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WINTER 2024 ROUNDUP OF RECENT TAX DEVELOPMENTS

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ROUNDUP OF RECENT TAX DEVELOPMENTS

- Individuals
- Business
- Inflation Reduction Act
- Corporate Transparency Act
- Retirement
- SECURE Act 2.0
- Estate Planning
- Michigan
- City of Detroit

INDIVIDUALS

IRS TO WIPE AWAY $1 BILLION IN PENALTIES

IRS announced December 19, 2023:

- $1 billion in automatic penalty relief to about 4.7 million taxpayers and businesses whose tax year 2020 and 2021 tax returns were affected by pandemic disruptions and notifications
- Although the IRS had paused much of its automated collection activity, failure-to-pay penalties continued to accrue over the past 22 months
- Taxpayers who already paid failure-to-pay penalties will automatically be given a refund or, if applicable, have that amount applied as a credit toward another existing tax liability

IRS TO WIPE AWAY $1 BILLION IN PENALTIES

IRS will be sending letters (LT38, *Reminder, Notice Resumption)* to affected taxpayers:

- Remind taxpayers of their outstanding tax liability
- Inform them of the penalty relief
- Present different options for paying tax liabilities

IRS TO WIPE AWAY $1 BILLION IN PENALTIES

Caveats:

- Failure-to-pay penalties for relevant taxpayers will resume on April 1, 2024
- The relief is also capped at taxpayers who were assessed less than $100,000 in tax

STUDENT LOAN REPAYMENT

CARES Act:

- Employers can contribute up to $5,250 per year toward student loan repayments
- Excluded from income / subject to payroll tax
- Requires written policy / compliance with Section 127 (qualified educational assistance programs)
- Sunsets December 31, 2025

STUDENT LOAN FORGIVENESS EXCLUSION

American Rescue Plan Act of 2021:

- Excludes from gross income
- Discharge of indebtedness income relating to student loan debt
  - Including private student loans
  - Unless student is required to provide services to the discharging lender
- Effective for 2021-2025

IRC § 108(f)(5)

COVID-19 EXPENSES AND PREVENTIVE CARE

- Generally, an HDHP is not permitted to provide benefits until the minimum deductible for the year is met
- Section 223(c)(2)(C) contains an exception for preventive care
- Notice 2020-15 created an exception for testing and treatment related to COVID-19
- The COVID-19 emergency ended on May 11, 2023
- Notice 2023-37 indicates that Notice 2020-15 will continue to apply only for plan years ending on or before December 31, 2024

MEDICAL EXPENSES

- **New FAQs added to irs.gov on March 17, 2023**
- **Background**:
  - Section 213 allows a deduction for medical expenses
  - Alternatively, may be paid or reimbursed from HSA, FSA, Archer MSA, or HRA
- **Medical Expenses**:
  - Costs of diagnosis, cure, mitigation, treatment or prevention of disease
  - Payment for medical services rendered by physicians, surgeons, dentists, and other medical practitioners
- **Includes**:
  - Costs of Equipment, supplies and diagnostic devices
  - Costs of medicines and drugs prescribed by a physician

MEDICAL EXPENSES

Examples of items added to FAQs that may be paid or reimbursed from an HSA, FSA, Archer MSA, or HRA:

- Dental, eye or physical exam
- Program to treat a drug-related substance use disorder
- Program to treat an alcohol use disorder
- Smoking cessation disorder
- Therapy if it's a treatment for a disease
- Nutritional counseling if it treats a specific disease diagnosed by a physician
- Weight-loss program if it treats a specific disease diagnosed by a physician

MEDICAL EXPENSES

- Gym membership if sole purpose is:
  - To affect a structure of the body (e.g., physical therapy); or
  - To treat a specific disease (e.g., obesity)
  - Note: cost of exercise to improve general health does not qualify
- Food or beverage if:
  - Not for normal nutritional needs;
  - Alleviates or treats a disease; and
  - Substantiated by a physician
- Nutritional supplements if recommended to treat a specific medical condition diagnosed by a physician

MEDICAL EXPENSES

- Nonprescription (over-the-counter) drugs & medications:
  - Except for insulin, not a deductible medical expense under Section 213
  - But, may be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA

NEW TIP REPORTING PROGRAM

- **Notice 2023-13**
  - Contains a proposed Revenue Procedure
  - Service Industry Tip Compliance Agreement ("SITCA") Program
- **Designed to take advantage of:**
  - Point-of-sale systems
  - Time and attendance systems
  - Electronic payment settlement methods

NEW TIP REPORTING PROGRAM

- **Features**:
  - Replaces current programs
  - Requires an annual report
  - Protects employers from liability under the rules defining tips as part of an employee's pay
- **Effective**:
  - Voluntary
  - Other programs would sunset at the end of the first full calendar year after the Revenue Procedure is published
  - Doesn't affect the Gaming Industry Tip Compliance ("GITCA") Program

DIRECT-FILE PROGRAM

IR-2023-192

- **IRS' direct-file pilot program for the 2024 filing season**:
  - Online, interview-based service giving taxpayers a free option to file their individual federal tax returns directly with the IRS
  - Does not include state tax returns
- **Limited by**:
  - State where the taxpayer resides
  - Small group of states with specified types of income, credits, and deductions

DIRECT-FILE PROGRAM

December 20, 2023, IRS Blog Post:

- Identity verification will be provided through ID.me
- Taxpayers who have previously been verified by ID.me can skip being verified again
- Taxpayers can opt to have their identity verified via a live chat at the outset of the ID verification process instead of submitting a selfie that matches a government-issued ID

DIRECT-FILE PROGRAM

- Alaska is no longer a participant due to the dividend paid to its citizens from the state's surplus oil and gas revenues
- That leaves 12 participating states:
  - 4 with state-level income taxes
  - 8 without
- Arizona, Massachusetts and New York will have their federal tax return data imported from the IRS's direct-file system into a state direct-file system
- California has a direct-file system, but currently can't integrate with the IRS
- "Several hundred thousand" taxpayers expected to try the new direct-file program

CASES

FBAR PENALTY

Bittner, U.S. Supreme Court, February 28, 2023

Background:

- A "Report of Foreign Bank and Financial Accounts" (FBAR) is required to be filed on or before June 30th of each year reporting foreign bank accounts held during the preceding calendar year
- Penalty for non-willful violations is $10,000
- Penalty for willful violations is greater of $100,000 or 50% of the account

FBAR PENALTY

Facts:

- Taxpayer was born in Romania, became a naturalize citizen, went back to Romania in 1990, and the returned to the U.S. in 2007
- Unaware of the FBAR requirement until he returned
- Hired a CPA and filed FBARs for 2007-2011
- Penalties for years prior to 2007 were expired due to the statute of limitations
- Reported all foreign bank accounts and balances

FBAR PENALTY

IRS:

- Assessed $2.7 million in penalties
- $10,000 for each individual account
  a) 2007 – 61 accounts
  b) 2008 – 51 accounts
  c) 2009 – 53 accounts
  d) 2010 – 53 accounts
  e) 2011 – 54 accounts

FBAR PENALTY

Issue:

- Does FBAR penalty apply on an account-by-account basis (IRS and 5th Circuit); or
- On a report-by-report basis (Taxpayer)

U.S. Supreme Court:

- The FBAR penalty for a non-willful violation applies on a per-report basis
- The penalty for willful violations applies on an account basis

BONUSES & COMMISSIONS NOT SELF-EMPLOYMENT INCOME

Schmerling, T.C. Summary 2023-14

Facts:

- Taxpayer worked as an automobile salesman
- Received W-2 for wages
- Reported manufacturer performance bonus on a 1099
- Reported commissions on sales of extended warranties on a 1099

BONUSES & COMMISSIONS NOT SELF-EMPLOYMENT INCOME

IRS:

- Recharacterized Schedule C gross receipts as “other income” on the 1040
- Disallowed all expenses shown on Schedule C

Court agreed with IRS:

- Bonus & commissions inextricably connected to his status as an employee

RECEIPT OF PARTNERSHIP UNITS FOR SERVICES

ES NPA Holding, LLC v. Comm'r, T.C. Memo. 2023-55

Background:

- Under Code Sec. 721(a), no gain or loss is recognized to a partner in the case of a contribution of property to the partnership in exchange for an interest in the partnership.
- Reg. Sec. 1.721-1(b)(1) provides that the receipt of a partnership capital interest in exchange for services is taxable to the service provider as income under Code Sec. 61.
- In Rev. Proc. 93-27, the IRS stated that it will not treat the receipt of a profits interest as a taxable event.
- Rev. Proc. 93-27 defines a profits interest as a partnership interest "other than a capital interest."
- A capital interest is, in turn, an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership occurring immediately after the transaction.

