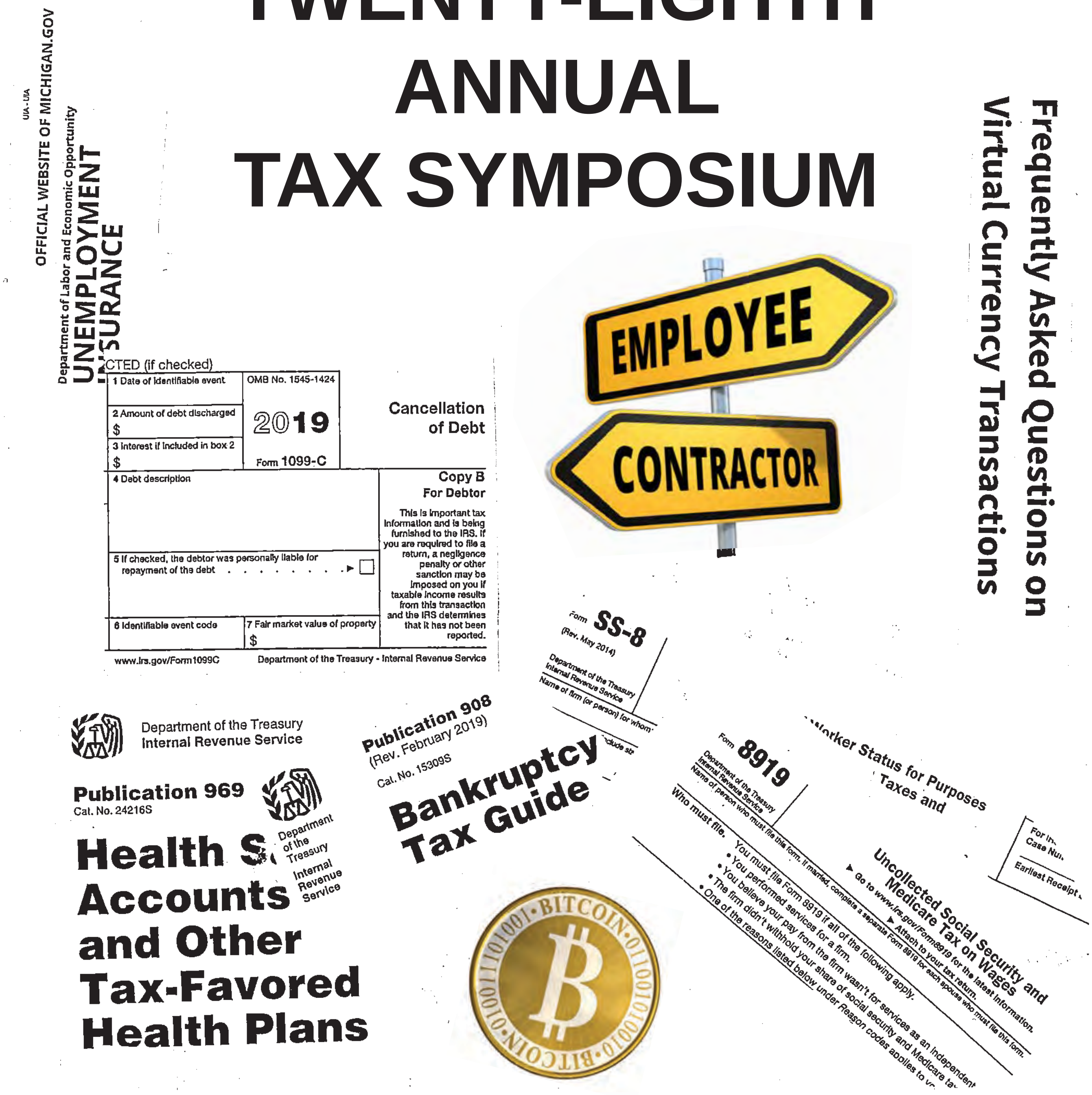
TWENTY-EIGHTH ANNUAL TAX SYMPOSIUM



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STAY CLASSY: THE TAX CONSEQUENCES OF WORKER CLASSIFICATION

I. WORKER CLASSIFICATION: THE BASICS

A. Persons who are retained to render services can meet any number of classifications: employees, contractors, subcontractors, agents, and brokers. An important distinction is made between "employees" and "independent contractors".

B. Definitions: "employee" vs. "independent contractor".

1. An employee is a person retained to render services for another person or an entity in exchange for wages or salary.

2. An independent contractor is a person or entity contracted to perform work for – or provide services to – another person or entity as a nonemployee.

C. There is no single test or criteria for determining whether a worker is an employee or an independent contractor.

1. In fact, a worker may be classified as an employee for one purpose and as an independent contractor for another.

2. Different governmental agencies and the laws and regulations governing employees and independent contractors use different and sometimes (but not always) overlapping standards for determining worker classification. For example, the criteria and tests used by the IRS to determine worker classification for tax purposes differs from the criteria and tests used for purposes of coverage under the Fair Labor Standards Act.

3. Contractual agreements and labeling of workers as "independent contractors" are not sufficient to establish that the workers are, in fact, independent contractors as opposed to employees.

D. There are many tax obligations of employers of employees.

1. For workers classified as employees, the employer must withhold and/or pay:

a. Federal Income Tax Withholding (FITW), as well as State income tax withholding.

b. Social Security and Medicare Taxes (FICA).

c. Federal Unemployment Tax (FUTA) (employer only).

d. State Unemployment (employer only).

2. Conversely, workers classified as independent contractors, employer is not required to collect or remit employment taxes. Independent contractors are paid lump sums and are responsible for paying their own income and, if applicable, self-employment taxes.

E. Over the years, the IRS has utilized various tests and criteria for worker classification for tax purposes.

1. In 1987, the IRS published Revenue Ruling 87-41 which included a "20-Factor Test" for determining worker classification. The 20 factors are:

a. Instructions – Does the worker have to comply with instructions about when, where, and how to conduct the work?

b. Training – Is the worker required to be trained as directed by the employer?

c. Integration – Does the worker’s work constitute an integral part of the employer’s business?

d. Services Rendered Personally – Are the services to be rendered by the worker required to be rendered personally?

e. Hiring, Supervising and Paying Assistants – Does the employer hire, supervise and pay assistants?

f. Continuing Relationship – Is the relationship between the worker and the employer ongoing or a one-off engagement?

g. Set Hours of Work – Is the worker required to work specific hours?

h. Full-Time Required – Is the worker required to devote substantially all of his or her time to the business of the employer?

i. Work Done on Premises – Is worker required to perform the work on the employer’s premises?

j. Order or Sequence Set – Is the worker required to perform the work in an order or sequence determined by the employer?

k. Oral or Written Reports – Is the worker required to submit regular oral or written reports to the employer?

l. Payment by Hour, Week, Month – Is the worker paid at a regular interval?

m. Payment of Expenses – Does the employer ordinarily pay for the worker's business and/or traveling expenses?

n. Furnishing of Tools and Materials – Does the employer furnish tools and materials to worker?

o. Significant Investment – Does the worker invest in and/or maintain the facilities used by the worker in performing the work?

p. Profit or Loss – Does the worker share in the profit or suffer loss as a result of the work performed?

q. Integration – Are the worker's services integral or essential to the employer's operations, as opposed to merely incidental thereto?

r. Working for More Than One Firm at a Time – Does the worker perform more than de minimis work for multiple, unrelated employers at the same time?

s. Making Service Available to General Public – Does the worker make his or her services available to the general public on a regular and consistent basis?

t. Right to Discharge – Does the employer retain the right to discharge the worker?

u. Right to Terminate – Does the worker retain the right to end the relationship with the employer?

2. Simplified Three-Factor Test groups the 20 factors above into three general categories: Behavioral Control, Financial Control, and Relationship Factors.

a. Behavioral Control:

i. Instructions.

ii. Training.

iii. Services Rendered Personally.

iv. Hiring, Supervising and Paying Assistants.

v. Continuing Relationship.

vi. Set Hours of Work.

vii. Full-Time Required.

viii. Work Done on Premises.

ix. Order or Sequence Set.

x. Oral or Written Reports.

b. Financial Control:

i. Payments by Hour, Week or Month.

ii. Payment of Expenses.

iii. Furnishing of Tools and Materials.

iv. Significant Investment.

v. Profit or Loss.

c. Relationship Factors:

i. Integration.

ii. Working for More Than One Firm at a Time.

iii. Making Services Available to General Public.

iv. Right to Discharge.

v. Right to Terminate.

3. Statutory Employees.

a. Workers in certain occupations are considered "statutory employees" for FICA purposes regardless of whether they are classified as independent contractors under the Three-Factor Test:

i. Compensated corporate officers.

ii. Agent drivers or commission drivers engaged in distributing meat, vegetable, fruit or bakery products; beverages (other than milk); or who picks up laundry or dry cleaning, if the driver is an agent and is paid on commission.

iii. Full-time life insurance salespersons whose principal business activity is selling life insurance or annuity contracts, or both, primarily for one life insurance company.

iv. Full-time traveling or city salespersons soliciting orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments. The goods sold must be merchandise for resale or supplies for use in the buyer's business operation. The work performed must be the salesperson's principal business activity.

v. An individual who works at home on materials or goods supplied by employer and must be returned to employer.

b. For FUTA, workers who fall into i. thru iv., above, are statutory workers.

c. Statutory employees for FICA purposes must be in one of the four specified occupations and satisfy the following requirements:

i. Contract must specify that the worker will perform substantially all of the services.

ii. Worker shall have no substantial investment in the facilities.

iii. There is a continuing relationship between employer and worker.

4. Section 530 Relief. Employers may be relieved from employment tax obligations in some instances if it can meet three statutory criteria:

a. Reporting Consistency – The taxpayer must have timely filed the requisite information returns consistent with its treatment of the worker as a non-employee. (For example, if the taxpayer claims the worker is an independent contractor, Forms 1099 must have been filed for the taxable years at issue.)

b. Substantive Consistency – If the taxpayer or predecessor treated the worker, or any worker holding a substantially similar position, as an employee at any time after December 31, 1977, the taxpayer will not be eligible for relief.

c. Reasonable Basis – The taxpayer must have relied on one of the following for purposes of treating the worker as a non-employee: 1) prior audit; 2) judicial precedent; 3) industry practice; or 4) other reasonable basis. Reasonable basis requirement is to be liberally construed.

II. <u>THE CONSEQUENCES OF WORKER MISCLASSIFICATION</u>

A. Federal Tax Liabilities – If an employer misclassifies a worker as an independent contractor, the tax consequences can include substantial interest and penalties in addition to the principal amounts of the tax.

1. Section 3509 – Failure to Withhold. If an employer fails to deduct and withhold, then the employer is liable for:

a. 1.5% of wages paid to employees.

b. 40% of employee's share of FICA (Social Security tax).

c. 100% of employer's share of FICA.

d. 100% of federal unemployment tax.

e. NOTE: If employer fails to file 1099-MISC and other reports, the amounts in a. and b., above, are doubled. Also, if an employer intentionally disregards the reporting rules, the IRS will attempt to collect 20% of wages paid to employees and 100% of the FICA due, both the employer's and employee's shares.

2. Failure to Pay. 0.5% of unpaid tax liability for each month up to 25% of total tax liability.

3. Penalties for Failure to File W-2s or 1099s:

   a. $50 for each W-2 employer failed to file.

   b. Between $50 and $550 for each 1099 employer failed to file. NOTE: Different upper limits will apply depending on the tax year the failure occurred in.

4. Section 7202. Any person who willfully fails to collect, account for, and pay over any tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

B. State Tax Liabilities.

1. MCL § 205.23 imposes interest and the following penalties for failure to pay:

   a. If due to negligence, greater of $10 or 10% of unpaid tax.

   b. If due to intentional disregard of the law, greater of $25 or 25% of unpaid tax.

   c. If due to fraudulent intent to evade tax, 100% of unpaid tax.

C. How do misclassification issues arise?

1. Routine audit of employer's W-2s or 1099s.

2. Worker receives 1099 and fails to pay any income taxes.

3. Worker applies for unemployment or Social Security benefits.

4. Worker that is misclassified contacts IRS or other state or federal agency.

D. To avoid misclassification issues, employers should:

1. Determine whether worker classifies as a “statutory employee” under FITW, FICA, and FUTA statutes.

2. Analyze the worker’s proper classification under the Three-Factor Test.

3. Determine whether Section 530 relief is available.

III. LATEST DEVELOPMENTS IN WORKER CLASSIFICATION CASES

A. Gig Economy – A labor market characterized by the prevalence of short-term contracts or freelance work as opposed to permanent jobs.

B. By their nature, workers in gig economy will be mostly classified as independent contractors. Examples are Uber drivers, delivery drivers for Grubhub, movers for Bellhops, babysitters on Care.com.

C. Uber and Lyft drivers are engaged as independent contractors. In Uber’s IPO filings, it stated that its drivers are properly classified as independent contractors because:

1. Drivers can choose whether, when, and where to provide services.

2. Drivers are free to provide services for Uber’s competitors.

3. Drivers provide their own vehicle to perform services.

D. Certain states like California and New Jersey are examining and confronting worker classification issues in the gig economy.

1. *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*.

a. The California Supreme Court examined the issue of whether truck drivers were properly classified as employees or independent contractors.

b. The Court applied the ABC Test, under which a worker will be deemed an employee unless:

i. The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

ii. The worker performs work that is outside the usual course of the hiring entity's business.

iii. The worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed.

c. The Court found that the employer retained sufficient control over the drivers, that the drivers performed work that was central to the employer's business, and that the drivers were not customarily engaged in the type of work being performed outside of their role with the employer. As such, the drivers were deemed employees and not contractors.

d. Ninth Circuit Court of Appeals issued opinion on May 2, 2019, that would make the *Dynamex* standard for worker classification be retroactively applicable.

2. CA Assembly Bill 5 makes the ABC Test used in *Dynamex* mandatory for worker classification in California. It does, however, exempt a number of professions, like doctors, dentists, lawyers, architects, accountants, engineers, insurance agents, investment advisers, direct sellers, real estate agents, hairstylists and barbers who rent booths at salons, as well as marketers and human-resources professionals.

3. Lawsuits have been filed in New Jersey, New York, and Massachusetts by Uber and Lyft drivers arguing they have been misclassified as independent contractors.

E. DOL Opinion Letter (FLSA2019-6).

1. Letter arose from request for determination on service providers in “gig” economy like Uber and Lyft.

2. Uber and Lyft provide a virtual marketplace, whereby the company acts as a referral business and links the drivers to new business opportunities. Therefore, the drivers are best classified as independent contractors.

3. Drivers have virtually complete control of their cars, work schedules, and log-in locations, together with their freedom to work for competitors.

THE WONDERFUL WORLD OF COMMON AREA MAINTENANCE

By: Gary A. Kravitz, Esq.

I. HOW CAM CAN GO BAD FOR A TENANT

A. Runaway increases.

B. Initial estimates wildly inaccurate.

II. TYPES OF LEASES – LEASES COME IN VARIOUS FLAVORS

A. Gross – Tenant only pays for rent and maintenance responsibilities assigned to Tenant.

B. Triple Net. Tenant pays rent plus the following items:

a. Real Estate Taxes: Tenant pays taxes on its own personal property and a portion of the real estate taxes on the Landlord's land.

b. Insurance: Tenant pays for its own insurance on the premises and a portion of the insurance Landlord maintains on the entire building.

c. Common Area Maintenance: Tenant pays for a portion of the costs to maintain common hallways, parking lots, landscaping and driveways.

C. Modified Net/Modified Gross.

1. Base year for taxes and insurance. Tenant only pays for increases over and above initial base year.

2. Landlord and Tenant split maintenance expenses. Costs may be capped or Tenant may have a deductible amount that it has to pay before Landlord obligations commence.

D. Absolute Net.

1. Typically, no abated rent, even if a casualty.

2. All expenses paid by Tenant.

3. Frequently used in sale – leaseback arrangements.

III. COMMON AREA MAINTENANCE (“CAM”)

A. Only applies to leases that are Triple Net/Modified Net/Modified Gross.

B. Usually expressed as a percentage of overall costs. Tenant’s space compared to overall shopping center or office building.

C. How is Tenant’s share of CAM calculated.

1. Total leaseable area vs current leased space.

2. Total square footage vs total leaseable area – question as to storage space and hallways.

3. Excluded tenants.

4. Excluded outparcels.

D. What’s included in CAM.

1. Parking lot maintenance.

2. Landscaping.

3. Lawn maintenance.

4. Snow removal/salting.

5. Security.

6. Electric use on outdoor lighting and monument signage.

7. Janitorial.

8. Many other items.

E. What’s not.

1. Enforcement actions against defaulting tenants.

2. Original development of Center.

3. Broker fees to bring in new tenants.

F. Common Areas of Debate.

1. Capital Costs.

2. Overhead/Administrative Costs.

IV. <u>GROSS-UP PROVISIONS</u>

A. Allows Landlord to round up expenses as if entire property was occupied.

B. Often found in office leases.

C. Used when only a portion of the building is occupied.

V. <u>COMMON TENANT CAM PROTECTIONS</u>

A. Limit on increases on CAM year to year. Expressed as a percentage by which CAM may increase each year.

1. Standard.

2. Cumulative.

3. Compounding.

4. Common exclusions from limitation. These are generally costs outside of Landlord's control.

   a. Snow removal.

   b. Taxes.

   c. Insurance.

B. Audit provision.

   1. End of each year has a CAM reconciliation.

      a. CAM usually charged as an estimate.

      b. Landlord checks estimate against actual incurred costs.

   2. Allows for review of Landlord's calculation.

   3. This is where the accountant comes in.

   4. Common Issues.

      a. How long is look back.

      b. Need penalty provision – enforcement.

      c. Who pays audit.

      d. Landlord limitations.

         i. How much can accountant charge?

         ii. Audit only paid on hourly basis.

         iii. Cap on costs of audit.

C. Stet specific amount of CAM for first year. Prohibit reconciliation adjustment.

VI. ALTERNATIVES TO STANDARD APPROACH TO CAM

A. Capped CAM charges.

B. Fixed CAM.

REPRESENTATIONS AND WARRANTIES IN A BUSINESS PURCHASE AGREEMENT

By: Stuart M. Bordman, Esq.

I. EXAMPLES OF REPRESENTATIONS AND WARRANTIES.

A. Lack of restrictions on transfer.

B. Organizational matters.

C. Capitalization.

D. Title to equipment and real estate.

E. Litigation.

F. Intellectual property.

G. Financial statements.

H. Collectability of accounts receivable.

I. Tax liabilities, audits and related matters.

J. Personnel matters.

K. Labor practices.

L. Benefit plans.

M. Events since the last balance sheet.

N. Environmental matters.

O. Insurance.

P. Compliance with governmental matters including licenses permits etc.

Q. Customers and suppliers.

R. Foreign Corrupt Practices Act.

S. Inventory.

T. Product liabilities.

II. REPRESENTATIONS AND WARRANTIES REGARDING FINANCIAL STATEMENTS AND TAXES.

A. The Financial Statements attached as Exhibit A present fairly in all material respects the financial position of the Company and each Subsidiary as of the dates designated therein and the results of operations and cash flows for the periods designated therein, and were prepared in accordance with GAAP (except as disclosed in the notes to those financial statements). The Financial Statements reflect the consistent application of such accounting principles throughout the periods involved.

The Interim Financial Statements attached as Exhibit B were prepared for management use on an unadjusted accrual basis. The Interim Financial Statements present fairly in all material respects the financial position of the Company and its Subsidiaries as of the date of the Interim Financial Statement.

B. **Schedule B** sets forth a listing of all outstanding trade accounts receivable as of the Effective Date. All trade accounts receivable of the Company and any Subsidiary reflected on the Financial Statements represent valid obligations arising from sales actually made or services actually performed in the Ordinary Course of Business. Except as set forth on **Schedule B** and subject to any reserve shown on the Financial Statements or the Closing Financial Statements, each of the accounts receivable will be collected in full, without any setoff, within six (6) months of the Closing Date.

C. The Company has no liabilities of any kind that are required to be reflected on a balance sheet prepared in accordance with GAAP, other than (i) liabilities that have arisen after the Balance Sheet Date in the Ordinary Course of Business which would not individually or in the aggregate have a material adverse impact on the Business as a whole, (ii) to the extent and for the amount reflected as a liability on any of the Financial Statements or the Closing Financial Statements.

D. The Company and each Subsidiary has duly and timely filed all Tax Returns required to be filed prior to the Closing Date and such Tax Returns are true, correct and complete in all material respects. The Company and each Subsidiary has complied in all material respects with all applicable Legal Requirements relating to the withholding of Taxes and has duly and properly withheld from salaries, wages and other compensation, and paid over to the appropriate Governmental Bodies, all amounts required to be so withheld and paid over for all periods. The Company and each Subsidiary has collected all sales, use or similar Taxes required to be collected, and has remitted, or will remit on a timely basis, such amounts to the appropriate Governmental Bodies.

E. Neither the Company nor any Subsidiary has waived any statute of limitations in respect of any Taxes or agreed to any extension of time with respect to a Tax assessment or deficiency.

F. None of the Tax Returns of the Company or any Subsidiary is currently the subject of an audit by a Governmental Body. **Schedule C** contains a list of all audits of all Tax Returns of the Company and any Subsidiary during the three (3) years immediately preceding the Closing Date. There are no Liens for Taxes upon any of the assets of the Company or any Subsidiary.

III. <u>REPRESENTATIONS REGARDING BASKET AMOUNT, MAXIMUM AMOUNT OF INDEMNIFICATION AND LIMITATIONS NOT APPLICABLE TO CERTAIN REPRESENTATIONS.</u>

A. Notwithstanding anything contained in this Agreement to the contrary, the Seller shall not be obligated to indemnify any Buyer Indemnified Party with respect to any losses pursuant to Section A above, unless and until the aggregate losses from all claims with respect thereto exceed, in the aggregate, One Hundred Thousand Dollars ($100,000) (the "Basket Amount") and then indemnification hereunder shall be only to the extent such losses exceed the Basket Amount.

B. Notwithstanding anything contained in this Agreement to the contrary, but subject in all respects to Section (c), below, in no event shall the Seller's aggregate obligation to provide indemnification for losses, exceed forty percent (40%) of the Purchase Price.

C. Notwithstanding anything contained in this Agreement to the contrary, the limitations set forth in Section (b) shall not apply to limit the indemnification to which the Buyer may be entitled for Losses arising from any breach of the Fundamental Representations provided, however, that in no event shall Seller's obligation to provide indemnification for losses exceed the final Purchase Price received by Seller.

CANCELLATION OF DEBT INCOME AND INCOME TAX TREATMENT IN INDIVIDUAL BANKRUPTCY PROCEEDINGS

By: David M. Eisenberg, Esq.

I. CANCELLATION OF DEBT INCOME

A. Introduction: The forgiveness of debt by a creditor may not provide complete relief.

B. Internal Revenue Code Section 61:

1. Gross Income includes "income from discharge of indebtedness."

2. Cancellation of Debt Income:

a. Example: Suppose you have a client with a $20,000.00 credit card balance that she is unable to pay. A settlement is reached with the credit card company in which it agrees to a one-time, lump-sum payment of $10,000.00 in full satisfaction of the $20,000.00 debt. That is $10,000.00 less than your client is obligated to pay and according to the IRS, that $10,000.00 is reportable as "other income" on your client's tax forms.

b. Most creditors and debt collectors are required to report the cancelled debt to both the debtor and the IRS on a Form 1099-C.

c. These include:

i. Financial Institutions.

ii. Any of the following, its successor, or sub-unit:

aa. The Federal Deposit Insurance Corporation (FDIC);

bb. The Resolution Trust Corporation (RTC);

cc. The National Credit Union Administration (NCUA); or

dd. Any other federal executive agency, including government corporations, any military department, the U.S. Postal Service, or the Postal Rate Commission.

iii. A corporate subsidiary of a financial institution or credit union (if the affiliation subjects the subsidiary to federal or state regulation).

iv. A federal government agency, including a department, an agency, a court or court administrative office, or a judicial or legislative instrumentality.

v. Any organization a significant trade or business of which is lending money.

C. Exceptions to Cancellation of Debtor Income:

1. Amounts cancelled as gifts, bequests, devises, or inheritances.

2. Certain qualified student loans cancelled under provisions that the loans would be cancelled if you work for a certain period of time in certain professions for a broad class of employers.

3. Certain other education loan repayment or loan forgiveness programs to help provide health services in certain areas.

4. Amounts of cancelled debt that would be deductible if you, as a cash basis taxpayer, paid it.

5. A qualified purchase price reduction given by the seller of property to the buyer.

6. Any Pay-for-Performance Success Payments that reduce the principal balance of your home mortgage under the Home Affordable Modification Program.

7. Amounts from student loans discharged on the account of death or total and permanent disability of the student.

D. Exclusion from Gross Income:

1. Debt cancelled in a Title 11 bankruptcy case.

2. Debt cancelled during insolvency.

3. Cancellation of qualified farm indebtedness.

4. Cancellation of qualified real property business indebtedness.

5. Cancellation of qualified principal residence indebtedness that is discharged subject to an arrangement that is entered into and evidenced in writing before January 1, 2018.

E. Debt Secured by Property:

1. If property secures the debt and the creditor takes that property in full or partial satisfaction of the debt, it is treated as a sale of that property to the creditor. The tax treatment depends on whether the debtor was personally liable for the debt or not.

   a. If personally liable, the amount realized is the fair market value of the property. The cancellation of debt income is the amount of the debt in excess of the fair market value of the property that the lender forgives. It must be included as income unless an exception or exclusion applies. The difference between the fair market value and the adjusted basis (usually the cost) will be a gain or loss on the disposition of the property. The character of the gain or loss depends on the character of the property.

b. If not personally liable for the debt, the amount realized is the entire amount of the debt plus the amount of cash and the fair market value of any property you received. There will be no cancellation of debt income.

2. Examples:

a. Rob buys a ski boat for $40,000. Rob pays $10,000 down and signs a personally guaranteed note for $30,000. The boat dealer takes a security interest in the boat. After paying down $5,000 on the note, Rob defaults on the loan. The boat is repossessed, which is now worth $21,000. Rob will have cancellation of debt income of $4,000 ($25,000 remaining debt owed minus $21,000 FMV of boat). Rob has a $19,000 loss on the disposition of the boat, which is the difference between the boat's fair market value of $21,000 (the amount realized on repossession) minus $40,000 (the adjusted basis in the boat).

b. The facts are the same except that Rob signed a note that does not give the boat dealer any recourse against him personally. When the dealer repossesses the boat, Rob has a loss of $15,000, the difference between the

$25,000 amount realized (the face amount of the remaining debt) and $40,000 (the adjusted basis in the boat). Rob will have no cancellation of debt income.

F. Debt Cancelled During Insolvency:

The insolvency exclusion from Cancellation of Debt Income exception only applies up to the amount by which a debtor is insolvent immediately before the cancellation of debt. Consider the following examples:

1. As of June 24, 2019, Frank had assets with an aggregate value of $40,000 and had liabilities totaling $70,000, making him insolvent in the amount of $30,000. On that date, a creditor offered to accept a payment of $5,000 in cancellation of a $20,000.00 debt. Frank accepted and made the payment, which resulted in $15,000.00 of C.O.D. Income. Because immediately before the cancellation of debt occurred, Frank was insolvent by ($30,000.00) more than the amount of debt that was forgiven ($15,000.00), Frank does not recognize any income from the cancellation of debt.

2. As of June 24, 2019, Sue had assets with an aggregate value of $115,000 and liabilities totaling $135,000, making her insolvent in the amount of' $20,000. On that date, a creditor offered to accept a payment of $25,000 in cancellation of a $60,000.00 debt. Sue accepted and made the payment, which resulted in C.O.D. Income of $35,000. Sue’s insolvency immediately before the transaction was only $20,000.00. Therefore, she does not recognize income for $20,000 of the cancelled debt, but Sue does recognize income for $15,000 of the cancelled debt.

G. While clients should always be counseled that the cancellation of debt may result in taxable income, the extent of that taxable income may vary, or even be nonexistent. A close examination of the client's financial circumstances, as well as the type of debt and manner in which it is forgiven, is necessary to determine whether the relief provided by the debt cancellation is complete.

II. INCOME TAX TREATMENT IN INDIVIDUAL BANKRUPTCY PROCEEDINGS

A. Discharge of unpaid income taxes in personal bankruptcy cases: Most are not dischargeable in individual bankruptcy proceedings.

B. Primarily two types of individual bankruptcy proceedings:

1. Chapter 7 bankruptcy proceeding: Chapter 7 Trustee is appointed to collect and liquidate the debtor's assets and distribute the proceeds to the debtor's creditors.

2. Chapter 13 bankruptcy proceeding: Sometimes called a wage earner's bankruptcy. The debtor proposes a repayment plan to make installment payments to creditors over three to five years.

C. Whether or not income tax debts can be discharged depends in large part, on whether they are considered "priority" debts. If the income tax debt qualifies as a priority debt, it must be paid in full during the bankruptcy or it will not be discharged.

D. Under Section 507(a)(8) of the Bankruptcy Code, income tax debt is considered a priority debt, which means they are paid first when assets are liquidated in a Chapter 7 bankruptcy proceeding and it means they must be paid in full through a Chapter 13 plan.

1. Depending on the value of the assets available to liquidate in a Chapter 7 bankruptcy proceeding, these priority tax debts may not be paid in full. If they are not paid in full, Section 523(a)(1)

of the Bankruptcy Code provides that such taxes are not discharged by the Chapter 7 bankruptcy proceeding.

2. In a Chapter 13 bankruptcy proceeding, priority tax debts must be paid in full over the life of the Chapter 13 Plan. If they are not so provided for in the Plan, the Plan cannot be confirmed by the bankruptcy court, which may result in dismissal of the bankruptcy proceeding without the debtor having received a bankruptcy discharge for any of his or her debts.

E. The Requirements.

1. The due date for filing the tax return in question was at least three years ago. The due date includes any extensions. Therefore, if an extension is received for a 2017 return, making it due in October 2018, the debtor would not be able to discharge it in bankruptcy until at least October of 2021.

2. The tax return was filed at least two years ago.

   a. The tax debt must be related to a tax return that was filed at least two years before the debtor files for bankruptcy.

   b. Measured from the date the return was actually filed. In most cases, this should be the same as the due date, unless a due date is missed and the return is filed late.

   c. Tax debts that arise from unfiled tax returns are not dischargeable. The IRS routinely assesses tax on unfiled returns, and these liabilities cannot be discharged unless and until the debtor files a tax return for the year in question.

3. The tax assessment is at least 240 days old.

   a. Often covers the same ground as the first two rules.

   b. The IRS must assess the tax at least 240 days before the bankruptcy petition is filed.

   c. Assessment can arise from a self-reported balance due on a filed tax return, from an IRS final determination in an audit, or an IRS proposed assessment that becomes final.

