virtual currency that he received in exchange for consulting services. Harper declared this consulting income on his tax returns
- Harper also liquidated virtual currency through Abra and Uphold from 2016 through present day. In 2016, 2017, 2018, and 2019, Harper declared capital gains for his virtual currency holdings and paid applicable taxes

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I. Advanced Practice Issues
Harper v. Rettig

- On August 9, 2019, Harper received a “Reporting Virtual Currency Transactions” letter from the IRS, stating that the IRS had information that Harper held one or more accounts containing virtual currency but may not have properly reported such transactions
- The letter also stated that if Harper did not accurately report his virtual currency transactions, he may be subject to civil and criminal enforcement activity
- As of August 9, 2019, Harper had no virtual currency records on any exchange besides Abra, Coinbase, and Uphold

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
Harper v. Rettig

- Harper claims that he accurately reported and paid taxes on all virtual currency transactions for the applicable years in question
  - He argues that the IRS *lacked any particularized suspicion* that he violated any law prior to obtaining the financial records referenced in the letter
  - Harper claims that he never received any notice of third-party summons from the IRS
- Under 26 U.S.C. §7602(a), the IRS has the statutory authority to issue administrative summonses "for the purposes of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or . . . collecting any such liability"
  - If the IRS exercises this authority, it must notify the taxpayer of the summons

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
Harper v. Rettig

- Section 7609(f) states that in the case of a John Doe summons, the summons is not valid unless and until it is authorized by a judicial officer after a hearing. In such case, it must be established that:
  - The summons relates to the investigation of a particular person or ascertainable group or class of persons;
  - There is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and
  - The information sought to be obtained from the examination of the records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources

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I. Advanced Practice Issues
Harper v. Rettig

- Harper asserts that his fourth amendment right to be protected against unreasonable search and seizure was **violated**, as he had a reasonable expectation of privacy in the financial records held by Abra, Coinbase, and Uphold
- Harper also asserts that his fifth amendment right of due process under the law was **violated**, as his information was seized prior to providing him notice and opportunity to challenge the seizure of property
- Harper claims that unless the IRS expunges his information, they are *unlawfully holding his information*

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
Harper v. Rettig

- In December 2020, the Department of Justice (DOJ) filed a motion to dismiss Harper's lawsuit, citing *lack of jurisdiction* and that the complaint *failed to state a claim on which relief could be granted*
  - The DOJ stated that there is a lack of jurisdiction, as Harper's complaint is essentially a lawsuit against the United States for which there has been no waiver of sovereign immunity
  - The DOJ asserted that the lawsuit is barred by the Anti-Injunction Act under §7421. Under this provision, interfering with the IRS's information gathering process by ordering the IRS to destroy information is barred. The DOJ stated that Harper's lawsuit would impede the IRS's information gathering process if the case proceeded

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
Harper v. Rettig

- On March 23, 2020, Judge Joseph DiClerico in the District of New Hampshire granted a motion to **dismiss** the case
  - Judge DiClerico stated that Harper’s suit is **barred** by the Anti-Injunction Act
  - Remember – Harper claimed that he already paid the IRS all applicable taxes on his cryptocurrency holdings and argued that the IRS said he may have additional tax liability
    - Judge DiClerico responded that “Harper's argument that his proposed injunction and declaratory judgment are not aimed at restraining the assessment or collection of taxes is incorrect.”
- This decision was a blow to many taxpayers who hold cryptocurrency, as they likely will have little recourse going forward if their information is provided to the IRS in response to a subpoena or request for information

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I. Advanced Practice Issues
The Ongoing Saga of John Doe

- The IRS is ramping up their cryptocurrency compliance efforts through the use of **“John Doe” summonses**, similar to the initial Coinbase John Doe summons
- On March 30, 2021, the United States government filed a petition asking the United States District Court for the Northern District of California to authorize an IRS John Doe summons
  - The John Doe summons would collect cryptocurrency transaction information from the cryptocurrency exchange “**Kraken**” for account holders who completed transactions of **at least $20,000 in value** between the period January 1, 2016 through December 31, 2020
  - The IRS asserted that there is a **reasonable basis** to believe that the taxpayers being investigated have failed, or potentially have failed, to comply with U.S. internal revenue laws regarding the reporting of income from cryptocurrency transactions

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I. Advanced Practice Issues

The Ongoing Saga of John Doe

- On March 31, 2021, the Court responded to the summons and stated that the request was "too broad," requesting the IRS to file a *tailored version* of its request by April 14, 2021
- On April 1, 2021, the United States District Court for the District of Massachusetts authorized the IRS to serve a John Doe summons to **Circle Internet Financial**, a cryptocurrency exchange
  - The John Doe summons will collect information regarding individuals who completed cryptocurrency transactions of *at least $20,000* in any one year, for the period beginning January 1, 2016 through December 31, 2020

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I. Advanced Practice Issues

The Ongoing Saga of John Doe

- The Circle Internet Financial John Doe summons used the same arguments presented in the Kraken John Doe summons request but resulted in a much different outcome
  - The Massachusetts district court found that the IRS met the requirements for the John Doe summons, whereas the California district court required the request to be more narrowly tailored
- While these district courts may not have reached the same conclusion, it is clear to conclude that the IRS is ***increasingly seeking out cryptocurrency noncompliance***
- One can expect such John Doe summonses to become more common in the future, as the IRS looks for ways to identify taxpayers who are not properly reporting cryptocurrency income

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues

Virtual Currency Taxation – Operation Hidden Treasure

- ***The IRS is on the hunt for buried treasure!***
- The IRS created "**Operation Hidden Treasure**," a joint effort between the IRS Criminal Investigation Division and the IRS Office of Fraud Enforcement (OFE)
- The main goal of this initiative is to seek out **fraud** and uncover **omitted income** related to cryptocurrency
- The IRS trained 200 employees across all business divisions to address noncompliance related to cryptocurrency. Through this training, the employees became knowledgeable about cryptocurrency and how to spot issues when examining returns
  - These employees are **in addition** to the in-house experts in the OFE and IRS Criminal Investigation Division

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I. Advanced Practice Issues

Virtual Currency Taxation – Operation Hidden Treasure

- One goal of the Operation Hidden Treasure initiative is to determine whether there is a ***common, recognizable tax evasion pattern*** amongst cryptocurrency holders
  - An example of this is **structuring** a series of transactions, each under $10,000, to avoid reporting requirements
- The OFE plans to create a **virtual currency network** to assist with tracking cryptocurrency basis and computing gain
  - This network will not only help train IRS employees, but also generate insightful data about cryptocurrency transactions

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I. Advanced Practice Issues

Virtual Currency Taxation – Operation Hidden Treasure

- As part of a civil effort, the Criminal Investigation Division will investigate cryptocurrency transactions that may be occurring on the dark web
  - Such transactions could be used to hide assets or income or possibly be used in *illegal transactions*
  - Officials are concerned that terrorists, counterfeiters, money launderers, criminals, and scammers, are using virtual currency as part of money laundering schemes
- A 2020 Crypto Crime Report estimated that 1% of overall convertible virtual currency transaction volume in 2019, or $10 billion, was for illicit activities
- Other figures released by FinCEN indicate that approximately $119 billion in suspicious and potentially illicit activities took place through convertible virtual currency transactions, representing approximately 11.9% of the total CVC transaction volume in 2019

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I. Advanced Practice Issues

Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- On December 18, 2020, the US Financial Crimes Enforcement Network (FinCEN) issued a **Notice of Proposed Rulemaking**, which would require exchanges or banks to ***submit reports, keep records, and verify the identity of customers*** in relation to transactions above certain thresholds involving convertible virtual currency (CVC) or legal tender digital asset (LTDA) wallets not hosted by a financial institution (unhosted wallets), or CVC/LTDA wallets hosted by a financial institution in certain jurisdictions identified by FinCEN
  - CVC is a **medium of exchange**, such as a cryptocurrency, that either has an equivalent value as currency, or acts as a substitute for currency, but lacks legal tender status

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I. Advanced Practice Issues

Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- The proposed rulemaking would mandate verification, recordkeeping, and reporting requirements for certain exchanges, withdrawals, deposits, or transfers of LTDA or CVC by a bank or money services business, or to a bank or money services business, that use an **unhosted or "otherwise covered wallet."**
  - An "**otherwise covered wallet**" is defined as a wallet held at a financial institution that is not subject to the BSA and is located in certain foreign jurisdictions that are of primary money laundering concern, such as Iran, Burma, and North Korea
- Under the proposed rulemaking, banks and money services businesses would be required **to file a report** with FinCEN that contains information about the customer's CVC or LTDA transaction, including the counterparty's name and physical address

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I. Advanced Practice Issues

Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- As part of this report, the bank or money services business would also have to *verify the identity of their customer if the transaction is greater than $10,000* (or the transaction is one of multiple CVC transactions involving the counterparty wallets and the customer occurring within a 24-hour period that total more than $10,000) *and the counterparty used an unhosted or otherwise covered wallet*
  - Such banks or money services businesses would have **15 days** from the date in which the reportable transaction occurred to file the report with FinCEN

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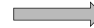
Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- Secondly, under the proposed rulemaking, the bank or money services business would be required to **keep records of a customer's CVC or LTDA transaction and counterparty**, including the verification of their customer's identity if a counterparty used an unhosted or otherwise covered wallet if the transaction was *greater than $3,000*
- The required information to be collected includes:
  - The name and address of the financial institution's customer;
  - The type of CVC or LTDA used in the transaction;
  - The amount of CVC or LTDA in the transaction;
  - The time of the transaction;
  - The assessed value of the transaction, in U.S. Dollars, based on the prevailing exchange rate at the time of the transaction;
  - Any payment instructions received from the financial institution's customer;
  - The name and physical address of each counterparty to the transaction of the financial institution's customer;



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I. Advanced Practice Issues

Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- ***Cont'd***
- The required information to be collected includes:
  - Other counterparty information the Secretary may prescribe as mandatory on the reporting form for transactions subject to reporting pursuant to §1010.316(b);
  - Any other information that uniquely identifies the transaction, the accounts, and to the extent reasonably available, the parties involved; and
  - Any form relating to the transaction that is completed or signed by the financial institution's customer
- In addition to the proposed rulemaking, on December 31, 2020, FinCEN issued Notice 2020-2, stating that they intended to propose to amend the regulations implementing the BSA regarding reports of foreign financial accounts (FBAR) to include virtual currency as **a type of reportable account**

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I. Advanced Practice Issues

Virtual Currency Taxation – FinCEN Proposed Rulemaking & Notice 2020-2

- Under current law, a United States person, including a citizen, resident, corporation, partnership, LLC, trust, or estate, must file an FBAR if:
  1. They hold a financial interest in, or signature authority over, at least one financial account located outside of the U.S.; and
  2. The aggregate value of those foreign financial accounts exceeded $10,000 at any time during the calendar year reported
- If enacted, individuals who fail to properly report their cryptocurrency holdings will face **potential civil monetary or criminal penalties**, including up to $12,921 in penalties for non-willful violations and up to $129,210 or 50% of the account balance for willful violations

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I. Advanced Practice Issues

B. State of the IRS: Operations During COVID-19

- The COVID-19 pandemic initially struck in the middle of the IRS's busiest time of year – filing season
  - A typical IRS filing season lasts between January through mid-April, as during this time period, many individuals and businesses contact the IRS with any tax questions and subsequently file their tax returns
- TIGTA prepared a report detailing the results of the 2020 filing season and impacts of COVID-19 on IRS operations
- Numerous IRS sites closed in late March and early April of 2020 and reopened months later in early to late June 2020
  - While many employees were able to telework, it is important to note that much of the work performed at the IRS processing centers is **not conducive to a telework environment**, such as receiving and sorting returns, processing paper tax returns, and corresponding with taxpayers

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
B. State of the IRS: Operations During COVID-19

- Since reopening the IRS Tax Processing Centers, the IRS has faced continued backlog. This figure (right) provides estimates of work remaining to be processed as of the weeks ending in May 2020, November 2020, and December 2019

Type of Work Remaining	Week Ending May 23, 2020	Week Ending November 14, 2020	Prior Year Week Ending December 28, 2019
Unopened Mail Volumes	10,276,573	2,964,216	*Not Available*
Paper Tax Returns — Individual	10,070,000	4,702,000	183,000
Error Resolution — Individual	1,535,229	601,917	24,621
Rejects — Individual	1,110,332	1,681,994	121,397
Unpostables — Individual	585,457	1,195,850	193,536
Accounts Management — Individual and Business (Adjustments)	1,176,723	1,471,862	1,263,397

Source: IRS Filing Season Statistics, Mail Receipts, and Accounts Management Inventory Reports for the weeks ending December 28, 2019; May 23, 2020; and November 14, 2020.

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I. Advanced Practice Issues
B. State of the IRS: Operations During COVID-19

- A much larger amount of work remained to be processed as of the end of 2020 compared to the end of 2019
- As of November 14, 2020, almost 3 million pieces of mail remained unopened
  - Per the TIGTA report, this unopened mail includes tax returns, payments, taxpayer correspondence, and mail that was returned as undeliverable. Additionally, nearly 5 million paper tax returns still had to be processed as of November 14, 2020
- Although the Tax Processing Centers opened as of June 2020, they were not always able to operate at full capacity due to social distancing requirements and workers remaining on weather and safety leave if they were at high risk for severe illness from COVID-19

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I. Advanced Practice Issues

B. State of the IRS: Operations During COVID-19

- As of November 2020, approximately 78% of all IRS workers were working either at the Tax Processing Center or teleworking, while the remaining 22% of IRS workers remained on weather and safety leave
- In an effort to reduce backlogs, the IRS ***incentivized*** workers to return to key service areas, such as mail sorting, by offering incentive pay
  - The IRS offered overtime to all employees
  - The IRS also plans on hiring additional employees in 2021 to assist with the backlog

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I. Advanced Practice Issues

B. State of the IRS: Operations During COVID-19

- In addition to the backlog from the 2020 tax filing season, the IRS announced a delayed start to the 2021 tax filing season
  - Traditionally, the IRS begins processing tax returns in late January; however, the IRS announced that 2021 tax filing season would begin on February 12, 2021
  - The delayed tax filing season start date was not a result of prior year backlog, but rather the result of additional time needed for programming and testing of IRS systems following the CAA 2021 legislative provisions, including the EIP2
  - The IRS was **unable** to adjust its forms and systems for certain CAA 2021 provisions prior to the beginning of filing season, including corrections to the recovery rebate credit and verification of the 2019 lookback election for the EITC or ACTC
    - These items are being manually processed by the IRS's Error Resolution System (ERS) unit, resulting in refund delays for impacted taxpayers

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I. Advanced Practice Issues

B. State of the IRS: Operations During COVID-19

- The IRS provided updates regarding the 2021 filing season on its webpage. The IRS continues to experience delays in services such as:
  - Live phone support;
  - Processing tax returns filed on paper;
  - Answering mail from taxpayers; and
  - Reviewing tax returns, even for returns filed electronically
- As of the week ending April 9, 2021, more than 8 million individual returns (Form 1040 or 1040-SR) were in “suspense” status awaiting review and manual processing
  - During “normal” tax seasons, the IRS does not suspend returns, as they are able to be reviewed and processed as they come in
- As of September 2021, the IRS inventory backlog totaled approximately 10 million paper returns needing to be processed. Approximately 5.7 million returns require additional information, and over 4 million returns were expected to be filed as of the extended October 15 due date

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I. Advanced Practice Issues

B. State of the IRS: Operations During COVID-19

- An April 22, 2021 National Taxpayer Advocate blog post reported that “a combination of the high volume of 2020 tax returns requiring manual processing, the backlog of unprocessed 2019 paper tax returns, congressional mandates to issue economic impact payments (EIPs) and provide other relief to taxpayers during the pandemic, limited resources, and technology issues have contributed to more refund delays and longer refund delays than are typical in a normal filing season.”
- The IRS emphasized that they understand the importance of timely processing tax returns and issuing refunds and that all returns are opened in the order they are received
- Similar to prior years, the “Where’s my refund?” tool can help taxpayers determine whether the return is received, is being processed, or is being reviewed

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- ***2. Identity Theft Central – Information for Individual Taxpayers***
- The IRS strengthened awareness of identity theft and data security protection by launching "Identity Theft Central," a 24/7 resource on how to identify theft and protective measures to guard against these actions
- Information is tailored to taxpayers, tax professionals, and businesses
- Taxpayers have access to the "Taxpayer Guide to Identity Theft," including information about steps to take if one falls victim to identity theft. The Identity Theft Central preemptively alerts taxpayers to possible tax-related identity theft schemes
- Sometimes identity theft will present itself in the form of a phishing email or scam. The IRS estimates that 91 percent of all data breaches and cyber-attacks begin with a phishing email. These emails may appear to come from a trusted source, such as a bank, or contain an urgent message that prompts one to follow a link to update information

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- ***2. Identity Theft Central – Information for Individual Tax Professionals***
- ***The unfortunate reality is that identity thieves often target tax professionals as they are often custodians of highly sensitive client data***
- The Federal Trade Commission (FTC) Safeguard Rule requires financial institutions to protect the consumer information they collect. The Gramm-Leach-Bliley (GLB) Act requires companies defined under the law as "financial institutions" to ensure the security and confidentiality of this type of information. The "financial institutions" definition includes professional tax preparers. As part of the law, tax preparers are required to create, implement, and maintain a written information security plan to protect client data, ***regardless the size of the firm***
- IRS Publication 4557, *Safeguarding Taxpayer Data*, clarifies FTC information security plan requirements for tax preparers

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I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- ***2. Identity Theft Central – Information for Businesses***
- The IRS, as part of the Security Summit, takes additional measures to protect business (corporation, partnership, estate, and trust) taxpayer data
- If a business return is flagged as a potentially fraudulent return, the IRS issues either Letter 6042C seeking information to validate the return or Letter 5263C seeking information to validate the entity
- If a tax professional prepares a business return, the IRS may ask a series of questions to authenticate the validity of the business return