RECEIPT OF PARTNERSHIP UNITS FOR SERVICES

Holding:

- The Tax Court held that a taxpayer did not have unreported income under Reg. Sec. 1.721-1(b) on its receipt of class C units in a partnership in exchange for cash and the performance of services because the taxpayer received a profits interest, rather than a capital interest, in the partnership, which is not treated as income under Rev. Proc. 93-27.
- It was a profits interest because there would be no distribution to the holders of the class C units on a hypothetical liquidation of the partnership after all capital accounts were first satisfied in full in accordance with the partnership agreement.

REAL ESTATE PROFESSIONAL

Teague, T.C. Summary 2023-16

Facts:

- Taxpayer deducted $23,967 in rental real estate losses on three cabins in Maine
- IRS determined that the taxpayer actively participated in a real estate activity
- But, only $1,540 was deductible because of income phase-out
- Taxpayer claimed he was a real estate professional and not subject to the phase-out

REAL ESTATE PROFESSIONAL

Real estate professional:

- Materially participate for more than 750 hours; and
- More than ½ of personal services are in the real property trade or business in which the taxpayer material participates

Taxpayer:

- Regularly visited the cabins
- Licensed real estate agent
- Did not maintain records of time spent
- Employed full time for Comcast

REAL ESTATE PROFESSIONAL

Result:

- Taxpayer believed he only needed 750 hours
- But, really needed more than 1,840, since that was the amount of time he testified that he worked for Comcast
- Taxpayer was unable to carry that burden of proof

PROFESSIONAL GAMBLER

Mercier, U.S. Tax Court, June 6, 2023

Facts:

- Taxpayers lived in Nevada and claimed to have extensive knowledge in video poker
- Husband had an appliance repair business
- Wife was an accountant
- Did not report gambling income from Form W-2G on return, because gambling losses couldn't be utilized on Schedule A since they were lower than standard deduction
- Claimed "unfair"
- Despite filing a Schedule C for the appliance business, didn't attempt to offset gambling winnings with losses on Schedule C until Notice of Deficiency received

PROFESSIONAL GAMBLER

Court:

- "Serious" about gambling, but not professionals
- E.g., kept no records and instead just relied on third-party information from the Casinos

PROFESSIONAL GAMBLER

- **Nine factor test**:
  - Business approach (e.g., records)
  - Expertise
  - Time & effort
  - Expectation that assets used in the activity may increase in value
  - Success in non-gambling activities
  - History of winnings & losses
  - Amount of occasional profits from gambling
  - Taxpayer's financial status
  - Evidence of personal pleasure or recreation

CASUALTY LOSS

Richey, T.C. Memo. 2023-43

Facts:

- Taxpayers claimed a casualty loss deduction of $640,000 based upon a claim that the value of their second home declined from $2.6 million to $1.9 million due to generalized flooding caused by Winter Storm Stella in 2017

Background:

- Section 165 permits a deduction for a nonbusiness loss
- Casualty loss is calculated by the difference in FMV before and after the casualty
- Reg. §1.165-7(a)(2)(iii) allows cost of repairs to be used if appraisals are not available

CASUALTY LOSS

Court denied deduction:

- Taxpayer claimed that photos showing the damage were deleted from his phone during a software update, and the photos he did have only showed ordinary construction activities
- Did not have appraisals, just MLS printouts from a real estate broker generated after the IRS audit began
- Claimed repairs were more in the nature of improvements, e.g., a deck and pool
- The construction permit indicated a second phase of repairs, but those costs had not been incurred yet
- The absence of any evidence of the home's condition prior to the storm made it impossible to determine the extent to which the expenses were for repairs
- There was no evidence as to whether the repairs/improvements would increase the FMV of the house
- There was no evidence of claims under the taxpayer's homeowner's insurance and the results

QUALIFIED CONSERVATION CONTRIBUTION

Cattail Holdings, LLC, T.C. Memo. 2023-17

Background:

- Taxpayer deeded a conservation easement
- Claimed a charitable contribution deduction
- Deed prohibited:
  - The extraction of minerals; or
  - The transportation of same if it would interfere with the conservation purposes of the property "in the discretion of the Grantee"

QUALIFIED CONSERVATION CONTRIBUTION

Law:

- A deduction for a charitable contribution is not allowed unless the entire interest in the property has been transferred
- Exceptions:
  - Remainder interest in a home or farm;
  - CRAT or CRUT;
  - Qualified conservation easement; or
  - Undivided part of the taxpayer's entire interest.
- IRC §170(h)(5)(B)(i) excludes deductions for conservation easements where there is a retention of a mineral interest and there may be extraction of minerals by any surface mining method.

QUALIFIED CONSERVATION CONTRIBUTION

Tax Court:

- IRS argued that the deed gave the taxpayer a contingent right to engage in surface mining
- Court disagreed and found that the deed prohibits surface mining and the discretion only related to the transportation of minerals that would interfere with the conservation purposes of the property

DAMAGES FOR EMOTIONAL DISTRESS ARE TAXABLE

Montes, U.S. Tax Court, June 29, 2023

Background – IRC §104(a)(2):

- Excludes from gross income "any damages other than punitive damages received whether by suit or agreement and whether as lump sums or as periodic payment on account of personal, physical injuries or physical sickness."

DAMAGES FOR EMOTIONAL DISTRESS ARE TAXABLE

Facts:

- Taxpayer worked for the San Francisco Fire Department
- Filed a lawsuit for harassment and settled
- Did not report the payment received upon the advice of her CPA
- IRS issued a notice of deficiency

DAMAGES FOR EMOTIONAL DISTRESS ARE TAXABLE

Court:

- The complaint alleged discrimination and retaliation
- The settlement agreement indicated that the payment was for general damages, including emotional distress and attorney's fees
- No physical injuries were alleged
- Payment must therefore be included in taxable income

CASCADING CREDITS

Webber, U.S. Tax Court, May 12, 2023

Facts:

- Taxpayer routinely filed tax returns late, but just before the statute of limitations ran
- Instead of requesting a refund, applied refund to following year tax as a credit elect
- Objective seemed to be to prevent the IRS from auditing the return that produced the credit being carried forward

CASCADING CREDITS

IRS:

- Denied the cascade of credit claims
- Proposed collection by levy
- Taxpayer argued that no refunds had been received

Court:

- IRS has the discretion to credit the overpayment or refund it
- Taxpayer has the burden of showing that the IRS allowed the credit
- If taxpayer can't, then he/she can claim an overpayment which opens the prior year to audit

FALSE INSTALLMENT AGREEMENT

Crandell, U.S. Court of Appeals for the 5th Circuit, June 9, 2023

Facts:

- Taxpayer was a medical doctor
- Did not file returns or pay taxes from 2006 through 2012
- Contracted with two hospitals, so no taxes were withheld
- Eventually, the taxpayer worked with a tax preparation firm to file the returns, but even then did not pay off the tax liability
- Taxpayer, working with the tax preparation firm, submitted a Form 433-A, *Collection Information Statement for Wage Earners and Self-Employed Individuals*
- The Form 433-A contained incomplete and inaccurate information

FALSE INSTALLMENT AGREEMENT

Result:

- The taxpayer was indicted for submitting a fraudulent Form 433-A
- Found guilty of tax evasion under IRC §7201
- Sentenced to 33 months in jail and $972,493.86 of restitution
- Taxpayer appealed claiming that submitting a false Form 433-A cannot support a conviction for tax evasion, because its just a payment plan and does not change the amount owed
- The Court of Appeals disagreed and affirmed the conviction

"NEWLY DISCOVERED EVIDENCE"

Thomas, 160 T.C. No. 4, February 13, 2023

Background:

- IRC §6015(e)(7) requires the Tax Court only to consider:
  a) The administrative record as of the time of the determination
  b) Any additional newly discovered or previously unavailable evidence