4. The tax return was not fraudulent.

5. The taxpayer is not guilty of tax evasion.

6. Other considerations:

   a. In addition, the taxpayer must prove that the previous four years' tax returns have been filed with the IRS in order to receive a discharge.

   b. The debtor must also provide a copy of their most recent tax return to the bankruptcy court.

F. Keep in mind that certain other types of taxes, including withheld payroll taxes, the trust fund penalty under IRC § 6672, most state sales taxes and certain excise taxes, are never dischargeable.

G. Determining Potentially Dischargeable Taxes:

   1. Order a transcript of record.

   2. Should advise the client of the possibility of an audit adjustment that creates a post-bankruptcy tax, the existence of assessed fraud penalties, or other activities that might constitute an

attempt “to evade or defeat … [a] tax,” which may provide an argument that the tax should not be discharged (11 USC § 523(a)(1)(C)).

3. In addition, once a future bankruptcy date (the date on which the tax liability meets all the mechanical tests for discharge) is computed, the transcript should be rechecked immediately prior to the filing date, to verify that there are no intervening events have occurred that might extend the above time frames.

H. Planning:

1. When picking the bankruptcy filing date, consideration should also be given to those tax debts that may soon meet the discharge requirements as well as those that currently meet the requirements.

2. While an installment agreement does not toll the above timeframes, other tax resolution methods do extend the time allowed for IRS collection and the mechanical time frames that must be met for discharge of taxes. For example, a collection due process hearing request will extend the three-year and 240-day periods, while an offer in compromise filing will extend only the 240-day period.

I. Tax Liens:

1. Even though income tax debt may be discharged through bankruptcy, to the extent that a tax lien was recorded on the debtor’s property, it will remain.

a. Federal Tax Liens

b. State Tax Liens

2. The bankruptcy automatic stay is applicable to the filing of tax liens.

   a. If the relevant taxing authority has not filed a notice of tax lien prior to the date the bankruptcy is filed, it cannot do so after the case has been filed with respect to unpaid taxes that accrued prior to the bankruptcy proceeding.

   b. A notice of tax lien that was filed prior to the bankruptcy filing will remain in place through the bankruptcy proceeding and after discharge.

3. Tax liens are secured claims in a bankruptcy proceeding, and may be paid through the sale of assets.

   a. In a Chapter 7 proceeding, the Trustee may sell some of the debtor's assets to make distributions to creditors. Creditors who have valid and perfected security interests, such as a tax lien, are paid in full from the proceeds of the secured asset to the extent of the value of the asset.

      Example: If a secured creditor has a claim of $100.00 and the asset is worth $500.00, the creditor is paid the full $100.00. The remaining value of the asset is property of the Estate and can be used to satisfy the claims of other creditors. On the other hand, if the asset is worth only $50.00, the creditor gets paid the full $50.00, and will have an unsecured claim for the remaining $50.00.

b. If there are prior mortgages or security interests in the subject property, those creditors will be paid first, and the tax lien will be pad if there is any remaining equity.

c. If the sale of the subject asset does not result in payment in full of the tax lien, the tax lien will remain attached to other of the debtor's assets, but the amount will be reduced by the amount received by virtue of the asset sale.

d. However, it is often the case that a Chapter 7 Trustee will only sell assets if there is sufficient equity in that asset, after satisfaction of all secured debts. But often, selling the asset isn't worthwhile. In that case, the tax lien would remain in place after the bankruptcy is concluded, in the original amount in which it was filed.

4. In a Chapter 13 proceeding, the same rules apply. If the debtor does not pay off the entire amount of the tax lien through the Chapter 13 Plan, whether through Plan payments or a sale of the asset, the lien will remain in place after the bankruptcy case has concluded.

5. As stated above, tax liens also attach to personal property, such as cars and household furniture. These assets are not usually sold in bankruptcy because they are worth little or subject to exemptions.

6. If the tax liens are discharged through the bankruptcy process through payment, then again, they survive, and a debtor's options of dealing with them remain the same as before bankruptcy.

a. The amount of the lien can be paid.

b. A payment plan or compromise can be negotiated.

c. It might be possible to redeem a specific item by paying its value.

d. Do nothing and gamble that the IRS won't take any action to foreclose on its lien. This makes more sense when the value of the property subject to the lien is relatively low, and personal liability for the debt has already been discharged.

ROUNDUP OF RECENT TAX DEVELOPMENTS

By: William E. Sigler, Esq.

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I. FEDERAL

A. Individuals—General Deductions, Credits and Exclusions—Summary

	2019	2018	2017
Standard deduction:			
Married Filing Joint (MFJ) or Qualifying Widow(er) (QW)	$24,400	$24,000	$12,700
Single	12,200	12,000	6,350
Head of Household (HOH)	18,350	18,000	9,350
Married Filing Separate (MFS)	12,200	12,000	6,350
Additional amount for age 65 or older or blind, each (MFJ, QW, MFS)	1,300	1,300	1,250
Additional amount for age 65 or older or blind, each (Single, HOH)	1,650	1,600	1,550
Itemized deduction phase-out begins at AGI of:			
MFJ or QW	N/A[2]	N/A[2]	$313,800
Single	N/A[2]	N/A[2]	261,500
HOH	N/A[2]	N/A[2]	287,650
MFS	N/A[2]	N/A[2]	156,900
Personal exemption[4]	$0	$0	$4,050
Personal exemption phase-out begins at AGI of:			
MFJ or QW	N/A[2]	N/A[2]	$313,800
Single	N/A[2]	N/A[2]	261,500
HOH	N/A[2]	N/A[2]	287,650
MFS	N/A[2]	N/A[2]	156,900
Earned income credit:			
Earned income (and AGI) must be less than (MFJ):[1]			
No qualifying children	$21,370	$20,950	$20,600
One qualifying child	46,884	46,010	45,207
Two qualifying children	52,493	51,492	50,597
Three or more qualifying children	55,952	54,884	53,930
Maximum amount of credit (all filers except MFS):			
No qualifying children	$529	$519	$510
One qualifying child	3,526	3,461	3,400
Two qualifying children	5,828	5,716	5,616
Three or more qualifying children	6,557	6,431	6,318

	2019	2018	2017
Investment income limit	$3,600	$3,500	$3,450
Child tax credit:			
Credit per child[3]	$2,000	$2,000	$1,000
Additional (refundable) credit—earned income floor	2,500	2,500	3,000
Adoption credit/exclusion:			
Maximum credit/exclusion (and amount allowed for adoption of special needs child)	$14,080	$13,810	$13,570
Credit/exclusion phase-out begins at AGI of:			
All taxpayers except MFS	$211,160	$207,140	$203,540
MFS	Not Allowed	Not Allowed	Not Allowed
Kiddie tax unearned income threshold	$2,200	$2,100	$2,100
Foreign earned income exclusion	$105,900	$103,900	$102,100
Source:	**Rev. Proc. 2018-57**	**Rev. Proc. 2017-58**; **Rev. Proc. 2018-18**	**Rev. Proc. 2016-55**

[1] To get earned income/AGI phase-out amount for all other filers (except MFS), reduce amount shown by: $5,790 ($5,800 if no children) in 2019; $5,690 ($5,680 if no children) in 2018; and $5,590 in 2017.
[2] The Tax Cuts and Jobs Act eliminates personal exemptions and the overall limitation on itemized deductions for tax years 2018 and 2019.
[3] For tax years 2018 and 2019, a $500 nonrefundable credit is provided for certain nonchild dependents.
[4] In determining whether a person is a qualifying relative under a Code provision that refers to the definition of *dependent* in IRC Sec. 152, the exemption amount will be treated as $4,150 (adjusted for inflation for tax years beginning after December 31, 2018). For 2019, the gross income limitation for a qualifying relative is $4,200.

B. Businesses -- A Summary

C-CORPORATION TAX RATE
21% Flat Tax Rate
CORPORATE ALTERNATIVE MINIMUM TAX
Repealed, beginning in 2018
QUALIFIED BUSINESS INCOME 20% DEDUCTION FOR PASS-THROUGH ENTITIES
Qualified income will be taxable at 80% of the normal tax bracket rate on other business income
Applies to the lesser of 20% of business income or 50% of total wages paid by the business

Specifically excludes certain types of professional service and investment income

C. Tax Cuts and Jobs Act -- A Comparison

1. Deductions, depreciation and expensing.

Changes to deductions, depreciation and expensing may affect a taxpayer's business taxes. Publication 535, Business Expenses, and Publication 946, How to Depreciate Property, explain many of these topics in detail.

Deductions

Deductions	2017 Law	What changed under TCJA
New deduction for qualified business income of pass-through entities	No previous law for comparison. This is a new provision.	This new provision, also known as Section 199A, allows a deduction of up to 20% of qualified business income for owners of some businesses. Limits apply based on income and type of business.
Limits on deduction for meals and entertainment expenses	A business can deduct up to 50% of entertainment expenses directly related to the active conduct of a trade or business or incurred immediately before or after a substantial and bona fide business discussion.	The TCJA generally eliminated the deduction for any expenses related to activities considered entertainment, amusement or recreation. However, under the new law, taxpayers can continue to deduct 50% of the cost of business meals if the taxpayer (or an employee of the taxpayer) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant or similar business contact. If provided during or at an entertainment activity, the food and beverages must be purchased separately from the entertainment, or the cost of the food or beverages must be stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. Notice 2018-76 provides additional information on these changes.

Deductions	2017 Law	What changed under TCJA
New limits on deduction for business interest expenses	The deduction for net interest is limited to 50% of adjusted taxable income for firms with a debt-equity ratio above 1.5. Interest above the limit can be carried forward indefinitely.	The change limits deductions for business interest incurred by certain businesses. Generally, for businesses with 25 million or less in average annual gross receipts, business interest expense is limited to business interest income plus 30% of the business's adjusted taxable income and floor-plan financing interest There are some exceptions to the limit, and some businesses can elect out of this limit. Disallowed interest above the limit may be carried forward indefinitely, with special rules for partnerships.
Changes to rules for like-kind exchanges	Like-kind exchange treatment applies to certain exchanges of real, personal or intangible property.	Like-kind exchange treatment now applies only to certain exchanges of real property. For more information, see Form 8824, Like-Kind Exchanges, and its instructions, as well as Publication 544, Sales and Other Disposition of Assets.
Payments made in sexual harassment or sexual abuse cases	No previous law for comparison. This is a new provision.	No deduction is allowed for certain payments made in sexual harassment or sexual abuse cases.
Changes to deductions for local lobbying expenses	Although lobbying and political expenditures are generally not deductible, a taxpayer can deduct payments related to lobbying local councils or similar governing bodies.	TCJA repealed the exception for local lobbying expenses. The general disallowance rules for lobbying and political expenses now apply to payments related to local legislation as well.

Deductions	2017 Law	What changed under TCJA
Excess Business Loss	Excess farm losses (defined below) aren't deductible if you received certain applicable subsidies. This limit applies to any farming businesses, other than a C corporation, that received a Commodity Credit Corporation loan. Your farming losses are limited to the greater of: $300,000 ($150,000 for a married person filing a separate return), or The total net farm income for the prior five tax years. (Publication 225 Page 25 – 3rd column)	Noncorporate taxpayers may be subject to excess business loss limitations. The at-risk limits and the passive activity limits are applied before calculating the amount of any excess business loss. An excess business loss is the amount by which the total deductions attributable to all of your trades or businesses exceed your total gross income and gains attributable to those trades or businesses plus $250,000 (or $500,000 in the case of a joint return). A "trade or business" includes, but is not limited to, Schedule C and Schedule F activities, the activity of being an employee, and certain activities reported on Schedule E. (In the case of a partnership or S corporation, the limitation is applied at the partner or shareholder level.) Business gains and losses reported on Schedule D and Form 4797 are included in the excess business loss calculation. Excess business losses that are disallowed are treated as a net operating loss carryover to the following taxable year. See Form 461 and instructions for details. For application of these rules to farmers, see also Publication 225 and Instructions to Schedule F.
Net Operating Loss	Generally, if you have an NOL for a tax year ending in 2017, you must carry back the entire amount of the NOL to the 2 tax years before the NOL year (the carryback period), and then carry forward any remaining NOL. (2017 Pub 536 page 3, 2nd column) If your NOL is more than the taxable income of the year you carry it to (figured before deducting the NOL), you generally will have an NOL carryover to the next year. (2017 Pub 536 page 4, 3rd column)	Most taxpayers no longer have the option to carryback a net operating loss (NOL). For most taxpayers, NOLs arising in tax years ending after 2017 can only be carried forward. The 2-year carryback rule in effect before 2018, generally, does not apply to NOLs arising in tax years ending after December 31, 2017. Exceptions apply to certain farming losses and NOLs of insurance companies other than a life insurance company. For losses arising in taxable years beginning after Dec. 31, 2017, the new law limits the net operating loss deduction to 80% of taxable income (determined with

Depreciation

Depreciation	2017 Law	What changed under TCJA
Temporary 100 percent expensing for certain business assets	Certain business assets, such as equipment and buildings, are depreciated over time. Bonus depreciation for equipment, computer software, and certain improvements to nonresidential real property allows an immediate deduction of 50% for equipment placed in service in 2017, 40% in 2018, and 30% in 2019. Long-lived property generally is not eligible. The phase down is delayed for certain property, including property with a long production period.	TCJA temporarily allows 100% expensing for business property acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023. The 100% allowance generally decreases by 20% per year in taxable years beginning after 2022 and expires Jan. 1, 2027. The law now allows expensing for certain film, television, and live theatrical productions, and used qualified property with certain restrictions. For more information, see Tax Reform: Changes to Depreciation Affect Businesses Now and New 100-percent depreciation deduction for businesses.
Changes to rules for expensing depreciable business assets (section 179 property)	A taxpayer can expense the cost of qualified assets and deduct a maximum of $500,000, with a phaseout threshold of $2 million. Generally, qualified assets consist of machinery, equipment, off-the-shelf computer software and certain improvements to nonresidential real property.	TCJA increased the maximum deduction to $1 million and increased the phase-out threshold to $2.5 million. It also modifies the definition of section 179 property to allow the taxpayer to elect to include certain improvements made to nonresidential real property. Publication 946, How to Depreciate Property, and the Additional First Year Depreciation Deduction (Bonus) FAQs provide additional resources on this topic.
Changes to depreciation of luxury automobiles	There are limits on depreciation deductions for owners of cars, trucks and vans.	TCJA increased depreciation limits for passenger vehicles. If the taxpayer doesn't claim bonus depreciation, the greatest allowable depreciation deduction is: • $10,000 for the first year, • $16,000 for the second year, • $9,600 for the third year, and • $5,760 for each later taxable year in the recovery period. If a taxpayer claims 100% bonus depreciation, the greatest allowable depreciation deduction is $18,000 for the first year, and the same as above for later years.

Depreciation	2017 Law	What changed under TCJA
Changes to listed property	Computers and peripheral equipment are categorized as listed property. Their deduction and depreciation is subject to strict substantiation requirements.	TCJA removes computer or peripheral equipment from the definition of listed property.
Changes to the applicable recovery period for real property	The General Depreciation System (GDS) and the Alternative Depreciation System (ADS) of the Modified Accelerated Cost Recovery System (MACRS) provide that the capitalized cost of tangible property is recovered over a specified life by annual deductions for depreciation.	The general depreciation system recovery periods are still 39 years for nonresidential real property and 27.5 years for residential rental property. The alternative depreciation system recovery period for nonresidential real property is still 40 years. However, TCJA changes the alternative depreciation system recovery period for residential rental property from 40 years to 30 years. Qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property are no longer separately defined and given a special 15-year recovery period under the new law.

2. <u>Businesses with Employees: Changes to Fringe Benefits and New Credit</u>.

For businesses that have employees, there are changes to fringe benefits and a new tax credit that can affect a business's bottom line.

Fringe benefit	2017 law	What changed under TCJA
Suspension of the exclusion for qualified bicycle commuting reimbursements	Up to $20 per month in employer reimbursement for bicycle commuting expense is not subject to income and employment taxes of the employee.	Under TCJA, employers can deduct qualified bicycle commuting reimbursements as a business expense. Employers must now include 100% of these reimbursements in the employee's wages, subject to income and employment taxes.
Suspension of exclusion for qualified moving expense reimbursements	An employee's moving expense reimbursements are not subject to income or employment taxes.	Under TCJA, employers must include moving expense reimbursements in employees' wages, subject to income and employment taxes. Generally, members of the U.S. Armed Forces can still exclude qualified moving

Fringe benefit	2017 law	What changed under TCJA
		expense reimbursements from their income.
Prohibition on cash, gift cards and other non-tangible personal property as employee achievement award	Employers can deduct the cost of certain employee achievement awards. Deductible awards are excludible from employee income.	Special rules allow an employee to exclude certain achievement awards from their wages if the awards are tangible personal property. An employer also may deduct awards that are tangible personal property, subject to certain deduction limits. TCJA clarifies that tangible personal property doesn't include cash, cash equivalents, gift cards, gift coupons, certain gift certificates, tickets to theater or sporting events, vacations, meals, lodging, stocks, bonds, securities, and other similar items.

Tax Credit	2017 law	What changed under TCJA
New employer credit for paid family and medical leave	No previous law for comparison. This is a new provision.	The TCJA added a new tax credit for employers that offer paid family and medical leave to their employees. The credit applies to wages paid in taxable years beginning after December 31, 2017, and before January 1, 2020. The credit is a percentage of wages (as determined for Federal Unemployment Tax Act (FUTA) purposes and without regard to the $7,000 FUTA wage limitation) paid to a qualifying employee while on family and medical leave for up to 12 weeks per taxable year. The percentage can range from 12.5% to 25%, depending on the percentage of wages paid during the leave. For more information on the new credit, see Notice 2018-71 and New credit benefits employers who provide paid family and medical leave.

3. Business Structure and Accounting Methods.

An organization's business structure is an important consideration when applying tax reform changes. The Tax Cuts and Jobs Act changed some things related to these topics.

Business structure topic	2017 law	What changed under TCJA
Changes to cash method of accounting for some businesses	Small business taxpayers with average annual gross receipts of $5 million or less in the prior three-year period may use the cash method of accounting.	The TCJA allows small business taxpayers with average annual gross receipts of $25 million or less in the prior three-year period to use the cash method of accounting. The law expands the number of small business taxpayers eligible to use the cash method of accounting and exempts these small businesses from certain accounting rules for inventories, cost capitalization and long-term contracts. As a result, more small business taxpayers can change to cash method accounting starting after Dec. 31, 2017. Revenue Procedure 2018-40 provides further details on these changes.
Changes regarding conversions from an S corporation to a C corporation	In the case of an S corporation that converts to a C corporation: • Net adjustments that are needed to prevent amounts from being duplicated or omitted as a result of an accounting method change and attributable to the revocation of the S corporation election (e.g. adjustments required because of a required change from the cash method to an accrual method): net adjustments that decrease taxable income generally were taken into account entirely in the year of change, and net adjustments that increase taxable income generally were taken into account ratably during the four-taxable-year period beginning with the year of change. • Distributions of cash by the C corporation to its shareholders during a post-termination transition period (generally one year after the conversion) are, to the extent of stock basis tax-free, then capital gain to the extent of remaining accumulated adjustments account (AAA). Distributions more than AAA are treated as dividends coming from accumulated Earnings and Profits (E&P). Distributions after that period are dividends to the	The TCJA makes two modifications to existing law for a C corporation that (1) was an S corporation on Dec. 21, 2017 and revokes its S corporation election after Dec. 21, 2017, but before Dec. 22, 2019, and (2) has the same owners of stock in identical proportions on the date of revocation and on Dec. 22, 2017. The following modifications apply to these entities: • The period for including net adjustments that are needed to prevent amounts from being duplicated or omitted as a result of an accounting method change and attributable to the revocation of the S corporation election is changed to six years. This six-year period applies to net adjustments that decrease taxable income as well as net adjustments that increase taxable income. • Distributions of cash following the post-termination transition period are treated as coming out of the corporation's AAA and E&P proportionally. See Revenue Procedure 2018-44 for more detailed information.

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Business structure topic	2017 law	What changed under TCJA
	extent of E&P and taxed as dividends.	

4. Businesses or Individuals that Rehabilitate Historical Buildings.

Topic	2017 law	What changed under TCJA
Changes to the rehabilitation tax credit	Owners of certified historic structures were eligible for a tax credit of 20% of qualified rehabilitation expenditures. Owners of pre-1936 buildings were eligible for a tax credit of 10% of qualified rehabilitation expenditures.	TCJA keeps the 20% credit for qualified rehabilitation expenditures for certified historic structures but requires that taxpayers take the 20% credit over five years instead of in the year they placed the building into service. The 10% credit for pre-1936 buildings is repealed under TCJA.

5. Opportunity for Tax-Favored Investments.

Opportunity Zones are a tool designed to spur economic development and job creation in distressed communities. Businesses or individuals can participate.

Topic	2017 law	What changed under TCJA
Opportunity Zones	No previous law for comparison. This is a new provision.	Investments in Opportunity Zones provide tax benefits to investors. Investors can elect to temporarily defer tax on capital gains that are reinvested in a Qualified Opportunity Fund (QOF). The tax on the gain can be deferred until the earlier of the date on which the QOF investment is sold or exchanged, or Dec. 31, 2026. If the investor holds the investment in the QOF for at least ten years, the investor may be eligible for a permanent exclusion of any capital gain realized by the sale or exchange of the QOF investment. For more information, see Notice 2018-48 and Revenue Procedure 2018-16.

D. Proposed Regulations Explain New Interest Deductibility Rules.

1. Background. The Tax Cuts and Jobs Act ("TCJA") significantly revised the rules regarding the deductibility of interest attributable to a trade or

business. Regulations have been issued by the IRS that both interpret and expand upon these new rules.

2. General Rules. The TCJA revises Internal Revenue Code Section 163(j) to impose a limit on the deduction of interest equal to the sum of (i) the business interest income of the taxpayer, (ii) 30% of "adjusted taxable income" and (iii) the taxpayer's floor financing interest expense. The 163(j) limitation applies to all interest expense of the taxpayer, whether an individual, corporation, partnership or trust, as opposed to only interest between related parties as under prior law. Any excess business interest (i.e., not deductible due to this limitation) may be carried forward indefinitely. The Proposed Regulations confirm that this limitation applies, as well, to interest deductions that were suspended under prior law and carried forward to years beginning on or after January 1, 2018.

3. Definition of Interest. The Proposed Regulations incorporate an expansive definition of "interest," and treat as interest items that are "closely related" to interest, such as commitment fees to make a loan. In addition, guaranteed payments to partners from partnerships for the use of capital are treated as interest. The Proposed Regulations also make clear that the 163(j) limitation applies after application of other interest deduction limits, such as disallowance, deferral or required capitalization but before limitations on deductibility under the at risk rules and passive activity rules.

4. C Corporations. The Proposed Regulations contain a blanket rule that provides that all interest incurred by a C corporation is business interest and thus subject to these limitations; i.e., no allocation is required between business interest and investment interest for a corporation. In the case of a consolidated group of C corporations, the 163(j) limitation applies to the group as a whole and the Proposed Regulations contain specific rules for allocation among consolidated group members. However, the 163(j) limitation does not apply to an affiliated group of corporations that does not elect to file a consolidated return.

5. Partnerships. In the case of debt incurred by a partnership, the 163(j) limitation is applied at the partnership level, and the partnership's non-deductible interest expense is allocated to the partners. However, partner-level adjustments are required with respect to the "inside basis" adjustment under Code Section 743(b), built-in loss of contributed property under Code Section 704(c)(1)(c) and income allocations under the remedial allocation method for contributed property. The Proposed Regulations provide that the allocation follows the same method as that used in allocating non-separately stated taxable income or loss. The non-deductible amount may be carried forward by the partners and deducted to the extent of any excess taxable income allocated to the partner from the applicable partnership in future years.

6. S Corporations. The Proposed Regulations prescribe some special rules for S corporations. First, unlike the rule that provides that all interest incurred by a C corporation is business interest and thus subject to the section 163(j) limitation, interest expense incurred by a S corporation is determined and treated in the same manner as that incurred by an individual (described in General Rules above). Second, the 163(j)

limitation is applied at the S corporation level, as it is for partnerships, but there is no pass-through to shareholders of non-deductible interest.

7. Exceptions. There are several important exceptions to the interest deductibility rules:

a. *Real property trade or business.* A "real property trade or business" may elect out of the 30% deductibility limitation, but must then depreciate its non-residential real property, residential rental property, and qualified improvement property over longer periods under the alternative depreciation system ("ADS") rather than the general depreciation system ("MACRS"). For this purpose, a "real property trade or business" is any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. The management or operation of a hotel qualifies as a real property trade or business. However, if at least 80% of the business's real property is leased to a trade or business under common control (50% of direct and indirect ownership interests in both businesses are held by related parties), the trade or business will not be eligible to make the election. Significantly, the Proposed Regulations make clear that a REIT can be engaged in a real property trade or business and thus make use of the election to not be subject to the interest deductibility limitation. In addition, a REIT is permitted to lease qualified lodging or health care facilities to their taxable REIT subsidiaries (generally under common control with the REIT) and still be permitted to make the election. However, a mortgage REIT cannot make such an election. Further, the new 100% bonus depreciation deduction generally will not be available to taxpayers that make the election to not be subject to the interest deduction limitation rules. Once made, the election is irrevocable, although the election will terminate if the taxpayer ceases to exist or ceases the operation of the electing trade or business.

b. *Special rule for REITs.* REITs derive most (if not all) of their income from property held for investment. However, consistent with the rule for C corporations, the Proposed Regulations provide that all interest income and expense of a REIT are treated as business income and expense and all other items of income, gain, loss and deduction are subject to the rules allocating such items to a trade or business. If a REIT chooses to be an electing real property trade or business and the value of the REIT's "real property financing assets" is 10% or less than the value of the REIT's total assets, a safe harbor exists to treat all of the REIT's assets as those of an electing real property trade or business. If the value of the real property financing assets is more than 10% of the value of the REIT's total assets, the REIT's business interest income and expense, and other items of gross income and expense are allocated between excepted and non-excepted trades or businesses under specific allocation rules set forth in the Proposed Regulations.

c. *Gross receipts less than $25 million.* The business interest limitation does not apply to taxpayers with average annual gross receipts, over the prior 3-year period, that are $25 million or less. "Gross receipts" of an entity include those of all "related" entities as well (i.e., aggregation is required). In the case of a partnership, the gross receipts test is applied at the partnership level. However, this exception does not apply to a "tax shelter," one of the definitions of which is a partnership or other entity that allocates more than 35% of losses to limited partners or limited entrepreneurs.

d. No exception for lending businesses. The Proposed Regulations make clear that an entity engaged in a lending activity is engaged in real property financing and thus, the activity is not a real property trade or business. Consequently, an entity such as a debt fund or mortgage REIT cannot make an election to be exempt from the interest deduction limitation. However, most lending businesses experience interest income in excess of interest expense and the denial of the election out of the interest deductibility limitation should generally not have much of an impact on these activities.

E. Penalty Relief for Some Underpayments of Estimated Tax. The IRS has announced (IR-2019-3) the waiver (Notice 2019-11) of estimated tax penalties for anyone who paid at least 85 percent of their total tax liability during 2018 through withholding or quarterly estimated tax payments or a combination of the two, saying the relief is designed to help those who were unable to properly adjust to changes under the Tax Cuts and Jobs Act. The IRS notes that the U.S. tax system is pay-as-you-go, which means taxpayers must pay most of their tax obligations during the year through withholding or estimated tax payments. Usually a penalty applies when the return is filed unless a taxpayer has paid 90 percent of their tax liability. The new 85 percent penalty waiver computation will be integrated into commercially available tax software and reflected in the upcoming revision of Form 2210 and instructions.

F. NOLs for Carryovers. The Joint Committee on Taxation might have ended the debate on how to compute net operating loss deductions when taxpayers have carryover losses under the Tax Cuts and Jobs Act and prior law. At the heart of the NOL computational issue — when a taxpayer has old and new carryovers — is the statute's statement that the limitation is based on taxable income determined "without regard to the deduction allowable under this section." Practitioners have discussed whether that phrase means without regard to any deduction or without regard to post-2017 deductions. According to the JCT's blue book explanation, the latter is the appropriate interpretation. The TCJA generally limits the NOL deduction for losses carried forward to 80 percent of taxable income, compared with NOLs under prior law that are deductible to the full extent of taxable income. That has raised questions on how taxpayers should determine the NOL limitation in years that they have pre-2018 and post-2017 carryover losses. According to the blue book, a taxpayer is entitled to offset taxable income in the amount of its pre-2018 NOL carryovers without limitation. A taxpayer's additional NOL deduction is "equal to the lesser of (1) its post-2017 NOL carryovers, or (2) 80 percent of the excess (if any) of the taxpayer's taxable income (before any NOL deduction attributable to post-2017 NOL carryovers) over the NOL deduction attributable to pre-2018 NOL carryovers."

G. Final 199A Regulations Released. On January 18, 2019, Treasury and IRS issued final IRC §199A regulations. Because they were issued in 2019, they are not binding on taxpayers for the 2018 tax year. However, taxpayers may rely on the final rules, in their entirety, or on the proposed regulations issued on August 16, 2018, in their entirety, for taxable years ending in calendar year 2018. The new rules clarify a number of issues, but leave others unresolved. Below are highlights from the final rules.

1. "Net Capital Gain" Defined for Taxable Income Limitation [§ 1.199A-1(b)(3)]. The IRC § 199A deduction is limited to 20 percent of taxable income minus "net capital gain." The final regulations clarify that "net capital gain" means "excess of net long-term capital gain for the taxable year over the net short-term capital loss for such year, plus any qualified dividend income."

2. "Trade or Business" [§ 1.199A-1(b)(14)].

a. *Rental Safe Harbor*. The § 199A deduction is available for "qualified business income" arising from a "qualified trade or business." The final regulations continue to define "trade or business" as a trade or business under IRC § 162, other than the trade or business of performing services as an employee. Commenters asked for a regulatory definition, a bright-line test, or a safe harbor. The agencies maintain, however, that whether an activity rises to the level of a trade or business is inherently a factual question and specific guidance under § 162 is beyond the scope of the final regulations. The summary states that the courts have developed two definitional requirements for an activity to rise to the level of a trade or business:

- Good faith intention to make a profit
- Considerable, regular, and continuous activity (it is unclear where the word "considerable" arose. It does not appear in the *Groetzinger* or *Higgins* cases)

In determining whether a rental real estate activity is a § 162 trade or business, the agencies state that relevant factors might include, but are not limited to, (i) the type of rented property (commercial real property vs. residential property), (ii) the number of properties rented, (iii) the owner's or the owner's agent's day-to-day involvement, (iv) the types and significance of any ancillary services provided under the lease, and (v) the terms of the lease (net lease v. traditional; short-term v. long-term). Recognizing the difficulties taxpayers and practitioners may have in determining whether a taxpayer's rental real estate activities is sufficiently "regular, continuous, and considerable" for the activity to constitute a section 162 trade or business, the agencies concurrently released Notice 2019-07. This proposed revenue procedure details a proposed safe harbor under which a rental real estate enterprise may be treated as a trade or business for 199A purposes. The regulations specify that those taxpayers who treat a rental activity as a trade or business for purposes of 199A should be consistent and comply with the information return filing requirements of IRC § 6041 (filing 1099s).

b. *Self-Rental Rule*. The final regulations continue to provide that rental activity that does not rise to the level of an IRC § 162 trade or business is nevertheless treated as a trade or business for purposes of § 199A, if the property is rented to a commonly controlled trade or business. In other words, self-rental activities do not have to rise to the level of a trade or business for the rental income to qualify as QBI. Common control under the final regulations means that the same person or group of persons, directly or by attribution under IRC §§ 267(b) or 707(b), owns 50 percent or more of each trade or business. Notably, the final rule was written *to* exclude self-rental income received from a C corporation from this special treatment. The final rule does expand the family attribution rules to include siblings and grandparents.