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- ***2. Identity Theft Central – The Dirty Dozen***
- The IRS released a "**Dirty Dozen**" list of tax schemes in 2020 and urged taxpayers to be especially aware of potential schemes during the COVID-19 pandemic
- During times of economic uncertainty and crisis, scam artists and schemers look to take advantage of unsuspecting individuals
- The "**Dirty Dozen**" list includes:

  - Phishing Attempts
  - Fake charities
  - Threatening Impersonator Phone Calls
  - Social Media Scams
  - EIP or Refund Theft
  - Senior Fraud
  - Scams targeting non-English speakers
  - Unscrupulous return preparers
  - Offer in Compromise Mills
  - Fake Payments with Repayment Demands
  - Payroll and HR Scams
  - Ransomware

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- In addition to the “Dirty Dozen” tax fraud schemes, the IRS warns that individuals are at a heightened risk of falling victim to unemployment compensation **identity theft related to unemployment compensation** as a result of the COVID-19 pandemic
  - Numerous states have seen an increased amount of *fraudulent unemployment claims* filed by criminals using stolen identities
  - Some of these criminals even use the stolen identity to fraudulently collect benefits in **multiple** states
- Individuals who receive unemployment compensation receive a Form 1099-G, *Certain Government Payments*, from the state that they receive unemployment compensation from, since unemployment compensation is generally considered taxable income
  - (***Note:*** due to ARPA, unemployment compensation was partially excluded from income during the 2020 tax year)

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I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- An individual *may be a victim of a fraudulent unemployment compensation identity theft scam* if:
  - He or she received a Form 1099-G and did not file for unemployment benefits
  - He or she received mail from a government agency regarding unemployment claims or benefits that he or she did not file for
  - While employed, he or she received a notice from his or her employer indicating a request for information about an unemployment claim in his or her name
- If an individual receives an incorrect Form 1099-G for unemployment benefits that he or she did not claim, he or she should report the unemployment identity theft *to the state where it occurred*
  - The state will issue a **corrected** Form 1099-G to the identity theft victim and alert the IRS

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I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- On January 12, 2021, the IRS announced that the **Identity Protection PIN (IP PIN) program** was expanded for **all taxpayers**
  - Prior to the announcement, the IRS only offered IP PINs to victims of identity theft
- An IP PIN is a unique six-digit code known only to the taxpayer and the IRS
  - The IP PIN acts as a safeguard to protect the taxpayer from fraudulent tax return filings
  - Electronic returns *must be filed* with a correct IP PIN, otherwise, they will be rejected

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I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- Taxpayers should be aware about certain aspects of the IP PIN Opt-In Program, including:
  - The IP PIN Opt-In Program is ***optional***
  - Spouses and dependents are eligible for an IP PIN if they can verify their identities
  - An IP PIN is **valid for a calendar year**, and the taxpayer must obtain a new IP PIN each filing season
  - Correct IP PINs **must be entered** on electronic and paper tax returns to avoid rejections or delays
  - There is no opt-out option

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
C. Keep Your Eyes and Ears Open

- Taxpayers may apply online for an IP PIN using the "Get an IP PIN" tool
  - This process requires taxpayers to verify their identities using the Secure Access authentication process if they do not have an IRS account
- Taxpayers whose adjusted gross income is $72,000 or less may complete Form 15227, *Application for an Identity Protection Personal Identification Number*, and mail or fax the form to the IRS. An IRS customer service representative will verify the taxpayer's identity by phone
- Taxpayers who cannot verify their identities online or by phone and who are ineligible to file Form 15227 can contact the IRS and make an appointment at a Taxpayer Assistance Center to verify their identities in person

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
D. Increased Scrutiny of Nonfilers and High-income Taxpayers

- The IRS recently issued an Information Release and Fact sheet, announcing that it will increase focus on **high-income nonfilers**
  - These individuals include those who received income in excess of $100,000 during the tax year and did not file a return with the IRS
- The IRS notes that individuals will have received numerous letters from the IRS informing them of their tax liability prior to receiving an in-person visit from a revenue officer
- The revenue officer will explain the tax liability to the individual, methods to provide payment, and consequences of non-compliance

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I. Advanced Practice Issues
D. Increased Scrutiny of Nonfilers and High-income Taxpayers

- To promote voluntary compliance with tax laws, the IRS outlined the following processes:
  - **Increased identification and case creation for individual and business nonfilers**: New cases will be assigned to IRS employees for resolution
  - **Automated Substitute for Return program (ASFR):** The purpose of the ASFR program is to secure valid voluntary delinquent tax returns and to compute tax, interest, and penalties based on income information submitted by payers when no return is filed
  - **Automated 6020(b) process**: This process identifies businesses who are liable for employment taxes but have not filed the appropriate forms (Form 940, Form 941, Form 943 or Form 944). The IRS aims to help these businesses become filing compliant and alert them of their tax liability
  - **Delinquent Return Refund Hold program (DRRH)**: The IRS will hold an individual's income tax refunds and credits when a current or prior year refund return is filed and the individual's account has at least one unfiled tax return within the five years prior to the current tax year

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
D. Increased Scrutiny of Nonfilers and High-income Taxpayers

- New research from a report by the National Bureau of Economic Research (NBER) indicates that relatively high audit rates in top income brackets drive such high-income individuals to adopt sophisticated tax evasion schemes
  - The NBER estimates that random audits are usually *ill-equipped* to detect such sophisticated schemes, leading to an *underestimation* of income tax evasion amongst high-income individuals
- The NBER estimates that "unreported income as a fraction of true income rises from 7% in the bottom 50% to more than 20% in the top 1%, of which 6 percentage points correspond to undetected sophisticated evasion."

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Advanced Practice Issues
D. Increased Scrutiny of Nonfilers and High-income Taxpayers

- On March 10, 2021, the Treasury Inspector General For Tax Administration (TIGTA) released a report regarding high-income taxpayers who owe delinquent taxes
- TIGTA noted that the IRS typically has focused on the dollar amount of taxes due when prioritizing Taxpayer Delinquent Accounts, rather than the taxpayer's income or wealth
- TIGTA believes that this creates a larger risk that wealthy taxpayers are **not paying their tax debts *despite having the ability to pay***
  - According to the TIGTA report and IRS data, taxpayers having an average AGI of over $1.5 million paid the IRS an average of only 39% of what they owed
- It is anticipated that the IRS will prioritize high-income taxpayers who owe delinquent taxes in the future

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Chapter 3

Individual Taxation Issues

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. *Getting caught watching the paint dry –*
B. Employee vs Independent Contractor – 2021 Updates

- The employee vs. independent contractor conundrum continues into 2021
- On August 10, 2020, a California state judge ordered both Uber and Lyft to reclassify their California drivers from independent contractors to employees with benefits, as both companies were accused of violating California Assembly Bill 5
- Uber and Lyft, along with DoorDash, Postmates, and Instacart, spent more than $200 million combined to campaign for the passage of Proposition 22, a ballot measure to overturn CA Assembly Bill 5
- On November 3, 2020, 58.6% of California voters approved the measure to classify app-based drivers as contractors

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I. *Getting caught watching the paint dry –*
B. Employee vs Independent Contractor – 2021 Updates

- Unsurprisingly, there have already been lawsuits filed in relation to the passage of Proposition 22
- On January 12, 2021, the Service Employees International Union (SEIU), along with four workers, sued the CA Supreme Court (*Castellanos v. State of California*), arguing that Proposition 22 should be declared **unconstitutional, invalid, and unenforceable**
- The petitioners argued that although Proposition 22 was titled the "Protect App-Based Drivers and Services Act," it does not live up to its namesake, as it actually ***withdrew*** several minimum employment protections from thousands of California workers
- On February 3, 2021, the CA Supreme Court rejected the case for direct review. The plaintiffs subsequently filed the lawsuit in the Alameda County Superior Court on February 11, 2021. *Surgent will continue to provide updates as this case progresses*

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- ***2. U.S. Department of Labor Proposed Rule***
- On September 22, 2020, the Department of Labor (DOL) issued a proposed rule to clarify the definition of employee under the Fair Labor Standards Act (FLSA) as it relates to independent contractors
  - On January 7, 2021, the DOL announced a final rule, largely substantiating the September 2020 proposed rule with additional clarifications
- The final rule outlined an "**economic reality" test**, centered around the idea of whether the worker is economically dependent on the potential employer for work in order to determine worker classification
- If the final rule was adopted, the economic reality test factors would be used to determine whether the individual is *economically dependent* on a potential employer, and therefore classified as an **employee**, or whether the individual is *in business for himself or herself*, and therefore classified as an **independent contractor**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- The economic reality test outlined **two "core" factors** to determine worker status:
  - 1) **<u>The nature and degree of the worker's control over the work</u>**: If an individual has the ability to exercise substantial control over key aspects of the performance of work, as opposed to the potential employer, the individual is more likely to be considered an independent contractor than an employee
    - Activities that demonstrate an individual's substantial control over key aspects of the performance of work include setting one's own work schedule, working with little to no supervision, choosing work assignments, and being able to work for others, including the potential employer's competition
  - 2) **<u>The worker's opportunity for profit or loss:</u>** This factor analyzes whether the individual has the ability to earn profits or incur losses based on his or her personal initiative, managerial skill, or business acumen

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- There are three other factors that make up the "economic reality" test, but these factors are given less weight in the analysis of determining worker status:
  - 3) **Degree of Skill Required**: This factor considers the degree of skill required to perform the work. An individual would be more likely to be considered an independent contractor if the work performed required specialized skills or training that was not provided by the employer
  - 4) **Permanence of the Working Relationship**: This factor considers the permanence and duration of the working relationship between the individual and potential employer. An individual is more likely to be classified as an independent contractor if his or her working relationship with the potential employer is definitive in nature or sporadic
  - 5) **Integrated Unit**: This factor considers the extent to which services rendered by an individual are an "integral part" of the potential employer's business and production. An individual is more likely to be considered an independent contractor if the performance of services is not integrated into the potential employer's production process

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- Upon analyzing the worker's status using the "economic reality" test, if the two "core" factors arrived at the same conclusion as to the worker's classification, the combined weight of these factors would outweigh the other three factors of less importance
  - If the two "core" factors did not arrive at the same worker classification conclusion, the remaining three factors may help determine the correct worker classification
  - The remaining three factors should always be evaluated in the context of the two core factors
- Had the DOL final rule been adopted, it would have served as the FLSA's sole and authoritative interpretation of independent contractor status under the FLSA and replaced any prior regulations and guidance

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- On March 11, 2021, the DOL Wage and Hour Division (WHD) announced a proposal to **rescind** the January 7, 2021 final rule outlining the economic reality test, stating that the final rules would minimize other factors traditionally considered by courts
  - On May 6, 2021, the DOL finalized the withdrawal of the Independent Contractor Status rule
- The DOL stated that this would make it *less likely* that the worker would be classified as an employee under the FLSA, resulting in **more** workers being classified as independent contractors

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Getting caught watching the paint dry –
B. Employee vs Independent Contractor – 2021 Updates

- The DOL also announced a proposal to withdraw the "**joint employer**" final rule that became effective in March 2020 but was largely vacated by a federal district court in September 2020
  - The joint employer final rule provided guidance for determining joint employer status when an employee performs work for his or her employer that *simultaneously benefits* another individual or entity
  - Under this final rule, a joint employer would be ***jointly and severally liable*** with the employer for the employee's wages
  - The final rule established a four-factor test is used to determine whether the potential joint employer is directly or indirectly controlling the employee
- The Southern District of New York found that the DOL joint employer final rule violated the Administrative Procedures Act and subsequently vacated most of the rule

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Donor Advised Funds – Overview

- Donor-advised fund ("DAF") is a charitable giving investment tool used to manage charitable funds for individuals, families, and organizations
- DAFs are operated as §501(c)(3) public charities under the supporting organizations ("SOs") of §509(a)(3)
- Benefit of current charitable deductions without the burden of designating gifts and executing funding to various organizations

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Donor Advised Funds – Overview

- Mechanics
  - Taxpayer opens a DAF account with a sponsoring organization (e.g., Vanguard Charitable, Fidelity Charitable, etc.)
  - Taxpayer makes irrevocable contributions of cash or other financial instructions to the account resulting in current charitable deductions
  - Taxpayer retains 'advisory' privileges over the account with regard to both how funds are invested and when distributions are made to other qualified charities

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Donor Advised Funds – Overview

- **Practical Considerations**
  - SOs distribute funds to final charitable destination on behalf of taxpayer
    - No additional deduction is received by the taxpayer for distributions from DAFs, as the deductions could be double-counted or there could be deductions for earnings in the account for which taxpayer has no basis
    - Earnings in a DAF account are double tax-deferred
  - Convenient and flexible for taxpayer to give directly to one charity rather than several charities
  - Available to high net-worth taxpayers ("HNW") and less wealthy taxpayers alike
  - Less costly and less administratively burdensome than private foundations ("PFs")

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DAFs, PFs, and SOs

- First DAF noted to be created in 1931 with New York Community Trust though the term was not codified until 2006
- §4966(d)(2) - *the term "donor advised fund" means a fund or account—*
  - *(i)which is separately identified by reference to contributions of a donor or donors,*
  - *(ii)which is owned and controlled by a sponsoring organization, and*
  - *(iii)with respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor.*
- SOs are exempt by virtue of §501(c)(3), so a contribution to a DAF is in effect a contribution to a charitable organization

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DAFs, PFs, and SOs (Cont'd)

- §501(c)(3) provides federal income-tax exemption for organizations described in §509
- §509 provides the definition of PFs as anything not otherwise described in §509(a) public charity
  - §509(a)(1): Substantial public support; churches, hospitals, schools; charities defined in §170(b)(1)(A)
  - §509(a)(2): More than 1/3 public support; grants, membership fees, performance of services; Less than 1/3 support from investment income
  - §509(a)(3): Supports other organizations; not owned controlled directly or indirectly by disqualified persons
  - §509(a)(4): Public safety organizations

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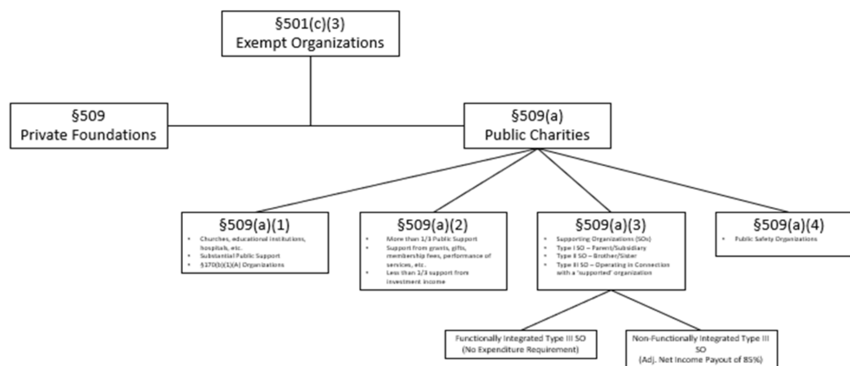
DAFs, PFs, and SOs (Cont'd)



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DAFs, PFs, and SOs (Cont’d)

- PFs – In General
  - Like public charities, carry out a charitable mission
  - Generally funded by only a few individuals
  - Operating vs Non-Operating
    - Operating PFs carry out charitable activities
    - Non-operating PFs simply fund other charitable organizations
- SOs – In General
  - Funded by many donors usually
  - No ‘control’ by donors
  - Donors retain limited advisory privileges
  - Generally treated as public charity for charitable contribution limitations

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DAFs, PFs, and SOs (Cont’d)

- Charitable Contribution Limitations Review

Features	Public Charity	Private Foundation
Mandatory Distribution Requirements	Generally, No	Yes
Limitations on Contribution Deductions	Generally 60% through 2027	30% Limitation
Excise Tax	No for qualifying distributions	Yes
Restrictions on investments and distributions	No	Yes
Donor control of Investments and Distribution	No	Yes

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Regulation of DAFs

- No definition of DAFs prior to 2006
- Codified as a result of abusive practices in the industry
- *New Dynamics Foundation v. U.S.* (2006)
  - California entity granted state tax exemption under the guise of organization for public benefit
  - Intended to work with tax and other financial professionals to establish individual DAF accounts to direct for charitable purposes
  - Terms were consistent with incorporating articles which outlined a purpose to promote and contribute to public good causes as defined in §170(c)

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Regulation of DAFs (Cont'd)

- *New Dynamics Foundation v. U.S.* (2006) (cont'd)
  - Issues arose with both marketing materials and oversight/administration of donated funds
  - Marketing materials indicated investors could grow funds "tax-free" in a public charity
  - Operational manuals outlined that directors of the funds could be contributors themselves with no safe-guards against conflicts of interest
  - New Dynamics founder indicated 95% of the funds could be used for administrative/personal purposes
  - When New Dynamics applied for federal tax-exemption under §501(c)(3)

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Regulation of DAFs (Cont'd)

- *New Dynamics Foundation v. U.S.* (2006) (cont'd)
  - When New Dynamics applied for federal tax exemption under §501(c)(3), IRS denied the application on the grounds that the organization did not provide sufficient cause for tax exemption under §501(c)(3)
    - Needed to be organized for religious, education, or charitable purposes exclusively; **and**
    - No part of the earnings can be directed for private individual or shareholder benefits
  - New Dynamics filed suit to overturn the IRS decision
  - Court agreed with the IRS on the following grounds:
    - Intent from formation to accrue inappropriate tax benefits related to estate taxes
    - Donations to legitimate charitable causes represented less than 5% of contributions
    - Former case law demonstrated legitimate funds implemented safeguards to prevent personal expenditures

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Regulation of DAFs (Cont'd)

- Following the New Dynamics Foundation case, Pension Protection Act of 2006 worked to prevent abuses and achieved the following:
  - Codified the term "donor advised fund"
  - Amended §509 to its current structure providing a framework for types of tax-exempt entities along with general requirements for maintaining tax-exempt status for each type of organization
  - Restricted ownership and control of SOs and the underlying DAFs
  - Outlined different types of SOs (e.g., Type I, II, III, Functionally Integrated, etc.) which resulted in further regulatory obligations

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DAF Tax Planning

- Generally, can be broken down into three phases:
  - Step 1: Donate
  - Step 2: Grow
  - Step 3: Support
- ***Step 1: Donate***
  - Taxpayer can generally set up automatic draft funding of DAF
    - Proactive approach to charitable deductions rather than waiting to the end of the tax year
    - Greater TVM potential for funds contributed throughout the year rather than just at year-end

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DAF Tax Planning (Cont'd)

- ***Step 1: Donate (cont'd)***
  - Taxpayers can pre-fund charitable giving in retirement years
    - Allows taxpayers to remain charitable in retirement without drawing on retirement funds
    - Maximizes return on retirement funds by keeping funds for the living liquid
  - Taxpayers 'bunching' deductions can use their DAF to achieve this
    - Reduces taxable income in higher years with convenient contributions to a DAF with higher itemized deduction limitations of generally 60%
    - Also useful for taxpayers that frequently itemize one year but claim the standard deduction for others

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DAF Tax Planning (Cont'd)

- ***Step 1: Donate (cont'd)***
  - Special rules on DAF contributions
    - Not qualified for the simplified $300/$600 charitable deduction under §170(p)
    - Not qualified for IRA QCD under §408(d)(8)
- ***Step 2: Grow***
  - Contributed funds grow tax-free since owned and controlled by the SO, a tax-exempt charitable organization
  - Contributing taxpayer retains advisory privileges over the invested funds (i.e. money market vs growth vs emerging markets vs fixed income, etc.)