Facts:

- Surviving spouse seeking relief from joint and several liability for deceased husband's taxes
- Sought to exclude blog posts from evidence

"NEWLY DISCOVERED EVIDENCE"

IRC §6015(b) – Innocent spouse relief:

1) Joint return
2) Understatement of tax attributable to one of the spouses
3) The other spouse did not know, and had no reason to know, about the understatement
4) Inequitable to hold the other spouse liable for the tax
5) Innocent spouse relief elected no later than two years after the IRS has begun collection activities

"NEWLY DISCOVERED EVIDENCE"

Court:

- Issue of first impression
- Held that the blog posts were "newly discovered" – at least by the IRS – as of the time of the trial
- Relevant because they provided information about the spouse's lifestyle, assets and business

EXCEPTIONS TO NOTICE REQUIREMENT FOR SUMMONSES

Polselli, U.S. Supreme Court, May 18, 2023

Background - IRC §7609(c)(2)(D):

- IRS may issue a summons both to determine whether a taxpayer owes tax and to collect the tax
- Notice is required if the purpose of the summons is to determine the liability of the taxpayer
- Notice is not required if the purpose of the summons is to collect the tax

EXCEPTIONS TO NOTICE REQUIREMENT FOR SUMMONSES

Facts:

- Taxpayer underpaid taxes for multiple years
- IRS assessed over $2 million in taxes and penalties
- In connection with its collection efforts, the IRS sent a summons to a law firm where the taxpayer had been a client
- Notice of the summons was not sent to the taxpayer

EXCEPTIONS TO NOTICE REQUIREMENT FOR SUMMONSES

Decision:

- The taxpayer claimed that he had to have a legal interest in the account or records sought by the summons in order for the notice exception to apply
- The Supreme Court disagreed
- Only three requirements must be met to exempt the IRS from providing notice:
  1) The summons is issued to help collection
  2) It helps collection of an actual assessment made or judgment rendered
  3) The assessment or judgment is against the person with respect to whose liability the summons is issued

ACA PAYMENTS GET PRIORITY IN BANKRUPTCY

In re: Howard D. Juntoff, Debtor, Nos. 1:19-bk-17032, July 31, 2023

- The Sixth Circuit Court of Appeals, joining the Third and Fourth circuits, affirmed a bankruptcy appellate panel decision that reversed a bankruptcy court and held that the shared responsibility payment under the Affordable Care Act is a tax measured by income that is entitled to priority status under the Bankruptcy Code.

BUSINESS

LIMITATION ON EXCESS BUSINESS LOSSES OF NON-CORPORATE TAXPAYERS

- TCJA limited the deduction of non-corporate business losses in excess of $250,000 ($500,000 MFJ), adjusted annually for inflation, for tax years beginning before 1/1/2026
- CARES Act temporarily suspended the limitation for 2018-2020
- ARP extends the limitation on excess business losses to tax years beginning before 1/1/2027
- Inflation Reduction Act of 2022 extends it further to tax years beginning after 2026 and before 2029

LIMITATION ON EXCESS BUSINESS LOSSES OF NON-CORPORATE TAXPAYERS

An excess business loss is:

- The taxpayer's aggregate deductions for the tax year from the taxpayer's trades or businesses, determined without regard to whether or not such deductions are disallowed for such tax year under the excess business loss limitation; over
- The sum of—
  - the taxpayer's aggregate gross income or gain for the tax year from such trades or businesses, plus
  - $250,000, adjusted annually for inflation in tax years after 2018
- For 2021, the amount is $262,000 ($524,000 for joint returns)
- For 2022, the amount is $270,00 ($540,00 for joint returns)
- For 2023, the amount is $289,00 ($578,00 for joint returns)
- For 2024, the amount is $305,000 ($610,000 for joint returns)

LIMITATION ON EXCESS BUSINESS LOSSES OF NON-CORPORATE TAXPAYERS

Example:

Facts:

For 2023, Sam, a single taxpayer, has $1 million of gross income and $1.4 million of deductions from a retail business that is not a passive activity.

Question:

What is his excess business loss?

Answer:

His excess business loss is $111,000 ($1,400,000 – [$1,000,000 + $289,000]).

Sam must treat his excess business loss of $111,000 as an NOL carryforward to 2024.

EMPLOYEE RETENTION CREDIT

IR-2023-169:

- Immediate moratorium on processing ERC claims at least through December 31, 2023
- Payouts will continue though, albeit at a slower pace
- Result of concern about “honest small business owners being scammed” by promotors claiming contingency fees, e.g., 25% of the refund
- Both specially trained auditors and IRS Criminal Investigation division are actively working to identify fraudsters

EMPLOYEE RETENTION CREDIT

OVERVIEW

Eligibility:

- A full or partial suspension of operations due to orders from an appropriate government authority during 2020 or the first three quarters of 2021
- A significant decline in gross receipts during 2020 or a decline in gross receipts in the first three quarters of 2021
  - For 2020, less than 50% of gross receipts in same calendar quarter as 2019
  - For 2021, less than 80% of gross receipts in same calendar quarter as 2019
- Qualification as a “recovery startup business” in the third or fourth quarter of 2021

EMPLOYEE RETENTION CREDIT

OVERVIEW

Wages Eligible:

- Claimed on wages paid between March 13, 2020 and Dec. 31, 2021
  - For 2020, 50% of qualified wages (with wages limited to $10,000 per employee for the year, including health care expenses)
  - For 2021, 70% of qualified wages (with wages limited to $10,000 per employee per calendar quarter, including health care expenses)
- Claim the credit by amending affected Forms 941, Employer's Federal Quarterly Tax Returns

EMPLOYEE RETENTION CREDIT

Supply chain issues:

- Example of an area of concern
- Addressed in new FAQs added on July 28, 2023
  a) Government order caused supplier to suspend operations;
  b) Could not obtain supplier's goods or materials elsewhere (regardless of cost); and
  c) Resulted in full or partial suspension of business operations

EMPLOYEE RETENTION CREDIT

IR-2023-193

- On October 19, 2023, the IRS announced a special withdrawal process to help those who filed an ERC claim and are concerned about its accuracy
- Allows certain employers that filed an ERC claim but have not yet received a refund to withdraw their submission and avoid future repayment, interest and penalties
- Withdrawing a fraudulent claim will not protect against potential criminal investigation and prosecution
- With stricter compliance reviews in place, existing ERC claims will go from a standard processing goal of 90 days to 180 days – or longer if the claim faces further review or audit
- The IRS may also seek additional documentation from the taxpayer to ensure the claim is legitimate

EMPLOYEE RETENTION CREDIT

- To use the ERC claim withdrawal process, all of the following must apply:
  a) The claim was made on an adjusted employment return (Forms 941-X, 943-X, 944-X, CT-1X)
  b) The adjusted return was filed only to claim the ERC, and there are no other adjustments
  c) The entire amount of the ERC claim is withdrawn
  d) The IRS has not paid the claim, or the IRS has paid the claim, but they haven't cashed or deposited the refund check
- Those who received a refund check, but haven't cashed or deposited it, can still withdraw their claim. They should mail the voided check with their withdrawal request using the instructions at IRS.gov/withdrawmyerc
- Taxpayers who are not eligible to use the withdrawal process can reduce or eliminate their ERC claim by filing an amended return
- To take advantage of the claim withdrawal procedure, follow the special instructions at IRS.gov/withdrawmyerc

EMPLOYEE RETENTION CREDIT

IR-2023-247 (December 21, 2023)

- IRS Announced an Employee Retention Credit Settlement Program
- Allows employers who erroneously claimed an employee retention credit to repay 80% of the credit they received
- Must identify any advisers or tax preparers who helped them with their claim to qualify for the program
- Interested employers must apply to the ERC Voluntary Disclosure Program by March 22, 2024
- Employers who are unable to repay the required 80% of the credit may be considered for an installment agreement
- The IRS will not charge interest or penalties, provided the 80% is repaid

EMPLOYEE RETENTION CREDIT

IR-2023-247 (December 21, 2023)

Additional Requirements:

- Must not be under a criminal investigation
- Must not be under an IRS employment examination for the period they are applying
- Must not have received an IRS notice and demand for repayment of any part of the ERC
- IRS must not have received information from a third party or an enforcement action that the employer is not in compliance

To apply:

- File form 15434, Application for Employee Retention Credit Voluntary Disclosure Program
- Employers who outsource their payroll must apply through the third party

EMPLOYEE RETENTION CREDIT

But, wait. There's more!