3. Computational Clarifications [§1.199A-1(d)(2)(iii)(A)]. IRS retained the netting rules set forth in the proposed rules. This rule provides that if an individual's QBI from at least one trade or business is less than zero, the individual must offset the QBI attributable to each trade or business that produced net positive QBI with the QBI from each trade or business that produced net negative QBI in proportion to the relative amounts of net QBI in the trades or businesses with positive QBI. Final regulations provide that for taxpayers with taxable income within the phase-in range, QBI from an SSTB must be reduced by the applicable percentage BEFORE the application of the netting rule. The rules also clarify that trades or businesses conducted by a disregarded entity will be treated as conducted directly by the owner of the entity for purposes of § 199A.

4. W-2 Wages [Rev. Proc. 2019-11]. In conjunction with the final rules, the agencies issued Rev. Proc. 2019-11, final guidance for determining W-2 wages for purposes of 199A. The guidance clarifies that W-2 wages include elective deferrals to Simplified Employee Pensions, simple retirement accounts, and other qualified plans. It also specifies that amounts reported on W-2s for statutory employees (as checked in Box 13) should not be included in the calculation of W-2 wages. The summary also states that W-2 wages include amounts paid to S Corporation shareholders and common-law employees.

5. UBIA of Qualified Property [§1.199A-2(c)(3].

a. *Property Contributed to Partnership or S Corporation in Non-Recognition Transfer*. The final regulations specify that each partner's share of unadjusted basis immediately after acquisition ("UBIA") is determined in accordance with how depreciation would be allocated for IRC § 704(b) book purposes on the last day of the taxable year. For S Corporations, each shareholder's share of UBIA of qualified property is a share of the unadjusted basis proportionate to the ratio of shares in the S corporation held by the shareholder on the last day of the taxable year over the total issued and outstanding shares of the S corporation. The final regulations also state that qualified property contributed to a partnership or S corporation in a non-recognition transaction should generally retain its UBIA on the date it was first placed in service by the partner or shareholder. Solely for purposes of 199A, the rules provide that if qualified property is acquired in a transaction described in § 168(i)(7)(B), the transferee's UBIA in the property is the same as the transferors' UBIA in the property, decreased by the amount of money received by the transferred or increased by the amount of money paid. This rule only applies to § 199A and not for purposes of determining gain, loss, basis or depreciation.

b. *1031 Like-Kind Exchange*. The final regulations revise the harsh UBIA rule that was proposed for qualified property undergoing a like-kind exchange. The final rule provides that the UBIA of qualified like-kind property that a taxpayer receives in an IRC § 1031 like-kind exchange is the UBIA of the *relinquished* property. This UBIA is adjusted, however, for boot paid or received in the exchange. UBIA is adjusted downward for excess boot received, and UBIA is adjusted upward for boot paid. This rule, as opposed to the one set forth in the proposed regulations, does not penalize taxpayers who engage in a like-kind exchange with respect to UBIA. For determining the depreciable period, the placed in service date of the replacement property is equal to the placed in service date of the relinquished property, to the extent that no boot is paid. If boot is paid, that portion of the replacement property is treated as separate qualified property with a placed in service date equal to the date the replacement property was first place in service.

c. *743 Basis Adjustment*. Final regulations also change course from the proposed regulations and provide that IRC § 743(b) basis adjustments should be treated as qualified property to the extent the adjustment reflects an increase in the fair market value of the underlying qualifying property.

d. *Must be Held at End of the Year*. The agencies state in the summary that the statute only allows UBIA for qualified property held at the close of the taxable year. UBIA is measured at the trade or business level. Therefore, if qualified property is held by a relevant pass-through entity (RPE), the applicable tax year is that of the RPE. If a shareholder transfers his or her interest in the RPE prior to the close of the RPE's taxable year, that shareholder is not entitled to a share of the UBIA from the RPE for that tax year.

e. *Inherited Property*. The final regulations clearly state that where qualified property is acquired from a decedent and immediately placed in service, the UBIA of the property will generally be the FMV at the date of the decedent's death under IRC § 1014. A new depreciable period also commences as of the date of the death.

6. <u>Treatment of Losses [§1.199A-3(b)(1)(iv)]</u>**.** The proposed rules provided that previously disallowed losses or deductions (under IRC §§ 465, 469, 704(d), and 1366(d)) allowed in the taxable year are taken into account for QBI if they were incurred in a tax year beginning *after* January 1, 2018. But previously disallowed losses incurred for taxable years beginning before January 1, 2018, cannot be taken into account for purposes of computing QBI. The final regulations provide an ordering rule for this provision. Consistent with prior DPAD rules, any losses disallowed, suspended, or limited under the provisions of §§ 465, 469, 704(d), and 1366(d) (or similar provisions) shall be used for purposes of 199A in order from the oldest to the most recent on a First in First Out basis. Concurrent with the final regulations, the agencies published proposed regulations that treat previously suspended losses as losses from a separate trade or business for purposes of 199A. The preamble to the final regulations reviews other loss issues—such as ordering rules for the use of suspended active business losses, methods for tracing losses to various trades or businesses, whether a loss retains its character, and whether a 199A deduction is a loss for calculating the loss limitation under IRC § 461(l)—for which taxpayers need further guidance. The agencies state that these issues are beyond the scope of the 199A regulations and will be addressed in future guidance. The final regulations retain the proposed regulations' treatment of NOLs and excess business losses with respect to calculating QBI. While a deduction under § 172 for a net operating loss is generally not considered to be with respect to a trade or business and is not taken into account in determining QBI, an excess business loss under 461(l) is

treated as a net operating loss carryover to the following taxable year and is taken into account for purposes of computing QBI in the subsequent taxable year in which it is deducted.

7. Certain Above-the-line Deductions and QBI [§1.199A-3(b)(1)(vi)]**.** The proposed regulations were silent as to the treatment of the deductible portion of the self-employment income tax under § 164(f), the self-employed health insurance deduction under § 162(l), and the deduction for contributions to qualified retirement plans under § 404 for purposes of calculating QBI. The final regulations clarify that these deductions are taken into account for purposes of computing QBI to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis. The agencies declined to address whether deductions for unreimbursed partnership expenses, interest expense to acquire a partnership or S corporation interest, and state and local taxes are attributable to a trade or business for purposes of the QBI calculation.

8. Guaranteed Payments and QBI [§1.199A-3(b)(2)]**.** The final regulations did not adopt comments suggesting that guaranteed payments for the use of capital are generally attributable to a trade or business and should be QBI. The agencies state in the summary that guaranteed payments for the use of capital should be treated in a manner similar to interest income. Under the "unlikely fact pattern" that these payments are property allocated to a trade or business, they would constitute QBI. The final regulations do specify that payments to partners for services under section 707(a) are similar to guaranteed payments, reasonable compensation, and wages and are excluded from QBI.

9. Reasonable Compensation [§1.199A-2]**.** The final regulations do not impose any reasonable compensation requirement on non-S corporation entities. They do clarify that reasonable compensation is excluded from the definition of QBI, but that it is included as W-2 wages for the purposes of the W-2 wage limitation to the extent all other requirements of that provision are met. The agencies refused to provide any safe harbor or bright line guidance with respect to proper reasonable compensation.

10. Gains and Losses as QBI (1231, 1245, 1250) [§1.199A-3(b)(2)]**.** The final rules reiterate that for purposes of calculating QBI, taxpayers must net their section 1231 gains and losses from multiple trades or businesses to determine whether they have excess gain (which means *no QBI*) or excess loss (which means *QBI loss*). This includes incorporating the 1231(c) recapture rule. Despite the rule, the final regulations remove the specific reference to § 1231 and provide that any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss, including any item treated as one under any other provision of the Code, is not taken into account when calculating QBI. Conversely, if an item is not treated as capital, it *is* taken into account as a qualified item of income, gain, deduction, or loss. This was meant to clarify that items of gain such as 1245 recapture, not treated as capital, are included in the QBI calculation. Rather than listing specific code provisions, the agencies opted for a definitional approach.

11. Allocation of QBI among Trades or Businesses [§1.199A-3(b)(5)]. The final regulations retain the rule in the proposed regulations that taxpayers may use "any reasonable method under all facts and circumstances" to allocate QBI among several trades or businesses. Once a method is chosen, however, it must be applied consistently with respect to that item until it is no longer reasonable under the facts and circumstances.

12. Aggregation [§1.199A-4]. The final regulations continue to allow aggregation of multiple trades or businesses for purposes of applying the W-2 wage and UBIA of qualified property limitations.

a. *Aggregation Requirements*. The final regulations generally retain the aggregation factors provided in the proposed regulations, with some modifications. For example, the language was modified to clarify that real estate trades or businesses may be aggregated. The requirements in the final regulations are as follows:

1) Each trade or business is a trade or business (with a special exception for self-rentals).

2) The same person or group must directly or indirectly (by attribution under IRC § 267(b) or 707(b)) own 50 percent or more of each trade or business to be aggregated for a majority of the year (ownership must exist for majority of year, including the last day of the year and all of the items must be reported on returns with the same taxable year) [Note: Family attribution rules now include grandparents, adopted grandchildren and siblings, in addition to spouses, parents, and children.]

3) None of the trades and businesses can be SSTBs.

4) Individuals and trusts must show that the trades or businesses meet two of the following three factors:

- The businesses provide *products, property, or services* that are the same or that are customarily offered together.
- The businesses share facilities or significant centralized business elements such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resources.

- The businesses are operated in coordination with, or reliance on, other businesses in the aggregated group (for example, supply chain interdependencies).

b. *RPEs May Aggregate*. The final regulations also permit RPEs to aggregate trades or businesses if operated directly or through lower-tier RPEs. The resulting aggregation must be reported by the RPE and by all owners of the RPE. An individual or upper-tier RPE may not separate the aggregated trades or businesses of a lower-tier RPE, but instead must maintain the lower-tier RPE's aggregation. An individual or upper-tier RPE, however, may aggregate additional trades or businesses with the lower-tier RPE's aggregation as long as the aggregation rules are satisfied.

c. *Aggregation Mechanics*. The final rules specify that a taxpayer who does not aggregate may aggregate in future years. Once the taxpayer chooses to aggregate, however, the taxpayer must continue to aggregate unless there is a material change in circumstances that would cause a change to the aggregation. Moving forward, an aggregation decision may not be made on an amended return. However, the final regulations provide that taxpayer may make an initial aggregation decision on an amended return for the 2018 taxable year only. The final regulations retain the annual disclosure requirement provided in the proposed regulations. RPEs who choose to aggregate under the new rules must also follow reporting and disclosure rules. If annual disclosures are not attached to the return, IRS is permitted to disaggregate. The taxpayer would not be permitted to re-aggregate for three years. The final regulations provide aggregation examples to illustrate the rules.

13. SSTB Clarifications [§1.199A-5]**.** The final regulations make some changes and clarifications with respect to the determination of specified service trades or businesses.

a. *Health*. The summary of the final regulations clarify that the sale of pharmaceuticals or medical devices by a retail pharmacy is not by itself a trade or business performing services in the field of health. The final regulations also include an example of an assisted living facility that is not considered a health care facility. The summary specifies that radiologists, veterinarians, and physical therapists are providing services in the field of health.

c. *Consulting*. The final regulations specify that services provided by engineers and architects cannot be considered to be SSTB, even if their services would otherwise meet the definition of consulting services.

c. *Financial Services*. The final regulations summary states that the provision of investment services by insurance agents, to the extent they are ancillary to the commission-based sale of an insurance policy, will generally not be considered the provision of financial services for purposes of section 199A.

d. *Commodities*. The final regulations specify that that the definition of dealing in commodities for purposes of 199A is limited to a trade or business that is dealing in financial instruments or otherwise does not engage in substantial activities with respect to physical commodities. As such, producers, processors, grain merchants, or handlers of commodities would not be SSTB. Similarly, income, deduction, gain, or loss from a hedging transaction entered in the normal course of a commodities business will not be SSTB. A sale by a trade or business of commodities held for investment or speculation is not a qualified active sale.

e. *De Minimis Rule*. The proposed regulations set forth a de minimis rule that allows trades or businesses that have very little SSTB activity to benefit from the deduction. The threshold for trades or businesses with less than $25 million of gross receipts is 10 percent, and for trades or businesses with more than $25 million of gross receipts it is 5 percent. The final regulations retained the de minimis rule, but clarify that RPEs can have multiple trades or businesses and that each trade or business is separately tested to see if it is an SSTB. The de minimis threshold is applied separately to each trade or business, not in the aggregate. The regulations also seem to clarify that this rule operates as a cliff. If the gross receipts of the SSTB activity exceeds the threshold by a dollar, the entire trade or business is an SSTB. The final regulations do remove the 80 percent rule set forth in the proposed regulations. This rule stated that an SSTB included any trade or business with 50 percent or more common ownership (directly or indirectly) that provided 80 percent or more of its property or services to an SSTB. The final regulations instead just provide that if a trade or business provides property or services to an SSTB and there is 50 percent or more common ownership of the trade or business, the portion of the trade or business providing property or services to the commonly-owned SSTB will be treated as a separate SSTB with respect to related parties.

14. Reporting Requirements for RPEs [§1.199A-6]**.** An RPE that chooses to aggregate can report combined QBI, W-2 wages, and UBIA of all qualified property for the aggregated trades or businesses. This aggregation must then be maintained and reported by all direct and indirect owners of the RPE, including upper-tier RPEs. The final regulations clarify that if an RPE fails to report one item to its owner, all items related to 199A should not be presumed to be zero. The RPE can report W-2 wages and not UBIA. It is only the unreported item that is presumed to be zero. This information can also be reported on an amended or late filed return for any open tax year. The final regulations make several clarifications with respect to trusts and estates. For purposes of determining whether a trust or estate has income above the threshold, the taxable income of the trust or estate is determined after taking into account any distribution deduction. The final regulations continue to require trusts that are RPEs to allocate QBI (which may be negative) to its beneficiaries, based upon the relative portions of DNI distributed to them.

15. Non Calendar-Year RPE [§1.199A-6]**.** Section 199A(f)(1) provides that 199A applies at the partner or S corporation shareholder level and that each partner or shareholder takes into account such person's allocable share of each qualified item. These include items included or allowed in determining taxable income from the taxable year. Section 199A applies to taxable years beginning after December 31, 2017. There is no statutory requirement under 199A that a qualified item arise after December 31, 2017. As such, the final regulations provide that income flowing to an individual from a partnership or S corporation is subject to the tax rates and rules in effect in the year of the individual in which the entity's year closes. Thus, if an individual receives QBI, W-2 wages, UBIA of qualified property, and the aggregate amount of qualified REIT dividends and qualified PTP income from an RPE with a taxable year that begins before January 1, 2018 and ends after December 31, 2017, such items are treated as having been incurred by the individual during the individual's tax year during which such RPE taxable year ends.

H. Safe Harbor Available for Vehicles Qualifying for Bonus Depreciation. The IRS announced (IR-2019-14) new guidance that provides a safe harbor method for determining depreciation deductions for passenger automobiles that qualify for the 100 percent additional first-year depreciation deduction and are subject to depreciation limitations. The depreciation deduction applies to qualified property, including passenger cars, acquired and placed in service after September 27, 2017, and before January 1, 2027. The Tax Cuts and Jobs Act increased the first-year limitation amount for qualifying cars by $8,000. If the depreciable basis of an automobile for which the 100 percent additional first-year depreciation deduction is allowable exceeds the first-year limitation, the excess amount is deductible in the first tax year after the end of the recovery period. The new safe harbor method of accounting for passenger automobiles in Rev. Proc. 2019-13 allows depreciation deductions for the excess amount during the recovery period subject to the depreciation limitations applicable to passenger automobiles. To apply the safe harbor method, the taxpayer must use the applicable depreciation table in Appendix A of IRS Publication 946, "How to Depreciate Property." The safe harbor doesn't apply to a passenger automobile placed in service by the taxpayer after 2022 or to a passenger automobile for which the taxpayer elected out of the 100 percent additional first-year depreciation deduction or elected under section 179 to expense all or part of the cost of the passenger automobile.

I. Final Regs on State and Local Tax Credits. The IRS published final regulations (T.D. 9864) that provide rules on the availability of charitable contribution deductions under section 170 when a taxpayer receives or expects to receive a corresponding state or local tax credit. Effective August 12, 2019, the final regs generally adopt, with some clarifying and technical changes, proposed regs (REG-112176-18) issued in August 2018. In response to comments, including concerns that the proposed regs would result in an overall decline in charitable giving, Treasury and the IRS have simultaneously issued guidance (Notice 2019-12) providing a safe harbor for payments made by some individuals. Under the safe harbor, an individual who itemizes deductions and makes a payment to a section 170(c) entity in return for a state or local tax credit may treat the portion of that payment that is or will be disallowed as a charitable contribution deduction under section 170 as a payment of state or local tax for purposes of section 164. This disallowed portion of the payment may be treated as a payment of state or local tax under section 164 when and to the extent that an individual applies the state or local tax credit to offset their state or local tax liability. The final regs retain the rule that a taxpayer generally is not required to reduce its charitable contribution deduction because of its receipt of state or local tax deductions. However, the final regs also retain the exception to this rule for excess state or local tax deductions. Specifically, the taxpayer must reduce its charitable contribution deduction if it receives or expects to receive state or local tax deductions in excess of their payment or the fair market value of property transferred by them. The final regs retain the 15 percent exception, under which a taxpayer may disregard SALT credits as a return benefit when those credits do not exceed 15 percent of the taxpayer's payment. However, the final regs clarify that this exception applies only if the sum of the taxpayer's SALT credits received, or expected to be received, does not exceed 15 percent of their payment or 15 percent of the FMV of the property transferred by them. The regs also provide that the final rules under reg. section 1.170A-1(h)(3) apply to payments made by a trust or decedent's estate in determining its charitable contribution deduction under section 642(c).

J. Guidance Issued on Making, Revoking Bonus Depreciation Elections. The IRS issued guidance (Rev. Proc. 2019-33) that allows a taxpayer to make a late election, or to revoke an election, under section 168(k) for some property acquired by the taxpayer after September 27, 2017, and placed in service by the taxpayer during its tax year that includes September 28, 2017. Section 168(k)(5) allows a taxpayer to elect to deduct additional first-year depreciation for any specified plant that is planted or grafted after September 27, 2017, and before 2027. Under section 168(k)(7), a taxpayer may elect not to deduct the additional first-year depreciation for all qualified property that is in the same class of property and placed in service by the taxpayer in the same tax year. The Tax Cuts and Jobs Act added section 168(k)(10), which allows a taxpayer to elect to deduct 50 percent, instead of 100 percent, additional first-year depreciation for all qualified property acquired and placed in service by specified dates. Proposed regulations (REG-104397-18) under section 168(k) were issued in August 2018. Commentators requested relief to make late elections under section 168(k)(7) or (10) for property placed in service during the taxpayer's tax year that includes September 28, 2017, because some taxpayers had already filed their federal tax returns for that tax year before the proposed regs were issued. Further, a taxpayer with an extended due date of September 15, 2018, or October 15, 2018, for its return for the tax year that includes September 28, 2017, may not have had enough time to analyze the proposed regs to make a timely election. As a result, Rev. Proc. 2019-33 provides procedures for making late elections, or revoking elections, under section 168(k)(5), (7), or (10) for property acquired by a taxpayer after September 27, 2017, and placed in service, planted, or grafted by the taxpayer during its tax year that includes September 28, 2017. Because of the administrative burden of filing amended returns, Treasury and the IRS have determined that it is appropriate to treat the making of late elections, or the revocation of elections, under section 168(k) as a change in method of accounting with a section 481(a) adjustment for a limited time. Rev. Proc. 2019-33 provides the procedures for a taxpayer to obtain automatic consent for a change in method of accounting to make the late elections or revoke them. Rev. Proc. 2018-31 is modified to include the accounting method change provided in Rev. Proc. 2019-33, which is effective July 31, 2019.

K. Final Regs on TCJA Changes to Bonus Depreciation. The IRS has issued final regulations (T.D. 9874) providing guidance on the additional first-year depreciation deduction under section 168(k) to reflect and clarify the increase of the benefit and expansion of qualified property by the Tax Cuts and Jobs Act. The final regs adopt, with changes in response to some comments and testimony, proposed regs (REG-104397-18) issued in August 2018. Further addressing those comments and testimony, the IRS has simultaneously released additional proposed regs (REG-106808-19) under section 168(k). The final regs provide that depreciable property must meet four requirements to be qualified property for purposes of the additional first-year depreciation deduction. The depreciable property must be of a specified type, and the original use of the depreciable property must start with the taxpayer or used depreciable property must meet specified acquisition requirements. The depreciable property must be placed in service by the taxpayer within a specified time period or must be planted or grafted by the taxpayer before a specified date. Lastly the depreciable property must be acquired by the taxpayer after September 27, 2017. The final regs identify eligible and ineligible qualified property. The regs clarify that only production costs of qualified film, television, or live theatrical production for which a deduction would have been allowed under section 181 are eligible for the additional first-year depreciation deduction. The regs further clarify that the owner of one of those productions is the only taxpayer eligible to claim the additional first-year depreciation and must be the taxpayer that places the production in service. The regs address property that is required to be depreciated under the alternative depreciation system (ADS) for some purposes other than section 168, clarifying that using the ADS in those cases doesn't make the property ineligible for the deduction. The regs also address the treatment of tax-exempt use property, as defined by section 168(h)(6). For used property purposes, the final regs define "predecessor" and clarify "prior depreciable interest." The regs also provide a safe harbor lookback period of five calendar years for determining if a taxpayer or predecessor had a prior depreciable interest in property. Under the regs, substantially renovated property is eligible for bonus depreciation, even if the taxpayer had a prior depreciable interest in the property before the renovation. The regs clarify the syndication transaction rule and include some changes regarding the eligibility of partnership basis adjustments under section 743(b) for bonus depreciation. In response to comments that a position under the 2018 proposed regs is a departure from the self-constructed property rules and is administratively burdensome, the final regs provide that specified property isn't acquired under a written binding contract but is self-constructed property. The regs modify the acquisition date of property that is acquired under a written binding contract and clarify the acquisition date for self-constructed property. The final regs provide rules for calculating the additional first-year depreciation deduction, for electing out of the bonus depreciation deduction, and for electing to apply section 168(k)(5) to a specified plant. Special rules apply in some situations described in the preamble to the final regs, which include some changes and clarifications to the 2018 proposed regs in response to comments.

L. Proposed Bonus Depreciation Regs on Qualifying Property. The IRS has issued proposed regulations (REG-106808-19) on the additional first-year depreciation deduction under section 168(k), providing rules on property not eligible for the deduction, a de minimis use rule on previously used property, and rules regarding components of larger properties. The proposed rules were released in conjunction with final regs (T.D. 9874), which adopt with changes proposed regs (REG-104397-18) published in August. The new proposed regs withdraw a portion of the August proposed regs. Discussion topic outlines for a November 13 public hearing on the new proposed regs are due by October 23. The new proposed regs address some ambiguities related to the operation of section 168(k)(9), which describes some property that is ineligible for bonus depreciation, the preamble states. These properties include some rate-regulated utilities and motor vehicle dealerships with floor plan financing indebtedness. The proposed regs clarify which businesses fall into these categories and clarify that floor plan financing interest is taken into account under section 163(j)(1)(C) only if the firm in fact received a benefit from that provision. The proposed regs also clarify an ambiguity in section 168(k)(9)(B) pertaining to the length of time that the provision applies to a given firm. The proposed regs create a de minimis rule that provides that a taxpayer will not be deemed to have had a prior depreciable interest in a property – and thus, that property will be eligible for bonus depreciation in that taxpayer's hands – if the taxpayer previously disposed of that property within 90 days of the date on which that property was placed in service. Treasury and the IRS said they primarily instituted this rule to coordinate with the syndication transaction rules of section 168(k)(E)(2)(iii). The proposed regs also clarify several aspects of the group prior-use rule, under which all members of a consolidated group are treated as having had a depreciable interest in a property if any member of the consolidated group had such a depreciable interest. First, the rule ceases to be in effect once the consolidated group terminates as a result of joining another consolidated group. Second, the group prior-use rule doesn't apply to a corporation after it deconsolidates from the consolidated group as long as that corporation did not own that property. Further, the proposed regs clarify the interpretation of an example in the August proposed regs regarding an asset acquisition as part of a sale of a member of a controlled group from one group to another. In such an asset acquisition, the bonus depreciation deduction is allowed and should be claimed by the acquiring group. The proposed regs provide for similar treatment regarding deemed acquisitions if an election was made under section 338(h)(10) or section 336(e). In response to comments, Treasury and the IRS have determined that a taxpayer may elect to treat one or more components acquired or self-constructed after September 27, 2017, of some larger self-constructed property as being eligible for the additional first-year depreciation deduction. The larger self-constructed property must be qualified property under section 168(k)(2), as in effect before the TCJA's enactment, for which the manufacture, construction, or production began before September 28, 2017. However, the election is not available for components of larger self-constructed property when the property isn't eligible for any bonus depreciation deduction under section 168(k). Further, the proposed regs add rules on the application of the mid-quarter convention, as determined under section 168(d), while also responding to comments received on the August proposed regs. Taxpayers generally may rely on the proposed regs pending the issuance of final regs.

M. 'My Boss Told Me Not to Pay' Rejected in Trust Fund Penalty Case. The Eleventh Circuit affirmed that an individual who was CFO and president of two companies was liable for trust fund recovery penalties for failing to pay the companies' trust fund taxes, rejecting his "my-boss-told-me-not-to-pay" argument and holding that the argument doesn't work even when a government agency receiver told him not to pay the taxes. *Steven J. Myers v. United States*; No. 18-11403.

N. H.R. 3151, the Taxpayer First Act of 2019.

1. Independent Appeals Process. The Act codifies the requirements of an independent administrative appeals function at IRS. In so doing, it renames the IRS Office of Appeals as the IRS Independent Office of Appeals (Independent Appeals). (Code Sec. 7803(e) as amended Act Sec. 1001) The new rules require that the administrative case file referred to Independent Appeals be available to certain individual and small business taxpayers. Eligible taxpayers are those that, for the tax year to which the dispute relates, are: (1) individuals with adjusted gross incomes not exceeding $400,000, and (2) entities with gross receipts not exceeding $5 million for the tax year. (Code Sec. 7803(e)(7)) In cases in which IRS has issued a notice of deficiency to a taxpayer, IRS must prescribe notice and protest procedures for taxpayers whose request for Independent Appeals consideration is denied. (Code Sec. 7803(e)(5))

2. Improved IRS Service. The Act requires IRS to develop a comprehensive strategy for customer service, to submit such plan to Congress not later than the date which is one year after the date of enactment, and to make the plan and

training materials available to the public within two years of that date. The strategy will include, among other things, a plan to determine appropriate levels of online services, telephone call back services, and training of employees providing customer services, based on best practices of businesses and designed to meet reasonable customer expectations. (Act Sec. 1101)

3. Low-Income Exceptions Regarding Offers-In-Compromise. Under pre-Act law, IRS is authorized to enter into an offer-in-compromise (OIC) agreement with a taxpayer to settle a tax debt for less than the taxpayer's actual liability. Generally, when proposing an OIC to IRS, the taxpayer must pay an application fee and provide an initial non-refundable lump sum payment. IRS has the authority to waive these payments. Under this authority, IRS does not require taxpayers certified as low-income, defined as those with incomes below 250% of the Federal poverty level, to include the application fee and initial payment. New law. With respect to offers-in-compromise submitted after the date of enactment, the Act codifies the current low-income taxpayer exception for the user fee or upfront partial payment. The Act also provides that the determination of low income is based on the individual's adjusted gross income as determined for the most recent tax year for which such information is available. (Code Sec. 7122(c)(3) as amended Act Sec. 1103)

4. IRS Enforcement. Effective on the date of enactment, the Act provides that, in the case of a suspected structuring violation, IRS may only pursue seizure or forfeiture of assets if either the property to be seized was derived from an illegal source or the transactions were structured for the purpose of concealing a violation of a criminal law or reg other than rules against structuring. The Act also establishes post-seizure notice and review procedures for IRS seizures based on suspected structuring violations. (31 USC 5317(c)(2), as amended Act Sec. 1201) Also, effective for interest received on or after the date of enactment, the Act amends the Code to exclude from gross income any interest received from the Federal government in connection with an action to recover property seized by IRS pursuant to a claimed violation of the structuring provisions of the BSA. (Code Sec. 139H, as added by Act Sec. 1202)

5. Innocent Spouse Relief. In general, married couples who file tax returns jointly are both responsible for the entire tax liability that should be reported on the return. However, under certain circumstances, the tax code provides relief from joint liability for certain innocent spouses. (Code Sec. 6015) One such type of relief is equitable relief; this relief is granted only if, taking into account all facts and circumstances, it is inequitable to hold the individual liable for the unpaid portion of tax or for a deficiency with respect to the joint return. The Act provides that the standard of review for innocent spouse relief by the Tax Court is to be conducted on a de novo basis, meaning that the Tax Court would take a fresh look at the case without taking previous decisions into account. The review would be based on the administrative record and any newly discovered or previously unavailable evidence. (Code Sec. 6015(e)(7), as amended Act Sec. 1203(a)(1)) The Act also allows taxpayers to request equitable relief with respect to any unpaid liability before the expiration of the collection period or, if paid, before the

expiration of the applicable limitations period for claiming a refund or credit. (Code Sec. 6015(f), as amended by Act Sec. 1203(a)(2))

6. John Doe Summonses. IRS may issue a third-party summons that doesn't identify the taxpayer (a "John Doe summons"), but only if there has been a court proceeding in which IRS proves that it meets certain requirements. (Code Sec. 7609(f)) Effective for summonses served after the date that is 45 days after the date of enactment, the Act prevents IRS from issuing a John Doe summons unless the information sought to be obtained is narrowly tailored and pertains to the failure (or potential failure) of the person or group or class of persons referred to in the statute to comply with one or more provisions of the Code which have been identified. (Code Sec. 7609(f), as amended Act Sec. 1204(a))

7. Taxes Collected by Private Collection Agencies. The Code permits IRS to establish a program that refers certain inactive tax receivable accounts to private collection agencies. (Code Sec. 6306(a)) The Code defines the term "inactive tax receivables." One type of inactive tax receivable is a receivable for which more than one third of the applicable limitations period has lapsed and no IRS employee has been assigned to collect the receivable. (Code Sec. 6306(c)(2)(A)) Certain tax receivables are not eligible for collection by private collection agencies. (Code Sec. 6306(d)) Effective with respect to tax receivables identified by IRS after Dec. 31, 2020, the Act makes the following additional tax receivables of individual taxpayers ineligible for collection under qualified tax collection contracts—receivables with respect to a taxpayer: (1) substantially all of whose income comes from supplemental security income benefits or disability insurance benefit payments, or (2) whose adjusted gross income does not exceed 200% of the applicable poverty level. (Code Sec. 6306(d)(3), as amended by Act Sec. 1205(a)) The Act also modifies the definition of inactive tax receivable by replacing the condition that more than 1/3 of the applicable limitations period has lapsed with the requirement that "more than two years has passed since assessment." (Code Sec. 6306(c)(2)(A)(ii), as amended by Act Sec. 1205(b)) And, effective for contracts with private collectors that are entered into after the date of enactment, the Act also substitutes "seven years" for "five years" in a rule that currently allows private debt collectors to offer a taxpayer an installment agreement providing for payment over a period as long as five years. (Code Sec. 6306(b)(1)(B), as amended by Act Sec. 1205(c))

8. Notice to Taxpayer of IRS Contact with Third Party. IRS may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of the taxpayer without providing reasonable notice in advance to the taxpayer that IRS may contact persons other than the taxpayer. (Code Sec. 7602(c)(1)) New law. Effective for notices provided, and contacts of persons made, more than 45 days after the date of enactment, the Act replaces the above requirement with a requirement that the taxpayer be provided with notice at least 45 days before the beginning of the period of contact. The period of contact may not be greater than one year. The Act requires that notice be provided only if there is a present intent at the time such notice is given for IRS to make such contacts. (Code Sec. 7602(c)(1), as amended Act Sec. 1206)

9. Designated Summonses. Effective for summonses issued more than 45 days after the date of enactment, the Act requires that prior to issuing a designated summons, the Commissioner of the relevant operating division of IRS and the Chief Counsel must review and provide written approval of the summons. The written approval must state facts establishing that IRS had previously made reasonable requests for the information and must be attached to the summons. The provision also requires that IRS certify in any subsequent judicial proceedings that a reasonable request for the information were made. (Code Sec. 6503(j), as amended by Act Sec. 1207)

10. Limits on Actions by IRS Contractors. The Act provides that IRS cannot, under the authority of Code Sec. 6103(n), provide books and records that IRS obtained under its authority, to a contractor described in Code Sec. 6103(n), other than when the contractor requires such information for the sole purpose of serving as an expert.