DAF Tax Planning (Cont'd)

- ***Step 2: Grow (cont'd)***
  - Taxpayer can rebalance portfolio with noncash contributions to the DAF with a related charitable deduction
    - Donor can choose to donate significantly appreciated assets to the fund, avoiding capital gains and achieving a deduction for the FMV of the appreciated assets contributed (subject to limitations)
    - DAFs are generally well equipped to receive more non-cash contributions where operating charitable organizations are not
  - Taxpayers can use asset contributions to a DAF to avoid §1091 Wash Sale rules

Caution to Taxpayers: DAFs carry a risk of loss which could decrease the ability to fund future grants. Advisors and taxpayers should remember market exposure and plan accordingly for down markets or if there are plans to grow the funds for a larger, future grant.

DAF Tax Planning (Cont'd)

- ***Step 3: Support***
  - Contributors to the funds can 'advise' on when and how the DAF resources are distributed
    - While very uncommon, an SO is not required to distribute funds according to the contributor, and thus, can distribute DAF resources as it sees fit
    - Usually follows the advice of contributors to retain future contributions to earn management fees rather than losing the taxpayer to another SO
      - SO restriction on distributions usually relates to organization receiving the grant being a qualified organization
  - Distributions from an SO to operating organization is tax-free to both the SO and receiving qualified charitable organization
    - No additional tax deduction to the taxpayer; avoids double counting deductions or a taxpayer taking deductions in earnings on the funds without tax basis

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DAF Tax Planning (Cont'd)

- ***Step 3: Support (cont'd)***
  - DAFs are a great opportunity to fund charitable organizations during a down economic climate
    - Relieves the cash-flow pressures of organizations receiving grants from the DAF without burdening taxpayers subject to the same unfavorable economic environment
    - Prepaid charitable gifts
  - DAFs simplify record keeping and reporting for taxpayers
    - Depending on all giving, a taxpayer could receive one charitable contribution statement from the DAF rather than individual statements from all the organizations the taxpayer may have supported without the DAF
    - Due diligence of distributed funds falls to SOs rather than the taxpayer
  - DAFs have low entry points for contributions to establish accounts and relatively low annual fees
    - Entry-level contributions can be as low as $5,000
    - Annual fees can be less than 1% of the assets in the DAF making them much more viable than PFs

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DAF - Tax Efficiency Example

- Facts: A donor has long-term appreciated stock in Publicly Traded, Inc. with a basis of $125,000 and market price of $200,000. The donor is interested in making charitable donation to DAF, Inc., his donor-advised fund, with a value of $200,000. He approaches his tax advisor to understand what the best way is to maximize the deduction, and the tax advisor demonstrates the following scenario.

	Sell Stock / Donate Cash	Donate Stock
(A) FMV	$200,000	$200,000
(B) BASIS	$125,000	$125,000
(C) Capital Gain	$75,000 (A - B)	$0
(D) Applicable Capital Gain Rate	20%	0%
(E) Capital Gain Tax	$15,000	$0
(F) Charitable Deduction	$200,000	$200,000
(G) Marginal Tax Rate	37%	37%
(H) Tax Saved with Charitable Contribution	$74,000 (F * G)	$74,000 (F * G)
(I) Total Cost to Donor	$141,000 (E + F – H)	$126,000 (E + F – H)
This example assumes marginal tax rate of 37% and no applicable limitation of contribution deductions of capital gain property.		

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DAF - Tax Efficiency Example (Cont'd)

- The previous example highlights using a DAF for appreciated stock
- Many operating charities are not able to receive financial instruments as contributions, so a DAF can be a good vehicle to convert the funds while avoiding capital gain taxes
- Some SOs are sophisticated enough to handle more complicated financial assets (e.g., cryptocurrency, swaps, futures, options, closely held partnership interests, etc.)

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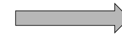
DAF – What Legislators are Considering

- On June 9, 2021, the Accelerating Charitable Efforts Act (“ACE Act”) was introduced to the 117th Congress and proposes several changes to DAFs and PFs
- As previously mentioned, one of the primary differences between private foundations and DAFs is the requirement for minimum distributions to operating charitable organizations from private foundations, where DAFs have no such requirement
- This bill attempts to shorten the gap between when donors to DAFs receive charitable deductions and when the funds are provisioned to operating charities by transitioning all DAFs to one of two types:
  - **15-year DAFs**: For the 15-year DAF, donors would receive immediate charitable deductions if all the contributed funds are distributed within 15 years of donation. The 15-year DAF would also limit the current charitable deduction related to complex assets to the amount of cash made available to DAF after sale of the asset rather than based on FMV upon donation (a potential problem if the contributed asset depreciates significantly after contribution but before being converted to cash inside the DAF)



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DAF – What Legislators are Considering

  - **50-year DAFs**: For the 50-year DAF, there would be no deduction until the DAF distributed the contributed funds, but the contribution would still benefit by avoiding capital gain and estate taxes. All funds would be required to be distributed within 50 years accordingly
- The ACE Act would make FIFO accounting mandatory for all assets managed by the DAF. Additionally, for private foundations paying out at least 7% of net FMV of assets (excluding assets for operation), the annual excise tax would be waived
- While it appears DAFs will remain in place for future tax years, the specifics regarding the ongoing management of the assets may change amidst legislative considerations

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities

- There are four limitations that apply before individuals and passthrough entities can claim deductions and losses passed through from a partnership or S corporation
  - Limitations apply in a *specific order* as outlined below:
    - Limitation 1: Basis Limitation
    - Limitation 2: At-Risk Limitations
    - Limitation 3: Passive Loss Limitations
    - Limitation 4: Excess Business Loss Limitations
  - In general, the legislative goal of passthrough entities is to provide tax-free distributions before allowing taxpayers to claim losses on tax returns. This preference will be seen in the various ordering rules for basis adjustments
  - Considering the losses generated during the pandemic, it is important to have an **increased familiarity** with these issues, as they will impact the next couple of filing seasons along with any related tax planning that may be executed
  - This review will focus on the mechanics of each limitation, providing the tax professional with an understanding of the impact of loss limitations on taxpayers. This will allow for more effective planning as it relates to loss utilization in future periods

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- **Limitation 1: Basis Limitation**
  - The **first limitation** to apply to losses passed through partnerships and S corporations is the *basis limitation*
    - Partnership basis limitations are required under §704(d)
    - S Corporation basis limitations are required under §1366(d)(1)
  - There is no specific form to support these calculations and the related basis limitations, or lack thereof, in a passthrough entity interest
    - Though there is no specific form, there are various examples of calculations provided throughout several IRS publications
  - Generally, the calculation for basis in a partnership interest or S corporation stock is the same, but there are some specific differences and nuances
    - The *primary differences* relate to the treatment of debt as it relates to a partnership interest and S corporation stock

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- **Limitation 1: Basis Limitation (cont'd)**
  - *Partnership Mechanics:*
    - The *starting point* for calculating basis in a partnership interest is the *ending basis* from prior year
    - For the *initial year* of a partnership interest, there is no ending basis from prior year, so the beginning basis is equal to zero
    - Partnership basis is always adjusted first for certain increases to basis, then for distributions, then applicable basis decreases

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- **Limitation 1: Basis Limitation – Partnership Mechanics (cont'd)**
  - Basis Formula: The basis for determining any applicable loss/deduction limitations is summarized below:

  Beginning Basis + Current Year Income Items from Schedule K-1 + Contributions + Increase in share of Partnership Liabilities – Distributions = Basis for decrease limitations
    - For purposes of the basis limitation, partnership liabilities will include *all types of liabilities* allocated to the partner/member (i.e., nonrecourse, qualified nonrecourse financing, and recourse debt)
    - ***Basis decreases*** include current year losses, deductions, and nondeductible expenses
    - If current year basis decreases plus prior year suspended basis decreases exceed the basis for loss limitation considerations, ***the excess is disallowed*** and carried forward indefinitely
    - Limitations apply to all categories of basis decreases on a pro rata basis based on the total of current year and prior year disallowed amounts by category (Reg. §1.704-1(d))
    - Disallowed losses preserve basis from falling below zero as required under §704(a)(2)
    - When basis is restored, basis decrease items will then be allowed (absent any other limitations)
    - To the extent distributions create ***negative basis*** for basis decrease limitations, the extent to which the basis limitation becomes negative results in distributions being treated at a minimum of partially taxable (i.e., distributions in excess of basis)

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- **Limitation 1: Basis Limitation (cont'd)**
  - Partnership Mechanics: Starting point is the ending basis from prior year
    - Special Items:
      - Guaranteed Payments and health insurance are ***not included*** in basis computations as they are payments made to partners based on their services to the partnership, without reference to current year operating results
      - With new partnership reporting requirements, basis is tracked on Schedule K-1 and can be determined by adding together the tax capital and allocable share of partnership liabilities at the end of the tax year
    - Examples to Follow!

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Example 1***: Heather Anderson is a 70% partner in XYZ partnership, a new partnership. Her year 1 capital contributions consisted of cash in the amount of $20,000. The year 1 Schedule K-1 indicates the following activity. As this is a new activity, there are no carryover amounts related to prior year disallowed amounts. There were no distributions from the partnership in year 1.

Category	Year 1 Activity
Ordinary Income (Loss)	$ (35,000)
Charitable Contributions	$ 2,000
Nondeductible Expenses	$ 3,000

- Additionally, the Schedule K-1 indicates no beginning of year liabilities but includes nonrecourse liabilities allocable to Heather in the amount of $5,000.
- The year 1 basis decrease limitations will be determined as follows:

Adjusted Basis, BOY	$ -
Current year income items	$ -
Current capital contributions	$ 20,000
Current year increases in liabilities	$ 5,000
Distributions	$ -
Adjusted basis used for basis limitation	**$ 25,000**

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Example 1 (cont'd)*** : The year 1 basis decrease limitations will be determined as follows:

Adjusted Basis, BOY	$	-
Current year income items	$	-
Current capital contributions	$	20,000
Current year increases in liabilities	$	5,000
Distributions	$	-
Adjusted basis used for basis limitation	**$**	**25,000**

Losses/Deductions/Expenses	Current Year	Prior Year	Total	Pro Rata %	CY Allowed Amounts	Carryover Amounts
Ordinary Loss	$ 35,000	$ -	$ 35,000	87.50%	$ 21,875	$ 13,125
Charitable Contributions	$ 2,000	$ -	$ 2,000	5.00%	$ 1,250	$ 750
Nondeductible Expenses	$ 3,000	$ -	$ 3,000	7.50%	$ 1,875	$ 1,125
Total	**$ 40,000**	**$ -**	**$ 40,000**	**100.00%**	**$ 25,000**	**$ 15,000**

- Note the current year allowed amounts totaling $25,000 equals the current year adjusted basis for basis limitation purposes
- The carryover amounts total of $15,000 equals the current year basis decrease items totaling $40,000 less the adjusted basis used for the basis limitation of $25,000. This can be a useful check figure to make sure everything is being considered and calculated correctly

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- Limitation 1: Basis Limitation (cont'd)
  - Partnership Mechanics:
    - ***Example 2***: John Smith is a 50% partner in ABC partnership. His ending basis in his partnership interest in year 5 is $5,000. The year 6 Schedule K-1 indicates the activity indicated below. The taxpayer also has a schedule of year 5 carryover/disallowed amounts, indicated below.

Category	Year 6 Activity	Year 5 Carryovers
Ordinary Income (Loss)	$ (11,000)	$ (3,000)
Rental Real Estate Income (Loss)	$ (2,000)	$ (2,000)
Charitable Contributions	$ 1,000	
Nondeductible Expenses	$ 1,000	
Distributions	$ 3,000	

    - Additionally, the Schedule K-1 indicates beginning Year 6 nonrecourse liabilities allocable to John of $6,000 and end of Year 6 liabilities allocable to John of $7,000.
    - The year 6 basis decrease limitations will be determined as follows:

Adjusted Basis, BOY	$	5,000
Current year income items	$	-
Current capital contributions	$	-
Current year increases in liabilities	$	1,000
Distributions	$	(3,000)
Adjusted basis used for basis limitation	**$**	**3,000**

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Example 2 (cont'd):*** The year 6 basis decrease limitations will be determined as follows:

Adjusted Basis, bgn of year	$ 5,000
Current year income items	$ -
Current capital contributions	$ -
Current year increases in liabilities	$ 1,000
Distributions	$ (3,000)
Adjusted basis used for basis limitation	**$ 3,000**

Losses/Deductions/Expenses	Current Year	Prior Year	Total	Pro Rata %	CY Allowed Amounts	Carryover Amounts
Ordinary Loss	$ 11,000	$ 3,000	$ 14,000	70%	$ 2,100	$ 11,900
Rental Real Estate Loss	$ 2,000	$ 2,000	$ 4,000	20%	$ 600	$ 3,400
Charitable Contributions	$ 1,000		$ 1,000	5%	$ 150	$ 850
Nondeductible Expenses	$ 1,000		$ 1,000	5%	$ 150	$ 850
Total	**$ 15,000**	**$ 5,000**	**$ 20,000**	**100%**	**$ 3,000**	**$ 17,000**

- Note the current year allowed amounts totaling $3,000 equals the current year adjusted basis for basis limitation purposes.
- The carryover amounts totaling $17,000 equal the prior year disallowed amounts of $5,000 plus the current year basis decrease items totaling $15,000 less the adjusted basis used for the basis limitation of $3,000 ($15k + $5k - $3k = $17k). This can be a useful check figure to make sure everything is being considered and calculated correctly

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitation (cont'd)***
  - **S Corporation Mechanics**: The overall methodology is very similar to that found in partnership basis limitations
    - Unlike partnerships, basis in S corporation stock *cannot* be determined by reference to Schedule K-1
    - Like partnerships, basis *cannot* be less than zero
    - Partnerships only pay distributions, but S Corporations can pay distributions similar to partnerships or make payments out of Accumulated Earnings and Profits taxed as Dividends. Payments out of E&P do not affect the shareholder basis; however, payments out of the S corporation capital are treated as tax-free to the extent of basis and are included in the basis formula
    - Partnership basis includes the allocable share of partnership liabilities in determining a partner's basis, but an **S Corporation shareholder only has debt basis to the extent a shareholder loaned money to the corporation** in addition to their stock basis
      - Note that an **S corporation shareholder guaranteeing the loan of a corporate debt does not provide debt basis** to a shareholder; the shareholder must have contributed capital in exchange for future repayment
      - Basis reductions are first applied to stock basis and then applied against debt basis. Basis restorations are applied against debt basis to the extent of the loan made and secondly applied to stock basis

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitation (cont'd)***
  - **The General Ordering Rules** for Items Affecting Stock Basis on or after 8/18/1998 (Reg. §1.1367-1(f)) are as follows:
    - Step 1: Income items increasing basis (including tax-exempt income)
    - Step 2: Distributions
    - Step 3: Decreases attributable to nondeductible expense
    - Step 4: Decrease attributable to losses/deductions
    - Special Notes:
      - ***Excess Nondeductible Items***: Excess nondeductible expenses do not carryforward unless a special election is made regarding ordering rules (as discussed on next slide). This contrasts with partnerships
      - ***Excess Losses and Deductions***: Excess losses/deductions carry forward like partnerships and are applied on a pro rata basis (§1366(d)(2); Reg §1.1366-2(a)(5))

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitation (cont'd)***
  - Special Notes (cont'd):
    - Effectively, loss/deduction items reduce basis *before* nondeductible items
    - There is *no change* in treatment of excess losses
    - With this election, excess nondeductible items are *carried forward* and affect tax basis in future periods as basis is restored
    - This special election is made by attaching a statement to the shareholder's timely filed original or amended return stating the taxpayer agrees to the carryover rules. Once made, the election ***must be applied consistently*** for all future periods unless the taxpayer receives permission to begin applying the general ordering rules
    - This election may be helpful in preserving basis to deduct losses currently. However, this could lower basis to a point where future non-dividend distributions become taxable. Depending on the facts and circumstances, this election may be a better answer for a client, but careful consideration and analysis should be done in advising taxpayers

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitation – S Corporation Mechanics (cont'd)***
  - **Debt Basis Basics**
    - S Corporation shareholders only have debt basis to the extent of capital provided to the corporation in agreement and expectation of future repayment
    - An S corporation shareholder guarantee of corporate loan **does not** provide the shareholder with debt basis (Reg. §1.1366-2(a)(2)(ii))
      - If a shareholder makes an actual payment on a corporate loan that was guaranteed by the shareholder, the shareholder can *increase* their debt basis (actual economic outlay test; TC Memo 2016-232)
    - Debt basis is ignored in determining the taxability of distributions; distributions are taxable to the extent they exceed stock basis (§1368(b)(1))
    - Losses and deductions exceeding stock basis and claimed against debt basis reduce the debt basis of the shareholder

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitation – S Corporation Mechanics (cont'd)***
  - **Debt Basis Formula**
    - Step 1: Debt Basis at the beginning of the tax year
    - Step 2: Income used to restore debt basis (+)
    - Step 3: Additional loans made to S corporation during tax year (+)
    - Step 4: Loan repayments to shareholder (-)
    - Step 5: Debt basis used for basis limitation
    - Step 6: Losses allowed by debt basis (not to exceed Step 5)
    - Step 7: Debt basis at the end of the tax year
  - If debt basis is used to deduct losses, net increases for any subsequent taxable year will apply first to restore any reductions in debt basis before any of it is used to increase the shareholders' basis in the S corporation stock (§1367(b)(2)(B))

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***S Corporation Basis Limitation Mechanics: (cont'd)***
  - Example 1: Patrick Miller is a 35% owner in S Corporation A. At the end of tax year 8, his basis in his S corporation stock was $4,000, and the amount of his outstanding loans to the S corporation was $2,000. Patrick's Schedule K-1 from the S corporation indicated the activity below. There were no loan repayments made by the S corporation during the tax year, and no distributions were paid.