- IRS also announced at the same time that it has started sending up to 20,000 letters with proposed tax adjustments that will recapture erroneously claimed ERC
- These mailings — which are on top of the 20,000 denial letters announced earlier in December — are currently just for tax year 2020
- Work continues for tax year 2021

LIMITED PARTNER EXCEPTION

Background:

- IRC §1402(a)(13), enacted in 1977, generally excludes a limited partner's share of partnership income or loss from SECA tax
- The exclusion does not apply to guaranteed payments
- The IRS proposed regulations a couple of times, most recently in 1997, but they stalled when Congress imposed a temporary moratorium
- The 1997 proposed regulations provided that an individual would not be treated as a limited partner if the individual had:
  - Personal liability for partnership debts;
  - Authority to contract on behalf of the partnership; or
  - participated in the partnership's trade or business for more than 500 hours during the taxable year

LIMITED PARTNER EXCEPTION

Developments:

- The courts have largely been left to sort out limited partner status
- For example, in *Renkemeyer* attorneys who actively participated in an LLP were found not to be limited partners
- In 2018, a SECA compliance program was launched focusing on partnerships operating in the asset management, financial services, private equity and hedge fund industries
- A guidance project has now appeared on the 2023-2024 priority guidance plan released September 29, 2023

LIMITED PARTNER EXCEPTION TO SELF-EMPLOYMENT TAX

Soroban Capital Partners LP v. Commissioner, 161 T.C. No. 12 (November 28, 2023)

- Involved limited partners in a NY hedge fund who received guaranteed payments for services, but not in their capacities as limited partners where they were prohibited from taking part in the hedge fund's management
- They were contesting the IRS' position that the amounts excluded in their capacity as limited partners (approx. $141 million for 2016 and 2017) should have been included in net earnings from self-employment
- Practitioners have been eyeing this case to see whether it resolves the limited partner issue (or, at least, whether a state-law limited partner is also a limited partner for self-employment tax purposes without also having to meet the functional test of *Renkemeyer)*

LIMITED PARTNER EXCEPTION TO SELF-EMPLOYMENT TAX

Soroban Capital Partners LP v. Commissioner, 161 T.C. No. 12 (November 28, 2023)

- Tax Court held:
  - Whether a limited partner in a state law limited partnership is a limited partner for purposes of the Section 1402(a)(13) exclusion from self-employment tax for limited partners requires an inquiry into the function and roles of the limited partner
  - Under the decision, a limited partner who actively participates in the business of the partnership would not be able to exclude his distributive share of income or loss from net earnings from self-employment

IRS ONLINE ACCOUNTS

IRS Announced December 18, 2023

- Partners and S corp shareholders can use IRS' online tool to:
  - Download business transcripts
  - Review business' name on account and balance due
  - Review business tax records and select digital notices
  - Register for clean energy credits, if eligible

UNANNOUNCED REVENUE AGENT VISITS

IR-2023-133:

- IRS announced that it is ending most unannounced visits to taxpayers by revenue agents
- Replaced by mailed letters to schedule visits
- Attributed to:
  - Safety concerns
  - Inflammatory rhetoric confusing taxpayers about visits by revenue agents

FORM 8300

IR-2023-157:

- Starting January 1, 2024, businesses are required to e-file Form 8300, *Report of Cash Payments over $10,000*

Exceptions:

- Fewer than 10 information returns for the calendar year
- Can request a waiver for hardship by filing Form 8508, but the waiver applies to all information returns

CASES

COD INCOME AND THE SMLLS

Jacobowitz, T.C. Memo. 2023-107

Facts:

- Taxpayer operated a business through an SMLLC
- Never filed a Form 8832, *Entity Classification Election*
- Secured a loan through a local bank
- Closed the business in 2008
- Bank sent the IRS a Form 1099-C, Cancellation of Debt, for 2016
- Taxpayer did not include any COD income on his 2016 Form 1040
- IRS issued a notice of deficiency

COD INCOME AND THE SMLLS

Taxpayer:

- Did not dispute debt
- Argued that under state law the members of an LLC are not personally liable for the debts of the LLC

Court:

- Disagreed
- Under the “check-the-box” regulations the LLC was a disregarded entity for tax purposes
- Thus, the taxpayer was obliged to report on his personal return any income or loss attributable to the LLC

ACCOUNTABLE PLAN

Simpson, T.C. Memo. 2023-4

Background:

- Accountable plan
  - Employee pays expense, submits receipt, and corporation reimburses
  - Excluded from employee's wages
  - Deductible by corporation

ACCOUNTABLE PLAN

- No accountable plan
  - Reimbursement is included in employee's wages
  - Employee treats reimbursement as an unreimbursed employee business expense subject to the 2% AGI limit on miscellaneous itemized deductions (which are not currently deductible)

ACCOUNTABLE PLAN

Accountable plan (IRC §62(a)(2)(A)):

1) Reimbursement must be for business expense allowable as a deduction paid or incurred by the employee in connection with the performance of services as an employee of the employer
2) Expense must be substantiated within a reasonable period of time
3) Reimbursement of travel & entertainment expenses must meet the strict substantiation requirements of IRC §274(d) and the regulations
4) For other expenses, substantiation must be sufficient to identify the nature of the expense and how it is attributable to the employer's business
5) Excess reimbursements must be returned to the employer within a reasonable period of time

ACCOUNTABLE PLAN

Facts:

- Taxpayers operated a business out of their house
- Claimed to have an unwritten accountable plan
- IRS disagreed and claimed:
  a) The reimbursements should be included in wages
  b) The expenses should be treated as unreimbursed employee business expenses

ACCOUNTABLE PLAN

Court:

- An accountable plan does not necessarily have to be in writing
- But, here there was no evidence that the corporation required any substantiation or that any excess amounts be returned
- Company was an S corporation, and reimbursements were indistinguishable from distributions

MILEAGE LOG

Craddock, T.C. Summary 2023-4

Background:

- To substantiate vehicle expenses, IRC §274(d) requires:
  1) Amount of expense
  2) Time and place of expense or use of listed property
  3) Business purpose of expense or use
  4) Business relationship
- Car & truck expenses also require a contemporaneous log, trip sheet or similar record, as well as corroborating documentary evidence

MILEAGE LOG

Facts:

- In addition to W-2 job, taxpayer had an unincorporated business making sales calls
- Typically drove his pick-up truck to work, and then left to conduct those sales calls
- Provided a mileage log and bank statements identifying various expenses as for “tolls,” “car parts,” “fuel,” and “insurance”

MILEAGE LOG

Court:

- Disallowed the deductions as not credible
- Mileage log showed the taxpayer in one state when the bank statements showed him in another
- No corroborating evidence provided other than the taxpayer's own testimony

INCOME STATEMENT VERIFIED BY CPA NOT SUBSTANTIATION

Barrios, T.C. Memo. 2023-32

Facts:

- Taxpayer did not file a 2011 tax return
- IRS prepared a substitute return based upon information provided by third parties
- Taxpayer petitioned the Tax Court and filed a return prepared by a CPA in 2018 while the case was pending
- Return showed $7,565,528 in gross receipts, $6,266,451 for COGS, $1,257,618 for wages, $54,024 for insurance, $35,144 for depreciation, and $189,368 for miscellaneous expenses

INCOME STATEMENT VERIFIED BY CPA NOT SUBSTANTIATION

- Taxpayer primarily relied on a profit & loss statement reconstructed after litigation had begun
- CPA supervised the preparation by discussing with the taxpayer's bookkeeper her general approach as to the inclusion and categorization of the 2011 expenses, and then spot-checking the work
- Bookkeeper used QuickBooks for the reconstruction, but had no direct knowledge of the expenses
- There was also some information from PayChex, Inc., but no testimony concerning the company's recordkeeping system

INCOME STATEMENT VERIFIED BY CPA NOT SUBSTANTIATION

Court:

- Ruled that taxpayer failed to substantiate expenses in excess of the amounts allowed by the IRS
- Lack of documentary evidence
- Non-compelling nature of the CPA's testimony
- CPA's "confidence that these expenses are substantially correct" is insufficient to substantiate the nature, amount or purpose of the claimed deductions