11. Office of the Taxpayer Advocate. The Office of the Taxpayer Advocate ("OTA") is expected to represent taxpayer interests independently in disputes with IRS. The National Taxpayer Advocate ("NTA") supervises the OTA. (Code Sec. 7803(c)(1)) Taxpayer Advocate Directives (TADs) are directives from the NTA to IRS that identify systemic problems and mandate changes to IRS tax administration or other processes. Certain IRS Deputy Commissioners have the authority to modify or rescind a TAD. The Act requires certain responses to TADs from the IRS Commissioner or Deputy Commissioner and clarifies the time period required for such a response. (Code Sec. 7803(c)(5), as amended by Act Sec. 1301(a)(1)) The Act makes other changes to the NTA's responsibilities. It requires the NTA to report to Congress any TADs not addressed by IRS, requires IRS to provide statistical support to the NTA upon request to the extent practicable, and requires the NTA to coordinate research efforts with the Treasury Inspector General for Tax Administration (TIGTA). (Code Sec. 7803(c)(2), as amended by Act Sec. 1301(b)(2); Code Sec. 6108(d), as amended by Act Sec. 1301(b)(3))

12. IRS Organizational Structure. Under the Act, the Treasury Department is required to submit to Congress by Sept. 30, 2020, a comprehensive written plan to redesign the organization of IRS. The Act requires the plan to, among other things: (a) streamline the structure of the agency including minimizing the duplication of services and responsibilities; (b) best position IRS to combat cybersecurity and other threats to IRS; and (c) address whether the Criminal Division of IRS should report directly to the Commissioner.

13. Community Volunteer Income Tax Assistance Programs. IRS, through its Volunteer Income Tax Assistance (VITA) Program, currently partners with IRS-certified volunteer organizations to provide free tax return filing assistance to low-income populations, persons with disabilities, taxpayers with limited English proficiency, and other underserved communities. The Act codifies the VITA program. The Secretary of the Treasury, unless otherwise provided by specific appropriation, may allocate from otherwise appropriated funds up to $30 million per year in matching grants to qualified entities for the development, expansion, or continuation of qualified tax return preparation programs assisting low-income taxpayers and members of underserved populations.

Additionally, the provision allows IRS to use mass communications and other means to promote the benefits and encourage the use of the program. (Code Sec. 7526A, as added by Act Sec. 1401)

14. Low Income Taxpayer Clinics. The Code provides that IRS may provide up to $6 million per year in matching grants to Low Income Taxpayer Clinics which assist low-income taxpayers with representation and controversies with IRS. (Code Sec. 7526) 5 CFR §3101.106(a) prohibits Treasury Department personnel from referring taxpayers to qualified low-income taxpayer clinics for advice and assistance. New law. Effective on the date of enactment, the Act allows Treasury Department personnel to advise taxpayers of the availability of, and eligibility requirements for receiving, advice and assistance from qualified low-income taxpayer clinics that receive funding under the Code, and to provide location and contact information for such clinics. (Code Sec. 7526(c), as amended by Act Sec. 1402)

15. Taxpayer Assistance Center Closures. The Act requires IRS to provide public notice, including by non-electronic means, to affected taxpayers 90 days prior to the closure of a TAC. The notice must include information on alternative forms of assistance available for affected taxpayers and the date of the proposed closure. (Act Sec. 1403)

16. Seizure and Sale of Perishable Goods. Under pre-Act law, if it is determined that any tangible property seized to satisfy unpaid taxes: (1) is liable to perish, (2) is liable to become greatly reduced in price or value by keeping, or (3) cannot be kept without great expense, the property may be sold after it has been appraised and the owner has been given an opportunity to pay the appraised value or furnish bond for payment. The general procedures governing the sale of seized property do not apply. Effective for property seized after the date of enactment, the Act limits the property that may be sold pursuant to the above procedures to property that is liable to perish. (Code Sec. 6336, as amended by Act Sec. 1404)

17. Whistleblower Reforms. With respect to disclosures made after the date of enactment, the Act allows IRS to exchange information with whistleblowers where doing so would be helpful to an investigation. It also requires IRS to notify whistleblowers of the status of their claims at certain points in the review process and authorizes, but does not require, IRS to provide status updates at other times upon written request of the whistleblower. To protect taxpayer privacy, it would prohibit whistleblowers from disclosing publicly information they receive from IRS, under penalty of law. (Code Sec. 6103(k)(13), as amended by Act Sec. 1405(a)) In addition, effective on the date of enactment, the Act amends the Code to extend anti-retaliation provisions to IRS whistleblowers similar to those that are provided to whistleblowers under the False Claims Act and the Sarbanes-Oxley Act. (Code Sec. 7623(d) as amended by Act Sec. 1405(b))

18. Information IRS is to Provide During Phone Calls. Effective on the date of enactment, the Act requires IRS to provide the following information over the telephone, while taxpayers are on hold with the IRS call center: information about

common tax scams, direction to the taxpayer on where and how to report such activity, and tips on how to protect against identity theft and tax scams. (Act Sec. 1406)

19. Misdirected Tax Refund Deposits. The Act requires IRS to prescribe regs, within six months of the date of enactment, to establish procedures to allow taxpayers to report instances in which a refund made by electronic funds transfer was not transferred to the account of the taxpayer, to coordinate with financial institutions to identify and recover these payments, and to deliver refunds to the correct accounts of taxpayers. (Code Sec. 6402(n) as amended Act Sec. 1407)

20. Cybersecurity and Identity Protection. The Act requires IRS to work collaboratively with the public and private sectors to protect taxpayers from identity theft refund fraud. (Act Sec. 2001)

21. Electronic Tax Administration Advisory Committee. '98 tax legislation authorized the Electronic Tax Administration Advisory Committee (ETAAC); ETAAC provides input to IRS on electronic tax administration. New law. Effective on the date of enactment, the act adds the following to the current requirements regarding ETAAC: ETAAC is to study and make recommendations to IRS regarding methods to prevent identity theft and refund fraud. (Act Set 2002)

22. Information Sharing and Analysis Center. The Security Summit, a partnership of IRS, State tax agencies, and the private-sector tax industry to address tax refund fraud caused by identity theft, in 2016, created an Identity Theft Tax Refund Fraud Information Sharing and Analysis Center ("ISAC"). The ISAC enables IRS and the States to work together with external third parties to serve as an early warning system for tax refund fraud, identity theft schemes, and cybersecurity issues. Effective on the date of enactment, the Act authorizes IRS to participate in the ISAC. (Act Sec. 2003(a)) Effective for disclosures made after the date of enactment, the Act provides that IRS may disclose specified return information to specified ISAC participants if such disclosure is in furtherance of effective Federal tax administration relating to the following: (1) the detection or prevention of identity theft tax refund fraud; (2) validation of taxpayer identity; (3) authentication of taxpayer returns; or (4) the detection or prevention of cybersecurity threats to IRS. (Code Sec. 6103(k)(14), as amended Act Sec. 2003(c))

23. Confidentiality Safeguards for Federal, State Contractors. Effective for disclosures made after Dec. 31, 2022, the Act provides that IRS will not be able to provide taxpayer information to any contractors or other agents of a Federal, state, or local agency unless the contractor has safeguards in place to protect the confidentiality of return information and agrees to conduct on-site compliance reviews every three years. The Federal, state, or local agency is required to submit a report of its findings to IRS and certify annually that such contractors and other agents are in compliance with the requirements to safeguard the confidentiality of Federal returns and return information. (Code Sec. 6103(p)(9), as amended by Act Sec. 2004(a))

24. Identity Protection Personal Identification Numbers. Within five years of the date of enactment, the Treasury Department is required to establish a program to issue an IP PIN to any U.S. resident individual who requests one. And, for

each calendar year beginning after the date of enactment, the Treasury Department is required to expand the issuance of IP PINs to individuals residing in such states as IRS deems appropriate, provided that the total number of states served by the program continues to increase. (Act Sec. 2005)

25. Point of Contact for Identity Theft Victims. Responding to concerns over the lack of continuity of assistance when taxpayers are victims of tax-related identity theft, the Act, effective on the date of enactment, requires IRS to establish procedures to implement a single point of contact for taxpayers adversely affected by identity theft. (Act Sec. 2006)

26. Notification of Suspected Identity Theft. Effective for determinations made after the date that is six months after the date of enactment, the Act requires IRS to notify a taxpayer if it determines there has been any suspected unauthorized use of a taxpayer's identity, or that of the taxpayer's dependents, if an investigation has been initiated and its status, whether the investigation substantiated any unauthorized use of the taxpayer's identity, and whether any action has been taken (such as a referral for prosecution). Furthermore, when an individual is charged with a crime, IRS must notify the victim as soon as possible, giving such victims the ability to pursue civil action against the perpetrators. (Code Sec. 7529(a), as added by Act Sec. 2007(a)) For purposes of this provision, the unauthorized use of the identity of an individual includes the unauthorized use of the identity of the individual to obtain employment. (Code Sec. 7529(b), as added by Act Sec. 2007(a))

27. IRS Management of Stolen Identity Cases. The Act requires that, not later than one year after the date of enactment, IRS, in consultation with the NTA, develop and implement publicly available caseworker guidelines that reduce the burdens for identity theft tax refund fraud (IDTTRF) victims as they work with IRS to sort out their tax affairs. The guidelines may include procedures to reduce the amount of time victims would have to wait to receive their tax refunds, the number of IRS employees with whom victims would need to interact, and the timeframe within which the issues related to the IDTTRF should be resolved. (Act Sec. 2008)

28. Improper Disclosure by Return Preparers. Effective with respect to disclosures or uses made on or after the date of enactment, the Act increases the civil penalty for the unauthorized disclosure or use of information by tax return preparers from $250 to $1,000 for cases in which the disclosure or use is made in connection with a crime relating to the misappropriation of another person's taxpayer identity ("taxpayer identity theft"). The proposal also increases the calendar year limitation from $10,000 to $50,000. The calendar year limitation is applied separately with respect to disclosures or uses made in connection with taxpayer identity theft. (Code Sec. 6713(b), as amended by Act Sec. 2009(a)(2)) The Act also increases the criminal penalty for knowing or reckless conduct to $100,000 in the case of disclosures or uses in connection with taxpayer identity theft. (Code Sec. 7216(a), as amended by Act Sec. 2009(b))

29. Management of IRS Information Technology. Effective on the date of enactment, the IRS Commissioner is required to appoint an IRS Chief Information

Officer (CIO). The IRS CIO will be responsible for, among other things, the development, implementation, and maintenance of information technology for IRS, ensuring that the information technology of IRS is secure and integrated, maintaining operational control of all information technology for IRS, and acting as the principal advocate for the information technology needs of IRS. (Code Sec. 7803(f), as amended by Act Sec. 2101(a)) Also, IRS must finish its plans for the completion of the Customer Account Data Engine (CADE 2) and have a third party independently verify and validate planning for CADE 2 and Enterprise Case Management system(s) generally within a year of enactment. (Act Sec. 2101(b))

30. Internet Platform for Form 1099 Filings. The Act requires IRS to, by Jan. 1, 2023, develop an internet portal that facilitates taxpayers filing Forms 1099 with IRS. The internet portal is to be modeled after a Social Security Administration (SSA) system that allows individuals to file Forms W-2 with SSA. The website will provide taxpayers with access to resources and guidance provided by IRS, and allow taxpayers to prepare, file, and distribute Forms 1099, and create and maintain taxpayer records. (Act Sec. 2102)

31. Disclosures for Third-Party Income Verification. Under Code Sec. 6103(c), the IRS may disclose the return or return information of a taxpayer to a third party designated by the taxpayer in a request for or consent to such disclosure. No later than three years after the first day of the sixth calendar month after enactment, the Act requires IRS to develop an automated system to receive these forms in lieu of the current system, which relies on the forms to be sent to IRS via secure fax. Additionally, the provision authorizes IRS to charge a separate user fee over a two-year period on all IVES requests, in order to fund the development of the new system. (Act Sec. 2201)

32. Limit on Re-Disclosures of Consent-Based Disclosures. Under Code Sec. 6103(c), a taxpayer may designate in a request or consent to the disclosure by IRS of his or her return or return information to a third party. Effective for disclosures made after 180 days after the date of enactment, the Act provides that persons designated by the taxpayer to receive return information must not use the information for any purpose other than the express purpose for which consent was granted and must not disclose return information to any other person without the express permission of, or request by, the taxpayer. (Code Sec. 6103(c), as amended by Act Sec. 2202)

33. Electronic Filing of Returns. The Code requires that Federal income tax returns prepared by tax return preparers be filed electronically other than returns prepared by any preparer that reasonably expects to file 10 or fewer individual tax returns during the calendar year. (Code Sec. 6011(e)(3). For taxpayers other than partnerships, the statute prohibits any requirement that persons who file fewer than 250 returns during a calendar year file electronically. (Code Sec. 6011(e)(2)(A)) For partnerships, a lower number than 250 applies; the exact number goes from 200 in 2018 to 20 for calendar years after 2021. (Code Sec. 6011(e)(5)(A)) Notwithstanding Code Sec. 6011(e)(2)(A) and Code Sec. 6011(e)(5)(A), all partnerships with more than 100 partners are required to file electronically. (Code Sec. 6011(e)(5)(B)) New law. Under the Act, the

above 250 amount is reduced to 100 in the case of calendar year 2021, and from 100 to 10 in the case of calendar years after 2021. (Code Sec. 6011(e)(2)(A), as amended by Act Sec. 2301(a); Code Sec. 6011(e)(5)(A), as amended by Act Sec. 2301(b)) The Act maintains the pre-Act rules regarding partnerships, except that it substitutes 50 for 20 in the above rule regarding calendar years after 2021. (Code Sec. 6011(e)(5)(B) and Code Sec. 6011(e)(6), as amended by Act Sec. 2301(b)) The Act also authorizes IRS to waive the requirement that a Federal income tax return prepared by a tax return preparer be filed electronically; such a waiver applies where the tax return preparer applies for a waiver and demonstrates that the inability to file electronically is due to lack of internet availability (other than dial-up or satellite service) in the geographic location in which the return preparation business is operated. (Code Sec. 6011(e)(3)(D), as amended by Act Sec. 2301(c))

34. Electronic Signatures by Taxpayers to Authorize Action by their Practitioner. For a request for disclosure to a practitioner with consent of the taxpayer, or for any power of attorney granted by a taxpayer to a practitioner, the Act requires IRS to publish guidance to establish uniform standards and procedures for the acceptance of taxpayers' signatures appearing in electronic form with respect to such requests or power of attorney. Such guidance must be published within six months of the date of enactment. (Code Sec. 6061(b)(3), as amended by Act Sec. 2302)

35. Payment of Taxes by Debit and Credit Cards. Effective on the date of enactment, the Act removes the prohibition on paying any fees or providing any other consideration in connection with the use of credit, debit, or charge cards for the payment of income taxes to the extent the fees, etc. are fully recouped by IRS in the form of fees paid to IRS by persons paying taxes. (Code Sec. 6311(d)(2), as amended by Act Sec. 2303)

36. Authentication of Users of IRS E-Services accounts. In the past, unscrupulous tax return preparers have used IRS's suite of electronic services (eServices) to perpetrate tax refund fraud. New law. Beginning 180 days after the date of enactment, the Act requires IRS to verify the identity of any individual opening an e-Services account before he is able to use such services. (Act Sec. 2304)

37. Notification of Unauthorized Inspection, etc. of Returns. Code Sec. 7431 provides for civil damages resulting from an unauthorized disclosure or inspection of returns or return information. Effective for determinations proposed after 180 days after the date of enactment, the Act requires IRS to notify a taxpayer if IRS or a Federal or State agency (upon notice to IRS by such Federal or State agency) proposes an administrative determination as to disciplinary or adverse action against an employee arising from the employee's unauthorized inspection or disclosure of the taxpayer's return or return information. (Code Sec. 7431(e), as amended by Act Sec. 3002)

38. E-filing by Exempt Organizations. The Act extends the requirement to e-file to all tax-exempt organizations required to file statements or returns in the Form 990 series or Form 8872 (Political Organization Report of Contributions and Expenditures). (Code Sec. 6033(n), as amended by Act Sec. 3101(a))

39. IRS Notice to Tax-Exempt Organizations that Fail to File. The Act requires that IRS provide notice to an organization that fails to file a Form 990-series return or postcard for two consecutive years. The notice must state that IRS has no record of having received such a return or postcard from the organization for two consecutive years and inform the organization that the organization's tax-exempt status will be revoked if the organization fails to file such a return or postcard by the due date for the next such return or postcard. The notice must also contain information about how to comply with the annual information return and postcard requirements. (Code Sec. 6033(j)(1), as amended by Act Sec. 3102(a)) This provision applies to failures to file returns or postcards for two consecutive years if the return or postcard for the second year is required to be filed after Dec. 31, 2019. (Act Sec. 3102(b))

40. Penalty for Failure to File. If a return is filed more than 60 days after its due date, and unless it is shown that such failure is due to reasonable cause, the failure to file penalty may not be less than the lesser of $205 or 100% of the amount required to be shown as tax on the return. (Code Sec. 6651(a)) The $205 amount is subject to an inflation adjustment. (Code Sec. 6651(j)) Effective for returns required to be filed after Dec. 31, 2019, $330 (adjusted for inflation for returns required to be filed in a calendar year beginning after 2020) is substituted for $205 in the above rule. (Code Sec. 6651(a) and Code Sec. 6651(j), as amended Act Sec. 3201)

O. IRS Provides Opportunity Zone Investment Relief in New FAQ. Taxpayers will get a pass from the IRS for some investments made in the Opportunity Zone program in 2018 before the regulations instituted a netting requirement. If a taxpayer invested a section 1231 gain in a qualified opportunity fund before the end of the 2018 tax year, they can still make a valid election to defer capital gains, according to a new entry in the IRS's list of frequently asked questions about Opportunity Zones. The proposed regulations (REG-120186-18) issued in April said that section 1231 gains are eligible to invest in the program, but only if the investor has section 1231 gains that exceed section 1231 losses at the end of the tax year. The regs say that "because the capital gain income from section 1231 property is determinable only as of the last day of the taxable year, these proposed regulations provide that the 180-day period for investing such capital gain income from section 1231 property in a QOF begins on the last day of the taxable year." But practitioners noted that some taxpayers had already invested section 1231 gains in 2018 as they were realized rather than waiting until the year's end because the netting rule in the proposed regs had yet to be issued. Under the new FAQ, the deferral election will still be valid if the investment was made before the end of 2018 as long as it was made during the 180 days following the realization of the gain and the amount invested was less than the taxpayer's 2018 net section 1231 gain.

P. Final Regs Allow Use of Truncated TINs on Some Forms W-2. The IRS has issued final regulations (T.D. 9861) that amend the current rules under sections 6051 and 6052 to allow employers to voluntarily truncate employees' Social Security numbers on copies of Forms W-2 that are provided to employees so that the truncated SSNs appear in the form of IRS truncated taxpayer identification numbers. The final regs also amend the current rules under section 6109 to clarify the application of the truncation rules to Forms W-2 and to add an example illustrating their application.

Q. IRS Addresses Tax Treatment of Clergy Members. The IRS provided general information about the tax treatment of clergy members and differences in tax treatment of individuals who are employees versus individuals who are self-employed. INFO 2019-0012.

R. IRS Sends Out 10,000 Letters to Virtual Currency Investors, Some of Which Demand a Response July 26, 2019. The IRS has announced a program to send letters to taxpayers it believes had virtual currency transactions which the taxpayers have failed to report on their tax returns. The news release contains the following comments from the Commissioner: "Taxpayers should take these letters very seriously by reviewing their tax filings and when appropriate, amend past returns and pay back taxes, interest and penalties," said IRS Commissioner Chuck Rettig. "The IRS is expanding our efforts involving virtual currency, including increased use of data analytics. We are focused on enforcing the law and helping taxpayers fully understand and meet their obligations." The news release indicates the IRS began sending these letters out the week before the news release came out (July 26, 2019) and more than 10,000 taxpayers will receive these letters. The release indicates the names were obtained via "various compliance efforts."

S. Interest Passed to Taxpayer Was Not Investment Interest Subject to Limited Deductibility (T.C.) (IRC §163). Interest expense passed to Taxpayer from his father as a gift and stemming from loans incurred by partnerships in which Taxpayer had an interest was not investment interest subject to deduction limitation, but rather correctly reported on his Schedule E as allocable to the real estate assets held by the partnerships, the U.S. Tax Court held in a division opinion. Taxpayer's father owned partnership interests that made debt-financed distributions to its partners. The father used the proceeds of the distributions to purchase investment assets and treated the interest on the debts as investment interest. Taxpayer received interests in the partnerships by gift from his father and treated the debts as properly allocable to the partnerships' real estate assets and reported the interest as offsetting the passed-through real estate income on his Schedule E. The IRS recharacterized the interest as investment interest and disallowed the deductions for interest expenses because of insufficient investment income. The court held that under Treasury Regulations Section 1.163-8T(c)(3)(ii) and Notice 89-35, Taxpayer should be treated as having made a debt-financed acquisition of the partnership interests he acquired from his father, and therefore, the debt proceeds are allocated among the real estate assets and the interest paid on the debt is allocated to those assets in the same manner. The court concluded that the interest paid on the loans wasn't investment interest. *Lipnick v. Commissioner*, 153 T.C. No. 1 (Aug. 28, 2019).

T. Withholding Calculator Adds Gig Economy Features. The IRS has advised (IR-2019-149) that its expanded, mobile friendly tax withholding estimator includes a new feature designed to help individuals with self-employment income accurately estimate the amount of tax to have taken from their pay. The IRS notes that the enhancement for self-employed individuals, which include freelancers and workers in the sharing economy, is one of many new features offered by the online tax withholding tool and urges everyone to use it to do a paycheck checkup and review their withholding for 2019, especially those who faced an unexpected tax bill or penalty this year as well as those who had a major life change, such as marriage, childbirth, adoption, or buying a home.

U. Durable Power of Attorney Prevented Statute of Limitations Tolling. Son holding durable power of attorney to act on decedent father's behalf when he was financially disabled continued statute of limitations making refund claim untimely, the First Circuit Court of Appeals held. Son of decedent argued that the IRS improperly denied his father's refund claim as untimely because the statute of limitations was tolled by financial disability. However, the court held that because Son held a durable power of attorney authorizing him to act on his father's behalf in financial matters, the statute wasn't tolled under tax code Section 6511(h)(2)(B). The court explained that a person is considered “authorized to act on behalf of [a financially disabled taxpayer] in financial matters” even if he has no affirmative obligation to act on the taxpayer's behalf. The court also concluded that for purposes of Section 6511(h)(2)(B), a person authorized to act on behalf of a financially disabled taxpayer isn't required to have actual or constructive knowledge of the need to file returns in a specific year. The court also found that Son didn't prove that he renounced the durable power of attorney. *Stauffer v. IRS*, No. 18-2105 (1st Cir. Sept. 16, 2019).

V. Final Regulations on Bottom-Dollar Guarantees. The IRS and Treasury finalized rules that bar bottom-dollar guarantees from being treated as valid payment obligations in determining whether debt is recourse to a partner. The rules (T.D. 9877) issued October 4, 2019, finalize temporary regulations released in October 2016 that were set to expire. The temporary rules not only barred bottom-dollar guarantees from being allowed in determining whether a loan is recourse to a partner under section 752, but also changed the way debt was considered for disguised sale purposes under section 707. A bottom-dollar guarantee would allow a partner to guarantee a portion of a loan that would be repaid if the partnership couldn’t pay it. But that partner may only guarantee a small portion of the outstanding debt, so if the partnership paid on the loan for years but was later unable to pay it off, the partner with the bottom-dollar guarantee would likely be off the hook for the rest of the unpaid amount. Essentially, the partner would receive basis in a partnership for debt he or she would likely never have to pay off. The 2016 temporary regulations eliminated that planning tactic, and the final rules upheld that result. The 2016 temporary regulations also changed the way debt was treated for disguised sale purposes. Under the temporary regulations, partners would generally have debt basis only up to their interest in partnership profits under the nonrecourse rules in section 752, even if that debt was recourse to the partner for section 752 purposes. Proposed regulations released in June 2018 walked back that requirement, allowing for debt that’s recourse to a partner under section 752 to be treated as such for disguised sale purposes. Since June 2018, partnerships were able to use either the temporary 2016 regulations in determining debt basis for disguised sales purposes, or the proposed June 2018 regulations. Final rules (T.D. 9876) were also released October 4 that adopt the 2018 proposed regulations without changes, except to the applicability date. “To avoid a lapse in rules for allocating partnership liabilities for disguised sale purposes, these final regulations apply to any transaction with respect to which all transfers occur on or after October 4, 2019, the date that the 707 Temporary Regulations expire. Preventing a lapse in rules benefits the Treasury Department, the IRS, and taxpayers by providing certainty regarding the applicable rules,” according to the regulation.

II. MICHIGAN

A. Taxpayers Who Missed Filing Deadline Have Options for Filing Late Michigan Returns. The Michigan Department of Treasury is advising taxpayers who missed the April 15 state income tax filing deadline that they have options for filing a late return. The Department recommends past-due tax filers to consider the following: (1) Filing a return to claim an outstanding refund. Taxpayers risk losing their state income tax refund if they do not file a return within four years from the due date of the original return. (2) Filing a return to avoid interest and penalties. Taxpayers should file past due returns and pay now to limit interest charges and late payment penalties. Failure to pay could affect a taxpayer's credit score and the ability to obtain loans. (3) Paying as much tax as possible. If taxpayers have to pay outstanding taxes but cannot pay in full, they should pay as much as they can when they file their tax returns. Payments can be made using Michigan's e-Payments service. When mailing checks, carefully follow tax form instructions. The Treasury will work with taxpayers who cannot pay the full amount of tax they owe. In addition, the Department advises taxpayers who receive a final tax bill and who are unable pay the entire amount owed to consider the following: (1) Requesting a penalty waiver. Penalty may be waived on an assessment if a taxpayer can show reasonable cause for their failure to pay on time. Reasonable cause includes serious illness, a fire or natural disaster, or criminal acts against you. Documentation should be submitted to substantiate the reason for a penalty waiver request. (2) Making monthly payments through an installment agreement. For installment agreements lasting for 24 months or less, taxpayers must complete, sign and return the Form 990 (Installment Agreement). The agreement requires a proposed payment amount that will be reviewed for approval by the Department. (3) Filing an Offer in Compromise application. An Offer in Compromise is a request by a taxpayer for the Department to compromise an assessed tax liability for less than the full amount. Options (1) through (3) for final tax bills should be filed separately from the state income tax return. (Treasury Offers Help To Taxpayers Who Missed Tax Filing Deadline, Mich. Dept. Treas., 04/18/2019.)

B. Principal Residence Exemption Allowed to Owners Temporarily Absent While Rebuilding Demolished or Destroyed Home. L. 2018, H5454 (P.A. 632), effective 12/28/2018, allows a property owner who previously occupied the property as his or her principal residence but had vacated the property because it was damaged or destroyed to retain a principal residence exemption (PRE) for not longer than the tax year during which the damage or destruction occurred and the immediately succeeding two tax years if the owner meets specified conditions. The bill also allows an owner of property who previously occupied that property as his or her principal residence but did not occupy that property on June 1 or November 1 while absent due to the damage or destruction of the property for which the PRE was not on the tax roll to file an appeal with the July or December board of review.

C. Michigan Allows Audit Closing Agreements. The Michigan Department of Treasury now offers an alternative to full field audits during some cash-basis audits and may offer to close some audits without an extensive, time-consuming full field audit.

Department auditors will project the taxpayer's tax liability by comparing normative industry data to the taxpayer's preliminary audit data. Whether the Department decides to offer a closing agreement depends on a variety of factors including the quality of the taxpayer's books and records and the size of its variance from normative data. If the taxpayer accepts the offer, it waives its appeal rights and the audit is closed without full field testing. If the taxpayer declines the offer, Department auditors will complete the full field audit and the taxpayer will retain all appeal rights. (Michigan Treasury Update, Mich. Dept. Treas., 05/01/2019.)