Category	Year 8 Activity
Ordinary Income (Loss)	$ (12,000)
Interest Income	$ 2,000
Charitable Contributions	$ 3,000
Nondeductible Expenses	$ 2,000

  - The current year loss limitations would be determined as follows:

Stock Basis		Debt Basis	
Adjusted Basis, BOY	$ 4,000	Debt Basis, BOY	$ 2,000
Current year income items (+)	$ 2,000	Income used to restore debt basis (+)	$ -
Current capital contributions (+)	$ -	Loans made to S Corp during the year (+)	$ -
Distributions (-)	$ -	Loan repayments (-)	$ -
Adjusted basis used for basis limitation	**$ 6,000**	**Debt basis used for basis limitation**	**$ 2,000**
Total Basis for loss/deduction/expense items	**$ 8,000**		

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Example 1: (cont'd)***

Losses/Deduction/Expenses	Current Year Loss/Ded/Exp	Prior Year Unallowed Basis Loss	Items Available for Carryforward	Items Available for Carryforward %	Regular Tax Amount Allowed by Basis	Regular Tax Basis Carryover
Ordinary Loss	$ 12,000	$ -	$ 12,000	80%	$ 4,800	$ 7,200
Charitable Contributions	$ 3,000	$ -	$ 3,000	20%	$ 1,200	$ 1,800
Nondeductible Expenses	$ 2,000	$ -	$ -	0%	$ 2,000	$ -
Total	$ 17,000	$ -	$ 15,000	100%	$ 8,000	$ 9,000
Adj. stock basis used for basis limitation	$ 6,000		Debt basis used for basis limitation		$ 2,000	
Nondeductible expense	$ (2,000)		Ordinary Loss/Charitables attr. to debt		$ (2,000)	
Ordinary Loss/Charitables attributable to stock basis	$ (4,000)		**Debt basis, EOY 8**		$ -	
Stock basis, EOY 8	$ -					

Note that the nondeductible items reduce stock basis first and ***will not be applied*** as a carryforward on a pro rata basis. The remaining basis for loss and deduction items is $6,000 ($8,000 - $2,000) allocable pro rata between ordinary losses and charitable contributions

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***S Corporation Basis Limitation Mechanics: (cont'd)***
  - Example 2: Neil Harmon is a 25% owner of Z Best S Corporation. His stock basis at the beginning of year 4 is $7,000, and his debt basis is $1,000. The corporation made no principal payments on Neil's shareholder loan to the corporation during the tax year, and the outstanding principal balance is $5,000 at year end. Below is a summary of the current year activity and the carryforward items related to Neil's ownership interest in the S corporation.

Category	Year 4 Activity	Prior Year Unallowed Amounts
Ordinary Income (Loss)	$ 5,000	$ (1,000)
Interest Income	$ 500	
Charitable Contributions	$ 1,000	
Nondeductible Expenses	$ 1,500	

  - Because the shareholder's debt basis is different from the outstanding principal balance in the loan, this indicates that losses/deduction have been claimed against the debt basis. We must determine what net increase, if any, will be used to restore the debt basis. The maximum amount of increase to restore the debt basis is limited to $4,000 ($5,000 - $1,000), the difference between the outstanding principal balance and the shareholder's debt basis. The current year net increase is determined as follows:

Category	Year 4 Activity	Prior Year Unallowed Amounts
Ordinary Income (Loss) (+/-)	$ 5,000	$ (1,000)
Interest Income (+)	$ 500	
Charitable Contributions (-)	$ 1,000	
Nondeductible Expenses (-)	$ 1,500	
Net Increase (Decrease)	$2,000	

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***S Corporation Basis Limitation Mechanics: (cont'd)***
  - Example: (cont'd) The year 4 basis limitations would be determined as follows:

Stock Basis		Debt basis	
Stock Basis, BOY	$ 7,000	Debt Basis, BOY	$ 1,000
Current Year Capital Contributions	$ -	Income used to restore debt basis	$ 2,000
Current Year Income Items	$ 5,500	Loans made to S corp during year	$ -
Less: income for debt restoration	$ (2,000)	Less: Loan Repayments	$ -
Less: distributions	$ -	Debt basis used for basis limitation	$ 3,000
Adj basis for basis limitation	$ 10,500	Loss allowed against debt basis	$ -
Loss allowed by basis limitation	$ (3,500)	**Debt Basis, EOY**	**$ 3,000**
Stock Basis, EOY	**$ 7,000**		

Losses/Deduction/Expenses	Current Year Loss/Ded/Exp	Prior Year Unallowed Basis Loss	Regular Tax Amount Allowed by Basis	Regular Tax Basis Carryover
Ordinary Loss	$ -	$ 1,000	$ 1,000	$ -
Charitable Contributions	$ 1,000	$ -	$ 1,000	$ -
Nondeductible Expenses	$ 1,500	$ -	$ 1,500	$ -
Total	**$ 2,500**	**$ 1,000**	**$ 3,500**	**$ -**

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – Basis Limitations

- ***Limitation 1: Basis Limitations – Closing Thoughts***
  - Determining basis is straightforward but coordinating suspended amounts can be tricky
  - Unlike other limitations, basis limitations apply to **all taxpayers**, C corporations included
  - With the new partner tax capital reporting requirements for Schedule K-1, much of the work is being done on behalf of the taxpayer from a basis perspective; however, the actual limitations and carryforward items will be determined at the *individual* taxpayer level
  - Because S corporation Schedules K-1 do not report shareholder basis, Schedule E of Form 1040 requires a basis calculation to be included/attached with the return if the taxpayer is claiming a loss
    - Individual taxpayers are **not required** to separately attach basis calculations for partnership losses being claimed on the return

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – At Risk Limitations

- ***Limitation 2: At-Risk Limitations (§465)***
  - After computing basis limitations for losses and deductions, taxpayers must then have sufficient "at-risk" basis to claim losses from S corporations or partnerships
  - At-risk limitation **calculations are much like calculating basis** in a partnership interest or S corporation stock, but the nuances and differences primarily relate to the treatment of debt items attributable to the partner/shareholder
  - It is important to calculate at-risk basis independent of basis in the partnership interest/S corporation stock, as they frequently are not the same
  - **Form 6198** is completed in reporting At-risk limitations. A form is prepared for each activity/group of activities
  - **Similarities** between partnership interest/S corporation **basis and at-risk basis** are outlined below:
    - **Contributions of Cash/Other Property**: Basis and at-risk basis are both increased by the amount of unencumbered cash and the adjusted basis of unencumbered property contributed to a partnership or S corporation (§465(b)(1)(A))
    - **Purchase of interest**: Purchasing an additional interest in an activity is treated as a contribution to the activity, and thus, increases at-risk basis in the activity (Prop. Reg. §1.465-22(d))
    - **Income/Gain/Loss/Deduction Adjustments**: Pro rata share of partnership and S corporation items of income, gain, loss, and deduction including tax-exempt income and nondeductible items increase and decrease the at-risk basis in the same manner as it does to the basis in the partnership interest or S corporation stock (Prop. Reg. §1.465-22(c))

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – At Risk Limitations

- ***Limitation 2: At-Risk Limitations (§465)***
  - **Similarities** between partnership interest/S corporation **basis and at-risk basis** are outlined below: (cont'd)
    - **Carryforward of Disallowed Amounts**: If income/gain from an activity exceeds deduction/loss items, no at-risk limitation will apply. Deductions/losses exceeding income are allowed to the extent of at-risk basis with the remaining disallowed amount being carried forward to the succeeding taxable year with the same character as originally incurred (§465(d); Prop. Reg §1.465-38(b)). Carryforward is indefinite
      - Effectively, losses and deductions cannot reduce at-risk basis below zero, similar to the general basis limitations
    - **Character of Disallowed Amounts**: Partially allowed deductions/losses and fully disallowed amounts are generally treated on a pro-rata basis to the extent of income
      - Prop. Reg. §1.465-38(a) suggests ordering the allowed amounts as follows: (1) capital losses, (2) §1231 losses/deduction, (3) deductions that are non-tax preference items under §57, and (4) all items representing tax preferences under §57
      - While the proposed regulations suggest this, the Form 6198 instructions describe allowing and disallowing amounts on pro rata basis consistent with the basis limitations (Reg §1.704-1(d)(2); Reg. §1.1366-2(a)(5))
      - Most professional tax software will default to a pro rata treatment. This methodology will likely hold under audit

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – At Risk Limitations

- ***Limitation 2: At-Risk Limitations (§465)***
  - **Differences** between partnership interest/S corporation basis interest and at-risk basis are outlined below:
    - **Partnership Liabilities**: Partnership basis includes all allocable liabilities to the taxpayer whereas at-risk basis only considers recourse and qualified nonrecourse financing debt (§465(b)(6))
      - Guarantees of partnership liabilities usually result in the liability allocation being treated as recourse for partnership basis purposes (Reg. §1.752-2). However, at-risk basis is increased only when payment is actually made on a guaranteed loan, and there is no legal right of indemnification for the paying partner(s) (Prop. Reg. §1.465-6(d))
    - **Contributions of Borrowed Funds**: A partner/shareholder cannot be at risk for amounts contributed to the interest/activity if the funds were borrowed from another taxpayer (or person related to another shareholder) with an interest in the same activity (§465(b)(3))
    - **Limited Amount At-Risk From Nonrecourse Liabilities, Guarantees, Stop Loss, and Other Arrangements**: Taxpayers protected against any loss through nonrecourse borrowing are not treated as at-risk to the extent of protection (§465(b)(4)), as excepted for qualified nonrecourse financing (§465(b)(6))

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – At Risk Limitations

- ***Limitation 2: At-Risk Limitations (§465)***
  - Differences between partnership interest/S corporation basis interest and at-risk basis are outlined below: *(cont'd)*
    - **Negative At-Risk Basis/Recapture of Prior Year Losses**: While basis in a partnership interest/shareholder stock cannot be reduced below zero, at-risk basis can be reduced by distributions to a taxpayer, recourse loans subsequently converted to nonrecourse loans, the initiation of a stop loss or similar arrangement (Prop. Reg. §1.465-3(b))
      - **Negative at-risk basis** results in recapture of the negative at-risk basis for the lesser of (1) absolute value of the negative at-risk amount or (2) the total amount of at-risk losses previously deducted net of amounts previously recaptured (§465(e)(2))
      - **Recaptured income** is treated as a deduction for the activity in the next taxable year (§465(e)(1)(b))
      - There is no guidance as to the character of the recapture, but points can be made that the income should retain the character to which the losses had been allowed. Most professional tax software will adopt a conservative approach and treat the recapture as ordinary income

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Loss Limitations – A Mechanical Review

A. Individual and Passthrough Entities – At Risk Limitations

- ***Limitation 2: At-Risk Limitations (§465)***
  - Differences between partnership interest/S corporation basis interest and at-risk basis: (cont'd)
    - **S corporation shareholder basis (including debt basis) is not necessarily the same as at-risk basis though debt basis is quite restrictive**
      - Shareholder basis is generally increased by direct loans to the S corporation
      - At-risk basis is increased only by the direct loans made to the S corporation where the shareholder is: (a) personally liable for the repayments of such amounts, or (b) had pledged unencumbered property (not used in the activity) as security for the borrowed amount (§465(b)(2))
        - A shareholder borrowing funds from a bank and then loaning funds to S corporation creates debt basis but will only create at-risk basis based on the terms of the note providing no indemnity to the borrowing shareholder
    - Examples to Follow…

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- ***Example 1***: James Wright has a 50% interest in ABC Partnership. The allocable share of partnership liabilities and partnership activity for Year 3 are outlined below. His adjusted basis in the partnership interest at the beginning of year 3 was $7,000, and James received $2,000 of cash distributions from the partnership during the tax year. The at-risk basis at the beginning of the year was $1,000, and previously allowed at-risk losses totaled $1,500.

Allocable Share Partnership Liabilities	BOY	EOY
Nonrecourse	$2,000	$1,000
Qualified Nonrecourse Financing	$5,000	$4,200
Recourse	$10,000	$9,800
Total	$17,000	$15,000

Allocable Share of K-1 Activity Items	Current Year	Carryover
Ordinary Income (Loss)	$(5,000)	$ -
Rental Income (Loss)	$(3,000)	$ -
Interest Income	$1,000	$ -
Charitable Contributions	$500	$ -
Nondeductible Expenses	$1,500	$ -

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- ***Example 1***: Partnership Interest Basis Limitation

Allocable Share Partnership Liabilities	BOY	EOY
Nonrecourse	$2,000	$1,000
Qualified Nonrecourse Financing	$5,000	$4,200
Recourse	$10,000	$9,800
Total	$17,000	$15,000

Allocable Share of K-1 Activity Items	Current Year	Carryover
Ordinary Income (Loss)	$(5,000)	$ -
Rental Income (Loss)	$(3,000)	$ -
Interest Income	$1,000	$ -
Charitable Contributions	$500	$ -
Nondeductible Expenses	$1,500	$ -

Adjusted Basis, BOY	$7,000
Current year income items	$1,000
Current capital contributions	$-
Current year change in liabilities	$(2,000)
Distributions	$(2,000)
Adjusted basis used for basis limitation	$4,000

Year 3 allowed losses/deductions/expenses are $4,000, for purposes of basis limitations. The allowed amounts are then considered for at-risk basis purposes.

Losses/Deduction/Expenses	Current Year Loss/Ded/Exp	Prior Year CFWD	Regular Tax Allowed by Basis	Regular Tax CFWD
Ordinary Loss	$5,000	$ -	$2,000	$3,000
Rental Loss	$3,000	$ -	$1,200	$1,800
Charitable Contributions	$500	$ -	$200	$300
Nondeductible Expenses	$1,500	$ -	$600	$900
Total	$10,000	$ -	$4,000	$6,000

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- Example 1: Partnership At-Risk Basis Limitations

Step 1: Determine Current Year Profit (Loss)	
Ordinary Loss/Rental Loss (allowed after basis limitation)	$(3,200)
Other Income (Interest)	$1,000
Other deductions, expenses, losses, nondeductible items (allowed after basis limitation)	$(800)
Current Year Profit (Loss) from Activity after basis limitations	**$(3,000)**
Net Losses are allowed only to the extent of sufficient At-Risk basis.	

Step 2: Determine At-Risk Basis Before Losses/Ded/Exp	
Adjusted At-Risk basis, BOY	$1,000
Current year increases	$-
Current year decreases:	
- Distributions	$(2,000)
- Decrease in qualified nonrecourse financing	$(800)
- Decrease in recourse	$(200)
Subtotal	$(2,000)
Recapture the $2,000 to the extent of previous allowed losses. As indicated in the facts, previously allowed losses were $1,500, thus, that is our recapture amount.	
Current Year Increases: capital contributions, increases in allocable share of recourse and qualified nonrecourse financing, and current year profit from activity	
Current Year Decreases: distributions, decreases in allocable share of recourse and qualified nonrecourse financing	

Step 3: At-Risk Limitations Allocations			
Income Items	**Total**	**Allowed Loss**	**At-Risk CFWD**
Interest Income	$1,000		
Losses/Deduction/Expenses			
Ordinary Loss	$2,000	$500	$1,500
Rental Loss	$1,200	$300	$900
Charitable Contributions	$200	$50	$150
Nondeductible Expenses	$600	$150	$450
Total	$4,000	$1,000	$3,000
Current year losses allowed for at-risk purposes to the extent of income in the activity.			
At-risk carryforward amounts equal the current year loss from the activity due to there being no at-risk basis in the activity after considering decreases and changes in partnership liabilities.			