BUSINESSMAN FAILS TO PROVE PARTICIPATION

Senty, James et al v. United States of America,
No. 3:2022cv00283 - Document 57 (W.D. Wis. 2023)

Facts:

- James Senty participated in several businesses in 2014-2105
  - Executive in several of the companies
  - President in one
  - Board member in another
  - Also owned real estate interests
- Claimed to work 70 hours a week
- Kept no log or appointment book

BUSINESSMAN FAILS TO PROVE PARTICIPATION

IRS:

- Asserted that he owed $206,000 in NII tax on several of the ventures

Taxpayer:

- Collectively spent more than 500 hours based on minimum time required by several of his employment contracts
- Also had board minutes

BUSINESSMAN FAILS TO PROVE PARTICIPATION

Court held for IRS:

- Contracts looked like “backfill,” i.e., identical language despite different companies
- One was signed by Senty both as president and employee
- Only four board meetings across three companies over two years
- Only other evidence was his deposition and the testimony of family and friends

SMALL BUSINESS STOCK EXCLUSION

Ltr. Rul. 202319013

Background:

- IRC §1202 excludes gain from the sale of qualified small business stock held for more than 5 years:

Stock Issuance Date	Exclusion
8/11/1993 to 2/18/2009	50%
2/19/2009 to 9/27/2010	75%
9/28/2010 -	100%

SMALL BUSINESS STOCK EXCLUSION

- Must be a C corporation that satisfies the active business requirements of IRC §1202(e)
  1) At least 80% of the assets are used in the active conduct of a qualified trade or business
  2) "Qualified trade or business" does not include:
     a) Health, law, engineering, architecture, accounting, actuarial science, performing arts, athletics, financial services, brokerage services, or consulting
     b) Trades or businesses where the principal asset is the reputation or skill of one or more of its employees

SMALL BUSINESS STOCK EXCLUSION

Facts:

- Enterprise cloud application services software company
- Employees had specialized technical skills and knowledge from training they received on the company's proprietary processes
- Company could recruit and train new employees to provide substantially the same services using its proprietary processes

IRS Ruled:

- Principal asset was intellectual property, not the skill of one or more employees
- Qualifies for the IRC §1202 exclusion

TAXATION OF UNREALIZED INCOME

Moore v. United States, U.S. Supreme Court Docket #22-800

Issue:

- Constitutionality of taxing the deemed repatriation of earnings under IRC §965 enacted by the TCJA of 2017

Background:

- Taxpayer invested in an Indian company that was a controlled foreign corporation
- IRC §965 deems the accumulated post-1986 deferred foreign income to be Subpart F income for 2017 or 2018, depending on its taxable year end

TAXATION OF UNREALIZED INCOME

Taxpayer's Argument:

- IRC §965 is an unapportioned direct tax that is not an income tax, thus violating the apportionment clause in the U.S. Constitution
- Essentially, the argument is that a tax on unrealized income is unconstitutional

Government's Argument:

- There is no blanket constitutional ban on Congress's disregarding corporate form to facilitate taxation of shareholders' income

TAXATION OF UNREALIZED INCOME

Ramifications:

- Subpart F
- Tax on global intangible low-taxed income (GILTI)
- New book minimum tax
- Mark-to-market for securities dealers
- Constructive sales, such as equity swaps
- Taxation of derivatives

Revenue Effects:

- If GILTI is struck down, perhaps $350 billion over the next 10 years
- Another $75 billion over the same period of Subpart F is repealed

INFLATION REDUCTION ACT

INFLATION REDUCTION ACT OF 2022

Many Tax Credits and Related Provisions:

- Clean Energy Tax Credits
- Carbon Management
- Residential Energy Efficiency
- Energy Innovation
- Offshore Wind and Oil & Gas Systems
- Community Investment and Energy Justice
- Investments in the Permitting Process
- Clean Energy Financing
- Agriculture & Forestry

New Advanced Manufacturing Production Tax Credit (IRC §45X)

- Tax credit for the production of clean energy technology components that are produced in the United States or by a U.S. possession
- Eligible components include solar components, wind turbine and offshore wind components, inverters, many battery components, and the critical minerals needed to produce these components
- Begins to phase out in 2029 and phases out completely in 2032

Extension of Energy Investment Tax Credit (IRC §48)

- Extends the existing energy investment tax credit for applicable energy projects
- Ends in 2024 for most technologies and is replaced by the new tech-neutral Clean Electricity ITC (48E), which begins in 2025
- Extends date of construction in most cases to 2024 and maintains a 10% or 30% credit

New Clean Electricity Investment Tax Credit (IRC §48E)

- This newly established ITC replaces the Energy ITC once it phases out at the end of 2024
- 48E is an emissions-based incentive that is neutral and flexible between clean electricity technologies
- Taxpayers choose between a PTC (45Y) and an ITC (48E).

Clean Vehicle Credit (IRC §30D)

- Maintains the existing $7,500 consumer credit for the purchase of a qualified new clean vehicle, including electric vehicles, plug-in hybrids, and hydrogen fuel cell vehicles
- Maximum of $80,000 per vehicle for vans, SUVs and pickups and $55,000 for other vehicles
- Income eligibility limit of $150,000 or $300,000 for joint filers
- Eliminates the previous manufacturer quota, which phased out the tax credit for manufacturers as they neared 200,000 clean vehicles sold

Clean Vehicle Credit (IRC §30D)

- About half the credit or $3,750 is based on where the battery components are made or assembled, e.g. –
  - 40% for EVs that go on sale before 2024
  - 50% for EVs that go on sale in 2024
  - 60% for EVs that go on sale in 2025
  - 70% for EVs that go on sale in 2026
  - 80% for EVs that go on sale after December 31, 2026

Clean Vehicle Credit (IRC §30D)

- Just like battery components, the credit has requirements based on where the raw materials used in the battery come from that must be met to qualify for half of the credit or $3,750:
  - 40% of “critical minerals” through end of 2023
  - 50% in 2024
  - 60% in 2025
  - 70% in 2026
  - 80% after 2026

New Previously Owned Clean Vehicle Credit (IRC §25E)

- Tax credit for the purchase of previously owned clean non-commercial vehicles, including electric vehicles and plug-in hybrids
- Credit is equal to the lesser of $4,000 or 30% of the vehicle cost
- Sets a maximum sale price of $25,000
- Model must be at least 2 years older than the year of sale
- Implements an income eligibility limit of $75,000 or $150,000 for joint filers

INFLATION REDUCTION ACT OF 2022

Rev. Proc. 2022-42, released December 12, 2022:

- Initial guidance on how auto manufacturers and dealers can qualify their cars available for clean vehicle credits
- Manufacturer's generally must enter into written agreements with the IRS agreeing to make periodic written reports with VIN numbers for each vehicle sold
- Seller's likewise must make reports about each sale in order for the new or used vehicles sold to be eligible for the tax incentives

TRANSFERABILITY OF EV CREDIT AT POINT OF SALE

REG-113064-23

- Under proposed regulations issued October 6, 2023, starting January 2024 qualified taxpayers will be able to transfer the section 30D and section 25E tax credits, worth up to $7,000 for the purchase of a new electric vehicle and $4,500 for a used electric vehicle, respectively, directly to the car dealer at the point of sale
- “Allows consumers to reduce the up-front cost of a clean vehicle, expanding consumer choices and helping car dealers expand their businesses”
- Treat the transfer as being repaid by the consumer to the dealer as part of the purchase price of the vehicle, thereby not affecting the dealer’s tax liability
- Consumers looking to take advantage of the credit must attest to being under the eligible income threshold
- Car dealers must register under a new website, the “IRS Energy Credits Online Portal,” to take part in the program

New Commercial Clean Vehicle Credit (IRC §45W)

- The credit is equal to the lesser of:
  - (1) 15 percent of the basis in the vehicle, or
  - (2) the incremental cost of the vehicle
- The credit is capped at $7,500 for qualifying vehicles with weight ratings of under 14,000 pounds and $40,000 for all other vehicles

New Commercial Clean Vehicle Credit (IRC §45W)