D. Nexus for Imposing Detroit, Michigan City Income Tax. The Michigan Supreme Court has vacated and remanded a Michigan Court of Appeals decision that held that a taxpayer lacked sufficient nexus to be subject to the Detroit, Michigan local income tax because it was not "doing business in the city" under Mich. Comp. Laws Ann. § 141.614. Although the taxpayer possessed a Detroit mailing address, it did not have any employees, owned no real or personal property, provided no services, and sold no goods, either in Detroit or elsewhere. The Michigan Court of Appeals held that the activities of taxpayer's officers and directors were not conducted "on behalf" of the taxpayer. The court also said that to the extent the taxpayer employed professional consultants, this fell under the exclusion found in Mich. Comp. Laws Ann. § 206.621(2)(b). In addition, it was uncontested that the taxpayer was not engaged in the sale of any goods or services in Detroit (or indeed, anywhere). The court of appeals found that the lack of physical presence, under *Quill Corp. v. North Dakota,* U.S. S.Ct., 504 US 298, 112 S Ct 1904 (1992), meant Detroit's assessment of income tax against the taxpayer violated the Commerce Clause. Therefore, Detroit could not satisfy the Mich. Comp. Laws Ann. § 141.614 requirement that the entity being assessed tax be doing business "in the city." The Michigan Supreme Court vacated the judgment of the court of appeals and remanded the case to the court of appeals for reconsideration in light of *South Dakota v. Wayfair, Inc.,* U.S. S. Ct., Dkt. No. 17-494, 06/21/2018, which overruled *Quill.* (Apex Laboratories International Inc. v. City of Detroit, Mich. S. Ct., Dkt. No. 157966, 05/28/2019, vacating and remanding Mich. Ct. App., Dkt. No. 338218, 05/17/2018.)

E. Michigan Issues Guidance on Taxability of Drone Services. The Michigan Department of Treasury has issued a release providing guidance for determining if drone services are subject to sales and use tax. (Michigan Treasury Update, Mich. Dept. Treas., 05/01/2019.)

1. <u>Drone Services</u>. Drones are essentially small flying robots that can be controlled remotely, or even flown completely autonomously using software-controlled flight plans that are embedded in their navigation systems. Drones may be equipped with a range of cameras and sensors for capturing still images, video, thermal images, multispectral images (images that capture data within specific wavelength ranges across the electromagnetic spectrum), other types of data. Specialty drone service providers are now using drones to provide a wide range of services to many different industries. With so many existing and potential commercial uses for drones, the Department has issued guidance for providers of drone services in Michigan for determining whether Michigan's sales and use taxes apply to the sales of such services.

Use tax on specific services. In general, Michigan sales and use taxes apply to the sale of tangible personal property, and not to the sale of services. By statute, however, certain specific services are subject to Michigan's use tax, including telecommunications services, the furnishing of hotel and motel accommodations, and certain laundering services.

2. Mixed Transactions. Considered by themselves, drone services are not subject to sales or use tax. However, it is possible—and very common—for a single sales transaction to involve a mixture of non-taxable services and taxable tangible personal property. Many, if not most, sales of drone services will likely include the sale of related tangible personal property. When such a single mixed sales transaction occurs, the service provider must determine the predominant nature of the transaction in order to determine whether the transaction is taxable. The entire transaction will be either fully taxable or fully non-taxable—an "all or nothing" result.

3. Incidental To Services Test. The test to be used for determining whether a mixed sales transaction is predominantly the sale of a non-taxable service or the sale of taxable tangible personal property was established by the Michigan Supreme Court in *Catalina Marketing Sales Corp. v. Michigan Department of Treasury,* 678 NW2d 619 (2004). The *Catalina* court concluded that following six factors must be evaluated in order to determine whether a single mixed sales transaction is a service:

- what the buyer sought as the object of the transaction;
- what the seller or service provider is in the business of doing;
- whether the goods were provided as a retail enterprise with a profit-making motive;
- whether the tangible goods were available for sale without the service;
- the extent to which the intangible services have contributed to the value of the physical item transferred; and
- any other factors relevant to the particular transaction.

While all of the above factors should be considered, the first factor—the object of the transaction—is the most important and bears the most weight. Another key factor is whether the tangible goods can be purchased without the service. Additionally, although not at issue in *Catalina,* the method of delivery of any related goods also bears on the taxability of the transaction. Goods provided digitally, such as through email, are not considered to be tangible personal property and are generally not subject to Michigan sales and use tax.

4. Examples. Focusing primarily on the two key *Catalina* factors noted above, the Department provides a few examples of how some typical mixed transactions involving drone services might be analyzed to determine their taxability.

Example 1: A videographer uses a drone to capture aerial footage of a client's wedding ceremony, which takes place on a remote and picturesque Michigan lakeshore. The videographer performs additional services, such as editing the video footage and adding music. Ultimately, the client pays $1,000 and receives a DVD containing the finished

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wedding video. The sale to the client is taxable. The buyer (the videographer's client) is seeking a professional wedding video; accordingly, the finished video, an item of tangible personal property, is the object of the transaction. Additionally, since the video is made entirely from the footage shot using the drone, it would be impossible for the videographer to make or sell the finished DVD without the related services.

Example 2: A large farming operation in Michigan contracts with a drone service company to conduct weekly agricultural surveys of its crops and farmland during the growing season, for an all-inclusive price. The drone is equipped with a camera and various sensors and, on a weekly basis, takes aerial photographs and collects data regarding soil hydration, soil composition, and possible pest issues. The drone service company immediately compiles the data gathered by the drone into a comprehensive report, which is emailed to the farmer each week. The service company also selects various representative photographs of the subject farmland, and emails the selected photography, as well. The farmer can view the reports and photographs on his computer or make hard copies by printing them out. The contractual transaction is non-taxable. Although the reports and photographs are the object of the transaction, and could not be sold absent the drone services, the items delivered in this case are not taxable tangible personal property, because they are delivered to the farmer via email in a digital format. If the drone service instead used FedEx to deliver printed photographs and a hard copy of the report to the farmer each week, the transaction would be fully taxable.

Example 3: A private search-and-rescue company in Michigan hires a drone service company to conduct aerial surveillance of a remote forested area in the Upper Peninsula. The drone operator provides a video monitor with a live feed, and search-and-rescue company personnel determine the parameters of the area to be searched by the drone. The personnel watch the video on the monitor in real time, as the footage is captured by the drone. When the injured missing person is finally located, the drone drops a small package of emergency supplies, and the search-and-rescue company arranges for the person to be taken out of the forest by helicopter and transported to the nearest hospital. Afterward, the drone service company prepares a surveillance report detailing the area searched and the outcome of the search. A hard copy of the report is mailed to the search-and-rescue company. The transaction is non-taxable. The report provided by the drone company is tangible personal property, and it may be helpful to the search-and-rescue company, but the report itself is not what was sought when the drone service company was hired. The object of the transaction was the use of the drone to conduct aerial surveillance that could be viewed, and utilized, in real time. The report is incidental to the provision of the drone services.

F. Court of Appeals Upholds Audit in Jim's Body Shop, Inc v Department of Treasury. In Jim's Body Shop, Inc v Department of Treasury, a published decision of the Court of Appeals issued on May 14, 2019, the court upheld an assessment of tax, penalty, and interest against Jim's Body Shop (JBS) and reaffirmed that an assessment arising from a sales or use tax audit is entitled to a presumption of correctness when taxpayers fail to maintain adequate records. JBS is an auto body shop that primarily provides auto body and collision repair services for insurance companies. During the use tax audit at issue, Treasury determined that JBS failed to preserve fundamental tax records, JBS failed to file complete sales, use, and withholding tax returns reporting its taxable activity, and failed to retain purchase invoices and other records that would substantiate activity taxable under the Use Tax Act (UTA). With only limited information available, Treasury therefore calculated total taxable activity by estimating the markup that JBS applied to all of its purchases. The markup, which was computed using all purchase invoices that JBS could produce, was subsequently used to estimate the taxable purchases consumed by JBS in rendering auto repair services. Although sales and use tax audits are entitled to a presumption of correctness under the plain language of Section 14a(4) of the UTA, JBS argued that Treasury had the burden of showing reasonableness before any such presumption could apply. In rejecting this argument, the Court of Appeals first noted that MCL 205.104a(4) allocates the burden of proof in a way that requires the taxpayer to prove actual inaccuracy in the audit. While that section requires reasonableness in the performance of the audit, the court held that the requirement is not a prerequisite to applying the presumption of correctness to the audit conclusion. In other words, a claim that an audit method was unreasonable, unsupported by proof that such unreasonableness resulted in actual inaccuracy, is not sufficient as a matter of law to meet the statutory burden in challenging an indirect audit conducted in accordance with MCL 205.104a(4). Within this context, the Court of Appeals examined the factual allegations and concluded that JBS failed to prove that the audit was actually inaccurate. Indeed, although JBS cited to certain instructions related to statistical sampling to claim impropriety in the sample that was used, the court noted that Treasury did not rely on a traditional sample; rather, it used the limited – and only – information that JBS could produce from its own records. And, while JBS produced competing computations of the markup and the resulting tax liability, they were not any more reliable since those computations were simply alternative methods rather than proof of actual inaccuracies in Treasury's calculation. Because JBS could not prove any inaccuracy due to the limited records it had actually retained, the Court of Appeals agreed that JBS could not rebut the presumption of correctness applied to Treasury's assesssment. In reaching that conclusion, the Court of Appeals also agreed with the denial of an industrial processing exemption claim for purchases of equipment and other materials used by JBS in its auto body repair operations. The court noted that, by definition, the industrial processing exemption requires an ultimate sale of tangible personal property at retail. However, applying the test of Catalina Marketing Sales Corp v Department of Treasury, 470 Mich 13 (2004), JBS was determined to be a servicer, rather than a retailer of tangible personal property, when it performed auto body and collision repairs for customers and insurance companies. JBS was accordingly not eligible for the industrial processing exemption under the UTA for any of its purchases. Finally, given the absence of even basic financial and tax records, Treasury imposed a negligence penalty under MCL 205.23(3) for the failure to exercise ordinary care. The owner of JBS testified that he was not aware of any of the company's tax reporting procedures and could not state whether returns for the tax periods at issue had actually been filed. Combined with the failure to retain basic financial documentation and otherwise file accurate returns, the Court of Appeals agreed that JBS exhibited a lack of ordinary due care sufficient to justify the imposition of the negligence penalty. Consequently, the Court of Appeals affirmed the decision of the Court of Claims upholding the assessment of tax, penalty, and interest against JBS as a result of the use tax audit performed by Treasury.

G. Vehicle Transfers May Be Subject to Equalization Tax. Use tax is imposed for the privilege of using, storing or consuming tangible personal property in

Michigan. MCL 205.93(1). Therefore, when a used vehicle, off-road vehicle (ORV), manufactured home, aircraft, snowmobile, or watercraft is transferred between non-dealers, absent a valid exemption, the transferee or purchaser owes use tax based on 6% of the purchase price. Unfamiliar to many taxpayers is a potential additional tax under the Streamlined Sales and Use Tax Revenue Equalization Act (the "equalization tax"). MCL 205.171 et seq. Section 9 of that act, MCL 205.197, imposes a tax on the privilege of storing, registering, or transferring ownership in Michigan of any vehicle (other than a vehicle stored, registered, or transferred by a licensed dealer), ORV, manufactured home, snowmobile, watercraft or certain aircraft. Tax is levied on the transferee at a rate of 6% of the retail dollar value at the time of acquisition as determined by Treasury. In addition, the act provides a credit for any use tax paid on the same property. As a result, use tax is imposed on the actual purchase price and, to the extent the retail dollar value of property exceeds the purchase price, equalization tax is imposed effectively on the difference. Although use and equalization taxes are sometimes collected by other state agencies, Treasury is responsible for administering them. If Treasury determines that tax was not paid on the appropriate value, it may send a letter to a buyer to obtain more information about a vehicle purchase and its value. For more information about how Treasury establishes the retail dollar value and how a taxpayer can rebut that determination, see Revenue Administrative Bulletin 2017-26.

H. STATE TAX LIENS.

1. Definition. A lien is a charge against or interest in specific property that is taken as security for the satisfaction of a debt. A lien may be voluntarily created by agreement of the parties, or it may arise by operation of statute. An example of a voluntary lien is the interest that a mortgage creates upon a homeowner's house in favor of the mortgage lender. Tax liens, on the other hand, generally arise by operation of law, and that is the case with state tax liens in Michigan. Notices of state tax liens are filed for public recording by the Michigan Department of Treasury. The reason that Michigan law provides for the creation of liens with respect to tax debts is to protect the State's interest as a creditor – in other words, to ensure that legitimate tax debts are paid. The filing of a state tax lien does not mean that Treasury will immediately seize a taxpayer's property. Rather, a state tax lien gives Treasury a legal right or interest in a debtor's property, typically lasting until the underlying tax debt is fully paid. If the liened property is sold before the tax debt has been satisfied, the proceeds otherwise due the debtor from the sale will be applied first to pay off the tax debt. Tax liens may be filed against property that is owned by either individual or business taxpayers.

2. Lien v. Levy v. Warrant. A lien is different from a levy or a warrant. As noted, a lien is a legal claim against the property of an individual or a business to secure payment of that taxpayer's tax debt. Levies and warrants are generally used later in the collection process, when a taxpayer has failed to resolve its tax debt through voluntary payment. Levies and warrants are ways of seizing a delinquent taxpayer's actual property to satisfy the underlying tax debt. A warrant may be used to close a taxpayer's business and to seize the taxpayer's real or personal property. A levy is a specialized form of warrant and is generally used to withdraw funds from a taxpayer's account at a financial institution. Treasury's authority to record and enforce tax liens derives from statute. State tax laws are administered pursuant to the Revenue Act (MCL

205.1-31), a statute that dictates specific procedures and processes for tax assessment and collection, as well as taxpayer appeals, that are of general applicability. The Revenue Act also creates tax liens. Section 29(1) of the Revenue Act provides, in part: "Taxes administered under this act, together with the interest and penalties on those taxes, shall be a lien in favor of the state against all property and rights of property, both real and personal, tangible and intangible, owned at the time the lien attaches, or afterwards acquired by any person liable for the tax, to secure the payment of the tax. The lien shall attach to the property from and after the date that any report or return on which the tax is levied is required to be filed with the department ..." Although this section specifies that the lien attaches "from and after the date that any report or return on which the tax is levied is required to be filed with the department," the stated purpose of the lien is to "secure the payment of the tax." Accordingly, if the tax levied on the report or return has been paid in full, the lien does not attach to the taxpayer's property.

3. <u>Notice of State Tax Lien</u>. Although the tax lien itself arises automatically by operation of law, Treasury will not file a Notice of State Tax Lien against a taxpayer's property, making the lien a public record, unless three things have first taken place:

- The taxpayer has been assessed a tax liability;
- Treasury has sent the taxpayer a Bill for Taxes Due (Intent to Assess) and/or a Final Bill for Taxes Due (Final Assessment), stating the amount of tax owed by the taxpayer; and
- The taxpayer has failed to pay the stated tax debt in full within 35 days (90 days if the taxpayer is an individual) from the date shown on the Final Assessment.

In general, a tax debt must be paid in full in order to avoid the filing of a Notice of State Tax Lien. However, Treasury works with taxpayers to arrange convenient payment terms, if needed. If an individual taxpayer enters into an installment agreement before 90 days from the date shown on the Final Assessment, Treasury will not file a lien notice as long as the taxpayer is current with all payments and otherwise remains in compliance with the agreement. Lien notices will be filed against business taxpayers even if an installment agreement is in place and the taxpayer payments and is current with all payments. A Notice of State Tax Lien is filed with the Register of Deeds in the county where the taxpayer resides or, if the taxpayer is a business entity, where the business is located. If the taxpayer resides, or the business entity is located, outside of Michigan, the Notice of State Tax Lien is filed with the Ingham County Register of Deeds, pursuant to applicable law. The lien is filed by Treasury in the amount of the outstanding tax debt. The lien constitutes a charge against all property owned by the taxpayer – no property is exempt or excluded. Section 29(1) of the Revenue Act specifies that the lien arises against, and attaches to, all property then owned by the taxpayer, both real and personal, tangible and intangible, as well as to any property that the taxpayer may afterwards acquire. Note that personal property includes a taxpayer's financial assets.

4. <u>Priority</u>. Once a lien has been filed, in most cases the property subject to lien cannot be sold or transferred until the past-due tax is paid. If a debtor's property is sold for nonpayment of debt – for example, the debtor's residence is sold

pursuant to foreclosure for nonpayment of mortgage debt – the proceeds are disbursed to pay creditors in the order in which those creditors placed liens on the property, or according to other statutory priority, if applicable. The Revenue Act provides that a properly filed and recorded state tax lien: ... "shall take precedence over all other liens and encumbrances, except bona fide liens recorded before the date the lien under this act is recorded. However, bona fide liens recorded before the lien under this act is recorded shall take precedence only to the extent of disbursements made under a financing arrangement before the forty-sixth day after the date of the tax lien recording, or before the person making the disbursements had actual knowledge of a tax lien recording under this act, whichever is earlier." This means that, to the extent that a creditor advances funds to the debtor more than 46 days after the date of recording of the state tax lien, the state tax lien will have priority. It is important to understand that this addresses only state tax liens arising under the Revenue Act and filed for recording by Treasury; for example, liens for income taxes (both personal and corporate) and sales and use taxes. It does not address unpaid property taxes. For more information about the priority of property tax liens, see MCL 211.40.

5. Limitations Period. Under applicable state law, Treasury has a minimum of six years to collect delinquent tax debts. This means that Treasury has at least six years to use any enforcement actions that it is authorized to take, including the filing of a Notice of State Tax Lien. This six-year limitations period, may be extended by certain actions, including the entry of a court judgment as well as the taxpayer's reaffirmation of the tax debt.

6. Release. Once it has been filed, a state tax lien will typically only be released when the underlying tax debt has been paid in full. The release of a state tax lien means that the pertinent county records will be updated to reflect the fact that the previously recorded lien has been released, and that the state taxing authority no longer has any legal claim to or interest in the debtor's property. When the determination is made that a tax debt on which a lien has been filed has been satisfied in full, Section 29a(1) of the Revenue Act specifies that Treasury has 20 business days to file for a release of the state tax lien on the taxpayer's property. That subsection states, in part, as follows: "If the department files for recording a lien imposed pursuant to this act against property or rights of property under the state tax lien registration act ... to satisfy a tax liability and the department determines that the tax liability out of which the lien arose is satisfied, the department shall file for recording a release regarding the property or rights of property, as applicable, ... not more than 20 business days after funds to satisfy the tax liability out of which the lien arose have been applied to the taxpayer's account." Section 29a(1) provides that Treasury must take action within 5 business days if it discovers or determines that a lien was filed and recorded in error: "If the department receives money to satisfy a tax liability or liabilities or receives information that would cancel that tax liability or those liabilities and subsequently files a lien for recording ... , the department, upon request and upon a determination by the department that the lien was filed and recorded in error, with all due haste, but not more than 5 business days after the department determines that it has erroneously filed a lien for recording, shall file for recording a certificate of withdrawal for that tax liability or those liabilities which were satisfied which states that the recorded lien for that tax liability or those liabilities was filed in error." The release or lien withdrawal filed by Treasury must state that the lien was filed

in error. This is consistent with Section 4 of the State Tax Lien Registration Act, which states: “If a state tax lien has been assessed and filed or recorded in error, the certificate of release or discharge shall contain a statement that explains that the tax lien has been assessed and filed or recorded in error.”

III. EMPLOYEE BENEFITS

A. Retirement Plans—Summary

	2019	2018	2017
IRA contribution limits (age at year-end):			
Under age 50	$6,000	$5,500	$5,500
Age 50 or older	7,000	6,500	6,500
Traditional IRA deduction phase-out begins at AGI of (taxpayer or spouse covered by employer retirement plan):			
Married Filing Joint (MFJ) (covered spouse) or Qualifying Widow(er) (QW)	$103,000	$101,000	$99,000
MFJ (non-covered spouse)	193,000	189,000	186,000
Single or Head of Household (HOH)	64,000	63,000	62,000
Married Filing Separate (MFS)	0	0	0
Roth IRA contribution phase-out begins at AGI of:			
MFJ or QW	$193,000	$189,000	$186,000
Single or HOH	122,000	120,000	118,000
MFS	0	0	0
SIMPLE retirement accounts elective deferral limits (age at year-end):			
Under age 50	$13,000	$12,500	$12,500
Age 50 or older	16,000	15,500	15,500
401(k), 403(b), 457 and SARSEP elective deferral limits (age at year-end):			
Under age 50	$19,000	$18,500	$18,000
Age 50 or older	25,000	24,500	24,000
Annual elective deferral limit[1]	$19,000	$18,500	$18,000
Profit-sharing plan/SEP contribution limit	$56,000	$55,000	$54,000
SEP compensation threshold (for coverage)	$600	$600	$600
Compensation limit-employer contributions:			
Profit sharing plans/SEPs	$280,000	$275,000	$270,000

	2019	2018	2017
Certain governmental plans in effect on July 1, 1993	$415,000	$405,000	$400,000
Annual benefit limit for defined benefit plan	$225,000	$220,000	$215,000
Highly compensated employee—any employee with compensation in excess of:	$125,000	$120,000	$120,000
Key employee—compensation in excess of:			
More than 1% owner	$150,000	$150,000	$150,000
Officers	180,000	175,000	175,000
Control Employee-compensation equals or exceeds:			
Any employee	$225,000	$220,000	$215,000
Officers	110,000	110,000	105,000
ESOP extension of five-year distribution period:			
Account balance threshold	$1,130,000	$1,105,000	$1,080,000
Additional account balance increments	225,000	220,000	215,000
Retirement savings contribution credit fully phased out at AGI over:			
MFJ	$64,000	$63,000	$62,000
Single and QW	32,000	31,500	31,000
HOH	48,000	47,250	46,500
MFS	32,000	31,500	31,000
Source:	**IR News Release 2018-211**	**IR News Release 2017-177**	**IR News Release 2016-141**

[1] Overall limit on an individual's elective deferrals to 401(k), 403(b), SARSEP and SIMPLE IRA plans combined; catch-up contributions for individuals age 50 or older at year-end are not subject to the limit.

B. IRS Expands Self-Correction Program for Certain Plan Failures. The Internal Revenue Service ("IRS") issued Revenue Procedure ("Rev. Proc.") 2019-19 (https://www.irs.gov/pub/irs-drop/rp-19-19.pdf) on April 19, 2019, updating the Employee Plans Compliance Resolution System ("EPCRS"), effective April 19, 2019. Rev. Proc. 2019-19 modifies and supersedes Rev. Proc. 2018-52 (which only became effective January 1, 2019). In particular, Rev. Proc. 2019-19 expands the Self-Correction Program ("SCP") eligibility to permit certain Plan Document Failures and certain plan loan failures to be self-corrected and also to provide an additional method under the SCP to correct Operational Failures by plan amendment. Importantly, the SCP allows the correction of certain plan failures without the need to contact the IRS or pay a user fee.

1. EPCRS Correction Programs. EPCRS provides three correction programs for retirement plans that intend to meet the requirements of 401(a), 403(a),

403(b), 408(k) or 408(p) but fail to do so. (Governmental 457(b) plans generally also may follow the EPCRS correction procedures.) By following the appropriate correction program, plans can correct their failures, preserve their qualified status and continue to provide participants with retirement benefits on a tax-favored basis.

2. Expansion of Correction Opportunities under the SCP. Rev. Proc. 2019-19 expands EPCRS to allow the correction of certain Operational Failures or Plan Document Failures under the SCP, summarized as follows:

- Correction of Plan Document Failures - Rev. Proc. 2019-19 allows certain Plan Document Failures, except for the initial failure to adopt a Qualified Plan or the failure to adopt a written 403(b) plan document timely, to be corrected through the SCP. Importantly, to correct through the SCP, the Plan, as of the correction date, must be subject to a Favorable Letter, and the correction must be made within the "significant" failure two-year correction period. Under Rev. Proc. 2019-19, discretionary plan amendments are not considered this type of "Plan Document Failure."

- Correction of Operational Failures - Rev. Proc. 2019-19 allows Operational Failures to be corrected by retroactive plan amendment under the SCP if: (a) the plan amendment results in an increase of a benefit, right, or feature; (b) the increase is available to all eligible employees; and (c) providing such increase is permitted under the Code and satisfies the EPCRS correction principles.

- Correction of Plan Loan Failures - Rev. Proc. 2019-19 expands the correction of certain plan loan failures under the SCP. Notably, the SCP loan correction is consistent with the loan correction procedure the IRS recently has taken for similar loan failures submitted through the Voluntary Correction Program ("VCP").

- Loan Default – A loan default occurs when a participant fails to make the required payments or makes late payments. The correction methods for a defaulted loan are the same as under Rev. Proc. 2018-52; namely, permitting correction by either a single-sum repayment, re-amortization of the outstanding loan balance, or a combination of the two.

- 1099-R Reporting - Rev. Proc. 2019-19 allows a plan sponsor to report a deemed distribution on the 1099-R in the year of the correction rather than the year of the failure.

- Exceeding Number of Permissible Loans - Rev. Proc. 2019-19 allows for a retroactive plan amendment when the number of plan loans exceeds the number of plan loans permitted by the plan, if: (i) the amendment satisfies Code § 401(a), (ii) the plan as amended would have satisfied the qualification requirements of § 401(a) (and the plan loan requirements under § 72(p)), and (iii) the plan loans (including plan loans in excess of the number permitted under the terms of the plan) were available to all participants.

- Unavailability for SCP - SCP continues to be unavailable for failures related to: (a) plan loans that are made in excess of the loan limits under § 72(p)(2)(A) or (b) plan terms that do not meet the requirements of § 72(p)(2)(B) or (C).

3. Other Changes. Rev. Proc. 2019-19 provides for other modifications, as follows:

- The IRS website under the heading "Correcting Plan Errors" will provide additional examples of insignificant Operational Failures.

- As of April 1, 2019, all VCP submissions are required to be made electronically through Pay.gov. Therefore, the transition rule allowing VCP submissions on paper has been removed.

C. IRS Expands Determination Letter Opportunities for Retirement Plans. On May 1, 2019, the IRS announced that it is expanding its determination letter program in two important regards. Since 2017, the determination letter program has been available only for new or terminating individually designed plans. Beginning on September 1, 2019, the determination letter program will be expanded to include (1) retirement plans that merge as the result of a corporate transaction, and (2) certain defined benefit plans. If a plan merger occurs in connection with a corporate merger, acquisition or similar transaction, the merged plan can be filed for a new determination letter in many cases. To be eligible for a new determination letter, the plan merger must occur by the end of the first plan year that begins after the corporate transaction, and the determination letter application must be filed by the end of the first plan year that begins after the plan merger. For example, if the corporate transaction occurs in 2019, the plan merger must occur by December 31, 2020 (assuming a calendar year plan), and the determination letter application must be filed by December 31, 2021. In addition, all "statutory hybrid plans" (mostly commonly cash balance defined benefit plans) can be filed for new determination letters during a limited window between September 1, 2019, and August 31, 2020. A new element of the determination letter program is the possibility of fines being imposed if the IRS identifies certain errors in the plan document. However, these fines are capped at twice the applicable VCP fee. Under the current VCP fee schedule, these fines would not exceed $7,000.

D. Final Hardship Regulations. On September 19 2019, the IRS finalized the hardship regulations that were previously issued in proposed form on November 9, 2018. While finalized regulations often differ from proposed regulations, due to the IRS considering written comments, these final regulations contain no substantive changes.

There are, however, some issues raised by the IRS in the final regulations that are worthy of note:

1. With respect to employee representation of financial hardship beginning in 2020, an employee can make a representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy a financial need, even if the employee does have cash or other liquid assets on hand, provided that those assets are earmarked to pay an obligation in the near future (e.g., rent).

2. Employee representations may be made over the phone, provided that the call is recorded.

3. The IRS retained the requirement from the proposed regulations that the plan administrator may rely on the employee's representation, unless the plan administrator has actual knowledge of the contrary.

4. It was clarified that plans could require a minimum amount for hardship distributions, provided the minimum is non-discriminatory.

5. Deferred compensation plans, including 457(f) plans, are not subject to the restriction on the suspension of deferrals, so if there is suspension of deferral language in these plans when a hardship distribution is taken from a 401(k) or 403(b) plan, that language can be retained (plan sponsors also have the ability to it eliminate it).

6. For 403(b) plans that have a remedial amendment deadline of March 31, 2020, the Treasury Department and the IRS are considering a later amendment deadline in separate guidance for the amendments relating to the final regulations.

7. To be considered using the safe harbor standards for hardship distributions, a plan need not allow hardship distributions for all safe harbor expenses or for expenses of all the categories of individuals described in the regulations.

E. Final Hardship Distribution Regulations. The Department of Treasury and the IRS have issued final regulations regarding hardship distributions from 401(k) and 403(b) plans. The final regulations respond to comments based on earlier proposed regulations and make a number of significant changes to the existing IRS rules that apply to hardship distributions.

1. <u>Plan Amendments/Plan Action Required</u>. Individually-designed 401(k) plans that currently permit hardship distributions will likely need to be amended to reflect the final regulations by December 31, 2021 – but operational changes will be needed to comply with the new regulations by January 1, 2020. (Individually-designed 403(b) plans and pre-approved 401(k) and/or 403(b) plans might have an earlier amendment deadline.) Plan sponsors that previously acted in response to the proposed regulations should review prior plan amendments and administrative changes to confirm operational and plan document compliance with the final regulations.

2. Elimination of Six-Month Suspension of Contributions. Effective for hardship distributions on or after January 1, 2020, 401(k) and 403(b) plans cannot impose a six-month suspension of contributions following a hardship distribution.

3. Changes to Safe Harbor Events. The final regulations modify the list of distributions deemed to be made on account of an immediate and heavy financial need by revising the casualty loss definition and adding a new FEMA disaster category, as well as incorporating prior IRS guidance on hardship distributions for primary beneficiaries. The revised list may be applied to hardship distributions as early as January 1, 2018.

4. Elimination of Requirement to Take Plan Loans. Effective January 1, 2019, employees are not required to take plan loans before receiving a hardship distribution.

5. Elimination of "Facts and Circumstances" Analysis. The facts and circumstances analysis for determining whether a hardship distribution is necessary to satisfy a financial need is eliminated in favor of a general standard that relies on three objective prongs (comparable to what was in the proposed regulations).

6. Expanded Hardship Distribution Sources for 401(k) Plans. Sources available for hardship distributions now include earnings on elective deferrals, QNECs, QMACs, and earnings on QNECs and QMACs, regardless of when contributed or earned.

7. Expanded Hardship Distribution Sources for 403(b) Plans. Earnings on pre-tax deferrals made to a 403(b) plan continue to be ineligible for hardship distributions. However, QNECs and QMACs would be eligible for hardship distributions in a 403(b) plan that are not held in a custodial account. QNECs and QMACs in a 403(b) plan that are held in a custodial account continue to be ineligible for hardship distributions.