- Year 3 allowed at-risk losses/deductions/nondeductible items will be as follows:
  - Ordinary Loss of $500
  - Rental Loss of $300
  - Charitable Contributions of $50
  - Nondeductible Expenses of $150
- Note the current year losses couldn't create negative at-risk basis but distributions and decreases in at-risk liabilities can create negative at-risk basis and create the potential for recapture. The year 3 recapture will be $1,500, which is the amount of prior year at-risk losses allowed
  - Recapture is capped at the lesser of the absolute value of the current year negative at-risk basis and the previous allowed at-risk losses
- Carryforward items are available as a deduction in the subsequent tax year if there is sufficient at-risk regardless of there being sufficient basis in the partnership interest in the subsequent year
  - Because the items were previously allowed subject to the basis limitations, they will not be subsequently disallowed

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- Example 2: Kathy Ferguson owns 30% of the outstanding stock of An S Corporation. The allocable shares of S corporation income, gain, expense, and loss items related to Year 5 activity are outlined below. Kathy received $3,000 in distributions from the S corporation during Year 5. Kathy has a $3,000 outstanding loan to the S corporation; however, her basis in the debt at the beginning of year 5 is $1,000. No payments on the outstanding loan were made to Kathy during the tax year. Additionally, her basis in the S corporation stock is $4,000 at the beginning of the year, and her at-risk basis at the beginning of the year was $2,000. Cumulative allowed at-risk losses are $500.

Allocable Share of K-1 Activity Items	Current Year	Basis Carryover	At-Risk Carryover
Ordinary Income (Loss)	$(1,000)	$(500)	$(700)
Interest Income	$500	$-	$-
Charitable Contributions	$1,000	$-	$-
Nondeductible Expenses	$1,500	$-	$-
Total	$2,000	$(500)	$(700)

Stock Basis			Debt basis	
			Debt Basis, BOY	$1,000
Stock Basis, BOY	$4,000		Income used to restore debt basis	$-
Current Year Capital Contributions	$-		Loans made to S corp during year	$-
Current Year Income Items	$500		Less: Loan Repayments	$-
Less: income for debt restoration	$-		Debt basis used for basis limitation	$1,000
Less: distributions	$(3,000)		Loss allowed against debt basis	$-
Adj basis for basis limitation	**$1,500**		**Debt Basis, end of tax year**	**$1,000**
Total Basis for Loss Limitation	**$2,500**			

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- Example 2: S Corporation Basis Limitation (cont'd)

Stock Basis			Debt basis	
			Debt Basis, bgn of tax year	$1,000
Stock Basis, bgn of tax year	$4,000		Income used to restore debt basis	$-
Current Year Capital Contributions	$-		Loans made to S corp during year	$-
Current Year Income Items	$500		Less: Loan Repayments	$-
Less: income for debt restoration	$-		Debt basis used for basis limitation	$1,000
Less: distributions	$(3,000)		Loss allowed against debt basis	$-
Adj basis for basis limitation	**$1,500**		**Debt Basis, end of tax year**	**$1,000**
Total Basis for Loss Limitation	**$2,500**			

Losses/Deduction/Expenses	Current Year Loss/Ded/Exp	Prior Year CFWD	Total CY and PY	Total CY and PY %	Regular Tax Allowed by Basis	Regular Tax CFWD
Ordinary Loss	$1,000	$500	$1,500	60%	$600	$900
Charitable Contributions	$1,000	$-	$1,000	40%	$400	$600
Nondeductible Expenses	$1,500	$-	-0-	-0-	$1,500	$-
Total	$3,500	$500	$2,500	100%	$2,500	$1,500

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- Example 2: S Corporation At-Risk Basis Limitation

Step 1: Determine Current Year Profit (Loss)	
Ordinary Loss (Current Year and Prior Year Carryforward ($600 + $700))	$(1,300)
Other Income (Interest)	$500
Other deductions/expenses/losses/nondeductible items ($1,500 nondeductible + $400 charitable contributions)	$(1,900)
Current Year Profit (Loss) from Activity	$(2,700)
Net Losses are allowed only to the extent of sufficient At-Risk basis	

Step 2: Determine At-Risk Basis Before Losses/Ded/Exp	
Adjusted At-Risk basis, BOY	$2,000
Current year increases	$-
Current year decreases	
- Distributions	$(3,000)
- Loan repayment on S corporation debt	
Subtotal	$(1,000)
Recapture the $1,000 to the extent of previous allowed losses. As indicated in the facts, previously allowed losses not previously recaptured are in the amount of $500, thus, that is our recapture amount	
Current Year Increases: capital contributions, additional qualifying loans made to S corp, and current year profit from activity	
Current Year Decreases: distributions, loan repayments on S corporation debt	

Step 3: At-Risk Limitations Allocation			
Income Items	Total	Allowed Loss	At-Risk CFWD
Interest Income	$500		
Losses/Deduction/Expenses			
Ordinary Loss	$1,300	$203	$1,097
Charitable Contributions	$400	$63	$337
Nondeductible Expenses	$1,500	$234	$1,266
Total	$3,200	$500	$2,700

- Year 5 allowed at-risk losses/deductions/nondeductible items will be as follows:
  - Ordinary Loss of $203
  - Charitable Contributions of $63
  - Nondeductible Expenses of $234
- Note the current year losses couldn't create negative at-risk basis but distributions and decreases in at-risk liabilities can create negative at-risk basis and create the potential for recapture. The year 5 recapture will be $500, which is the amount of prior year at-risk losses allowed.
  - Recapture is capped at the lesser of the absolute value of the current year negative at-risk basis and the previous allowed at-risk losses
- Carryforward items are available as a deduction in the subsequent tax year if there is sufficient at-risk basis regardless of there being sufficient basis in the partnership interest in the subsequent year
  - Because the items were previously allowed subject to the basis limitations, they will not be subsequently disallowed due to a basis limitation

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Loss Limitations – A Mechanical Review

Limitation 2: At Risk Limitations (§465)

- Debt basis creates at-risk basis to the extent of:
  1. The taxpayer is personally liable for the debt; and
  2. The taxpayer is not otherwise protected from loss
  - At-risk basis limitations are applicable to individuals, estates, trusts, and closely held C corporations
    - Closely held C corporation includes any corporation owned directly or indirectly by or for five or fewer individual owners at any point during the past half of the tax year
    - Ownership attribution can apply
    - Significant changes in ownership of a C corporation that trigger short-year tax filing obligations can make these rules more complicated in application and can unexpectedly trigger application of the at-risk limitation rules in a particular organization that would not have previously been subject to the provisions
  - Planning opportunities are available for aggregating at-risk basis for related activities
    - Aggregating activities allows a taxpayer to treat multiple, related trades or businesses as one activity to the extent the taxpayer (1) actively participates in the management of the trade/business; OR (2) the trade or business is carried on by a partnership or S corporation and 65% or more of its losses for the tax year are allocable to a person who actively participates in the management of the trade or business
    - Active participation is determined based on all available facts and circumstances

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- After computing basis limitations and at-risk loss limitations, the allowable losses, deductions, and credits are then subject to the §469 **passive-activity loss limitations (PALs)**
  - PALs ***restrict*** the utilization of losses and deductions along with the allowability of credits to the extent of passive income each year, with any excess amounts carried forward indefinitely
    - If a passive activity is ***fully disposed***, the activity no longer meets the definition of a passive activity, and all carryforward items are released for utilization in claiming the carryover losses, deductions, and credits
    - **Portfolio income** (i.e., interest dividends, and capital gains) from passthrough income and directly allocable/related deductions are not considered from a passive activity for purposes of §469
    - **Charitable Contribution Deductions** are not considered in the passive activity loss limitations but are considered for both basis and at-risk basis limitation calculations
    - **Nondeductible items** are not considered in the passive activity limitations
    - **Guaranteed payments** (including partner health insurance premiums) are excluded from passive activity calculations and are included in the taxpayer's ordinary income regardless of the other types of income distributed by the partnership. It is worth noting that a partner receiving guaranteed payments will often meet the material participation requirements (as discussed later), and thus, not be subject to the passive loss limitations

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- ***Limitation 3: Passive Loss Limitations (PALs)***
  - PALs apply to individuals, estates, trusts, closely held C corporations, and personal service corporations (§469(a)(2))
    - The closely held C corporation definition is the same as it is for the at-risk basis limitations (§465(j)(1))
    - ***Personal service corporations*** are characterized as such where the principal activity is the performance of personal services executed substantially by employee-owners. This definition is similar to the definition included in §269A(b)(1), with further details outlined in the instructions of Form 8810
  - PALs are calculated and presented on different forms depending on the type of taxpayers
    - Form 8582 is prepared for individuals, estates, and trusts
    - Form 8810 is prepared for closely held C corporations and personal service corporations

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- What constitutes a **passive activity**?
  - The taxpayer did not:
    - **Materially participate in the activity; OR**
    - Engage in any **rental activity**, subject to specific exceptions
  - **Material participation** is met by fulfilling one of the following seven tests (Temp. Reg. §1.469-5T(a)):
    - **Test 1**: Participation is more than 500 hours in a given tax year;
    - **Test 2**: Participation constitutes substantially all the participation of all individuals (both owners and non-owners);
    - **Test 3**: Participates more than 100 hours in a year and more than anyone else;
    - **Test 4**: Significant participation in the activity and all significant participation activities in aggregate exceeds 500 hours;
    - **Test 5:** Prior year material participation in any five of the preceding ten taxable years;
    - **Test 6**: Activity is personal service in nature and the taxpayer materially participated in any three preceding taxable years; **OR**
    - **Test 7**: Facts and circumstances (last resort, good luck)!

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- What constitutes a passive activity?
  - Rental Activities are passive activities by default (§469(c)(2)), subject to 8 exceptions outlined below:
    - **Exception 1:** Real Estate Professionals (§469(c)(7))
    - **Exception 2**: Average customer use of property is seven days or less (e.g., vacation condo) (Temp. Reg. §1.469-1T(e)(3)(II)(A))
    - **Exception 3:** Average period of use is 30 days or less and significant personal services are provided (e.g., dude ranch)
    - **Exception 4:** Extraordinary personal services are provided (e.g., boarding school dormitories, hospitals)
    - **Exception 5**: Rental activity is incidental to the nonrental activity
    - **Exception 6:** Property is available to nonexclusive customers during defined business hours (e.g., golf course)
    - **Exception 7:** Taxpayer provides the property for use in a partnership, S corporation, or JV which the taxpayer owns an interest in (e.g., taxpayer solely owns warehouse that is used by S corporation distribution company the taxpayer is a shareholder of and provides the warehouse for use to the S corporation distribution company (PLR 9722007)

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- What constitutes a passive activity?
  - Rental activities are passive activities by default subject to 8 exceptions (cont'd):
    - **Exception 8**: A special $25,000 loss is allowed for a taxpayer and/or spouse that **actively participated** in a passive rental real estate activity, subject to phaseout rules. Losses in excess of $25,000 are still subject to the passive activity loss limitations
      - Active participation is different from material participation and is less stringent
      - IRS Publication 925 is a convenient tool for understanding the applicability of the active participation rules/exception
  - **Grouping Activities** is also available, similar to the at-risk limitations. One or more trade or business activities, including rental activities, can be treated as a single activity/economic unit, which can allow a taxpayer to materially participate across several activities rather than a single activity, and thus, avoid PAL limitations
    - Grouping can also impact the active participation requirements for rental activities, so if a taxpayer is attempting to group rental activities, he should think holistically regarding the effects of all passive activities

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- PAL Limitation Mechanics
  - PALs are looked at in the **aggregate of passive income against passive losses** (§469(d)1))
    - Basis limitations and at-risk basis limitations look at an activity/entity-by-entity basis, while PALs bring all separate, passive activities together to look at a total loss/deduction/credit profile of a taxpayer in a given tax year. PALs are allocated to activities and within activities on a **pro-rata basis** in accordance with the regulations (§469(j)(4))
    - The $25,000 special loss allowance is also allocated to and within activities on a pro-rata basis like other passive loss limitations
    - The character of losses and deductions still apply, like both the basis limitations and the at-risk basis limitations
  - Closely held C corporations may offset active income to the extent of any net active income (§469(e)(2))
    - Net active income refers to the taxable income of the taxpayer for a taxable year without consideration for income or loss from a passive activity and portfolio income
    - Essentially passive activities ***cannot create*** an NOL

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- PAL Limitation Mechanics
  - **Former passive activities losses and credits**: The amounts being carried forward for a former passive activity are allowed in subsequent years to the extent of income/regular tax liability for such activity, with the unused balance being carried forward as though the unused losses/credits arose from a passive activity (§469(f)). Passive activity losses/deductions/credits are only completely freed up upon disposal
  - **Dispositions of Passive Activities**: For the disposition of substantially all of a passive activity, the carryforward amounts of disallowed losses, deductions, and credits are freed up to be used in the year of disposition and no longer carried forward (§469(g))
- **Grouping Passive Activities**: Like the at-risk basis limitations, grouping activities is available, as Reg. §1.469-4(c)(1) defines an activity in terms of appropriate economic units. Regulation §1.469-4(c)(2) provides a facts and circumstances test for determining whether activities being grouped results in an appropriate economic unit
  - Factors to consider include: 1) similarities and differences in types of trades or businesses, (2) the extent of common control, (3) the extent of common ownership, (4) geography of activities, and (5) interdependencies between/among activities. Because grouping activities can result in activities being treated more beneficially than nonpassive activities, consideration should be given to this where a taxpayer has many activities
- Mechanical examples to follow…

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- PALs Mechanics
  - Example 1: Moira has ownership interests in three separate distribution companies, Distributor 1, LLC (D1), Distributor 2, LLC (D2), and Distributer 3, S Corp Inc. (D3). Moira treats all activities as separate passive activities. After consideration of all relevant capital/debt basis limitations and at-risk limitations, the allowable income/losses, deductions, etc. are as presented below:

Category (not representative of Schedule K-1 box numbers)	D1, LLC	D2, LLC	D3, S Corp
1. Ordinary Income (Loss)	$(11,600)	$(1,200)	$12,000
2. Guaranteed Payments/Partner Health Insurance Premiums	$10,000		
3. Interest income		$4,000	
4. Rental Income (Loss)	$(3,600)		
5. Section 1231 Gain (Loss) Passive		$(500)	
6. Section 179	$1,800		$4,000
7. Charitable Contributions	$1,000		$500
8. Nondeductible Expenses	$800	$700	$2,500
Prior Year Unallowed Amounts			
1. Ordinary Income (Loss)	$(1,000)		$(4,500)
5. Section 1231 Gain (Loss) Passive		$(300)	

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- PALs Mechanics -- Example 1: (cont'd)

Step 1 requires that we determine the overall gain or loss from all activities. This will consider current year amounts, and any carried forward disallowed losses/deductions amounts from prior year

Category (not representative of Schedule K-1 box numbers)	D1, LLC	D2, LLC	D3, S Corp	Total
1. Ordinary Income (Loss)	$(11,600)	$(1,200)	$12,000	
2. Guaranteed Payments/Partner Health Insurance Premiums	$10,000			
3. Interest income		$4,000		
4. Rental Income (Loss)	$(3,600)			
5. Section 1231 Gain (Loss) Passive		$(500)		
6. Section 179	$1,800		$4,000	
7. Charitable Contributions	$1,000		$500	
8. Nondeductible Expenses	$800	$700	$2,500	
Activity Net Passive Income (1 + 4 + 5 - 6)			**$8,000**	**$8,000**
Activity Net Passive (Loss) (1+ 4 + 5 - 6)	**$(17,000)**	**$(1,700)**		**$(18,700)**
Prior Year Unallowed Amounts				
1. Ordinary Income (Loss)	$(1,000)		$(4,500)	$(5,500)
5. Section 1231 Gain (Loss) Passive		$(300)		$(300)
All Passive Activities Net Income (Loss)				**$(16,500)**
Total Losses Allowed (to the extent of passive income)				**$8,000**

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Loss Limitations – A Mechanical Review

Limitation 3: Passive Loss Limitations (§469)

- PALs Mechanics -- Example 1: (cont'd)

  Step 2 requires us to allocate allowed losses between activities on a pro rata basis for all loss activities

Loss Allocation Between Activities	D1, LLC	D2, LLC	D3, S Corp	Total
Overall Loss (Absolute Value)	$18,000	$2,000	N/A Net Passive Income in Activity	$20,000
Ratio	90%	10%		100%
Unallowed Loss	$(14,850)	$(1,650)		$(16,500)
Allowed Loss	**$3,150**	**$350**	**$4,500**	**$8,000**

  Step 3 requires us to allocate allowed losses within activities on a pro rata basis based on category

Unallowed Loss Carryforward Allocation within Activities *	D1, LLC				D2, LLC				D3, S Corp	Total
	Total Activity Loss	Pro Rata %	Unallowed Loss	Allowed Loss	Total Activity Loss	Pro Rata %	Unallowed Loss	Allowed Loss	N/A - Net Passive	Total Unallowed Loss by Character
1. Ordinary Loss/Rental Loss (Incl. Section 179)	$18,000	100.00%	$14,850	$3,150	$1,200	100%	$990	$210		$15,840
2. Section 1231 Loss Passive	$-		$-	$-	$800	0%	$660	$140		$660
Total Carryforward	**$18,000**	**100.00%**	**$14,850**	**$3,150**	**$2,000**	**100.00%**	**$1,650**	**$350**		**$16,500**

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Loss Limitations – A Mechanical Review

Limitation 4: Excess Business Loss Limitations §461(l)

- ***Limitation 4: Excess Business Loss Limitation***
  - The last limitation after the PALs limitation is the **Excess Business Loss Limitation** under §461(l)
    - Prior to the CARES act and applicable to individuals, trusts, and estates, this provision limited the NOL deduction by disallowing excess business losses for tax years beginning after December 31, 2017, and ending before January 1, 2026
    - Excess business losses are defined as the excess of:
      - (1) The taxpayer's aggregate trade/business deductions for a given tax year (excluding NOL and 199A deductions), over
      - (2) The taxpayer's aggregate trade/business income plus $262,000 ($524,000 MFJ) for tax year 2021. This amount is indexed for inflation annually
      - The excess amount is carried forward as an NOL. In effect, the NOL deduction is limited to $262,000 ($524,000 MFJ) for tax year 2021