- Notice 2024-5, issued December 20, 2024:
  - IRS will accept DOE's modeled incremental cost
  - Applicable to vehicles placed into service during 2024

New Commercial Clean Vehicle Credit (IRC §45W)

- The DOE analysis calculated the incremental cost for compact plug-in hybrid vehicles, which includes mini-compact and subcompact cars, to be less than $7,500
- The DOE has also provided an incremental cost analysis for several classes of street electric vehicles with a gross vehicle weight rating of 14,000 pounds or more
- For street EVs with a gross vehicle weight rating of less than 14,000 pounds, Treasury and the IRS have concluded that the incremental cost will not limit the available credit amount for vehicles placed into service during 2024
  - The IRS will accept a taxpayer's use of $7,500 as an incremental cost for those vehicles

Credit for Residential Clean Energy (IRC §25D)

- Extends credit through 2034 for residential solar, wind, geothermal, and biomass fuel
- Maintains the previous credit rate but adjusts the project dates
- Applies a 30% credit for projects started between 2022 and 2032
- Credit decreases to 26% for projects started in 2033 and 22% for projects started in 2034
- Expands eligibility to battery storage technology

Credit for Energy Efficiency Home Improvements (IRC §25C)

- Extends credit for energy efficiency home improvements through 2032
- Increases credit from 10% to 30%
- Replaces lifetime cap on credits with a $1,200 annual credit limit, including $600 for windows and $500 for doors
- Increases limit to $2,000 for heat pumps and biomass stoves
- Removes eligibility for roofs
- Updates language to reflect advances in energy efficiency
- Expands credit to cover the cost of home energy audits up to $150 and electrical panel upgrades up to $600

INFLATION REDUCTION ACT OF 2022

Notice 2023-59:

- Outlines requirements for claiming the IRC §25C credit for home energy audits that are expected to be included in proposed regulations
- Examples of topics include:
  - Home energy audit
  - Qualified home energy auditor (not required for 2023)
  - Qualified certification program
  - Written report
  - Substantiation requirement

INFLATION REDUCTION ACT OF 2022

Credit for builders of new energy-efficient homes (IRC §45L)

- Eligible contractors who build or substantially reconstruct qualified new energy-efficient homes may be able to claim tax credits up to $5,000 per home
- Preliminary guidance may be found in Notice 2023-65

Home Energy Performance-Based Whole House Rebates (HOMES)

- $4.3 billion through 2031 to DOE to help state energy offices implement a HOMES rebate program to provide rebates to homeowners and aggregators for whole-house energy saving retrofits
- Additional funding can be provided to low- and moderate-income individuals, who earn less than 80% of the area median income

High-Efficiency Electric Home Rebate Program

- $4.5 billion through 2031 for grants from DOE to States and Tribes to implement a high-efficiency electric home rebate program
- Provides up to $14,000 per household including $8,000 for heat pumps, $1,750 for heat pump water heaters, and $840 for electric stoves
- Also includes rebates for improvements to electrical panels or wiring and home insulation or sealant
- Eligible recipients must fall below 150% of the area median income

INFLATION REDUCTION ACT OF 2022

Prevailing Wage and Apprenticeship Requirements:

- Increased credit amounts and deductions may be available to certain taxpayers satisfying prevailing wage and apprenticeship requirements
  - Increased credits: IRC §30C, 45, 45Q, 45V, 45Y, 45Z, 48, 48C and 48E
  - Increased deductions: IRC §179D
  - Increased credits also available under IRC §45L and 45U if just a prevailing wage requirement is satisfied
- The prevailing wage requirement is met if laborers and mechanics are paid at rates not less than the prevailing rates for construction, alteration or repair of similar character in the locality where the facility is located as determined by the Secretary of Labor

INFLATION REDUCTION ACT OF 2022

- The apprenticeship requirement is met if the following percentage of total labor hours is performed by qualified apprentices:
  - 10% if construction begins prior to 1/1/2023
  - 12.5% if construction begins after 12/31/2022 and before 1/1/2024
  - 15% if construction begins after 12/31/2023

Notice 2022-61

CORPORATE TRANSPARENCY ACT

CORPORATE TRANSPARENCY ACT

- On September 29, 2022, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) issued regulations regarding the beneficial ownership reporting requirements
- The final rulemaking is effective January 1, 2024
- Reporting companies created or registered before January 1, 2024, have one year (until January 1, 2025) to file their initial reports
- Reporting companies created or registered after January 1, 2024, originally had 30 days after creation or registration to file their initial reports
- FINCEN later issued a Notice of Proposed Rule Making extending the 30 day period to 90 days for new entities created in 2024

CORPORATE TRANSPARENCY ACT

Several Exemptions:

- Financial institutions or certain issuers of securities in heavily regulated industries (e.g., banks, credit unions, broker-dealers, money services businesses registered with FinCEN, and issuers registered with the U.S. Securities and Exchange Commission)
- "Large operating companies"
  - Entity that employs more than 20 full time employees in the U.S.,
  - Has an operating presence at a physical office within the U.S., and
  - Filed a federal income tax or information return in the U.S. for the previous year demonstrating more than $5,000,000 in gross receipts or sales
- Other types of legal entities, including certain trusts, will be excluded to the extent that they are not created by the filing of a document with a secretary of state or similar office

CORPORATE TRANSPARENCY ACT

A "reporting company" is a corporation, limited liability company, or other similar entity that is:

- Created by the filing of a document with a secretary of state or similar office, or
- Formed under the law of a foreign country and registered to do business in the U.S. by the filing of a document with a secretary of state or a similar office

<u>Note</u>: There is no dollar minimum or profit motive requirement

CORPORATE TRANSPARENCY ACT

Examples:

- Single owner S corporation or single member LLC filing a Schedule C
- A hobby that generates no profits if it is registered as an LLC for liability protection purposes

CORPORATE TRANSPARENCY ACT

A "beneficial owner" is an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise:

- Exercises substantial control over the entity, or
- Owns or controls not less than 25 percent of the ownership interests of the entity

Examples:

- Senior officer of the reporting company;
- Having authority over the appointment or removal of any senior officer or a majority of the board of directors (or similar body); or
- Directing, determining, or having substantial influence over important decisions made by the reporting company

CORPORATE TRANSPARENCY ACT

In addition to reporting information about itself and its beneficial owners, and entity created on or after January 1, 2024 must also report information about its "company applicants"

- The individual who directly files the document that creates or first registers the reporting company
- The individual primarily responsible for directing the filing of the relevant document
- There can be up to two persons who qualify as company applicants

CORPORATE TRANSPARENCY ACT

Penalties for Noncompliance:

- Civil Penalties:
  - Not more than $500 for each day that the violation continues
- Criminal Penalties:
  - Fines of not more than $10,000, and
  - Imprisonment for not more than two years, or both
- Separate from the CTA, persons could face criminal liability under the federal criminal code, which prohibits knowingly and willfully providing false information or concealing a material fact to any of the three branches of the federal government

CORPORATE TRANSPARENCY ACT

Example:

Facts:

You are the sole owner and the president of an LLC

Question:

Are you the beneficial owner?

Answer:

You are the beneficial owner because you exercise substantial control as the senior officer, you own more than 25%, and no one else exercises substantial control

CORPORATE TRANSPARENCY ACT

Example:

Facts:

A, B and C own 50%, 40% and 10%, respectively, of a company, and D serves as president

Question:

Who are the beneficial owners?

Answer:

A & B are beneficial owners because they own more than 25%. D is a beneficial owner because he exercises substantial control as a senior officer. C is not a beneficial owner.

CORPORATE TRANSPARENCY ACT

Example:

Facts:

Four individuals each own 25% of a company, and four additional persons serve as CEO, CFO, COO and general counsel

***Question*:**

Who are the beneficial owners?

Answer:

All eight are beneficial owners

CORPORATE TRANSPARENCY ACT

Example:

Facts:

Person A prepares and files a document through an online portal creating a new company

Question:

Who is the company applicant?

Answer:

Person A

CORPORATE TRANSPARENCY ACT

Example:

Facts:

Person A prepares a document creating a new company and directs person B to file it using an online portal

Question:

Who is the company applicant?