F. 40(3)(b) Plan Remedial Amendment Period. The IRS has established (Rev. Proc. 2019-39) a system of recurring remedial amendment periods for correcting form defects in a section 403(b) plan and a system of section 403(b) preapproved plan cycles, plus a limited extension of the initial remedial amendment period for some form defects and deadlines for the adoption of plan amendments. For section 403(b) individually designed plans, the revenue procedure allows an eligible employer to retroactively correct form defects in its written section 403(b) plan first occurring after March 31, 2020. The guidance details when a remedial amendment period begins and ends for nongovernmental or governmental plans, adding that the termination of an individually designed plan ends (and will generally shorten) the remedial amendment period for each form defect of the plan. Accordingly, any retroactive remedial plan amendments or other required plan amendments for a terminating plan must be adopted in connection with the plan termination regardless of whether the requirements are included on a required amendments list. The revenue procedure describes the circumstances in which a form defect may not be corrected retroactively. The plan amendment deadline for form defects is the date on which the remedial amendment period regarding the form defect ends. The revenue procedure also provides guidance on the deadline for discretionary amendments and an example illustrating the deadlines. Further, the revenue procedure extends the initial remedial amendment period regarding an individually designed plan form defect first occurring on or before March 31, 2020, to the later of (i) March 31, 2020, or (ii) the end of the period provided within the revenue procedure, determined without regard to the requirement that the form defect first occur after March 31, 2020. However, for a form defect that is related to a change in section 403(b) requirements that was effective before 2019 and thus was not established in a required amendments list, the initial remedial amendment period remains March 31, 2020. The guidance provides details on the annual publication of the required amendments list and the operational compliance list. As with section 403(b) individually designed plans, retroactive corrections of form defects are allowed for a preapproved plan in its written section 403(b) plan first occurring after March 31, 2020. The system provides for two cycles, one for the period covered by the initial remedial amendment period and a second cycle that begins immediately after March 31, 2020. The system of preapproved plan cycles is expected to continue after the second cycle. Under this system, during each cycle, a plan sponsor can apply for a plan letter during a one-year submission period, which generally will occur at the beginning of each cycle. Future guidance will provide additional rules on the preapproved plan cycles and the recurring remedial amendment periods. The revenue procedure describes plan amendment deadlines and a limited extension of the initial remedial amendment period for some form defects. The provisions referenced in the guidance for preapproved plans are similar in many ways to preapproved qualified plans under section 401(a), as described in Rev. Proc. 2016-37. Rev. Proc. 2019-39 is effective September 30, 2019. It modifies Rev. Proc. 2013-22 and Rev. Proc. 2017-18.

IV. HEALTH CARE

A. Health Savings Accounts (HSAs)—Summary

<table>
<tr><th colspan="2"></th><th>2020</th><th>2019</th><th>2018</th></tr>
<tr><td colspan="4">Health savings accounts (HSAs):</td><td></td></tr>
<tr><td rowspan="3">Self-only coverage:</td><td>Contribution limit</td><td>$3,550</td><td>$3,500</td><td>$3,450</td></tr>
<tr><td>Plan minimum deductible</td><td>$1,400</td><td>$1,350</td><td>$1,350</td></tr>
<tr><td>Plan out-of-pocket limit</td><td>$6,900</td><td>$6,750</td><td>$6,650</td></tr>
<tr><td rowspan="3">Family coverage:</td><td>Contribution limit</td><td>$7,100</td><td>$7,000</td><td>$6,900</td></tr>
<tr><td>Plan minimum deductible</td><td>$2,800</td><td>$2,700</td><td>$2,700</td></tr>
<tr><td>Plan out-of-pocket limit</td><td>$13,800</td><td>$13,500</td><td>$13,300</td></tr>
<tr><td colspan="2">Additional contribution limit—age 55 or older at year-end</td><td>$1,000</td><td>$1,000</td><td>$1,000</td></tr>
<tr><td colspan="2">Source:</td><td>Rev. Proc. 2019-25</td><td>Rev. Proc. 2018-30</td><td>Rev. Proc. 2018-27</td></tr>
</table>

B. Final Regs Expand Opportunities for Employers to Offer Account-Based Group Health Plans. On June 13, 2019, the Internal Revenue Service, U.S. Department of Labor, and U.S. Department of Health and Human Services ("Agencies") issued final regulations (see source reference at the end of this alert) expanding opportunities for employers of all sizes to offer two new types of health reimbursement arrangements ("HRAs") to employees:

- Individual Coverage HRAs ("ICHRA"). ICHRAs are integrated with individual health insurance coverage or Medicare, allowing employees and dependents to reimburse premiums for such coverage, as well as other eligible medical expenses.

- Excepted Benefit HRAs ("EBHRA"). EBHRAs allow employees to pay for eligible medical expenses up to an annual $1,800 (indexed) dollar limit.

These Final Regulations are a substantial departure from previous guidance regarding HRAs. Effective January 1, 2020, employers will have far greater plan design options for implementing these account based plans.

1. <u>Individual Coverage Health Reimbursement Arrangements (ICHRAs)</u>.

a. *Background*. Under previous guidance, stand-alone, general purpose HRAs violated the Affordable Care Act's ("ACA") prohibitions against annual dollar limits on essential health benefits and the requirement to cover preventative services without cost-sharing. Thus, prior guidance generally required an HRA to be integrated with an ACA-compliant group health plan, or limited to covering only retirees or reimbursing only limited-scope benefits (e.g., vision and dental expenses). In a significant course reversal, the Final Regulations now allow an HRA to be integrated with individual market health insurance or Medicare coverage, subject to certain rules, including the following:

- Requirement that all individuals covered by an ICHRA be enrolled in individual health insurance or Medicare;

- Prohibition against offering a choice between ICHRA coverage and coverage under a traditional group health plan to the same class of employees;

- Requiring ICHRAs to generally be offered on the same terms to all participants within a class of employees;

- Opportunity before each plan year and at retirement to opt out of and waive future reimbursements; and

- Providing a written notice to participants at least 90 days before the plan year begins, or before the date the participant is first eligible to participate.

b. *ERISA Safe harbor*. Although an ICHRA is a group health plan subject to ERISA, the Final Regulations create a safe harbor exception under which the individual health insurance coverage integrated with the ICHRA is exempt from ERISA with the following conditions:

- The purchase of the individual health insurance coverage is completely voluntary;
- The employer does not endorse any issuer or health insurance coverage;
- The reimbursement of individual health insurance coverage does not apply to coverage consisting solely of excepted benefits;
- The employer receives no consideration in connection with the employee's selection or renewal of individual health insurance coverage; and
- The employer provides annual written notice to each participant that the individual health insurance coverage is not subject to ERISA.

c. *Compliance with the ACA's Employer Mandate*. An ICHRA is a self-insured employer sponsored group health plan that qualifies as minimum essential coverage. An employer sponsoring an ICHRA will be considered to have provided minimum essential coverage and avoid the Code Section 4980H(a) excise tax so long as coverage is offered to substantially all full-time employees. In addition, if the ICHRA is affordable, it will be deemed to offer minimum value under the Final Regulations and will also avoid the Code Section 4980H(b) excise tax.

2. <u>Excepted Benefit Health Reimbursement Arrangements (EBHRAs)</u>. The EBHRA is a general purpose HRA that is permitted to reimburse qualifying medical expenses under Code Section 213(d), subject to the following requirements:

- The employer must provide other group health plan coverage that is not: (i) an account-based group health plan, or (ii) coverage limited to excepted benefits;
- The maximum annual reimbursement must be limited to $1,800 (indexed);
- The EBHRA may not reimburse premiums for individual health insurance coverage, or Medicare, but may reimburse premiums for COBRA, excepted benefits and, in some cases, short-term, limited-duration coverage;

- The EBHRA must be available on a uniform basis to similarly-situated individuals (as defined under the HIPAA non-discrimination rules); and
- The EBHRA may not be offered to employees who are also offered an ICHRA.

EBHRAs are self-insured group health plans subject to ERISA's requirements and are also subject to Code Section 105(h)'s non-discrimination rules. We anticipate These additional options will likely increase demand for these types of benefits, especially with certain types of employers. For example, large employers with low paid or variable hour workforce. In addition, these benefits will likely provide greater cost certainty for employers and provide protection against potential penalties under the Employer Shared Responsibility Payment provisions of the ACA. Federal Register, Vol. 84, No. 119, Thursday, June 20, 2019, Final Rules: 26 CFR Parts 1 and 54, 29 CFR Parts 2510 and 2590, and 45 CFR Parts 144, 146, 147, and 155, "Health Reimbursement Arrangements and Other Account-Based Group Health Plans."

V. ESTATE PLANNING

A. Estate and Gift Taxes—Summary

	2019	**2018**	**2017**
Estate and gift tax exclusion[1]	$11,400,000	$11,180,000	$5,490,000
GST tax exemption	$11,400,000	$11,180,000	$5,490,000
Basic credit amount[2]	$4,505,800	$4,417,800	$2,141,800
Gift tax annual exclusion	$15,000	$15,000	$14,000
Gift tax annual exclusion for gifts to non-U.S. spouse	$155,000	$152,000	$149,000
Amount eligible for 2% interest rate on estate tax installment payment under Section 6166	$1,550,000	$1,520,000	$1,490,000
Maximum decrease in value allowed if estate used "special use valuation"	$1,160,000	$1,140,000	$1,120,000
Large gift received from a foreign person amount—notice required	$16,388	$16,076	$15,797
Source:	**Rev. Proc. 2018-57**	**Rev. Proc. 2017-58**; **Rev. Proc. 2018-18**	**Rev. Proc. 2016-55**

[1] Plus the amount, if any, of deceased spousal unused exclusion.
[2] Plus the amount, if any, of deceased spousal unused credit amount and any credit restored from gifts made to a same-sex spouse.

B. U.S. Supreme Court Decides North Carolina Trust Income Tax Case. On June 21, 2019, the U.S. Supreme Court, in a unanimous decision written by Justice Sotomayor, affirmed the North Carolina Supreme Court's decision that the presence of in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it. The Court, however, limited its holding to the specific facts presented, stating that it did not imply approval or disapproval of trust taxes that are premised on the residence of beneficiaries whose relationship to trust assets differs from that of the beneficiaries in this case. (*North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, U.S. S.Ct., Dkt. No. 18-457, 06/21/2019.) The Court specified that the Due Process analysis of state trust tax cases focuses on the extent of the in-state beneficiary's right to control possess, enjoy, or receive trust assets. In this case, the Court determined that the residence of the trust beneficiaries in North Carolina alone does not supply the minimum connection necessary to sustain the State's tax because the beneficiaries did not receive any income from the trust during the years in question; they had no right to demand trust income or otherwise control, possess, or enjoy the trust assets in the tax years at issue; and they also could not count on necessarily receiving any specific amount of income from the trust in the future. The Court noted that the decision does not address state laws that consider the in-state residency of a beneficiary as one of a combination of factors, that turn on the residency of a settlor, or that rely only on the residency of noncontingent beneficiaries.

C. Making Large Gifts Now Won't Harm Estates After 2025. The IRS has announced (IR-2018-229) that proposed regulations implementing changes made by the Tax Cut and Jobs Act (P.L. 115-97) to the basic exclusion amount (BEA) used in computing federal gift and estate taxes won't hurt individuals planning to make large gifts between 2018 and 2025. The TCJA temporarily increased the BEA from $5 million to $10 million for tax years 2018 through 2025, with both dollar amounts adjusted for inflation. For 2019, the inflation-adjusted BEA is $11.4 million. In 2026, the BEA will revert to the 2017 level of $5 million, adjusted for inflation. To address concerns that an estate tax could apply to gifts exempt from gift tax by the increased BEA, the proposed regs provide a special rule that allows the estate to compute its estate tax credit using the higher of the BEA applicable to gifts made during life or the BEA applicable on the date of death.

D. The TCJA Impact on Estate and Trust Miscellaneous Deductions. Under prior tax law, a fiduciary could deduct most expenses incurred by an estate or trust against the income. These expenses included interest, state income and property taxes, trustee fees, attorney and accounting fees and other miscellaneous deductions incurred by the trust such as fees to maintain property in the trust, investment advisor fees and administration expenses. The TCJA suspended the deduction for miscellaneous itemized deductions for individuals until 2025. The issue for estates and trusts is that the fiduciary tax laws follow individual tax law, unless explicitly exempted. Since the Act did not provide any explicit exemptions, the deductibility of many of the fiduciary deductions was uncertain. The IRS's Notice 2018-61 clarifies that an estate or trust may continue to deduct expenses incurred in the administration of an estate or trust, which would not otherwise be incurred if the property were not held in such estate or trust. For example, investment advisor fees are incurred whether an estate or trust holds a brokerage account or whether an individual holds the brokerage account outright. Therefore, under the TCJA, estates and trusts can no longer deduct investment advisor fees. However, trustee fees, attorney fees, accounting fees and some other administration expenses such as appraisal fees, for example, incurred by an estate or non-grantor trust would still be deductible.

VI. MERGERS & ACQUISITIONS

A. Treasury Issues Final Regulations under Section 704 T.D. 9871. Treasury has issued final regulations (Final Regulations) under Section 704(b) generally adopting temporary regulations (Temporary Regulations) released in 2016 addressing the allocation of partnership creditable foreign tax expenditures (CFTEs). The Section 704(b) regulations treat a partnership's allocations of CFTEs as not having economic effect, thereby requiring such allocations to be an accordance with the Partners' Interest in the Partnership (PIP) test. The Temporary Regulations contained a safe harbor rule and examples demonstrating when an allocation of CFTEs from an 'activity' satisfies the PIP test. The Final Regulations, which generally became effective July 24, 2019, modify the definition of 'activity' by adding a cross-reference to the disregarded payment rule to clarify that such payments effectively reduce net income in the payor CFTE category by subdividing that activity and assigning related CFTEs to the payee's CFTE category.

B. Final Self-Employment Tax Regulations on Partnerships with a Disregarded Entity. The Treasury has issued final regulations (T.D. 9869) on self-employment tax treatment of partners in a partnership that owns a disregarded entity (DE). The final regulations adopt the temporary regulations (T.D. 9766) issued in 2016. The final regulations reflect the IRS's position that if a partnership owns a DE and the partners in that partnership are employed by the DE, those partners are subject to the same self-employment tax and employment benefit plan restrictions as partners in a partnership that does not own a DE. The regulations confirm the IRS's continued support of Rev. Rul. 69-184, which provides that a partner in a partnership cannot be an employee of the same partnership. The effective date of the regulations is the later of August 1, 2016, or the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan. The preamble to the final regulations clarifies the effective date by providing the following example: '. . . an entity may have had two affected plans, with one plan year that began on September 1, 2016, and another plan year that began on January 1, 2017. In this case, the applicability date for this entity would have been January 1, 2017.'

C. PLR 201923003. In this PLR, the IRS ruled that deductible liabilities assumed by a controlled corporation in a Divisive D Reorganization are excluded under Section 357(c)(3) in determining the amount of liabilities assumed by the controlled corporation for purposes of Sections 357(c), 358(d), and 361(b)(3).

D. TAM 201929019*.* The IRS determined that when two partnerships merged, the deemed distribution of partnership interests in the resulting partnership qualified as an 'exchange' for purposes of Section 743(b). Consequently, the merger resulted in a mandatory downward basis adjustment to the resulting partnership assets under Section 743(b).

VII. REAL ESTATE

A. IRS Finalizes Section 199A Safe Harbor for Rental Real Estate. The IRS finalized a safe harbor revenue procedure under which a rental real estate enterprise will be treated as a trade or business for purposes of Code Sec. 199A. The procedure includes several changes from a proposed revenue procedure previously issued in Notice 2019-7, such as (i) allowing taxpayers to treat their interests in residential or commercial properties as separate rental real estate enterprises in one year and then treating their interests in all similar residential or all similar commercial properties as a single rental real estate enterprise in a future year; (ii) allowing taxpayers with rental real estate enterprises that have been in existence for four or more years to qualify immediately under the 250-hour rental services test if the rental services have been provided in three of the five consecutive tax years ending with the tax year at issue; and (iii) allowing an interest in mixed-use property to be treated as a single rental real estate enterprise or bifurcated into separate residential and commercial interests. Rev. Proc. 2019-38.

1. Background. Reg. Sec. 1.199A-1(b)(14) defines the term "trade or business" for purposes of the deduction under Code Sec. 199A as a trade or business under Code Sec. 162 other than the trade or business of performing services as an employee. In addition, Reg. Sec. 1.199A-1(b)(14) provides that the renting or licensing of tangible or intangible property (rental activity) that does not rise to the level of a Code Sec. 162 trade or business is nevertheless treated as a trade or business for purposes of Code Sec. 199A if the property is rented or licensed to a trade or business conducted by the individual or a relevant passthrough entity (RPE) which is commonly controlled under Reg. Sec. 1.199A-4. Earlier this year, in order to address questions of whether a rental real estate enterprise rises to the level of a trade or business for purposes of the Code Sec. 199A deduction, the IRS issued Notice 2019-7. In Notice 2019-7, the IRS set forth a proposed revenue procedure containing a safe harbor for treating a rental real estate enterprise as a trade or business solely for purposes of Code Sec. 199A. On September 24, after considering the public's comments on Notice 2019-7, the IRS issued Rev. Proc. 2019-38.

2. Rev. Proc. 2019-38. If the requirements in Rev. Proc. 2019-38 are met, a taxpayer's rental real estate enterprise will be treated as a single trade or business as defined in Code Sec. 199A(d) for purposes of applying the regulations under Code Sec. 199A, including the application of the aggregation rules in Reg. Sec. 1.199A-4. RPEs may also use this safe harbor. In order to rely upon the safe harbor, taxpayers and RPEs must satisfy all of the requirements in Rev. Proc. 2019-38.

a. However, as also stated in Notice 2019-7, failure to satisfy the safe harbor requirements does not preclude a taxpayer or the IRS from otherwise establishing that an interest in rental real estate is a trade or business for purposes of Code Sec. 199A.

b. For purposes of the safe harbor, a rental real estate enterprise is defined as an interest in real property held for the production of rents and may consist of an interest in a single property or interests in multiple properties. The taxpayer or RPE relying on Rev. Proc. 2019-38 must hold each interest directly or through an entity disregarded as an entity separate from its owner under any provision of the Code.

c. Generally, taxpayers and RPEs may either treat each interest in similar property held for the production of rents as a separate rental real estate enterprise or treat interests in all similar properties held for the production of rents as a single rental real estate enterprise. For purposes of applying Rev. Proc. 2019-38, properties held for the production of rents are similar if they are part of the same rental real estate category. The two types of rental real estate categories for the purpose of combining properties into a single rental real estate enterprise are residential and commercial. Thus, commercial real estate held for the production of rents may only be part of the same enterprise with other commercial real estate, and residential properties may only be part of the same enterprise with other residential properties.

d. Once a taxpayer or RPE treats interests in similar commercial properties or similar residential properties as a single rental real estate enterprise under the safe harbor, the taxpayer or RPE must continue to treat interests in all similar properties, including newly acquired properties, as a single rental real estate enterprise when the taxpayer or RPE continues to rely on the safe harbor. However, a taxpayer or RPE that chooses to treat its interest in each residential or commercial property as a separate rental real estate enterprise may choose to treat its interests in all similar commercial or all similar residential properties as a single rental real estate enterprise in a future year.

e. An interest in mixed-use property may be treated as a single rental real estate enterprise or may be bifurcated into separate residential and commercial interests. For purposes of Rev. Proc. 2019-38, mixed-use property is defined as a single building that combines residential and commercial units. An interest in mixed-use property, if treated as a single rental real estate enterprise, may not be treated as part of the same enterprise as other residential, commercial, or mixed-use property.

f. Each rental real estate enterprise that satisfies the requirements of this safe harbor is treated as a separate trade or business for purposes of applying Code Sec. 199A and the regulations thereunder.

3. <u>Safe Harbor Requirements</u>. The determination to use the safe harbor in Rev. Proc. 2019-38 must be made annually. Solely for the purposes of Code Sec. 199A, each rental real estate enterprise will be treated as a single trade or business if the following requirements are satisfied during the tax year with respect to the rental real estate enterprise:

a. Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise. If a rental real estate enterprise contains more than one property, this requirement may be satisfied if income and expense information statements for each property are maintained and then consolidated;

b. For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed per year with respect to the rental real estate enterprise. For rental real estate enterprises that have been in existence for at least four years, in any three of the five consecutive tax years that end with the tax year, 250 or more hours of rental services are performed per year with respect to the rental real estate enterprise; and

c. The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: (i) hours of all services performed; (ii) description of all services performed; (iii) dates on which such services were performed; and (iv) who performed the services. If services with respect to the rental real estate enterprise are performed by employees or independent contractors, the taxpayer may provide a description of the rental services performed by such employee or independent contractor, the amount of time such employee or independent contractor generally spends performing such services for the enterprise, and time, wage, or payment records for such employee or independent contractor. Such records are to be made available for inspection at the request of the IRS.

4. Compliance. The taxpayer or RPE attaches a statement to a timely filed original return (or an amended return for the 2018 tax year only) for each tax year in which the taxpayer or RPE relies on the safe harbor. An individual or RPE with more than one rental real estate enterprise relying on this safe harbor may submit a single statement but the statement must list the required information separately for each rental real estate enterprise. The statement must include the following information: (i) a description (including the address and rental category) of all rental real estate properties that are included in each rental real estate enterprise; (ii) a description (including the address and rental category) of rental real estate properties acquired and disposed of during the tax year; and (iii) a representation that the requirements of Rev. Proc. 2019-38 have been satisfied.

5. Rental Services. For purposes of Rev. Proc. 2019-38, rental services include, but are not limited to:

a. advertising to rent or lease the real estate;

b. negotiating and executing leases;

c. verifying information contained in prospective tenant applications;

d. collecting rent;

e. daily operation, maintenance, and repair of the property, including the purchase of materials and supplies;

f. management of the real estate; and

g. supervision of employees and independent contractors.

Rental services may be performed by owners, including owners of an RPE, or by employees, agents, and/or independent contractors of the owners. The term "rental services" does not include financial or investment management activities, such as arranging financing; procuring property; studying and reviewing financial statements or reports on operations; improving property under Reg. Sec. 1.263(a)-3(d); or hours spent traveling to and from the real estate.

6. Exclusions. Certain rental real estate arrangements are excluded from the safe harbor provisions of Rev. Proc. 2019-38. The following types of property may not be included in a rental real estate enterprise and are therefore not eligible for the safe harbor:

a. real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence under Code Sec. 280A(d).

b. real estate rented or leased under a triple net lease. For purposes of Rev. Proc. 2019-38, a triple net lease includes a lease agreement that requires the tenant or lessee to pay taxes, fees, and insurance, and to pay for maintenance activities for a property in addition to rent and utilities.

c. real estate rented to a trade or business conducted by a taxpayer or an RPE which is commonly controlled under Reg. Sec. 1.199A-4(b)(1)(i).

d. the entire rental real estate interest if any portion of the interest is treated as a specified service trade or business (SSTB) under Reg. Sec. 1.199A-5(c)(2) (which provides special rules where property or services are provided to an SSTB).

7. Effective Date. Rev. Proc. 2019-38 applies to tax years ending after December 31, 2017. Alternatively, taxpayers and RPEs may rely on the safe harbor set forth in Notice 2019-7 for the 2018 tax year. The contemporaneous records requirement will not apply to tax years beginning before January 1, 2020. However, taxpayers bear the burden of showing the right to any claimed deductions in all tax years.

B. Passive activity losses. Married rental property owners/Homeland Security Dept. employee-wife and retired husband were precluded under Code Sec. 469 from deducting rental losses for stated year, in which their AGI exceeded Code Sec. 469(i)'s phase-out level for limited offset thereunder and in respect to which they failed to show that husband, who was primarily responsible for properties' upkeep, qualified as real estate professional pursuant to Code Sec. 469(c)(7)(B)(ii)'s 750-hour test. Although they offered calendar purporting to show husband worked total of more than 750 hours, calendar entries were clearly inflated. Notably, every task listed, even for such trivial things as “doing nothing more than receiving rent payment,” was recorded as taking at least 1 hour. There were also significant hours recorded for things like snow removal, even though such appeared to be for taxpayers' rather than tenants' benefit. And they recorded significant hours for merely watching or supervising contractors, even though such supervision didn't count as “work performed.” (*Ronnie Hairston, et ux. v. Commissioner*, (2019) TC Memo 2019-104, 2019 RIA TC Memo ¶2019-104)

C. Interest Passed to Taxpayer Was Not Investment Interest Subject to Limited Deductibility (T.C.) (IRC §163). Interest expense passed to Taxpayer from his father as a gift and stemming from loans incurred by partnerships in which Taxpayer had an interest was not investment interest subject to deduction limitation, but rather correctly reported on his Schedule E as allocable to the real estate assets held by the partnerships, the U.S. Tax Court held in a division opinion. Taxpayer's father owned partnership interests that made debt-financed distributions to its partners. The father used the proceeds of the distributions to purchase investment assets and treated the interest on the debts as investment interest. Taxpayer received interests in the partnerships by gift from his father and treated the debts as properly allocable to the partnerships' real estate assets and reported the interest as offsetting the passed-through real estate income on his Schedule E. The IRS recharacterized the interest as investment interest and disallowed the deductions for interest expenses because of insufficient investment income. The court held that under Treasury Regulations Section 1.163-8T(c)(3)(ii) and Notice 89-35, Taxpayer should be treated as having made a debt-financed acquisition of the partnership interests he acquired from his father, and therefore, the debt proceeds are allocated among the real estate assets and the interest paid on the debt is allocated to those assets in the same manner. The court concluded that the interest paid on the loans wasn't investment interest. *Lipnick v. Commissioner*, 153 T.C. No. 1 (Aug. 28, 2019).

TRUST ACCOUNTING FOR ACCOUNTANTS

By: Geoffrey N. Taylor, Esq.

I. OVERVIEW

A. Duty to account.

1. Among the many duties a trustee owes to trust beneficiaries is the duty to maintain accurate books and records of the trust assets and its administration and to provide beneficiaries with periodic accountings or reports.

2. Accountings allow trust beneficiaries to stay informed about the administration of the trust and to protect their beneficial interests in the trust.

B. Nature of duty to account.

1. Trustees hold property for the benefit of third parties (i.e., the trust beneficiaries).

2. The trustee must act at all times for the sole benefit of the beneficiaries and act impartially as to those beneficiaries.

3. The trustee must keep trust beneficiaries reasonably informed.

C. General content of an accounting.

1. The beneficiaries of the trust are entitled to receive accountings (also called “reports”) showing the assets, liabilities, receipts, and disbursements of a trust.

2. The purpose is to inform the beneficiaries regarding the activities of the trustee; e.g., how assets are being invested,

how income and principal are being distributed, and how expenses are being incurred.

3. The preparation and provision of a report can protect the trustee from breach of trust claims. See, e.g., MCL 700.7905(1)(a).

4. Although similar concepts are involved, trust accounting is not the same as financial or tax accounting.

5. A central distinction involves the differences between income beneficiaries and principal or remainder beneficiaries.

II. <u>SOURCE OF DUTY TO ACCOUNT</u>

A. Trust agreement.

1. Trust agreement specifies accounting requirements.

a. A trustee must first review the trust agreement to determine whether trust accounting provisions are included and, if so, what is required to be provided, to whom, and when.

b. "With respect to each trust established under this Trust Agreement, the Trustee shall, at least annually, render to each beneficiary of a trust who is currently entitled or eligible to receive a mandatory or discretionary distribution of income or principal from such trust a statement of account showing (i) the receipts, disbursements, and transactions involving the trust during the accounting period, (ii) an inventory of the trust property at the end of the accounting period reflecting the cost and market value of the assets to the extent reasonably available, (iii) the trust's liabilities, (iv) the source and amount of the Trustee's compensation, if any, and (v) any other disclosures required by applicable law. The statement shall be delivered as soon as practicable after the close of the accounting period or upon termination of the trust or resignation or removal of the Trustee. The Trustee may, but shall not be obligated to, provide an account statement to any other beneficiary."

2. Trust agreement provides the trustee is not required to account.

   a. The trust agreement may affirmatively state the trustee is not required to account.

   b. "In no event shall the trustee have any obligation to account to any beneficiary."

   c. However, regardless of what the trust agreement provides, under the Michigan Trust Code, a beneficiary is always entitled to receive relevant information about the trust property and to petition the probate court to order the trustee to provide statements of account and other information. See MCL 700.7105(2).

3. Trust agreement is silent regarding accountings.

   a. Occasionally, the trust agreement is silent regarding a trustee's obligation to account.

   b. In this case, the default provisions of MCL 700.7814(3) apply (see below).

B. Michigan Trust Code.

1. MCL 700.7814.

a. MCL 700.7814(1) sets the tone regarding a trustee's obligation to report to trust beneficiaries. "A trustee shall keep the qualified trust beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests. Unless unreasonable under the circumstances, a trustee shall promptly respond to a trust beneficiary's request for information related to the administration of the trust."

b. Absent a contrary provision of the trust agreement, MCL 700.7814(3) provides "[a] trustee shall send to the distributees or permissible distributees of trust income or principal, and to other qualified or nonqualified trust beneficiaries who request it, at least annually and at the termination of the trust, a report of the trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust property and, if feasible, their respective market values."

c. Thus, the required components of a trustee's report under MCL 700.7814(3) are as follows:

   i. assets and their market values

   ii. liabilities

   iii. receipts

   iv. disbursements

   v. source and amount of trustee's compensation

d. MCL 700.7814(4), which cannot be modified or overridden by the terms of the trust agreement, empowers the probate court to compel the trustee to account. "If the terms of a trust direct that accounts and information be provided to less than all qualified trust beneficiaries, at the court's direction, the trustee shall provide statements of account and other information to persons excluded under the terms of the trust to the extent and in the manner the court directs."

e. Under MCL 700.7814(3), a trust beneficiary may waive the right to a trustee's report or other information otherwise required to be furnished. A trust beneficiary, with respect to future reports and other information, may withdraw a waiver previously given.

2. MCL 700.7103(g) – qualified trust beneficiary.

a. MCL 700.7814, and the Michigan Trust Code generally, focuses on the rights of "qualified trust beneficiaries."

b. Under MCL 700.7103(g), a "qualified trust beneficiary" means a trust beneficiary to whom one or more of the following apply on the date the trust beneficiary's qualification is determined:

i. The trust beneficiary is a distributee or permissible distributee of trust income or principal.

ii. The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the interests of the distributees under the trust described in subparagraph i terminated on that date without causing the trust to terminate.

iii. The trust beneficiary would be a distributee or permissible distributee of trust income or principal if the trust terminated on that date.

III. <u>TRUST ACCOUNTING CONCEPTS</u>

A. Income versus principal generally.

1. Income is the return the trust receives for the use of trust property.

2. Principal is the trust property itself.

B. Current versus remainder beneficiaries.

1. Trust has only current beneficiaries.

a. Where a trust provides for outright distributions on the death of the grantor, the trust accounting can be fairly straightforward.

b. E.g., “The trustee shall distribute $1,000 to Charity and the remaining assets to A.”

c. Here, the trustee simply reports to A (i) the trust assets and their market values on the grantor’s date of death, (ii) the trust liabilities, if any, (iii) trust receipts (e.g., income) and disbursements (e.g., expenses and the $1,000 distribution to Charity), and (iv) the source and amount of the trustee’s compensation, if any.