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Loss Limitations – A Mechanical Review

Limitation 4: Excess Business Loss Limitations §461(l)

- The CARES Act amended §461(l) limiting its application to tax years 2021 through 2026 and repealed the applicability for tax years 2018 through 2020. As such, individuals that were subject to the limitation in prior years can file an amended return to allow the deduction
- **Trade or Business Income/Deductions**: An activity qualifies as a trade or business and should be included in the limitation calculation if the taxpayer engages in the activity for a profit with continuity and regularity based on all facts and circumstances. The fact of a profit being generated is not a factor considered. This can include salaries; tips; business income from Schedules C, F, and E; capital gains/losses from Schedule D; and business gain/losses from Form 4797. Furthermore, to the extent a taxpayer is a trader in securities, dividends, interest, etc., he could be considered for the §461 limitation in a given tax year
- Calculations should be completed on Form 461, and the form should be attached to the return
- Note that while the other limitations discussed applied in a successive order, there is potential for other limitations to apply before the §461 limitation including capital loss limitations, §179 limitations, basis, at-risk, and passive loss limitations
- **Example**: Bill and Kathy's MFJ tax return is being completed. Their return shows portfolio income totaling $250,000. They have ownership interest in one partnership and one S corporation. The partnership ordinary loss allowed before the excess business loss limitation is $945,000, and the S corporation ordinary income is $215,000. The net business loss is $730,000 ($215,000 - $945,000), and the excess business loss is $206,000 ($730,000 - $524,000). This amount is carried forward as an NOL to future tax years

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Loss Limitations – A Mechanical Review

Loss Limitations - Recap

- ***Loss Limitations – A Mechanical Review: Recap***
  - Every partnership and S corporation activity should be tracking basis and at-risk basis to determine the allowance of any losses/deductions
  - At-risk basis includes debt only to the extent of unmitigated risk of loss. Tax practitioners need to think about the payor of last resort to determine if the debt basis should be included in the at-risk basis
  - Each partnership and S corporation activity should be evaluated for material participation to determine if the passive activity loss limitations apply
  - Grouping elections should be evaluated for at-risk and passive activity loss purposes to determine if there are any advantages to the taxpayer
  - The IRS has continued to crackdown on the application of these loss limitations, and with the increase in tax losses due to the COVID-19 pandemic, tax practitioners need to be more aware of the mechanical issues at play for both proper annual compliance as well as planning for the utilization of such losses

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Loss Limitations – A Mechanical Review

Corporate Loss Limitations

- ***Corporate Net Operating Losses – A Quick Note***
  - The enactment of TCJA brought about significant changes to the corporate NOL rules including the limitation of the NOL deduction to 80% of taxable income, the disallowance of NOL carrybacks, and the removal of the 20-year carryforward limitation
  - The CARES Act of 2020 changed the NOL deductions again for tax years 2018 through 2020 by allowing NOL carrybacks for five years and removing the 80% NOL deduction limitation for tax years 2018 through 2020
  - Due to the suspension of certain TCJA NOL limitations, taxpayers can use the various amended return processes and/or superseded returns to claim refunds as an additional source of cash flow for struggling entities

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Chapter 4

Numbers Applicable to Rulings

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
A. Tax Rates for the Individual

Single:

If taxable income is:	The tax is:
Not over $9,950	10 percent of taxable income.
Over $9,950 but not over $40,525	$995, plus 12 percent of the excess over $9,950.
Over $40,525 but not over $86,375	$4,664, plus 22 percent of the excess over $40,525.
Over $86,375 but not over $164,925	$14,751, plus 24 percent of the excess over $86,375.
Over $164,925 but not over $209,425	$33,603, plus 32 percent of the excess over $164,925.
Over $209,425 but not over $523,600	$47,843, plus 35 percent of the excess over $209,425.
Over $523,600	$157,804.25, plus 37 percent of the excess over $523,600.

Head of Household:

If taxable income is:	The tax is:
Not over $14,200	10 percent of taxable income.
Over $14,200 but not over $54,200	$1,420, plus 12 percent of the excess over $14,200.
Over $54,200 but not over $86,350	$6,220, plus 22 percent of the excess over $54,200.
Over $86,350 but not over $164,900	$13,293, plus 24 percent of the excess over $86,350.
Over $164,900 but not over $209,400	$32,145, plus 32 percent of the excess over $164,900.
Over $209,400 but not over $523,600	$46,385, plus 35 percent of the excess over $209,400.
Over $523,600	$156,355 plus 37 percent of the excess over $523,600.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
A. Tax Rates for the Individual

Married Filing Jointly and Surviving Spouse:

If taxable income is:	The tax is:
Not over $19,900	10 percent of taxable income.
Over $19,900 but not over $81,050	$1,990, plus 12 percent of the excess over $19,900.
Over $81,050 but not over $172,750	$9,328, plus 22 percent of the excess over $81,050.
Over $172,750 but not over $329,850	$29,502, plus 24 percent of the excess over $172,750.
Over $329,850 but not over $418,850	$67,206, plus 32 percent of the excess over $329,850.
Over $418,850 but not over $628,300	$95,686, plus 35 percent of the excess over $418,850.
Over $628,300	$168,993.50, plus 37 percent of the excess over $628,300.

Married Filing Separately:

If taxable income is:	The tax is:
Not over $9,950	10 percent of taxable income.
Over $9,950 but not over $40,525	$995, plus 12 percent of the excess over $9,950.
Over $40,525 but not over $86,375	$4,664, plus 22 percent of the excess over $40,525.
Over $86,375 but not over $164,925	$14,751, plus 24 percent of the excess over $86,375.
Over $164,925 but not over $209,425	$33,603, plus 32 percent of the excess over $164,925.
Over $209,425 but not over $314,150	$47,843, plus 35 percent of the excess over $209,425.
Over $314,150	$84,496.75 plus 37 percent of the excess over $314,150.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
A. Tax Rates for the Individual

Estates and Trusts:

If taxable income is:	The tax is:
Not over $2,650	10 percent of taxable income.
Over $2,650 but not over $9,550	$265, plus 24 percent of the excess over $2,650.
Over $9,550 but not over $13,050	$1,921, plus 35 percent of the excess over $9,550.
Over $13,050	$3,146, plus 37 percent of the excess over $13,050.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
A. Tax Rates for the Individual

- For 2021, the tax rate on capital gain and/or qualifying dividend income is available to individuals only with ordinary taxable income of the following:

Ordinary Taxable Incomes	0% Capital Gains Rate	15% Capital Gains Rate	20% Capital Gains Rate
Single	$40,400 and below	$40,401 to $445,850	Over $445,850
Joint filers and surviving spouses	$80,800 and below	$80,801 to $501,600	Over $501,600
HOH	$54,100 and below	$54,101 to $473,750	Over $473,750
Married Filing Separate	$40,400 and below	$40,401 to $250,800	Over $250,800

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
B. Standard Deduction

Filing Status	2021
Married filing jointly	$25,100
Surviving spouse	$25,100
Heads of households	$18,800
Unmarried	$12,550
Married filing separately	$12,550

Additional standard deductions for the elderly and blind in 2021:

Taxpayer	Either	Both
Unmarried	$1,700	$3,400
Married	$1,350	$2,700

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
C. Personal Exemptions

Personal Exemption: **2021 – $0!!!**

The exemption amount and who claims the dependent are still important for other provisions. For the purposes of other code sections, the 2021 personal exemption amount is $4,300

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
E. Earned Income Tax Credit

2021 earned income and adjusted gross income (AGI) must each be less than:

If filing...	Qualifying Children Claimed			
	Zero	One	Two	Three or more
Single, Head of Household or Widowed	$21,430*	$42,158	$47,915	$51,464
Married Filing Jointly	$27,830	$48,108	$53,865	$57,414

***as modified by ARPA**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
F. Exclusion From Income for Certain Redemptions of Bonds

- An exclusion is available for income from the redemption of United States savings bonds for taxpayers who pay qualified higher-education expenses (as defined in §135)

Filing status	2021 phase-out amount
Married filing jointly	$124,800
Others	$83,200

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
G. Dependent-care Credit

- Qualifying individual:
  - Dependent under age 13
  - Physically or mentally incapable dependent
    - Requires taxpayer to provide abode for > ½ year
  - Physically or mentally incapable spouse
- Taxpayer need not maintain household to claim (i.e., no > ½ support test)

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
G. Dependent-care Credit

- As previously discussed, ARPA makes a variety of changes to the child and dependent-care credit, including:
  - ARPA makes the child and dependent-care credit **refundable**
  - Starting in tax year 2021, ARPA increases the eligible employment-related expenses limit to $8,000 if there is one qualifying individual with respect to the taxpayer, or $16,000 if there are two or more qualifying individuals with respect to the taxpayer
    - For taxpayers with AGI of $125,000 or less, the maximum amount of the credit is $4,000 ($8,000 x 50%) for taxpayers with one qualifying individual and $8,000 ($16,000 x 50%) for taxpayers with two or more qualifying individuals
  - ARPA increases the applicable credit percentage to 50%, reduced by 1 percentage point for each $2,000 (or fraction thereof) by which the taxpayer's AGI for the tax year exceeds $125,000

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
G. Dependent-care Credit

- ***Example 1***: In 2020, Karen pays $10,000 in eligible employment-related expenses to care for her three daughters while she works. The children are qualifying individuals for purposes of the dependent-care credit. Karen's AGI is $97,000
  - Since the eligible employment-related expenses occurred during the 2020 tax year, the maximum amount of qualified employment-related expenses that Karen can use to determine the dependent-care credit is $6,000
- ***Example 2:*** Assume the same facts in Example 1, except Karen pays $10,000 in eligible employment-related expenses in **2021**
  - Since the eligible employment-related expenses occurred during the 2021 tax year, Karen can take into account *the entire $10,000 of eligible employment-related expenses* when determining the dependent-care credit

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

1. Education credits

- American Opportunity Credit
  - Maximum $2,500 for 2021
- Lifetime Learning credit
  - Maximum $2,000 for 2021
  - Phase-out increased for inflation adjustment

2021 Phase out	MFJ	$160,000 to $180,000
	Single	$ 80,000 to $ 90,000

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

2. Qualified tuition expenses

- The Bipartisan Budget Act of 2018 retroactively extended the above-the-line deduction for qualified tuition expenses for the 2017 tax year. The SECURE Act, signed into law December 20, 2019, extended the above-the-line deduction for qualified tuition expenses for tax years 2018 through 2020
  - Starting in tax year 2021, The TCDTRA repeals the deduction for qualified tuition and related expenses and increases the income limitation phaseout range for the Lifetime Learning Credit

3. Coverdell education savings accounts (CESAs)

Note: The Department of Education has announced that for financial-aid purposes, it will no longer treat the CESA as the student's asset, but the parent's. Generally 35% of the student's assets are considered available resources while only 5.6% of a parent's assets are so treated

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

3. Coverdell education savings accounts (CESAs)

The Case to Kill the Coverdell:

- Once an attractive option for families looking to save for college, the popularity of CESAs have dwindled in recent years, especially due to the impact of the TCJA of 2017 and the SECURE Act of 2019. Consider the following:
  - CESAs once had the advantage of allowing qualified withdrawals for K-12 expenses. The TCJA of 2017 expanded §529 plans by allowing qualified withdrawals for K-12 expenses, eliminating that advantage of CESAs over §529 plans
  - The SECURE Act expanded §529 plans by allowing qualified withdrawals for student loan repayment (up to $10,000) and apprenticeship programs. Student loan repayment and apprenticeship program expenses are not considered qualified withdrawals for CESAs

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

3. Coverdell education savings accounts (CESAs)

The Case to Kill the Coverdell:

- (continued)
  - Combined contributions are capped at $2,000 per beneficiary, per year, not indexed for inflation
  - Section 529 plans have an indefinite life and can last for generations, whereas CESAs must be disbursed for qualified education expenses or given to another family member under age 30 by the time the original beneficiary turns 30 years old
  - Section 529 plans can qualify for state tax deductions and credits, whereas CESAs do not
- CESAs are not necessarily ***bad*** college savings instruments. CESAs generally provide a broad range of investment options, while §529 plan investment options are more limited in nature. Despite the broader range of investment options, recent law has made other options, such as §529 plans, ***much more attractive***

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

4. Qualified tuition programs (§529 plans)

Contributions by donors are eligible for the $15,000 annual gift-tax exclusion ($30,000 for “split” gifts by married couples). Therefore, for transfer-tax purposes such contributions are treated as a completed gift to the beneficiary

Planning point:

If the contribution is larger than the amount of the gift-tax annual exclusion, the donor may prorate the contribution to the prepaid tuition plan over five years for purposes of claiming the gift-tax annual exclusion. This allows the contribution of **up to five times the amount of the annual exclusion (up to $75,000 for an individual and up to $150,000 for split gifts)** to be made **without gift-tax consequences**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

5. SECURE Act update: Section 529 plans

- Section 302 of the SECURE Act expands §529 education savings accounts coverage to include expenses associated with ***registered apprenticeship programs*** and distributions for ***qualified education loan repayments***
- Up to $10,000 (lifetime maximum) can be withdrawn from a §529 plan to pay student loan principal amounts and related interest expenses for the beneficiary or the beneficiary's siblings
- This provision applies to distributions made after December 31, 2018

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

6. Student loan interest

There is an **above-the-line deduction for interest** paid on certain loans used to pay **qualified higher-education expenses**

The amount allowable cannot exceed $2,500

Income phase-out ranges are adjusted annually for inflation

Taxpayer	2021
Married filing jointly	$140,000- $170,000
Single (including head of household)	$70,000 - $85,000

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

- ***6. Student loan interest***
- While the student loan interest deduction is available to eligible taxpayers, federal student loan interest payments have been **suspended** since March 13, 2020 through September 30, 2021
- The Department of Education initially announced the suspension in March 2020, and President Biden ***extended*** the suspension through September 30, 2021 through executive order
- The suspension of student loan interest payments only applies to **federal** loans, not private loans

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ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
H. Education Benefits

- ***6. Student loan interest***
- Many taxpayers have taken advantage of federal student loan interest suspension
- As of February 2021, the number of student loans currently in forbearance or deferral is more than double what it was a year ago
- As a result of the federal student loan interest payment suspension, taxpayers will likely have a much smaller student loan interest deduction in the 2020 and 2021 tax years

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I. Tax Rates and Other Information for 2021
I. Transportation

- ***Mileage –***
- **The cents-per-mile rate for 2021 is 56 cents (down from 57.5 cents in 2020)**
- Medical and moving mileage rates decrease to 16 cents a mile for 2021 (down from 17 cents in 2020)

SURGENT
ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
I. Transportation

- ***3. Depreciation***
- **Autos (including trucks and vans):**
- $10,200 for the placed-in-service year
- $16,400 for the second tax year
- $9,800 for the third tax year, and
- $5,860 for each succeeding year

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ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
I. Transportation

3. Depreciation

- As always, the dollar limits must be proportionately reduced if business/investment use of a vehicle is less than 100%

- The §179 expense limitation with respect to a sport-utility vehicle placed in service after October 22, 2004 is limited to $26,200 for 2021 (indexed for inflation after 2018 (TCJA))

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021

3. Depreciation

Section 179	2021
Acquisition Limit	$2,620,000
Income Limit	Trade/ Business Income
Overall Limit	$1,050,000

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
I. Transportation

- ***4. Qualified transportation expenses***
- The amount of the fringe benefits that are provided to any employee and that may be excluded may not exceed **$270 per month** in the aggregate for transportation in a commuter highway vehicle and transit passes for 2021
- **$270 per month** in the case of qualified parking for 2021
- *TCJA eliminated the deduction for these fringe benefits. The amounts are still excludable from the employees' income, but not deductible by the employer after 2017*

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
Notice 2021-52

- ***5. Federal per-diem rates October 1, 2020 to Sept. 30, 2021***
- High-Cost Locality $296
- $222 for lodging
- $ 74 for meals and incidentals
- Other Locality $202
- $138 for lodging
- $ 64 for meals and incidentals

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
J. Social Security Adjustments

- In 2021, the taxable wage base rose to **$142,800**
- 2021 Max OASDI tax of:
  - $8,853.60 (employer's share),
  - $8,853.60 (employee's share), or
  - $17,707.20 (self-employed individual)
- The Medicare portion of the tax remains a combined 2.9% on all earned income

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
J. Social Security Adjustments

2. 2021 Excess earnings

	May Earn up to :	If in Excess, the amount withheld
Younger than FRA	$18,960/year in 2021 ($1,580/month)	$1 for every $2 over the annual limit
The year you reach FRA	$50,520/year in 2021 ($4,210/month)	$1 for every $3 over the annual limit
Once you reach the month of FRA	No limit	No limit

SURGENT ACCOUNTING & FINANCIAL EDUCATION

3. Full retirement age

Year of Birth	Full Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

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Note:

Workers who delay retirement beyond age 66 and consequently do not receive benefits are entitled to an increase in old-age benefits of 8% per year for workers reaching retirement age in 2021

Note:

- A husband or wife of an insured individual is entitled to 50% of the PIA
- Reduced benefits will be paid if the husband or wife is younger than the normal retirement age

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
J. Social Security Adjustments

- ***4. Medicare***
- The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 imposes a new premium on high-income enrollees in Medicare Part B (physician services) that will vary based on the income reported by each enrollee to the IRS for federal income-tax purposes
- Termed the "income-related reduction in Part B subsidy," the new premium will effectively constitute an income-tax surcharge

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
J. Social Security Adjustments