Answer:

Persons A and B

CORPORATE TRANSPARENCY ACT

- The Beneficial Ownership Information Registry began accepting reports on January 1, 2024
- Website for reporting: https://boiefiling.fincen.gov/
- Company must report:
  - Name
  - Tradenames
  - U.S. address
  - Jurisdiction of formation
  - EIN / TIN

CORPORATE TRANSPARENCY ACT

Information required to be reported on beneficial owners and company applicants:

- name
- date of birth
- Address
- the identifying number and issuer from either a non-expired U.S. driver's license, a non-expired U.S. passport, or a non-expired identification document issued by a State (including a U.S. territory or possession), local government, or Indian tribe. If none of those documents exist, a non-expired foreign passport can be used. An image of the document must also be submitted

RETIREMENT

PROPOSED REGULATIONS ON RMD'S

- **Issued on February 23, 2022, under the SECURE Act**
- **Address two important issues relating to RMDs**
  - Delay in RBD to age 72*
  - 10 year limit on RMDs after death
- **Distributions taken in 2021 can be based on a "reasonable interpretation of the law"**

*now age 73 for 2023 under SECURE 2.0

REG-105954-20

PROPOSED REGULATIONS ON RMD'S

- **Eligible Designated Beneficiary ("EDB")**
  - The participant's surviving spouse
  - The employee's child who has not yet reached the "age of majority"
  - "Disabled"
  - "Chronically ill"
  - Not more than 10 years younger than the participant

PROPOSED REGULATIONS ON RMD'S

- **Death before RBD:**

BENEFICIARY	DISTRIBUTION PERIOD
Not a "designated beneficiary"	5-year rule
Designated beneficiary, but not an EBD	10-year rule
EBD	Life Expectancy

PROPOSED REGULATIONS ON RMD'S

- **Death after RBD:**

BENEFICIARY	DISTRIBUTION PERIOD
Not a "designated beneficiary"	5-year rule
Designated beneficiary, but not an EBD	Life Expectancy for 10 years with balance distributed in 10th year
EBD	Life Expectancy

PROPOSED REGULATIONS ON RMD'S

- **"Age of Majority" – age 21**
- **"Disability"**
  - Unable to engage in substantial gainful activity
  - A medically determinable physical or mental impairment that results in marked and severe functional limitations, and that can be expected to result in death or to be of long-continued and indefinite duration
  - Social Security Administration determination
- **"Chronically ill"**
  - Unable to perform at least two activities of daily living (such as eating, toileting, and dressing) without substantial assistance for a lengthy, indefinite period
  - Plan receives documentation of that status by October 31 of the year following the year of the employee's death

Note: The determination of disability or chronically ill is made as of the date the employee dies.

PROPOSED REGULATIONS ON RMD'S

Example:

Facts:

Ed names his nephew, Adam, as beneficiary of his 401(k) account. Ed dies March 2, 2023. Adam is involved in an accident September 15, 2023, and as a result is chronically ill.

Question:

Is Adam an EDB?

***Answer*:**

Adam is not an EDB because he was not chronically ill when Ed died.

PROPOSED REGULATIONS ON RMD'S

Example:

Facts:

Marie names her daughter, Donna, as beneficiary of her 403(b) account. When Marie dies at age 40, Donna is only 10 years old. At that time, she is not Disabled. However, five years later, Donna becomes disabled.

Question:

Is Donna an EDB?

***Answer*:**

Donna is an EDB, because she is Marie's child who has not reached the age of majority. Ten years after Donna turns 21, the plan must distribute the entire account to Donna. Had she been disabled when Marie died, Donna would have been able to continue taking distributions throughout her life or life expectancy.

PROPOSED REGULATIONS ON RMD'S

- **Trusts as beneficiaries**
  - Previously, the regulations treated a trust as being, at most, one designated beneficiary, with an age equal to that of the oldest beneficiary of the trust
  - In Private Letter Rulings, the IRS had allowed a more generous policy, particularly with regard to so-called "look-through" trusts
  - The Proposal codifies those trust rules, and thereby expands available estate planning techniques
  - If a trust satisfies the look-through rules, then the beneficiaries of the trust are considered designated beneficiaries

PROPOSED REGULATIONS ON RMD'S

- **Special Needs Trusts:**
  - SECURE Act 2.0 includes a clarification that a third-party special needs trust (e.g., a trust established by a parent for a child with a disability) may have a charitable organization as the remainder beneficiary
  - Concern was that it might preclude qualification for lifetime distributions to the disabled beneficiary of the SNT after the account holder's death
  - Effective starting in 2023

PROPOSED REGULATIONS ON RMD'S

- **50% penalty tax relief**
  - Penalty applies if a participant or beneficiary does not take an RMD
  - RMD rules require the participant or his/her estate to take an RMD for the year of death in the same manner as if the participant lived until the end of the year—i.e., by December 31 of the year of death
  - Proposed regs would waive the penalty provided that the beneficiary takes the RMD no later than his or her tax return due date (with extensions)

Note: SECURE 2.0 Act reduces the penalty to 25%. In addition, the penalty drops down to 10% if you take the necessary RMD by the end of the second year following the year it was due.

PROPOSED REGULATIONS ON RMD'S

- **Effective date of the Proposed Regulations was January 1, 2022**
- **Notice 2022-53 provides that:**
  - The final RMD regulations will apply no earlier than 2023.
  - A defined contribution plan will not be treated as having failed to satisfy the RMD rules under Code Section 401(a)(9), as amended by the SECURE Act, merely because it did not make a "specified RMD"
  - If a beneficiary did not take a "specified RMD" the IRS will not assert that the 50% excise tax applies, and will refund any excise tax that has already been paid for a missed RMD in 2021
- **Notice 2023-54**
  - Final regulations won't apply until 2024

PROPOSED REGULATIONS ON RMD'S

A "specified RMD" is defined as:

- Any distribution that would be required to be made in 2021 or 2022 under a plan or IRA if that distribution would be required to be made to:
  - A designated beneficiary of an employee or IRA owner if the employee or IRA owner died in 2020 or 2021 and on or after their required beginning date, and the designated beneficiary is not an eligible designated beneficiary taking distributions under the life expectancy rule, or
  - A beneficiary of an eligible designated beneficiary if the eligible designated beneficiary died in 2020 or 2021 and they were taking distributions under the life expectancy rule

FURTHER TRANSITION RELIEF

Background:

- Prior to SECURE 2.0, a person born in 1951 would attain age 72 in 2023, so 2023 RMD would due by April 1, 2024 and the 2024 RMD by December 31, 2024
- After SECURE 2.0, the person would attain age 73 in 2024, so 2024 RMD would due by April 1, 2025 and the 2025 RMD by December 31, 2025

Notice 2023-54:

- Any distributions made between January 1, 2023 and July 31, 2023 that were characterized as RMDs, but aren't under the new rules, could be rolled over by September 30, 2023

ESOP COMPLIANCE ISSUES

IR-2023-144, August 9, 2023:

- Compliance issues with ESOPs identified by the IRS include:
  - Valuation issues with employee stock
  - Prohibited allocation of shares to disqualified persons
  - Failure to follow through with tax requirements for ESOP loans
- The IRS announcement provides examples of potentially abusive ESOP arrangements, including:
  - A business that creates a management S corporation whose stock is wholly owned by an ESOP for the sole purpose of diverting taxable business income to the ESOP.
  - In this instance, the S corporation purports to have provided loans to the business owners in the amount of the business income to avoid taxation.