2. Trust has current and remainder beneficiaries.

a. What happens when a trust provides for a beneficiary to have a lifetime interest or an interest for a term of years, with the remainder to a different beneficiary?

b. The classic example is a marital trust. E.g., "The trustee shall distribute all income to Spouse for life and remainder to Child."

c. There is an inherent conflict between the nature of the interests of held by Spouse and Child. For example, Spouse wants the trustee to maximize current income rather than capital appreciation and wants expenses allocated to principal rather than income. Child wants exactly the opposite.

d. Personal circumstances can add significantly to that conflict (e.g., Spouse and Child are unrelated and hate each other).

e. Provisions of the trust can also add to the conflict (e.g., Spouse and Child each can receive distributions for health, maintenance, and support in accustomed manner of living during Spouse's lifetime).

f. In this situation, the manner in which the trustee allocates receipts and disbursements between income and principal may materially affect Spouse's and Child's interests.

C. Trust accounting income.

1. Trust accounting income (sometimes referred to as "fiduciary accounting income") is defined by the trust agreement, not federal tax law.

2. If or to the extent the trust agreement is silent, trust accounting income is determined under state law (e.g., the Michigan Uniform Principal and Income Act).

3. Trust accounting income is not the same as taxable income.

D. Michigan Uniform Principal and Income Act ("Act").

1. General.

a. The Act provides the rules that govern the allocation of receipts and disbursements to or between principal and income. MCL 555.501 et seq.

b. If the trust agreement contains provisions regarding allocations of receipts and/or disbursements to principal and/or income, the terms of the trust agreement control.

c. In the absence of contrary terms in the trust instrument, the provisions of the Act control (i.e., if or to the extent the trust agreement is silent, the Act provides the "default" rules).

d. The trust agreement often gives the trustee discretion regarding allocations, which may effectively override the default rules under the Act. "The Trustee shall have the power to determine what part of cash or other property received by it is income and what part is principal, and to determine what expenses and other charges, including Trustee's fees and disbursements, shall be a charge against principal and what against income; provided, however, that stock dividends, rights to subscribe for any stock or securities, or any profit or gain which may accrue from any sale, exchange or other disposition of any property or assets included in the Trust, shall not be determined to be income subject to distribution, but shall be determined to be principal and shall be added thereto and treated in all respects in the same manner as the original principal of the Trust estate after deduction therefrom as a charge against the same of all income taxes payable with respect thereto, and all losses sustained as a result of the sale, exchange or other disposition of assets and property comprising a part of the Trust estate shall be charged against principal and shall not be charged against the income of the Trust estate or reduce the amount of such income subject to distribution. All cash dividends except liquidating dividends shall be considered as income."

2. Income.

   a. The Act defines "income" as "money or property that a fiduciary receives as current return from a principal asset." MCL 555.502(d).

   b. The Act allocates the following receipts to income:

      i. Interest.

      ii. Money (other than liquidation proceeds) received from an entity, such as a corporation, partnership, or limited liability company (e.g., dividends and cash flow distributions).

      iii. Rent.

      iv. 10% of required minimum distributions from an IRA or qualified plan.

c. The Act allocates the following disbursements to income:

i. 50% of compensation paid to the trustee or any person providing investment advisory or custodial services.

ii. 50% of expenses for accountings, judicial proceedings, or other matters involving both income and remainder interests.

iii. Other ordinary expenses, including interest, ordinary repairs, regularly recurring taxes assessed against principal, and expenses of a proceeding or other matter than concerns primarily the income interest.

iv. Insurance premiums.

3. Principal.

a. The Act defines "principal" as "property held in trust for distribution to a remainder beneficiary when the trust terminates." MCL 555.502(j).

b. The Act allocates the following receipts to principal:

i. Assets used to fund the trust and assets received from a payer under a contract naming the trust or the trustee as beneficiary.

ii. Money or other property received from the sale, exchange, liquidation, or change in form of a principal asset (e.g., capital gains).

iii. Life insurance proceeds.

iv. 90% of required minimum distributions from an IRA or qualified plan and all nonrequired distributions from an IRA or qualified plan.

v. Property other than money received from an entity.

vi. Money received from liquidation of an entity.

c. The Act allocates the following disbursements to principal:

i. The other 50% of compensation paid to the trustee or any person providing investment advisory or custodial services.

ii. The other 50% of expenses for accountings, judicial proceedings, or other matters involving both income and remainder interests.

iii. Debt principal payments.

iv. Expenses of a proceeding that concerns primarily trust principal, including a proceeding to construe the trust or to protect the trust or its property.

v. Estate, inheritance, and other transfer taxes, including penalties, apportioned to the trust.

vi. Disbursements for environmental matters.

IV. <u>TRUST ACCOUNTINGS/REPORTS</u>

A. Form.

1. MCL 700.7814 does not prescribe a form for the accounting (referred to in the statutes as a "report").

2. However, probate courts will be familiar with the SCAO forms for estates, guardianships, and conservatorships, which are PC 583 Account of Fiduciary – Short Form and PC 584 Account of Fiduciary.

3. Cash method is generally used.

4. The goal is to present the information in a manner that can be easily understood by the beneficiaries. The beneficiaries need to receive all material facts necessary for them to protect their interests.

B. Content.

1. Inventory.

a. The inventory lists the trust assets as of the beginning of the accounting period and as of the end of the accounting period.

b. Provide the assets' carrying values/cost basis and fair market values (if feasible).

c. List any trust liabilities.

2. Statement of receipts and disbursements.

a. Provide all receipts and disbursements, including the source and amount of the trustee's compensation, for the accounting period.

b. For trusts with current and remainder beneficiaries, list trust income receipts and disbursements separately from trust principal receipts and disbursements.

C. Timing.

1. Generally, a fiduciary must prepare a report at least annually.

2. However, a court may require otherwise, so it is vital to review any applicable court order.

D. Providing reports can protect the trustee.

1. Default statute of limitations.

a. A judicial proceeding by a trust beneficiary against a trustee for breach of trust must be commenced within 5 years after the first of the following to occur (i) the removal, resignation, or death of the trustee; (ii) the termination of the trust beneficiary’s interest in the trust; or (iii) the termination of the trust.

b. This is a long period for the trustee to look over his shoulder.

2. Shortened statute of limitations if report is provided.

a. A trust beneficiary cannot commence a proceeding against a trustee for breach of trust more than 1 year after the date the trust beneficiary was sent a report that

(i) adequately disclosed the existence of a potential claim for breach of trust and (ii) informed the trust beneficiary of the time allowed for commencing a proceeding.

b. A trustee report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the trust beneficiary knows of the potential claim or should have inquired into its existence.

BACK FROM THE DEAD
NEW RULES FOR HEALTH REIMBURSEMENT ACCOUNTS

By: Marc S. Wise, Esq.

Health reimbursement arrangements ("HRAs") have been around for decades. Revenue Ruling 61-146 provided the initial guidance that the employer reimbursement of individual medical insurance premiums was excluded from the employee's gross income under IRC 106.

I. ACA PROHIBITION ON REIMBURSEMENT

Once the Affordable Care Act was passed, IRS and DOL guidance changed the rules. IRS Notice 2013-54 and DOL Technical Release 2013-03 confirmed the ACA prohibition of individual payment or reimbursement of individual health insurance premiums by the employer.

II. IRS NOTICE 2015-17

IRS Notice 2015-17 provided significant interim guidance on health reimbursement arrangements. The noteworthy provisions include:

A. Transitional Relief for Small Employers for Insurance Premium Reimbursement to Employees.

The IRS stated that the $100 per day/per person excise tax under IRC Section 4980D would not be asserted for any failure to satisfy the market reform provisions under the Affordable Care Act by employer payment plans that pay, or reimburse employees for individual health policy premiums or Medicare Part B or Part D premiums (1) for 2014 for employers that are **not** Applicable Large Employers ("ALEs") for 2014, and (2) for January 1 through June 30, 2015 for employers that are **not** ALEs for 2015.

After June 30, 2015, such employers may be liable for the Code Section 4980D excise tax.

An ALE generally is, with respect to a calendar year, an employer that employed an average of at least 50 full-time employees (including full-time equivalent employees) on business days during the preceding calendar year. Special rules allowed the employer to determine its status as an ALE by reference to a period of at least six consecutive calendar months, as chosen by the employer, during the 2013 calendar year for determining ALE status for 2014 and during the 2014 calendar year for determining ALE status for 2015, as applicable (rather than by reference to the entire 2013 calendar year and the entire 2014 calendar year).

Employers eligible for the relief that have employer payment plans were not required to file IRS Form 8928 solely as a result of having such arrangements for the period for which the employer is eligible for the relief.

This relief did not extend to stand-alone HRAs or other arrangements that reimburse employees for medical expenses other than insurance premiums.

B. Treatment of S-Corporation Health Care Arrangements for 2% Shareholders.

The IRS also stated that until further guidance is issued, the $100 per day/per person excise tax under IRC Section 4980D will not be asserted for any failure to satisfy the market reforms for a 2% S-Corporation shareholder/employee healthcare arrangement. Taxpayers may continue to rely on Notice 2008-1 with regard to the tax treatment for the payment of health insurance for 2% S-Corporation shareholders.

The guidance in this section does not apply to reimbursements of individual health insurance coverage with respect to employees of an S-Corporation who are not 2% shareholders.

C. Integration of Medicare Premium Payment or Reimbursement Arrangement with a Group Health Plan.

An arrangement under which an employer reimburses (or pays directly) some or all of Medicare Part B or Part D premiums for employees constitutes an employer payment plan, as described in Notice 2013-54, and if such an arrangement covers two or more active employees, is a group health plan subject to the market reforms. An employer payment plan cannot be integrated with Medicare coverage to satisfy the market reform provisions because Medicare coverage is not a group health plan.

If the Medicare premium payments or reimbursements are integrated with a group health plan offered by the employer for purposes of the annual dollar limit prohibition and the preventive services requirements, the payment or reimbursement of such premiums is permitted.

D. Increases in employee compensation to assist with payments of individual market coverage.

An arrangement where an employer increases an employee’s compensation, but does not condition the payment of the additional compensation on the purchase of health coverage (or otherwise endorse a particular policy, form, or issuer of health insurance), will not be treated as an employer payment plan. Such arrangement will not be subject to the $100 per day/per person excise tax under IRC Section 4980D.

E. Insurance Premium Reimbursement Plans.

The IRS provided in the Notice that, although Rev. Rul. 61-146 permitted insurance payments or reimbursements for individual health insurance for employees on a pre-tax basis, this guidance did take into consideration the Affordable Care Act.

This type of arrangement is subject to the market reform provisions of the Affordable Care Act that are applicable to group health plans without regard to whether the employer treats the money as pre-tax or post-tax to the employee. Thus, except as otherwise provided in the Notice, such individual insurance reimbursement plans are subject to the $100 per day/per person excise tax under IRC Section 4980D.

Notice 2015-87 provided guidance on a multitude of ACA provisions. The guidance included how to deal with employer HRA contributions for premiums and other cost sharing expenses. It provided detail on the concept of "integrated HRAs" and the treatment of employer flex credits for the employer shared responsibility payments and affordable health insurance.

The penalties for paying or reimbursing the individual premiums of employees is found in IRC 4980D. The penalty is $100 per day/per employee.

III. MINIMUM VALUE REQUIREMENTS

A. Prior to recent changes, HRAs had to meet integration requirements detailed in IRS Notice 2013-54. In order to have an integrated HRA, the employee was required to participate in an employer-sponsored group health plan of either the employee, spouse or parents. The HRA could then be "integrated" with the employer group health plan to provide an integrated package of benefits. HRAs were not permitted to be integrated with individual health insurance policies. To the extent the health plan did not provide ACA minimum value, the HRA could only provide reimbursement for cost-sharing amounts under major medical and/or non-essential health benefits.

B. HRAs were prohibited from integrating with individual health insurance plans due to certain ACA provisions. Since an HRA is a group health plan, the HRA would not comply with the ACA prohibition of annual limits on essential health benefits. Since all HRAs have limited benefit levels, this ACA provision would be violated. Also, the HRA itself provided no coverage for any services, and health plans are required to cover preventive services at no cost to the employee-participant.

IV. THE CURRENT WORKAROUND

In order to reimburse employees for individual health insurance policies, the only current option is to give the employees additional taxable compensation.

A. The payment must be standard compensation subject to all withholdings.

B. The employees must have the unrestricted right to receive the compensation as cash.

C. You cannot require the employee to use the added compensation to purchase health insurance.

D. The employer cannot impose any conditions on the employee receiving the additional compensation.

E. The employer cannot require the employee to provide proof of health insurance coverage.

V. PRESIDENTIAL EXECUTIVE ORDER STARTS THE BALL ROLLING

The President issued Executive Order 13813 on October 12, 2017 requiring the Secretaries of the Treasury, Labor and Health and Human Services to expand the availability and permitted use of health reimbursement accounts.

VI. NEW HRA REGULATIONS

A. Regulations were issued on June 20, 2019 by the Internal Revenue Service, the Department of Labor, and the Department of Health and Human Services. The new regulations totaled 497 pages in length. The title of the new regulations is:

"New Rules on Health Reimbursement Arrangements
and Other Account-Based Group Health Plans"

B. The regulations include several distinct components:

1. Individual coverage HRAs.

2. Excepted Benefit HRAs.

3. DOL-only safe harbor to clarify that individual health insurance coverage purchased with HRA will not be subject to ERISA, so long as certain conditions are met.

4. IRS-only rule regarding eligibility for premium tax credits for HRA participants and beneficiaries.

5. HHS-only rule creating special enrollment period for individuals who newly gain access to an individual coverage HRA or QSEHRA.

VII. NEW GOVERNMENT APPROVED ACRONYM

ICHRA (pronounced "ICK-RA"). Individual Coverage Health Reimbursement Account.

VIII. NEW INDIVIDUAL COVERAGE HRAs – EFFECTIVE JANUARY 1, 2020

A. Employees must be enrolled in an individual health insurance policy or Medicare Part A and B or Part C.

B. Employee cannot be eligible for ICHRA and a traditional group health plan.

C. Employer must offer the ICHRA on the same terms to each employee class.

D. Opt-out provisions are required.

E. Pre-tax employee premium payments are permitted for off-Exchange individual policies.

F. Substantiation and verification of individual coverage is required.

G. Advance notice to employees is required.

H. Plan document requirements – Plan and SPD must be prepared to comply with the Code and ERISA.

IX. NEW INDIVIDUAL COVERAGE HRAs – CLASS RULES

Employers are permitted to create “classes” within their workforce, based on 10 specified “classes” enumerated in the regulations.

A. Permitted classes (classes may be combined):

1. Full-time employees.

2. Part-time employees.

3. Seasonal employees.

4. Employees covered by a Collective Bargaining Agreement.

5. Employees who have not satisfied a waiting period.

6. Nonresident aliens with no US based income.

7. Employees working in the same rating area.

8. Salaried employees.

9. Non-salaried employees (e.g. hourly).

10. Temporary employees of a staffing firm.

X. NEWLY HIRED EMPLOYEES

The new hire rule allows employers to phase in for employees hired after a certain date. This rule allows employers to subdivide other classes into existing employees and new hires and the minimum class size is not going to apply to this new hire subclass.

- ✓ ICHRA must still be offered on the same terms to all new hires.
- ✓ New hires cannot have a choice between the group plan or ICHRA.
- ✓ Employer can discontinue the special rule at any time. When this happens anyone in the new hire subclass will be absorbed back into the regular class of employees.
- ✓ Cannot be used to offer different ICHRA amounts based on hire date.
- ✓ Class size minimums do not apply unless the new hire subclass is subsequently subdivided and the minimum requirement would otherwise apply.

XI. NOTICE REQUIREMENTS

A. The notice must be provided to all eligible employees at least 90 days prior to the start of the plan year.

B. The written notice will be required to include certain relevant information, including:

1. A description of the terms of the HRA, including the maximum dollar amount made available that is used in the affordability determination under the Code Section 36B rules , including information on when the amounts will be made available (for example, monthly or annually at the beginning of the plan year).

2. A statement of the right of the participant to opt-out of and waive future reimbursement under the HRA.

3. A description of the PTC eligibility consequences for a participant who accepts the HRA.

4. A statement on how the participant may find assistance for determining their individual coverage HRA affordability.

5. A statement that the participant must inform any Exchange to which they apply for advance payments of the PTC of certain relevant information; contact information (including at least a phone number) of an individual or a group of individuals who participants may contact with questions regarding the individual coverage HRA.

6. A statement that the participant should retain the written notice because it may be needed to determine whether the participant is allowed the PTC.

7. A statement that the HRA may not reimburse any medical care expense unless the substantiation requirements are satisfied.

8. A statement of availability of an SEP for employees and dependents who newly gain access to the HRA.

9. The date as of which coverage under the HRA may first become effective and date on which the HRA plan year ends.

10. A statement to clarify further that there are multiple types of HRAs and the type the participant is being offered is an individual coverage HRA.

XII. DEPARTMENT OF LABOR MODEL ATTESTATION FORM

A. The Department of Labor (DOL) has issued a model attestation form that can be used. Employees must provide proof of enrollment in an individually purchased health insurance plan (whether purchased on the Exchange or not) prior to any reimbursement. The final regulations identify Medicare and student health insurance as eligible individual health insurance. Employees must annually verify that they have coverage under individual health insurance at the time of open enrollment. Employees can meet this requirement by completing a “model attestation” provided by the DOL.

B. Employers must require coverage substantiation from the employee with each request for reimbursement. To meet this requirement, employees can complete a second model attestation provided by the DOL.

XIII. SPECIAL ENROLLMENT PERIODS

A. Since enactment of the ACA, there is one time during the year, called “Open Enrollment”, when plans are available on the individual marketplace for individuals to enroll in. Open Enrollment is typically November 1 – December 15th each year (some states extend the deadline). After Open Enrollment has ended, individuals need a qualifying life event called a “Special Enrollment Period” to purchase individual health insurance, such as marriage, divorce, having a baby and moving.

B. The triggering event for ICHRA SEPs is the first day employees are eligible for coverage. Whether the SEP will take place 60 days before the triggering event or 60 days after depends on whether the employer is subject to the 90-day notice requirement. For new and existing ICHRAs, employers must send eligible employees the required notice at least 90 days before the start of the new plan year. If the employer is subject to this 90-day notice requirement, the 60-day SEP will be BEFORE the triggering event.

C. For employees who become newly eligible for the ICHRA mid-year, the notice must be sent by the day plan eligibility begins, at the latest. If your company is NOT subject to the 90-day notice requirement, the 60-day SEP is either before OR AFTER the triggering event.

D. For employees newly hired by employers established less than 120 days prior to the beginning of the first plan year of the HRA, the notice may be provided no later than the date on which the HRA may first take effect for the individual for that first plan year of the HRA.

XIV. ERISA APPLICATION

An ICHRA is a group health plan subject to ERISA. Plan document, summary plan description and Form 5500 requirements apply. The underlying insurance coverage is not an ERISA group health plan if five requirements are met:

A. The purchase of the underlying insurance is voluntary.

B. The employer only provides general information on choosing health insurance.

C. Reimbursement is limited solely to individual health insurance.

D. The employer receives not direct or indirect consideration for the selection or renewal of individual health insurance.

E. The employer provides the notice annually that the individual health insurance coverage is not subject to ERISA.

XV. PAY OR PLAY MANDATE AND ICHRAs

A. The pay or play penalties under IRC 4980H are still around.

B. The ‘A’ Penalty 2020: If the employer does not offer coverage to 95% of its full-time employees and one employee receives a subsidy to purchase insurance on the Health Exchange, the Employer is subject to a penalty equal to $2,570 x every full-time employee (minus 30).

C. The ‘B’ Penalty 2020: If the employer offers coverage that is unaffordable (exceeds 9.78% in 2020 of income using a safe harbor method) or does not offer minimum value and any employees qualify for a subsidy to purchase insurance on the Health Exchange, the Employer is subject to a penalty equal to $3,860 x the number of full-time employees that receive a subsidy to purchase insurance on the Health Exchange.

XVI. PAY OR PLAY, ICHRAs AND IRS NOTICE 2018-88

Notice 2018-88 confirmed that an individual coverage HRA is an eligible employer-sponsored plan and, therefore, an offer of an individual coverage HRA constitutes an offer of an eligible employer-sponsored plan for purposes of Code Section 4980H(a). The notice also explained how Section 4980H(b) (including the HHI safe harbors) would apply to an ALE that offers an individual coverage HRA, described potential additional affordability safe harbors related to offers of individual coverage HRAs, requested comments and provided examples.

XVII. IRS PROPOSED REGULATIONS 54.4980H-5 – ISSUED SEPTEMBER 30, 2019

The regulations and IRS guidance address the expected application to ICHRAs of certain employer shared responsibility rules and describe several potential affordability safe harbors specific to ICHRAs. The preamble also indicates that additional regulations will be proposed on this subject. In the interim, the following guidance has been provided:

A. Code Section 4980H(a). ICHRAs are considered eligible employer-sponsored plans so an applicable large employer ("ALE") can count ICHRA offers toward the 95% threshold for avoiding penalties under Code Section 4980H(a).

B. Affordability Under Code Section 4980H(b). The regulations treat an employee's required contribution for individual coverage as the excess of the monthly self-only premium for the lowest-cost silver plan offered by the Exchange where the employee resides over the self-only amount made available to the emplo9yee under the ICHRA for the month.

C. To reduce the administrative burden of making that calculation, anticipated guidance would allow ALEs to determine the silver plan premium based on each employee's worksite (rather than the employee's residence).

D. ALEs with calendar year ICHRAs would be able to use the silver plan premium for the prior calendar year to calculate affordability, allowing ICHRA contributions to be determined before premiums are announced for the Exchanges' November 1st Open Enrollment. To address potential premium changes where an ICHRA plan year spans two calendar years, ALEs would be permitted to assume that the relevant silver plan's premium for the first month of the play year will be the same for all months in the plan year.

Additional guidance is expected to explain how the three affordability safe harbors (Form W-2, rate of pay and federal poverty line) apply to ICHRA offers.

E. Minimum value under Code Section 4980H(b). ICHRA coverage that is affordable, considering the affordability safe harbors and the special rules for ICHRAs, would be treated as providing minimum value for Code Section 4980H(b) purposes.

F. IRS guidance indicates that employers would be considered to make an offer for purposes of the Code Section 4980H rules with respect to any employee in a designated class to whom the ICHRA is offered, even if the employee (or a dependent child) does not have individual market coverage.

XVIII. PROPOSED AFFORDABILITY SAFE HARBORS

A. Worksite location safe harbor.

B. Calendar plan year safe harbor.

C. Non-calendar plan year safe harbor.

XIX. ESTIMATED IMPACT OF ICHRAs

The government estimates 800,000 employers will offer ICHRAs. By 2024, the government estimates almost 11 million people will be covered by ICHRA.

XX. EXCEPTED BENEFIT HRAs

A. Under the ACA, HRAs have been required to integrate with a group health plan, unless they fit the narrow criteria to be considered a stand-alone HRA (like a QSEHRA). However, government regulators have recognized that some employers may wish to offer tax-free reimbursement without regard to whether or not employees have qualified insurance coverage. The Excepted Benefit HRA offers reimbursement options to employees that do not participate in the group health plan.

B. There are four requirements for an HRA to qualify as an Excepted Benefit HRA:

1. The HRA must not be an integral part of the plan.

2. The HRA must provide benefits that are limited in amount ($1,800 max for 2020).

3. The HRA cannot provide reimbursement for premiums for certain health insurance coverage.

4. The HRA must be made available under the same terms to all similarly situated individuals.

UNEMPLOYMENT INSURANCE TAX STRATEGIES AND FORMS

By: Kaitlin A. Brown, Esq.

I. FACTORS THAT INFLUENCE UNEMPLOYMENT INSURANCE TAX RATES

A. Registration for Michigan Taxes (Form 518): Complete this form if you are starting a new business, reinstating an old business, purchasing/acquiring an existing business, or changing the type of ownership of your business. It is also required if you need to register for any Michigan taxes identified on the form.

1. Corporations, LLCs, and LLPs must enclose a copy of the Articles of Incorporation or Organization.[1]

2. You must register for state unemployment tax if you "[h]ave employees performing services in Michigan, [p]lan to have employees working or performing services in Michigan; or [h]ave acquired all/part of the payroll, accounts, services or assets of a business having employees in Michigan."[2]

3. Deadline: Mail your Form 518, with Schedules A and B, "at least six weeks, but not more than three months, before you intend to start your business to allow you registration to be processed. Treasury will forward you application to UIA."[3]

4. The UIA issues your unemployment account number.

B. Taxable Wage Base:

1. Taxable wage bases are to be unchanged for 2019, the state Department of Talent and Economic Development. Effective

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[1] Michigan Department of Treasury, Form 518, p. 1.

[2] State of Michigan, Michigan Business Taxes Registration Booklet, at p. 3 (https://www.michigan.gov/documents/taxes/518_10-17_605471_7.pdf) ("Registration Booklet").

[3] Form 518 Instructions at p. 3.

January 1, 2019, the standard unemployment-taxable wage base is to be $9,000 and the modified taxable wage base for delinquent employers is to be $9,500.

C. Unemployment tax rate: Unemployment tax rates for experienced employers range from .06% to 10.3% in 2019. Rates of the bond-obligation assessment paid by experienced employers range from .72% to 2.42%.

D. Factors considered in establishing unemployment tax rate:

1. Prior Actual Reserve

2. Benefits Charged

   a. Try to keep low by utilizing strategies listed below.

3. Contributions Paid

   a. Make payments timely.

4. New Actual Reserve

   a. If you make voluntary contribution, such that the prior actual reserve plus contributions paid, plus voluntary payment (collectively, actual reserve) is be more than the required reserve, then your ABC calculation should be 0%.

   b. Voluntary Payment: “Because of the rounding of the Account Building Component (ABC), an irrevocable voluntary payment, as provided under Section 19(d), may reduce a rate by 0.1% or more, thereby saving the employer some unemployment taxes. Voluntary payments must be received by UI within 30 days of the mailing of this notice but no later than the 120th day of the year to be included in the current tax rate calculation.

Voluntary payments can be submitted through your MiWAM account. Checks or money orders MUST be mailed separately…"[4]

5. Experience Rating

   a. Chargeable Benefits Component: 36 months of benefit charges divided by 36 months of taxable payroll, rounded to next higher 0.1%, up to a maximum of 6.3%.[5]

   b. Account Building Component: (required reserve less actual reserve) x ABC multiplier, all divided by last 12 months of total payroll, rounded to the next higher 0.1%, up to a maximum of 3%.[6]

   c. Nonchargeable Benefits Component: As of 2018, "This component does not reflect the experience of the business, but is assigned to recover costs, which are pooled among all employers. Most employers pay a uniform rate of 1%. However, if there are no benefit charges for the last nine years, ending last June 30th, the rate could be as low as 0.06%. This component is applied to the accounts of all contributing employers. Amounts paid based on this component will not appear in the "taxes credited to experience rating account" portion of the rate calculation."[7]

6. Payroll Tax Base

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[4] 2018 Tax Rate Notice, Michigan Unemployment Insurance Agency.
[5] *Id.*
[6] *Id*.
[7] *Id*.

E. Recommended practices to limit increases in your unemployment tax rate:

1. Accurately and timely document reason for and circumstances surrounding separation, particularly if one of the reasons includes:

   a. Three (3) consecutive days of no-call, no-show: This is considered voluntary resignation (*not termination*) of employment, making an employee disqualified from receiving unemployment benefits under MCL 421.29(a).

   b. Voluntary Resignation: Confirm acceptance of voluntary resignation initiated by employee, without good cause attributable to employer, which is another reason why an employee would be disqualified from receiving unemployment benefits under MCL 421.29(a). Include reason cited by employee for decision to resign, so long as not attributable to the company (*e.g.*, received offer of alternate employment, to relocate, etc.). Ask employee to sign acknowledgement, if possible.

   c. Negligently losing a requirement of the job of which he or she was informed at the time of hire: This renders the employee disqualified from benefits under MCL 421.29(a).

   d. If an individual fails to secure a statement from a medical professional that continuing in the individual's current job would be harmful to the individual's physical or mental health, has not successfully secured alternative work with the employer, and has not successfully attempted to be placed on a leave of absence to last until the individual's mental or physical health would no longer be harmed by the current job: This constitutes disqualification under MCL 421.29(a).

e. Document misconduct as being connected to work (including history of misconduct leading to termination) and not related to performance: This will result in disqualification under MCL 421.29(a). Under the UIA, misconduct includes actions amounting to "willful or wanton disregard of an employer's interests as is found in deliberate violations or disregard of standards of behavior which the employer has the right to expect of his employee, or in carelessness or negligence of such degree or recurrence as to manifest equal culpability, wrongful intent or evil design, or to show an intentional and substantial disregard of the employer's interests or the employee's duties and obligations to his employer." *Carter v. Michigan Employment Security Comm*, 364 Mich 538, 541 (1961). Ask employee to sign acknowledgement, if possible. Keep in mind that "mere inefficiency, unsatisfactory conduct, failure in good performance as the result of inability or incapacity, inadvertencies or ordinary negligence in isolated instances, or good-faith errors in judgment or discretion" are not to be deemed "misconduct" within the meaning of the unemployment compensation statute. *Id.*[8]

2. Retain employees, with low turnover rate.

3. Provide employees with a legally compliant handbook, and have employee sign an acknowledgement of receipt. This will assist

[8] See other disqualifying bases in Employer's Guide to UIA Tax Filings & Responding to Claims (2017 Outline from Tax Symposium for Maddin Hauser).

in establishing misconduct any hearing contesting eligibility, by evidencing that employee was aware of workplace conduct rule/standard of behavior.

4. Coach out: Employees who know they are not meeting expectations (and may suffer adverse consequences such as termination as a result) are more likely to seek alternate employment and voluntarily resign. Have employees sign acknowledgement of receipt of any written warning or summary of coaching conversation.

5. Coach up: Keep employees engaged by showing them your commitment to their advancement within the organization.

6. Do not delay a termination decision, if you know separation is inevitable and absent compelling reasons to delay. The company's portion of unemployment benefits owed, if any, only increases with time. In addition, the likelihood of exposure to other employment related claims increases with such delay.

7. If temporary reduction in force not exceeding 45 calendar days, document accordingly and notify the unemployment agency of the circumstances.

8. Consider allocating payments in excess of amounts otherwise owed (*e.g.*, severance, vacation, PTO) to a specific number of weeks. Benefits owed may be reduced as a result.

II. AVOIDING SUTA DUMPING PENALTIES UPON A TRANSFER OR SALE OF BUSINESS

A. In addition to the Form 518, all employers must also complete a *Liability Questionnaire* (UIA Schedule A) and a *Successorship Questionnaire* (UIA Schedule B).[9]

1. *Liability Questionnaire* (UIA Schedule A): This form requires the employer to identify the UIA account number (if already assigned), Federal Employer Identification Number, identify the date on which employees will first be employed in Michigan, and identification of the employer status as agricultural, domestic/household, nonprofit, governmental agency, Indian tribe and tribal units, Federal Unemployment Tax Act Subjectivity (if subject to FUTA in another state, other than Michigan, then also required to file and pay in Michigan), and elective coverage (*e.g.*, churches which would not otherwise be liable for unemployment taxes).