Modified Adjusted Gross Income for 2019		2021 Premium
File individual tax return	**File joint tax return**	
$88,000 or less	$176,000 or less	$148.50
above $88,000 up to $111,000	above $176,000 up to $222,000	$207.90
above $111,000 up to $138,000	above $222,000 up to $276,000	$297.00
above $138,000 up to $165,000	above $276,000 up to $330,000	$386.10
above $165,000 up to $500,000	above $330,000 up to $750,000	$475.20
Above $500,000	Above $750,000	$504.90

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
K. Medical Expenses

- ***1. Long-term-care insurance***

Age	Maximum Deductible Premium
	2021
40 or less	$450
More than 40 but not more than 50	$850
More than 50 but not more than 60	$1,690
More than 60 but not more than 70	$4,520
More than 70	$5,640

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
K. Medical Expenses

- ***1. Long-term-care insurance***

Planning point:

- The provision of long-term-care insurance is fast becoming a significant part of any retirement plan. **Medicaid can only be relied on by the indigent** (and, even then, not in every circumstance)
- It is often impossible (and always time-consuming and frustrating) to try to qualify for Medicaid as a member of the middle class. In addition, there is little personal choice in the context of Medicaid

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021
K. Medical Expenses

- ***2. Health savings accounts***

HSA 2021	Self Only	Family
Min. Deductible	**$1,400**	**$2,800**
Out-of-Pocket	**$6,900**	**$13,800**
Max Deduction	**$3,600**	**$7,200**
Catch-Up ≥ 55	$1,000/per acct	$1,000/per acct

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I. Tax Rates and Other Information for 2021
L. Other

- ***1. Tax benefits effective for individuals***

- The exclusion for foreign-earned income = **$108,700 in 2021**

- ***3. Adoption credit***

- **Qualified adoption expenses = $14,440 in 2021**
  - Credit and Exclusion phased out ratably
  - Between $216,660 and $256,660 for 2021

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I. Tax Rates and Other Information for 2021

M. Retirement Plan 2021 Numbers

	2021
1. Maximum annual benefit	**$230,000**
2. Maximum annual addition	**$ 58,000**
3. Maximum compensation	**$290,000**
4. SIMPLE deferral maximum	**$ 13,500**
▪ ***SIMPLE Catch-up***	**$ 3,000**
5. SEP minimum compensation	**$ 650**
6. Maximum elective deferral	**$ 19,500**
▪ ***Catch-up***	**$ 6,500**
7. Highly compensated	**$130,000**

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I. Tax Rates and Other Information for 2021

M. Retirement Plan 2021 Numbers

9. IRAs **$6,000**

- ***Catch-up*** **$1,000**

Year Beginning	Joint return Phase-Out	Single taxpayer Phase-Out
2021	$105,000 – $125,000	$66,000 – $76,000

- The maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between $198,000 and $208,000 in 2021

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ACCOUNTING & FINANCIAL EDUCATION

I. Tax Rates and Other Information for 2021

M. Retirement Plan 2021 Numbers

Roth Limits **$6,000**

- ***Catch-up*** **$1,000**

Year Beginning	Joint return Phase-Out	Single taxpayer Phase-Out
2021	$198,000 – $208,000	$125,000 – $140,000

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Chapter 5

Investments, Retirement, and Miscellaneous

SURGENT ACCOUNTING & FINANCIAL EDUCATION

I. Investments

A. Real Estate

The Law:

- A taxpayer qualifies as a Real Estate Professional (REP) and is not engaged in a passive activity from rental activities if:
- (i) More than one-half of the personal services performed in trades or businesses by the taxpayer during such taxable year are performed in real property trades or businesses in which the taxpayer materially participates; and
- (ii) Such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates

SURGENT ACCOUNTING & FINANCIAL EDUCATION

A. Real Estate

The Law:

- With respect to the evidence...the extent of participation may be established by any reasonable means.
- Contemporaneous daily time reports, logs…**are not required** if the extent of participation may be established by other reasonable means.
- Reasonable means may include…the identification of services performed…the approximate number of hours spent performing such services…appointment books, calendars, or narrative summaries.
- Tax Courts have consistently held that **they do not allow a post-event "ballpark guesstimate."**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

A. Real Estate
The Law:

- The active participation requirement is met so long as the taxpayer has participated significantly and in a bona fide way with respect to management decisions (such as approving new tenants or repairs or deciding on rental terms) or arrangements for others to provide services (such as repairs)
- Thus, unlike the material participation requirement, the active participation requirement can be satisfied without regular, continuous, and substantial involvement in operations

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Surgent Sidebar

- Best Individual Income Tax Update
- Time as Investor
- *1.469-5T(f)(2)(ii).*

- ***Personal services –** any work performed by an individual in connection with a trade or business,* ***excluding any work performed by an individual in the capacity as an investor***
- (A) In general.
  - Work done…shall not be treated as participation in the activity unless the individual is directly involved in the day-to-day management or operations of the activity.
- (B) Work done in individual's capacity as an investor includes --
  - (1) Studying and reviewing financial statements or reports on operations
  - (2) Prep or compiling summaries
  - (3) Monitoring the finances

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Surgent Sidebar

- Best Individual Income Tax Update
- *1.469-5T(f)(2)(i)*

- ***Personal services –*** (2) Exceptions
- **(i) Certain work not customarily done by owners.**
- Work done in connection with an activity shall not be treated as participation in the activity for purposes of this Section if:
  - (A) Such work is not of a type that is customarily done by an owner of such an activity; and
  - (B) One of the principal purposes for the performance of such work is to avoid the disallowance, under section 469 and the regulations thereunder, of any loss or credit from such activity.

SURGENT ACCOUNTING & FINANCIAL EDUCATION

B. Cases

- **Taryn L. Dodd v. Comm'r, T.C. Memo 2021-118**
  - *Distributive share of partnership net §1231 gain*
- **Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104**
  - *Conduct of trade or business*
- **Blum v. Comm'r, T.C. Memo. 2021-18**
  - *Lawsuit Settlements; 104(a)(2)*
- **San Jose Wellness v. Comm'r**
  - *Medical Cannabis and Deductible Expenses; 280E*
- **Konstantin Anikeev and Nadezhda Anikeev v. Comm'r**
  - *Taxability of Credit Card Rewards*

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Tax Court Update

1. Taryn L. Dodd v. Comm'r, T.C. Memo. 2021-118

- ***Facts:***
  - Taryn Dodd was employed as an office manager at Braude & Marguiles, P.C. (B&M), a law firm in Washington, D.C. that specialized in real estate and construction law
  - Dodd was also a managing member of Cadillac Investment Partners, LLC, which was involved in the purchase, leasing, and sale of real property
    - She held a 33.5% share of Cadillac's profit, loss, and capital account, and she regularly signed agreements, tax returns, and documents on Cadillac's behalf
  - In 2013, Cadillac sold commercial real property for $4 million and generated a net §1231 gain of $3,203,916, which was reported on Form 1065 that was signed by Dodd
  - As Cadillac's managing member, Dodd received a Schedule K-1 with her $1,073,312 share of the net §1231 gain. She also was allocated ordinary business income, net rental real estate income, and distributions
  - Dodd timely filed her 2013 Form 1040 and included Form 4797 with her return, reporting net §1231 gain of $1,073,312. While she reported a tax liability of $183,976, withholding credits of $14,245, and "amount you owe" as $169,882, ***she included no payment with her return***
  - On August 18, 2014, the IRS assessed the tax shown on the return as due, as well as imposed an addition to tax for failure to pay and interest. **Dodd did not pay the liability upon receiving this notice**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

1. Taryn L. Dodd v. Comm'r, T.C. Memo. 2021-118

- ***Facts:***
  - A CDP hearing as well as a supplemental CDP hearing were held before the case was remanded to the Appeals Office for a second supplemental hearing, as it was determined that the Settlement Officer *failed to determine Dodd's underlying liability challenge*
  - During the second supplemental hearing, a new Settlement Officer, along with an Appeals Officer, were assigned to Dodd's case and confirmed that her 2013 tax was properly assessed
  - The Appeals Officer requested certain documents from Dodd, including Cadillac's partnership agreement and loan documents
  - The loan document stated that certain property was held as collateral for the loan, and it provided that repayment of the loan would be accelerated if such property was sold
    - The property that generated the 2013 net §1231 gain served as collateral for this loan, and as a result, the sale of the property triggered the acceleration clause
    - The funds from the sale of the property were wired to pay off the loan in 2013
  - Dodd provided the Settlement Officer with a reconciliation of her adjusted basis in Cadillac at year-end 2013. Dodd's adjusted basis included an increase of $1,073,312 attributable to her share of the net §1231 gain, a subsequent $611,994 decrease in basis related to the reduction of her share of partnership liabilities, and a $201,601 decrease in basis as a result of a distribution
  - The Appeals Officer and Settlement Officer concluded that Dodd constructively received the net §1231 gain and would be taxed on it
    - The case was remanded to the Tax Court for further proceedings and the parties agreed to submit the case for decision without trial under Rule 122

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Tax Court Update

1. Taryn L. Dodd v. Comm'r, T.C. Memo. 2021-118

- ***Issues & Analysis***
- Section 702(a) provides that a partner is taxable on their distributive share of partnership income, ***regardless of whether the income is actually distributed***
- Preparers may have heard of similar situations of "**phantom income**" haunting certain partners. It does not matter whether a partner actually receives cash as a result of their share of gain; they are still liable for any tax resulting from their share of the gain
- ***Conclusion***
- The Court concluded Dodd was required to include $1,072,312 of net §1231 gain in gross income for 2013, rejected her challenge to the tax liability, and sustained the collection action

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Facts***
- Charles Morgan was a real estate developer who had over 26 years of experience; his companies built over 26,000 homes throughout Indiana and North Carolina between 1983 and 2009
  - Similar to many other real estate developers, Mr. Morgan's businesses experienced financial decline leading up to 2009, resulting in approximately $75 million in defaulted and unpaid obligations as of February 2009
- Creditors filed a "Complaint on Unpaid Indebtedness and for the Appointment of Receiver" in the Indiana superior court
  - At the time, Morgan's companies were allegedly insolvent
  - The Indiana superior court appointed LS Associates, LLC to be a receiver for all Morgan companies as of March 2009. Mr. Morgan was ***prohibited*** from incurring any expenses on behalf of his companies during this time
- Another entity owned by Mr. Morgan, Falcon, was ***not*** placed into receivership
  - Falcon was formed in 1996 to hold, operate, and maintain aircraft
  - Before the receivership was established, Mr. Morgan flew on aircraft held by Falcon to visit potential building sites as well as current developments
  - Falcon did not lease its aircrafts to any third parties at any time; however, Mr. Morgan was passionate about aviation and often piloted the aircrafts himself in his free time

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Facts Cont'd***
- Although his existing real estate development companies were insolvent, Mr. Morgan was determined to begin a new business in the real estate development industry
- In December 2008, he formed Legacy, a single-member LLC that he used to conduct a search for his new trade or business
  - Legacy employed former employees of Morgan's insolvent companies in addition to other outside consultants
- During the receivership, Mr. Morgan continued to use Falcon aircraft to search for new business opportunities through Legacy
- Legacy entertained various business opportunities, but ultimately **did not purchase** any new businesses as of the end of 2012
- In 2012, Charles Morgan and his wife, Roxanna, filed a joint Form 1040 and attached Schedule C for Falcon to their return
  - Falcon reported a gross loss of $303,302 and gross income totaling $516,654 (gross income comprised a $315,000 fee that Legacy paid for consulting and $201,654 paid by the Morgans for their personal use of Falcon's aircrafts)
  - A total of $819,956 of aircraft use and maintenance expenses was reported as an offset to income
- The Morgans also attached Schedule E to their 2012 Form 1040, reporting $648,118 of total expenses related to Legacy with no offsetting gross receipts
- Lastly, the Morgans claimed an NOL deduction of $966,121 on their 2012 Form 1040 attributable to NOL carryforwards from Falcon and Legacy from the 2010 and 2011 tax years

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Issues & Analysis***
- This particular case involves several issues, including:
  1) Whether the couple was carrying on a trade or business and, therefore, was entitled to deductions claimed on Schedule C and Schedule E;
  2) Whether the couple was entitled to an NOL deduction attributable to an alleged NOL carryover; and
  3) Whether the couple was liable for an accuracy-related penalty
- The ***primary issue*** at hand in this case was whether the Morgans were carrying on a trade or business in 2012, as §162(a) allows taxpayers to deduct *all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business*
- Generally, an activity is considered a trade or business if:
  - The taxpayer undertook the activity with intention to earn a profit;
  - The taxpayer is regularly and actively involved in the activity; and
  - The taxpayer's activity has actually commenced. In other words, the taxpayer must do more than simply research or investigate an activity in order to be considered carrying on a trade or business

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Issues & Analysis***
- Section 195(a) states that no current deduction is allowed for start-up expenditures. A **start-up expenditure** is defined by §195(c)(1) as any amount:
  - Paid or incurred in connection with:
    - Investigating the creation or acquisition of an active trade or business;
    - Creating an active trade or business; or
    - Engaging in any activity for profit or the production of income before the day on which the active trade or business begins in anticipation of such activity becoming an active trade or business; AND
  - That, if paid or incurred in connection with the operation of an existing trade or business, would be allowable as a deduction for the taxable year in which it was paid or incurred
- Such start-up expenditures may be immediately deducted or capitalized and deducted over time once the taxpayer actually commences carrying on a trade or business
  - If a taxpayer acquires a trade or business, the business is considered to have commenced on the date acquired
  - If a prior trade or business never ceased, any business investigation expenses are deductible if they are incidental to an existing trade or business

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Issues & Analysis***
- The IRS commissioner argued that the Morgans were no longer carrying on a trade or business because their companies were placed into receivership in 2009 and, as such, the expenses they deducted on their 2012 Form 1040 were not deductible under §162
- The IRS commissioner stated that the expenses incurred were either for the purpose of searching for a new trade or business or for personal use
- Mr. Morgan claimed that he did not begin a new trade or business because his homebuilding activities never ceased
  - The commissioner countered that the homebuilding activities ceased in 2009, as LS Associates, LLC was appointed as receiver, all homebuilding activity ceased, and all employees associated with the homebuilding activities were terminated. No homes were built after February 2009
  - The commissioner cited that while Mr. Morgan expressed interest in creating a new business endeavor, he expressed uncertainty regarding what that specific business activity would be
- The Morgans also insisted that Mr. Morgan's search for a new trade or business conducted through Legacy constituted a trade or business in itself
  - The commissioner responded that Legacy did not meet the §162 requirements to be classified as a trade or business, and the business investigation expenses that Legacy incurred were considered start-up expenditures. Since no business began or was acquired by the end of 2012, such expenses were **not deductible**

SURGENT ACCOUNTING & FINANCIAL EDUCATION

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Issues & Analysis***
- Lastly, the Morgans asserted that the economic recession was an event occurring outside the normal course of trade or business and, as such, they were entitled to deduct business expenses for 2010 through 2012 to preserve their business
  - They cited the opinion found in *T.J. Enters., Inc. v. Commissioner* that expenses *"incurred to protect, maintain, or preserve a taxpayer's business, even though not in the normal course of such business, may be deductible as ordinary and necessary business expenses"*
  - The commissioner countered that this interpretation would widen the scope of §162 too broadly, as it would essentially eliminate the requirement of "carrying on" a trade or business
- ***Conclusion***
- The Court ultimately sided with the Commissioner, stating that Mr. Morgan was not carrying on a trade or business through Legacy in 2010, 2011, or 2012
- Mr. Morgan's business was deemed to have ended in 2009 when his real estate development companies were placed under receivership
- The Court concluded that Falcon's business activities by themselves **did not constitute an active trade or business**
  - As previously stated, Falcon did not lease aircraft or provide services to any third parties, and its only gross receipts came from the Morgans and Legacy

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Conclusion***
- The secondary issue at hand was whether the Morgans were entitled to an NOL deduction for the 2012 tax year related to NOL carryovers from 2010 and 2011
- Section 172 allows a taxpayer to deduct NOLs for a taxable year equal to the aggregate of the NOL carryforwards and carrybacks to that year
- The commissioner argued that the NOL carryover was not valid because the expenses in 2010 and 2011 were related to Legacy and Falcon, and since neither was carrying on a §162 trade or business in 2010 or 2011, the expenses could not give rise to an NOL
  - The Morgans responded that both Falcon and Legacy were subject to TEFRA audit procedures in 2010 and 2011 (the years in question), and thus the claimed deductions could not be disallowed
  - The commissioner did not complete a TEFRA audit of either Legacy or Falcon in 2010 or 2011 within the valid time period under §6229(a); as a result, the commissioner was required to accept the 2010 and 2011 Forms 1065 as filed

2. Estate of Charles P. Morgan, Deceased, Roxanna L. Morgan, Personal Representative and Roxanna L. Morgan v. Commissioner of Internal Revenue, T.C. Memo 2021-104

- ***Conclusion***
- Items that are considered nonpartnership items are not resolved under the TEFRA rules
- Per *Greenwald v. Commissioner*, the need for partner-level factual development is enough to except an item from the definition of a partnership item
  - Particularly, Mr. Morgan's outside basis in Falcon, defined as his adjusted basis in the partnership interest, could **prevent** the deduction of Falcon's 2010 and 2011 losses
- The Morgans were unable to provide sufficient evidence to affirm their outside basis in Falcon; therefore, it was determined by the Court that they were unable to deduct Falcon's 2010 and 2011 NOLs
- The Court determined that the Morgans were not liable for an accuracy-related penalty under 6662(a) because they relied on advice from a tax preparer who prepared their return
- ***Final thoughts***
- Clients should be mindful that the mere search for a trade or business does not rise to the level of a §162 trade or business in and of itself
- Though COVID-19 has certainly caused unprecedented challenges for many businesses, the IRS remains clear in its assertion that the scope of §162 may not be interpreted too broadly as to essentially eliminate the requirement of "carrying on" a trade or business

Tax Court Update

3. Blum v. Comm'r, T.C. Memo. 2021-18

- ***Facts:***
  - Debra Blum, taxpayer, received $125,000 in 2015 in settlement of a lawsuit filed against her personal injury attorneys, which was excluded from income on her 2015 tax return
  - The original personal injury case was against the hospital where the taxpayer received a knee replacement surgery and involved a negligence assertion for a faulty wheelchair
    - The case was granted summary judgment for the hospital
  - Following the failed suit against the hospital, the taxpayer filed suit against her own attorneys for malpractice in breach of their duty to properly pursue her lawsuit against the hospital
    - Her suit against her attorneys **did not** allege she suffered any personal injuries to the fault of her attorneys

Tax Court Update

3. Blum v. Comm'r, T.C. Memo. 2021-18

- ***Facts (cont'd):***
  - The malpractice suit against her attorneys was settled where the taxpayer agreed to drop any claims against the former attorneys
  - The settlement documents state that the taxpayer **did not** sustain physical injuries as a result of the negligence of the attorneys
  - The IRS selected the taxpayer's 2015 federal tax return for examination, as they received a Form 1099-MISC from the attorneys' insurance company which reported the $125,000, but the taxpayer failed to include the corresponding payment on the 2015 federal tax return

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Tax Court Update

3. Blum v. Comm'r, T.C. Memo. 2021-18

- ***Issues:***
  - Is the taxpayer eligible to exclude the $125,000 from gross income on the grounds of settlement based on personal injury/physical illness?
- ***Analysis:***
  - Gross income includes **all income from whatever source derived** unless otherwise excluded (§61)

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Tax Court Update

3. Blum v. Comm'r, T.C. Memo. 2021-18

- ***Analysis (cont'd):***
  - Historical court proceedings demonstrate exclusions from income should be narrowly construed (*States v. Burke*, 504 U.S. 229, 248 [69 AFTR 2d 92-1293] (1992))
  - Section 104 provides the exclusion of settlement proceeds on the grounds of personal injury/physical illness
    - The nature of the claim is controlling argument as to whether damages are excludable from gross income (*States v. Burke*), AND
    - Settlement agreement must expressly state the damages compensate for personal physical injuries or physical illness (TC Memo 2019-142) and if it fails to expressly state such, the court looks to the intent of payor (TC Memo 2017-111)

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Tax Court Update

3. Blum v. Comm'r, T.C. Memo. 2021-18

- ***Conclusion:***
  - Because the settlement proceeds related to the malpractice suit rather than personal injury, the taxpayer **should have included** $125,000 in gross income on the 2015 tax return
    - Taxpayer attempted to claim the settlement was compensation for what should have been received by the hospital, but the nature of the suit against her attorneys was **malpractice, not personal injury**
  - The tax court sustained the IRS judgment
    - Deficiency of tax was sustained
    - IRS conceded the accuracy-related penalty against taxpayer
  - Settlement agreement language can be the determining factor for purposes of §104
  - Counsel should advise to the language included in the settlement agreement
  - Considering COVID-19, there could be many suits arising against hospitals in future years, and analyzing settlement agreements will become much more common during return filing season

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Tax Court Update

4. San Jose Wellness v. Comm'r, 156 T.C. No. 4

- ***Facts:***
  - Pursuant to California law, San Jose Wellness operated as a medical cannabis dispensary and sold other non-cannabis related items and services
  - Expenses incurred for the operation were deducted on tax returns 2010, 2011, 2012, 2014, and 2015, and included expenses for depreciation and charitable contributions
  - The deductions were disallowed under §280E by the IRS for applicable years on the grounds the amounts paid/incurred are disallowed for carrying on a trade or business consisting of trafficking a controlled substance
- ***Issues:***
  - Are the deductions disallowed under §280E?
  - Is the taxpayer liable for accuracy-related penalty on the 2015 return?

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Tax Court Update

4. San Jose Wellness v. Comm'r, 156 T.C. No. 4

- ***Analysis:***
  - Section 280E*: "…no deduction or credit shall be allowed for any amount **paid or incurred** in the taxable year **in carrying on** any trade or business if such trade or business (or the activities which comprise such trade or business) **consists of trafficking** in [certain defined] controlled substances."*
    - The court was asked to determine whether depreciation deductions under §167 and charitable contribution deductions under §170 fall within the prohibition of §280E
  - Section 63 defines taxable as: Gross Income – Allowable Deductions
    - Allowable deductions include those under §167 and §170
    - One main question was whether depreciation is considered paid or incurred in the taxable year
    - Are charitable contribution deductions paid in connection with carrying on a trade or business?

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Tax Court Update

4. San Jose Wellness v. Comm'r, 156 T.C. No. 4

- ***Conclusion:***
  - Court held based on legislative framework and previous case law
    - Section 167 depreciation is treated as paid or incurred during the taxable year in which a deduction would otherwise be allowed
    - Section 170 charitable contribution deductions are generally made for purposes of building goodwill, thus related to trade or business and nondeductible under §280E for San Jose Wellness as a medical cannabis business
    - Previous rulings indicated that though San Jose Wellness offered ancillary goods and services unrelated to the controlled substance business, all deductions are still disallowed
    - Court sustained the IRS assessed deficiencies and accuracy-related penalties
  - Section 280E does not generally disallow deductions for COGS, as COGS is considered a reduction in gross income rather than a deduction
    - This was a distinction the IRS tried to impose in the initial regulations for §163(j) as updated by TCJA
    - The final regulations were updated to reflect that the COGS were allowable in determining §163(j) interest limitations as the disallowance of COGS was not within the scope of legislative intent

Tax Court Update

4. San Jose Wellness v. Comm'r, 156 T.C. No. 4

- ***Conclusion (cont'd):***
  - Generally, cannabis businesses are taxed on Gross Profit for federal tax purposes
    - Where it is legal for state purposes, the state generally allows deductions for state tax return filings
  - Care should be taken in claiming deductions for cannabis-related businesses because of the broad disallowance of §280E
    - §263A generally cannot be used to shift deductions to COGS and §471 should be used to determine COGS (*Alterman v. Commissioner*, T.C. Memo 2018-67), and thus, this results in an unfavorable outcome for cannabis-related businesses
      - Section 263A (enacted in 1986) was never intended to change nondeductible expenses of §280E (enacted in 1982) to deductible expenses
  - With a change in administration and Congress, should cannabis be made legal federally, the cannabis income tax landscape would change drastically as it would no longer be considered a controlled substance

Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Facts:***
  - Mr. and Mrs. Anikeev ("the taxpayers") each had Blue Cash American Express ("Amex") credit cards where they earned Reward Dollars up to 5% of everyday purchases
  - Reward dollars could be redeemed for Amazon gift cards or as credits on their Amex card balances as statement credits with no limit on the amount of Reward Dollars a card user could earn
  - To maximize earning of Reward Dollars, the taxpayers developed a system:
    - **Purchase of Visa Gift Cards with Amex**: Taxpayers would use their Amex cards to purchase as many Visa gift cards as possible from local grocery stores and pharmacies, resulting in Reward Dollars being earned. The Visa gift cards would be used to purchase money orders that would be deposited in the taxpayers' bank account, which would then be used to pay off the Amex card balance
    - **Purchase of Money Orders with Amex**: Occasionally, the taxpayers would purchase money orders from Rite Aid with the Amex, which would generate Reward Dollars. The money orders would be deposited into the taxpayers' bank account

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Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Facts (cont'd)***
  - Total money order deposits to the taxpayers' bank account in 2013 and 2014 was a combined total of $4,028,743
  - To manage the credit limits on the credit cards, the taxpayers made frequent payments on the cards to allow them to keep purchasing Visa Gift Cards and Money Orders in order to continue accruing Reward Dollars
  - For tax year 2013, total Amex Charges were $1,219,077, of which $1,208,376 were purchases of Visa gift cards and money orders. Of the total amount, $10,701 were for purchases more personal in nature. Reward Dollars redeemed in 2013 were $36,200
  - For tax year 2014, the total Amex purchases for Visa gift cards and money orders were $5,184,033. Reward Dollars redeemed in 2014 were $277,275.
  - The joint tax returns filed by the taxpayers for 2013 and 2014 reported total income of $152,410 and $163,124, respectively
  - The IRS issued a deficiency notice to the taxpayers for the redeemed rewards not being included in gross income

SURGENT ACCOUNTING & FINANCIAL EDUCATION

Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Issues***
  - Are cash rewards paid to taxpayers as statement credits considered a cash equivalent or an accession to wealth, and so constitute taxable income?
- ***Analysis***
  - Section 61 broadly defines income as being from whatever source derived unless specifically excluded
  - Services and goods received with purchase price adjustments are generally not considered taxable
  - Rev. Rule 76-96 provides that credit card rewards are generally not taxable as they are treated as a reduction in purchase price of goods or services rather than income
    - This is consistent with the IRS policy on cash rebates as discussed in Publication 17

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Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Conclusions***
  - The IRS argued that the Reward Dollars received relating to purchases of Visa gift cards and money orders were cash equivalents rather than a reduction of purchase price of goods or services
    - The IRS attempted to argue Visa gift cards and money orders are not goods or services, and thus, cannot have a price reduction
    - "Cash equivalents" references the landmark *Cowden* case; the Court rejected the argument that the transactions of the taxpayers were inconsistent with the cash equivalent doctrine
  - The Court concluded the Reward Dollars redeemed associated with the purchase of Visa gift cards were not taxable
    - Though neither a good or service, the gift cards had product characteristics, consistent with the longstanding IRS policy, and thus, the Reward Dollars related to the Visa Gift Cards closely resembled rebates and should not be taxable

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Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Conclusions (cont'd)***
  - The Court concluded the Reward Dollars redeemed associated with the purchase of money orders were taxable
    - Money orders (and reloadable debit cards) are neither a good nor service nor do they offer any product characteristics, and thus, the Reward Dollars associated with those purchases were deemed cash equivalents rather than as rebates. As such, they were considered taxable
  - The Court noted the case looked primarily at inconsistencies of the facts with the IRS policy
  - The Court asked the IRS to refine its policies for future use rather than to piecemeal rules using the tax courts

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Tax Court Update

5. Konstantin Anikeev and Nadezhda Anikeev v. Comm'r, T.C. Memo 2021-23

- ***Conclusions (cont'd):***
  - Accession to wealth was not a determinative factor
  - A less aggressive taxpayer seeking Reward Dollars may not have caught the attention of the IRS (as noted in the decision)
  - These cases can be very subjective to the particular facts and circumstances
  - Because practitioners rarely have insights in credit card rewards redeemed by clients, these circumstances can arise without the practitioner being aware of them
    - It could be worthwhile to note any changes in standard of living without changes in taxable income or inherited assets to identify if there are inconsistencies worth asking questions about

SURGENT ACCOUNTING & FINANCIAL EDUCATION

6. Self-certification Procedure for Waiver of 60-day Rollover Limit
Rev. Proc. 2016-47

- Normally, a distribution from an IRA or workplace plan only qualifies for tax-free rollover treatment if it is contributed to another IRA or workplace plan by the 60th calendar day after it was received. This is the situation where taxpayer receives the funds distributed and accordingly has 60 days to contribute it to another retirement account in order to accomplish the tax free rollover. NOT direct trustee-to-trustee institutional transfers where the taxpayer is not in receipt of the distributed funds
- A taxpayer who misses the 60-day limit now has a relatively simple alternative -- whereas before the only relief would be through a private letter ruling
- As a result, the PLRs have decreased precipitously, and it is anticipated that this self-certification procedure will continue to be the chosen course of action

SURGENT ACCOUNTING & FINANCIAL EDUCATION

6. Self-certification Procedure for Waiver of 60-day Rollover Limit
Rev. Proc. 2016-47

- After having missed the time limit, Taxpayer certifies to the plan administrator that he or she falls under one or more of 11 circumstances, listed in the revenue procedure and the sample certification letter replicated ahead as well as in the materials, which qualify for a waiver
  - Taxpayer must make contribution to the plan or IRA as soon as practicable after reason(s) of the listed 11 no longer prevent taxpayer from making the contribution. This requirement is deemed satisfied if the contribution is made within 30 days after the reason(s) no longer prevent taxpayer from making the contribution
  - This self-certification is not a per se waiver by the IRS of the 60-day rollover requirement. However, in very good news, taxpayers may report the contribution as a valid rollover and therefore tax-free unless later informed to the contrary by IRS
  - The sample certification letter follows herein

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6. Self-certification Procedure for Waiver of 60-day Rollover Limit

Rev. Proc. 2016-47

Certification for Late Rollover Contribution

Name
Address
City, State, ZIP Code
Date: ______________________

Plan Administrator/Financial Institution
Address
City, State, ZIP Code

Dear Sir or Madam:

Pursuant to Internal Revenue Service Revenue Procedure 2016-47, I certify that my contribution of $ [ENTER AMOUNT] missed the 60-day rollover deadline for the reason(s) listed below under Reasons for Late Contribution. I am making this contribution as soon as practicable after the reason or reasons listed below no longer prevent me from making the contribution. I understand that this certification concerns only the 60-day requirement for a rollover and that, to complete the rollover, I must comply with all other tax law requirements for a valid rollover and with your rollover procedures.

6. Self-certification Procedure for Waiver of 60-day Rollover Limit

Rev. Proc. 2016-47

Pursuant to Revenue Procedure 2016-47, unless you have actual knowledge to the contrary, you may rely on this certification to show that I have satisfied the conditions for a waiver of the 60-day rollover requirement for the amount identified above. You may not rely on this certification in determining whether the contribution satisfies other requirements for a valid rollover.

(1) Reasons for Late Contribution

I intended to make the rollover within 60 days after receiving the distribution but was unable to do so for the following reason(s) (check all that apply):

___ An error was committed by the financial institution making the distribution or receiving the contribution.

___ The distribution was in the form of a check and the check was misplaced and never cashed.

___ The distribution was deposited into and remained in an account that I mistakenly thought was a retirement plan or IRA.

6. Self-certification Procedure for Waiver of 60-day Rollover Limit

Rev. Proc. 2016-47

___ My principal residence was severely damaged.

___ One of my family members died.

___ I or one of my family members was seriously ill.

___ I was incarcerated.

___ Restrictions were imposed by a foreign country.

___ A postal error occurred.

___ The distribution was made on account of an IRS levy and the proceeds of the levy have been returned to me.

___ The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite my reasonable efforts to obtain the information.

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6. Self-certification Procedure for Waiver of 60-day Rollover Limit

Rev. Proc. 2016-47

(2) Signature

I declare that the representations made in this document are true and that the IRS has not previously denied a request for a waiver of the 60-day rollover requirement with respect to a rollover of all or part of the distribution to which this contribution relates. I understand that in the event I am audited and the IRS does not grant a waiver for this contribution, I may be subject to income and excise taxes, interest, and penalties. If the contribution is made to an IRA, I understand you will be required to report the contribution to the IRS. I also understand that I should retain a copy of this signed certification with my tax records.

Signature: ________________________________

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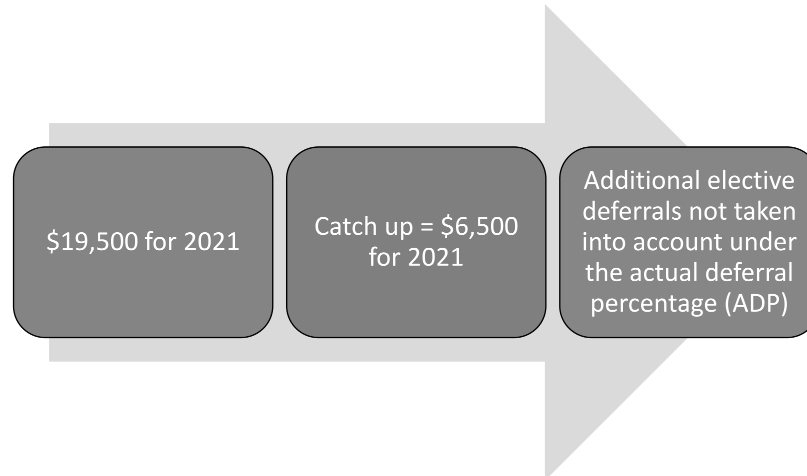
C. Section 401(k) Limitations

1. 401(k) Maximum Elective Deferral



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D. Self-employed Persons

1. SEP

- Can contribute 20% of self-employment income
- Contributions are flexible
- Plan can be established with a simple document
- No annual reporting is required
- Maximum contribution is $58,000 in 2021

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2. *SIMPLE*

- Larger contribution than a SEP
- Defer up to $13,500
- Employer ***required*** to match up to 3% of participants
  - (2-percent of compensation of all eligible employees).
- Eligibility is narrower than a SEP
- Maximum contribution is $27,000 for 2021

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3. *Profit-sharing Plans*

- Simple to institute
- Completely discretionary contributions
- Contributions do not have to be made annually

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4. Section 401(k) Plans

- Section 401(k) plans
  - Salary deferral permitted
  - Cash or deferred election
  - Elective contributions = employer contributions

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5. Solo §401(k) Plans

- Solo 401(k) Plans
  - Discretionary profit-sharing contributions or discretionary employer-matching contributions
  - Must contribute 3% of compensation for non-key employees if the plan is top-heavy and any key employee makes a 3% compensation salary deferral

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6. Money-purchase Pension Plan

- Fixed annual contribution by the employer
- Must meet nondiscrimination rules
- Compensation capped for purposes of determining the applicable contribution to $290,000 (2021)
- The maximum contribution = $58,000 (2021)

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7. Defined-benefit Plan

- High administrative costs
- May not provide an annual benefit greater than the lesser of:
  - 100% of average compensation in the employee's three highest-paid years (the "percentage limit") or
  - $230,000 in 2021 (the "dollar limit")

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DBP for Self-employed Persons

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Q&A

We will now answer viewer questions that have come in during the webinar

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Thank you!

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