2. *Successorship Questionnaire* (UIA Schedule B): Not only are all employers required to complete this form (even if the company made no acquisitions), but employers are also required to file an additional Schedule B if, subsequent o completing the initial registration form, the employer transfers "assets (by sale or transfer), organization (payroll/employees), trade (customers/-accounts), or business (products/services), in whole or in part, to a new or previously existing business in Michigan.[10]

B. Successor/Purchaser/Merger: If your business succeeds or replaces an existing business or businesses because of incorporation, purchase or

[9] UIA Schedule A – Liability Questionnaire.
[10] UIA Schedule B – Successorship Questionnaire.

merger, you must provide the names and account numbers of those previous business(es) by completing and submitting the necessary forms. This allows the State of Michigan to determine whether the transfer of accounts has been completed properly, or if the transfer has resulted in unlawful SUTA Dumping.

C. Successor Liability: “If you buy or acquire either an existing or discontinued business or its stock of goods, you can be held liable for tax debts incurred by the previous owner. You must withhold sufficient purchase money to cover these tax debts until the previous owner produces a receipt showing the taxes have been paid or a certificate stating that no taxes are due. This certificate may be obtained through the Department of Treasury, Tax Clearance Section. Upon the owner's written waiver of confidentiality; under the Authorization for Disclosure section, at the bottom of page 2 of the *Request for Tax Clearance Application* (Form 5156), Treasury will release a business's know tax liability for purposes of establishing an escrow account to a third party. The Tax Clearance Section can be reached at 517-636-5260.”[11]

   1. When two or more businesses are merged, it is really the unemployment “experience” that is merged, and then a new rate is calculated, based on the combined payment and charge histories of the involved companies. That is not the same thing as calculating the "average rate."

D. SUTA Dumping: “A person shall not do either of the following: (a)Transfer the person's trade or business or a portion of the trade or business to another employer for the sole or primary purpose of reducing the contribution rate or reimbursement payments in lieu of contributions required under this act. (b) Acquire a trade or business or

[11] Registration Booklet at 1.

a part of a trade or business for the sole or primary purpose of obtaining a lower contribution rate than would otherwise apply under this act."[12]

1. "Trade or business" includes the employer's employees, but the transfer of some or all of an employer's employees to another employer shall be considered a transfer of trade or business for purposes of this section if, as a result of the transfer, the transferring employer no longer performs trade or business with respect to the transferred employees and that trade or business is performed by the transferee employer.

2. Vertical Method: Create a "new" employer who is assigned a "new" employer tax rate of 2.7%, and then transfer to the new employer.

3. Horizontal Method: Transfer employees to a subsidiary with a lower UI tax rate.

4. Acquire Rate Method: Find another employer that has a low UIA tax rate to transfer employees to that employer.[13]

E. Penalty:

1. "In addition to any sanction available under section 54(b) or 54b, if a person knowingly violates or attempts to violate subsection (1), or if a person knowingly advises another person so as to cause a violation of subsection (1), the person is subject to the following:

    a. If the person is a transferring or acquiring employer, the employer shall be assigned the higher of the following

[12] MCL 421.22b – Michigan Employment Security Act – Transferring trade or business with intent to reduce contribution rate or reimburse payments.

[13] Michigan Unemployment Insurance Agency – Fact Sheet #114 – (SUTA Dumping) https://www.michigan.gov/documents/uia_FS114-SUTAdumping_103447_7.pdf

contribution rates: (A) The highest contribution rate assignable under this act for the rate year during which the violation or attempted violation occurs and for the 3 rate years immediately following that rate year. (B) If the employer's business is already at the highest rate assignable for a year in which the violation occurs or if the highest rate assignable would result in an increase of less than 2% of taxable wages, an additional penalty rate of 2% of taxable wages for that year.

b. If the person is not an employer, the person is subject to a civil fine of not more than $5,000.00."

c. "Knowingly" means having actual knowledge of, or acting with deliberate ignorance or reckless disregard for, the prohibition involved.

2. An employing entity or an owner, director, or officer, who willfully violates or intentionally fails to comply is subject to the following sanctions:

a. If the unemployment agency determines that an amount has been obtained or withheld as a result of the intentional failure to comply with this act, the unemployment agency may recover the amount obtained as a result of the intentional failure to comply plus damages equal to 3 times that amount.

b. The unemployment agency may refer the matter to the prosecuting attorney of the county in which the alleged violation occurred for prosecution. If the unemployment agency has not made its own determination under subdivision (i), the recovery sought by the prosecutor must include the amount described in subdivision (i) and additional penalties based on the amount at issue.[14]

3. An employing unit or an owner, director, officer, or agent of an employing unit, who makes a false statement or representation knowing it to be false, or knowingly and willfully with intent to defraud fails to disclose a material fact, to obtain or increase a benefit or other payment under this act or under the unemployment compensation law of any state to prevent or reduce the payment of benefits to an individual entitled thereto or to avoid becoming or remaining a subject employer, or to avoid or reduce a contribution or other payment required from an employing unit is subject to administrative fines and is punishable as follows:

    a. Subject to subdivisions (ii) and (iii), the unemployment agency may recover the amount obtained as a result of the knowing false statement or representation or the knowing and willful failure to disclose a material fact and may also recover damages equal to that amount. For a second or subsequent violation described in this subdivision that occurs after the unemployment agency has sent proper notice of the original violation to the interested parties, the unemployment agency may recover damages equal to 1.5 times the amount obtained.

    b. Subject to subdivision (iii), if the unemployment agency determines or redetermines or an administrative law judge, the Michigan compensation appellate commission,

[14] MCL 421.54 – Michigan Employment Security Act – Sanctions; penalties http://www.legislature.mi.gov/(S(ft2c0n3lehtedfktana4ukv3))/mileg.aspx?page=GetObject&objectname=mcl-421-54

or a court orders that an impostor committed identity theft, the unemployment agency shall attempt to recover from the impostor the amount obtained as a result of the knowing false statement or representation or the knowing and willful failure to disclose a material fact and may also recover damages equal to 4 times that amount.

c. It may also refer a matter to the prosecuting attorney who may impose penalties depending on the amount at issue.

d. If the employer failed to disclose to the UIA information connecting the transfer of employees to that employer, the penalties are up to 4 times the amount of unemployment taxes saved as a result of the SUTA Dumping, plus interest on the unpaid taxes and interest on the penalties.

e. If my business advisor knowingly advises me to engage in SUTA Dumping, that person could face a civil fine of up to $5,000, or conspired with me to give false information or incomplete information to reduce my tax rate, could face a penalty of up to 3 times the amount of the underpaid taxes, plus interest on the penalty.[15]

F. Forms to Consider Filing Upon Succession/Purchase/Merger:

1. Business Transferor's Notice to Transferee of Unemployment Tax Liability and Rate (Form UIA 1027): Whenever you sell or transfer any part of the payroll, accounts, services or assets of a business. When a business is sold (or otherwise transferred), the buyer (or other transferee) of the business may be liable to

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[15] *Id.*

pay the unpaid unemployment taxes and interest, and may receive the unemployment tax rate, penalty, and the benefit charges of the seller.

a. Deadline: The seller, seller's real estate broker or other agent or attorney must deliver the completed Form UIA 1027 to the purchaser of the business at least two business days before the transfer of the business (not including Saturday, Sunday, or legal holiday) before the transferor's acceptance of the transferee's offer to acquire the business to disclose the transferee's outstanding unemployment tax liability

b. Penalty: Failure of the business transferor or transferor's agent to provide correct information is a misdemeanor, punishable by up to 90 days imprisonment and/or fine of up $2,500.00. Civil liability for consecutive damages may also apply, as well as other remedies provided by law.

2. Disclosure of Transferor Account (Form UIA 1346)

3. Discontinuance or Transfer of Payroll or Assets in Whole or Part (Form UIA 1772): Required if the sale to the purchaser results in the total transfer of the seller's business.

4. Employer's Report on Partial Transfer of Business (UIA Form 1184)

5. Report and Agreement on Partial Transfer of Business Certification (UIA Form 1184-1)

6. Request for Tax Clearance Application (Form 5156)

III. STRATEGIES FOR COMPLIANCE: DISTINCTIONS BETWEEN EMPLOYEE LEASING COMPANIES

A. Status Questionnaire for Employee Leasing Companies (UIA Form 1045)

B. Distinctions between employee leasing companies (ELCs), According to Administration Rule 421.190:[16]

1. “Captive provider” means “an employee leasing company which limits itself to providing services and employees to only 1 client entity and the entity’s subsidiaries and affiliates and which does not hold itself out as available to provide leasing services to other client entities that do not share an ownership relationship with the employee leasing company.” R. 421.190(a).

    a. “Client entity” (aka “work-site employer”) means “the business entity that contracts with an employee leasing company for the purpose of providing employees and related services to the client entity.” R. 421.190(b).

2. “Common paymaster” is found when “different services performed by 1 individual are divided among 2 or more employers that are related through commonality of ownership, and the individual is compensated by 1 of those employers that acts as the common paymaster. … different employers benefit from the services of the same individual, but these services are reflected in the experience rating of, and the payment of employment taxes by, only 1 of the employers.” R. 421.190(c).

[16] Michigan Unemployment Insurance Agency Administrative Rules (https://www.michigan.gov/documents/uia/Administrative_Rules_505959_7.pdf)

a. Even though 2 or more related corporations concurrently employ the individual, they are treated as a single employing unit. The common paymaster “shall be the corporation that has the highest Michigan unemployment tax rate. *Id.*

b. Corporations are related if any one of the following apply at any time during the calendar quarter:

   i. Corporations are members of a controlled group, as defined in 26 U.S.C. §1563 or would be members if certain stock ownership percentage requirements between corporations were relaxed and certain exclusions made inapplicable.

   ii. If the corporation does not issue stock either 50% or more of the members of 1 corporation's board of directors or other governing body are members of the other corporation's board of directors or other governing body, or the holders of 50% or more of the voting power to select such members are concurrently the holders of 50% or more of that power with respect to the other corporation.

   iii. Fifty percent or more of 1 corporation's officers are concurrently officers of the other corporation.

   iv. Thirty percent or more of 1 corporation's employees are concurrently employees of the other corporation. Corporations are considered related for an entire calendar quarter if 1 of the requirements listed in paragraphs (i) to (iv) of this subdivision is satisfied. Concurrent employment means the contemporaneous existence of an employment relationship between an individual and 2 or more corporations. R. 421.190(c)

3. An Employee leasing company (ELC) (aka a Professional Employer Organization (PEO) means, “an independently established business entity that does all of the following: (i) provides employees to a client entity. (ii) Pays the wages of employees. (iii) Reports and withholds applicable taxes from the wages of the employees. (iv) Administers the benefits for the employees. (v) Provides other payroll, human resources, and other management assistance services that are agreed upon with its client entity. The employees provided to the client entity may have previously been employed directly by the client entity. The relationship between the client entity and ELC is intended to be long-term or continuing, rather than temporary or intermittent, and the employees are, generally, not subject to reassignment. The majority of the workers at a client entity's worksite, or a majority of workers in a specialized group within that workforce, consists of employees assigned by the leasing company. R. 421.190(d)

   a. An ELC that meets all of the above requirements will be considered the employer of the leased employees if: an ELC that meets the requirements of section 41 of the act is a liable employer and responsible to pay unemployment taxes on the employees leased to the client entity. For unemployment tax purposes in Michigan, he ELC, and the client entity, is the employer of the leased employees if all of the following conditions are met:

      i. An employing entity representing itself to be an ELC shall comply with the requirements of this rule to be considered by the agency to be an ELC for purposes of the act and this rule. If the agency determines the entity is not an ELC within the meaning of this rule, then the payroll of workers at the client entity will be assigned or reassigned to the client entity and the client entity's prior experience rating will be reinstated.

ii. The ELC shall administer all payroll and all benefit services for the client entity, pay the wages of the workers, and have the right, both in contract and in fact, to hire, promote, reassign, discipline, and terminate the leased workers. The ELC cannot delegate the rights to the client entity. The client entity's officers may be considered employees of the leasing company when they are acting as operational managers, or performing services, for the client entity.

iii. The ELC retains the right to exercise direction and control over the daily activities of the workers or can delegate the right to the client entity.

iv. Neither the ELC nor any individual owner of the ELC, nor owners of the ELC in the aggregate, has an ownership interest of more than 20% in the client entity, including the client entity's subsidiaries and affiliates, and the client entity does not have more than 20% ownership interest in the ELC.

v. Neither the ELC nor any individual owner or other employee of the ELC has direct or indirect control over the client entity.

vi. The ELC does not limit itself to providing services and employees to any 1 client entity, including that entity's subsidiaries and affiliates, but holds itself out to the public in general as available to provide leasing services. The ELC shall not be a captive provider of employee services. R. 421.190(2)(a - f)

b. An ELC that does not meet the definition should report any workers it is leasing back to the client company under the UIA account number of the client company, rather than under the ELC account number.

4. “Payrolling is the practice of establishing a related or associated company for the purposes of reassigning the employee payroll functions from 1 business entity to the related business entity, usually to take advantage of the lower unemployment tax rate of the related business entity. Direction and control of the involved employees are not transferred along with the payroll to the related business entity, and the related entity is not an employee leasing company. The related business entity to which the payroll is assigned is not the employer for unemployment insurance tax purposes. The entity for which services are performed and which exercises direction and control over the employee is the employer.” R. 421.190(1)(e)

5. “Temporary help firm” means “an employer whose primary business is to provide a client entity with the temporary services of 1 or more individuals under contract with the employer. Employment with a temporary help firm is characterized by a

series of limited-term assignments of an individual to a client entity based on a written or oral contract between the temporary help firm and the client entity. The assignment is usually for a specified period. A separate written or oral employment contract exists between the temporary help firm and each individual it hires as an employee. The employee of the temporary help firm is subject to reassignment by the temporary help firm. Completion of an assignment for the client entity by an employee employed by the temporary help firm does not, in itself, terminate the employment contract between the temporary help firm and the individual. A temporary help firm that meets the requirements of section 41 of the act is a liable employer and shall pay unemployment taxes on its employees." R. 421.190(1)(f)

C. Depending on which category best describes the relationship, create a Management/Service Agreement to confirm the respective roles and responsibilities.

HELP! – MY CLIENT HAS CRYPTOMANIA!

By: Robert D. Kaplow, Esq.

I. WHAT IS CRYPTOCURRENCY

A. Block chain technology is the underlying technology of cryptocurrencies

B. Bitcoin, Ethereum and Litecoin

C. Blockchain technology is the use of a highly encrypted, fixed or immutable distributed ledger which is authenticated by a peer-to-peer network

D. Created in 2008

E. Allows online payment to be sent from one party to another without going through a financial institution

F. Creates a network of time stamped transactions that cannot be changed

G. Cryptocurrency is mined by a powerful computer program

II. TERMINOLOGY (FROM IRS DEFINITIONS)

A. Bitcoin – a form of cryptocurrency. For purposes of this outline, bitcoin is used generically to represent all forms of cryptocurrency

B. Blockchain – the technology underlying cryptocurrencies

C. Distributed ledger technology - uses independent digital systems to record transactions, the details of which are recorded in multiple places at the same time with no central data storage locator

D. Hard fork – occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or the existing distributed ledger

1. may result in creation of new cryptocurrency on a new ledger in addition to the legacy cryptocurrency

2. transactions involving the new cryptocurrency are recorded on a new ledger

E. Air drop – a means of distributing units of cryptocurrency to the ledger addresses of multiple parties

F. Key – the means to access the cryptocurrency

G. Wallet – storage of the cryptocurrency

III. <u>WHY DO I CARE ABOUT CRYPTOCURRENCY?</u>

A. Because clients are using them for business and personal transactions.

B. Because clients are buying cryptocurrencies as an investment

IV. <u>CURRENCY OR PROPERTY</u>

A. Arguments for Currency

1. Circulates

2. Accepted as payment for goods

3. Used and accepted as a medium of exchange

4. IRS definition of virtual currency – functions like government issued legal tender

B. Effects of Treating Cryptocurrency as Property

1. Gain or loss on use – capital or ordinary

2. No like kind exchanges

3. Miner of bitcoins - income

4. Investor versus trader

C. SEC – Security

D. Commodity

V. <u>IRS POSITION</u>

A. IRS Notice 2014 – 21, 2014-16 IRB 938

1. Ruling issued in March 2014

2. Applies general tax principles to cryptocurrency

3. IRS ruled that cryptocurrency is treated as property for tax purposes and not as currency.

4. Receipt of bitcoins for services rendered is ordinary income based on the fair market value of the bitcoins

5. Payment for goods and services – if using bitcoins, will have gain or loss based on value of bitcoins transferred in excess of the basis of the bitcoins

6. Basis of the cryptocurrency is the amount paid for the bitcoins, or the fair market value of bitcoins received for goods or services as of the date of receipt

7. Basis – cryptocurrency exchanges can be used to determine fair market value

8. Example –

   Taxpayer delivers $10,000 worth of bitcoin to purchase a painting. If the taxpayer's basis in the bitcoins was $2,000, the taxpayer has a taxable gain of $8,000 in connection with this transaction

9. Payment of wages by payment by bitcoin is subject to normal employment tax rules – i.e., withholding, FICA, FUTA, etc.

B. Recent Pronouncement

1. Commentators have been waiting for further guidance from IRS regarding the use of cryptocurrency

2. IRS Notice 2018-71, March 23, 2018. IRS reminded taxpayers that income from virtual currency transactions is reportable on income tax returns.

3. Failure to properly account for cryptocurrency transactions can subject the taxpayer to civil or criminal penalties

4. IRS issued Revenue Ruling 2019-24 and Frequently Asked Questions (FAQ) on October 9, 2019

C. Revenue Ruling 2019-24, 2019-44 IRB 1

1. Not as broad as many people hoped

2. Clarified the rules for tax treatment of hard forks and air drops

3. IRS ruled that a hard fork will not create taxable income if the taxpayer does not receive new units of cryptocurrency

4. An air drop following a hard fork will generate taxable income to the taxpayer

5. Example –

Situation 1 – Brian holds 50 units of Crypto M, a currency, on October 1, 2019. Crypto M experiences a hard fork creating Crypto N. Brian does not receive any units of Crypto N and his ownership of crypto M is not changed. No tax consequences to Brian as a result of the hard fork.

Situation 2 – Jeff owns 50 units of Crypto R. On June 1, 2020, Crypto R experiences a hard fork and creates Crypto S. Jeff receives 25 units of Crypto S. Jeff has ordinary income for the value of Crypto S received.

D. FAQ's (43 questions and answers)

1. Expand on the information provided in Notice 2014-21, and apply the same tax principles

2. Basically, a taxpayer will have gain or loss using bitcoins to pay for property, and will have income upon the receipt of bitcoins

3. Based on fair market value of the bitcoins when transferred or received

4. Gain or loss is based on the difference between the fair market value of the bitcoins transferred and the basis of the bitcoins

5. Taxpayers can identify specific units of bitcoin and substantiate the basis in those units

6. If not specifically tracked, taxpayers are deemed to have sold the units on a first in – first out (FIFO) basis

7. Capital gains and losses from virtual currency transactions are reported on Form 1040, Schedule D and Form 8949, Sales and Other Dispositions of Capital Assets

E. IRS Investigation

1. IRS is aware that some taxpayers may have failed to report income and pay the resulting tax or did not report their transactions properly

2. IRS actively addressing potential non-compliance

3. IRS mailed out 10,000 letters in July to taxpayers who may have reported transactions involving cryptocurrency incorrectly or not at all

4. IRS also issued subpoenas to Coinbase for information regarding transactions by their customers

5. IRS Large Business and International Division has issued notices that they will be reviewing for virtual currency transactions in connection with their audits

6. IRS is also stepping up training of revenue agents and revenue officers regarding cryptocurrencies

7. New question being added to Form 1040, Schedule 1

> At any time during 2019, did you receive, sell send, exchange or otherwise acquire any financial interest in any virtual currency?

8. Congressional Regulation –

Bills pending to regulate virtual currencies on these topics:

a. Crime Prevention & Detection

b. National Security & Terrorism

c. Regulatory Certainty

d. Consumer Protection

e. U.S. Competitiveness & Economic Prosperity

f. Taxation

VI. <u>ESTATE PLANNING ISSUES – CRYPTOCURRENCY</u>

A. Need disclosure to CPA and estate planning attorney

- Cannot protect it if don't know about it

B. Who owns it – title in Trust?

C. How do we get access?

1. Anonymous

2. Private key –

- access to password

-copy of password to someone

3. Quadriga case

D. Ownership by Fiduciary of Estate – prudent investor rule

VII. <u>ESTATE PLANNING ISSUES – DIGITAL ASSETS</u>

A. Types of digital assets

1. Website

2. Domain name

3. Social media – Gmail, Facebook, Linked In, etc.

4. Facebook or You Tube Channel

5. Bank and other financial records

B. Disclosure of contents of digital account

C. Access to passwords

D. Fiduciary Access to Digital Assets Act (FADAA) – Michigan statute

1. Procedures to allow access to digital assets

2. Can name a "Digital Executor" – in estate plan documents, or in separate writing

E. Online Option Tools –

- Google
- Facebook

F. Third party service providers for digital asset directives management

G. Have digital assets owned by an LLC if business related

VIII. CRYPTOCURRENCY AS A RETIREMENT PLAN INVESTMENT

A. Allowable as an investment

B. Many risks

- Volatility
- Valuation issues

- Prudent investment
- Security risk – hackers
- Record keeping
- Future government regulation

<u>MISSING PLAN PARTICIPANTS: WHAT'S THE PROBLEM?</u>

By: Charles M. Lax, Esq.

I. <u>WHO ARE MISSING PLAN PARTICIPANTS</u>?

A. Generally, a missing plan participant is a former employee who has a right to retirement benefits, but has failed to keep their contact information current.

B. How do you know if a plan participant is missing?

1. Returned mail

2. Returned emails

3. Uncashed distribution checks

4. For directed investment account plans, no web activity

C. Deceased plan participants with no beneficiary designation forms on file are a special category of a missing plan participant.

D. Another type of plan participant which is often associated with missing plan participants is one for whom the plan may have good contact information, yet are simply unresponsive (such as failing to cash distribution checks).

II. <u>WHAT IS THE MAGNITUDE OF THE MISSING PLAN PARTICIPANT PROBLEM</u>?

A. A March 2018 survey by Boston Research Technologies estimated that 11% of separated plan participants have stale addresses on file with the plan.

B. One out of every 5 relocations results in a missing plan participant.

C. A recent study by the Employee Benefit Research Institute estimates that defined contribution plan participants will hold an average of 9.9 jobs over a 45 year career.

D. There are more than 3 million missing plan participants.

E. The number of missing plan participants will continue to grow.

III. WHAT PROBLEMS CAN BE CREATED BY MISSING OR UNRESPONSIVE PLAN PARTICIPANTS?

A. Increased plan costs for unnecessarily maintaining the plan participants' accounts.

B. Possible plan qualification issues due to the failure to follow plan provisions.

1. IRC §401(a)(9) mandates required minimum distributions ("RMDs") at certain ages or circumstances.

2. IRS §401(a)(14) mandates that the distribution of benefits must begin no later than 60 days following the close of the latest plan year in which the plan participant:

a. Turns age 65 (or the plan's normal retirement age, if earlier)

b. Completes 10 years of plan participation

c. Terminates service with the employer

C. The Department of Labor's ("DOL") fiduciary obligations extend to the requirement that plan fiduciaries make reasonable efforts to locate missing plan participants or beneficiaries.

1. ERISA §404(a)(1)(A) provides that a fiduciary must act prudently and solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses in administering the plan.

2. ERISA §404(a)(1)(D) provides that fiduciaries are required to act in accordance with plan documents.

3. Fiduciary breaches can subject plan fiduciaries to the imposition of damages and penalties.

D. The IRS' plan correction programs (the Employee Plans Compliance Resolution System or "EPCRS") will often require complete correction of a plan failure which necessitates the location of missing plan participants.

E. Plan sponsors and practitioners have noticed inconsistent enforcement actions during audits because of the dearth of guidance by the different government agencies.

   1. The IRS and DOL appear to be taking different positions on the responsibility to make RMDs if the participant is missing.

   2. It appears that even within the DOL itself, different investigators are taking different positions on the plan's responsibilities and potential penalties being asserted against fiduciaries.

F. For plan participants not having a current address on file could mean a variety of things:

   1. Being unaware of investment changes

   2. Being unaware of changes in plan provisions

   3. Missed distributions

   4. Forgetting about their benefits altogether

IV. <u>GUIDANCE CONCERNING MISSING PLAN PARTICIPANTS</u>

A. DOL Field Assistance Bulletin No. 2014-01

   1. This guidance addressed the issue of how fiduciaries of terminated defined contribution plans call fulfill their obligations under ERISA to locate missing plan participants and properly distribute account balances.

   2. At a minimum these are required search steps:

      a. Use certified mail when attempting to locate the participant.

b. Check other plan and employer records that may have more up-to-date information.

c. Check with designated plan beneficiaries if they have current contact information.

d. Use Internet search tools that are available without cost.

e. If it is prudent and depending on the amount involved, commercial locator services, investigation databases, investigators, etc. may be appropriate.

3. If the participant still cannot be located what distribution options should be utilized?

   a. The DOL's preferred method is for the funds to be rolled into an IRA because this alternative is most likely to preserve the funds for retirement.

   b. A second option that should be utilized if the fiduciary is unable to locate an IRA provider to accept the funds, is to move them to a federally insured bank account in the participant's name. This will, however, subject the distribution to income tax and excise tax on a premature distribution.

   c. The third and least favored option is to transfer the funds to a state's unclaimed property fund.

   d. An unacceptable distribution option is using 100% income tax withholding for the funds. This will likely be deemed a breach of fiduciary duty by the DOL.

4. Unfortunately, the DOL has neither failed to provide guidance , nor has it extended this guidance to "active plans."

B. IRS Website

1. For many years the IRS maintained a program where they forwarded letters to help locate missing plan participants or beneficiaries.

2. In Rev. Proc. 2012-35, the IRS indicated that they would no longer process requests to locate missing plan participants or beneficiaries.

3. Plan sponsors and plan administrators are now directed to use:

   a. Commercial locator services

   b. Credit reporting agencies

   c. Internet search tools

4. Unfortunately, the IRS has failed to clarify if these are the only actions that must be taken.

C. Section 6.02(5)(d) of Rev. Proc. 2018-52

1. This Section of the Revenue Procedure describes the steps to be taken under the IRS' retirement plan correction program when current or former plan participants and beneficiaries have additional benefits but cannot be located.

2. It provides that if no response is generated by regular mail, then:

   a. Try certified mail.

   b. If that fails, use a commercial locator service, credit reporting agency or Internet search tool.

   c. Depending on the circumstances (probably based upon the amount of benefits) the use of more than one of the methods may be warranted.

3. A plan sponsor will not be considered to have failed to correct if reasonable actions were taken to locate the lost participant.

D. The PBGC's Missing Participant Program ("MPP")

1. MPP was expanded effective January 1, 2018 to cover terminating defined contribution plans and certain defined benefit plans not subject to PBGC jurisdiction.

2. The plan's coverage by the MPP now includes the following types of terminating plans:

   a. PBGC insured single employer plans

   b. Defined contribution plans

   c. Small professional service defined benefit plans

   d. PBGC insured multiemployer plans

3. The two ways to use the program are:

   a. Transfer to the PBGC funds sufficient to pay the missing participant's benefits when the participant is located in which case the PBGC will pay the benefits.

   b. Send the PBGC information about the missing participant and their benefits and the PBGC will share that information with the participant when found.

E. An October Memorandum 2017 from the IRS to its field agents addressed the failure to satisfy RMD requirements for missing plan participants.

1. It indicates that agents should not challenge a plan's qualification for the failure to make RMDs if certain steps are taken.

2. Generally, the steps are those contained in FAB 2014-01.

F. Revenue Ruling 2019-19 dealing with the failure to cash distribution checks.

1. Strangely, the IRS published this Revenue Ruling on a set of facts where the results are patently clear.

2. In this case, the plan made an RMD to a participant, withheld the appropriate amount of taxes as required by IRC § 3405(e)(1) and issued a 1099-R to the participants required by IRC § 6047(d). The net check was not cashed by the participant during the year in question.

3. The IRS' ruling held:

a. The failure to cash the check does not permit the participant to exclude the distribution from gross income.

b. The failure to cash the check does not alter the employer's obligation to issue a 1099-R.

c. The failure to cash the check does not alter the employer's obligation to withhold taxes under IRC § 3405.

V. <u>HOW DO PLAN "CASH OUT" RULES WORK</u>?

A. Qualified plans may establish rules allowing for the mandatory distribution of "small balances" to plan participants.

B. The threshold chosen by a plan can be as high as $5,000. Lower thresholds are permitted but are rarely selected.

C. Under the "cash out" rules, plan participants who fail to select an immediate distribution on a distributable event (i.e., termination of employment) will have their benefits rolled automatically into an IRA.

D. Plans are also permitted to provide that account balances of $1,000 or less can be cashed out by simply forwarding a check (net of withholding) to the participant.

E. Utilizing cash-out provisions are one of the most effective means of minimizing the missing participant problem.

VI. BEST PRACTICES FOR DEALING WITH MISSING PLAN PARTICIPANTS

A. First and foremost, a written policy should be adopted and followed.

B. Plan sponsors should be diligent in maintaining contact information for plan participants and their beneficiaries during their period of active participation.

C. At the time a participant terminates employment:

1. They should be reminded of their benefits.

2. They should be informed of when benefits are available and how to apply for them.

3. Update contact information for the participant and beneficiaries.

D. Contact information should be monitored on a regular basis.

1. Each year plan participants should receive benefit statements, summary annual reports and other notices.

2. If any of these items are returned, immediate efforts should be made to locate them.

E. If a required distributable event occurs under the plan and a participant cannot be located, or is unresponsive:

1. First, these steps should be taken:

a. Use certified mail.

b. Check other plan and employer records that may have up-to-date information.

c. Check with designated beneficiaries to determine if they have up-to-date information.

d. Use Internet search tools that are available without cost. The National Registry at www.unclaimedretirementbenefits.com is a source that is often utilized.

2. Next, the size/amount of the account/benefit may warrant additional costs of utilizing commercial locator services, credit reporting agencies, investigation data bases and private investigators. For example, Retirement Clearinghouse at www.rch1.com provides locator services in additional to other services relating to terminated plan participants.

3. Finally, if the participant still cannot be located, the following steps should be followed:

   a. Roll the account/benefit into an IRA.

   b. If an IRA is not available, the funds (net of taxes) should be moved to a federally insured bank account.

   c. If all else fails, the account/benefit should be paid to the state's unclaimed property fund.