SECURE ACT 2.0

SECURE ACT 2.0

- **Included within the Consolidated Appropriations Act, 2023**
- **Called SECURE ACT 2.0 because it builds on the changes made by the *Setting Every Community Up for Retirement Enhancement Act of 2019 (*SECURE Act)**
- **Originated as three separate bills**:
  - SECURING A STRONG RETIREMENT ACT (H.R. 2954) passed by the House of Representatives on March 29, 2022
  - RETIREMENT IMPROVEMENT AND SAVINGS ENHANCEMENT TO SUPPLEMENT HEALTHY INVESTMENTS FOR THE NEST EGG (RISE & SHINE) ACT (S. 4353) approved by the Senate Health, Education, Labor, and Pensions Committee on June 15, 2022
  - ENHANCING AMERICAN RETIREMENT NOW (EARN) ACT approved by the Senate Finance Committee on June 22, 2022

SECURE ACT 2.0: RETIREMENT PLANS

- **Auto-enrollment**
  - Mandatory for new plans starting in 2025
  - At least 3% of salary, no higher than 10%
  - Escalates at 1% per year of service up to a minimum of 10% and a maximum of 15%
  - An employee can opt out
  - Employers with 10 or fewer employees exempt

SECURE ACT 2.0: RETIREMENT PLANS

- **The 10-50% nonrefundable saver's credit for contributions to retirement plans, IRAs and ABLE accounts is replaced**
  - New 50% federal match of non-Roth contributions deposited into taxpayer's plan by Treasury
  - Phases out at certain income thresholds
  - Maximum $2,000
  - Effective after 12/31/2026

Start-up Cost Credit for New Plans:

- **Employers with 50 or few employees**
  - Goes from 50% to 100% for 3 years
  - Max $5,000 per year
- **Employers with 51-100 employees**
  - 50%
  - Max $5,000 per year
- **Additional credit for up to $1,000 of employer matching**

SECURE ACT 2.0: RETIREMENT PLANS

SEP/SIMPLE Plans:

- **Employers may make additional discretionary contributions to SIMPLE plans**
  - Up to 10% of compensation
  - Maximum of $5,000 (indexed)
  - Begins 2024
- **Annual deferral and catch-up limits to SIMPLE plans increased by 10% starting in 2024 for employers with 25 or fewer employees**
- **Employers of domestic employees (e.g., nannies) may provide benefits under a SEP starting in 2023**

SECURE ACT 2.0: RETIREMENT PLANS

Long-term Part-Time Workers:

- Employees working 500+ hours in 2 consecutive years must be eligible to defer
- Also applies to 403(b) plans
- Begins 2025

Note: Under SECURE 1.0 there was a similar 3-year rule starting in 2024

SECURE ACT 2.0: RETIREMENT PLANS

Pension-linked ("sidecar") emergency savings accounts:

- Employers may automatically opt NHCEs into emergency savings accounts
- No more than 3% of salary
- $2,500 cap
- Contributions over limit can be stopped or directed to Roth account
- Treated as Roth elective deferrals and may be matched up to the cap
- Up to 4 no-fee, no-tax withdrawals available per year
- Upon separation, account balance may be taken as cash or rolled into a Roth plan or IRA
- Begins 2024

Cash-out distributions:

- Currently, plan sponsors may “cash out” terminated participant balances under $5,000 and, unless the participant elects otherwise, rollover cash outs over $1,000 to an established IRA
- Starting in 2024, $5,000 is increased to $7,000
- An automatic portability provider (“APP”) will be permitted to rollover an automatic cash out IRA established with a participant’s prior employer-sponsored retirement plan into a subsequent eligible defined contribution employer-sponsored retirement plan, provided that:
  - The individual is an active participant in the subsequent plan;
  - The participant was given notice and did not opt out of the transaction; and
  - The APP acknowledges fiduciary status and meets certain other requirements.

Other retirement plan changes:

- Employees making “qualified student loan payments” can have those payments matched in the retirement plan starting in 2024
- Catch-up contributions increase to $10,000 in 2025 for participants age 60-63
- 10% early distribution penalty waived for certain unforeseeable personal or family emergency expenses
  - One distribution up to $1,000 per year
  - Option to repay within 3 years
  - Begins 2028

Other retirement plan changes – con't:

- Certain barriers to the availability of life annuities in qualified plans and IRAs eased starting in 2023
- Qualified longevity annuity contracts:
  - 25% of account balance limit eliminated
  - Cap raised to $200,000
  - Begins immediately
- Starting in 2023, new 401(k) plans sponsored by sole proprietors or single-member LLCs may allow certain deferral contributions up to the date of the employer's tax return filing date for the first year of the plan
- Starting in 2024, discretionary plan amendments increasing benefits may be adopted by the due date of the employer's tax return

Other retirement plan changes – con't:

- Effective immediately, early distributions to terminally ill individuals are exempt from the 10% premature distribution penalty
- A surviving spouse is currently allowed to elect to treat a deceased IRA owner's IRA as the surviving spouse's own IRA for RMD purposes. Starting in 2024, this option is extended to qualified plans.
- Starting 3 years after enactment, distributions up to $2,500 per year to pay premiums on long-term care insurance contracts are exempt from the 10% premature distribution penalty

Other retirement plan changes – con't:

- Roth IRAs are currently exempt from the RMD rules. Starting in 2024, this exemption is extended to Roth amounts in qualified plans.
- Starting in 2023, a SEP and a SIMPLE IRA are permitted to be designated as Roth IRAs
- Plans may allow employees to designate employer matching or nonelective contributions as Roth contributions (effective immediately)

Other retirement plan changes – con't:

- All catch-up contributions to qualified plans must be made on a Roth basis
  - Exception for participants whose prior year wages do not exceed $145,000 (indexed)
  - Not applicable to SIMPLE IRAs and SEP plans
  - This was one of the primary revenue raisers to get the Act within the 10-year budget window by which legislation is "scored" for cost purposes
- Notice 2023-62 indicates that the first two years after December 31, 2023 will be treated as an administrative transition period, so the foregoing requirement will apply beginning after December 31, 2025

SECURE ACT 2.0: INDIVIDUAL RETIREMENT ACCOUNTS (IRA)

Required Minimum Distributions (RMDs):

- Increase in required minimum distribution age:
  - Age 73 starting January 1, 2023
  - Age 75 starting January 1, 2033
- Beginning in 2023, the penalty for not taking an RMD is reduced from 50% to 25%, and decreased even further to 10% if corrected during a 2 year window.

IRA charitable donations:

- Currently, individuals age 70-1/2 and older may transfer up to $100,000 per year from an IRA to a public charity or private operating foundation
- Expanded to permit a one-time election to transfer up to $50,000 to a qualifying charitable remainder annuity trust, a charitable remainder unitrust, or a charitable gift annuity
- The $50,000 and $100,000 limits will be indexed for inflation
- Effective for taxable years ending after the date of enactment

SECURE ACT 2.0: INDIVIDUAL RETIREMENT ACCOUNTS (IRA)

Other IRA changes:

- Catch-up limit for those age 50 and older is inflation indexed after December 31, 2023
- Beneficiaries of 529 college savings accounts are permitted tax and penalty free rollovers of up to $35,000 over their lifetime to ROTH IRAs starting in 2024
- Effective immediately, corrective distributions of excess contributions to an IRA are no longer subject to the 10% premature distribution penalty if the distribution is made before the due date of the IRA owner's federal income tax return for the year of the excess contribution (including extensions)

ESTATE PLANNING

PROPOSED CLAWBACK REGS

- TCJA doubled the estate and gift tax exemption from $5 million to $10 million, inflation adjusted until Jan. 1, 2026
- However, it wasn't clear under TCJA what happens if the taxpayer makes gifts while the higher exemption is in place and then dies after the higher exemption sunsets and the exemption is lower
- Reg. 20.2010-1(c)(1), published November 26, 2019, provided relief from the "clawback"
- Proposed regs released April 26, 2022, would exclude certain transactions from the anti-clawback rules

REG-118913-21

PROPOSED CLAWBACK REGS

- **Proposed Regs would exclude:**
  - Transfers where the donor retains a life estate or other powers or interests described in Sections 2035 through 2038 and Sec. 2042, including gifts made within three years of death and life insurance policies with reversionary interests
  - Enforceable gifts of promissory notes if the promissory note has not yet been paid
  - Gifts of interests in family partnerships and LLCs under Sec. 2701 where the senior generation maintains a preferred equity interest
  - Gifts of interests in trusts, including GRATs and QPRTs, subject to the special valuation rules of Sec. 2702
  - The relinquishment of an interest involving any of the above transactions within eighteen months of the donor's death

PROPOSED CLAWBACK REGS

Example:

***Facts*:**

Rob makes a completed gift of a promissory note in the amount of $9,000,000 on January 1, 2023. The promissory note is Rob's only lifetime gift, and it remains unpaid as of the date of Rob's death on January 1, 2026, at which time the lifetime exemption amount for estate tax purposes has been adjusted to $6,800,000.

Question:

Is the note includible in Rob's estate?

***Answer*:**

The note is treated as includible in Rob's gross estate, and the anti-clawback rules do not apply to the original gift of the note in 2023. As a result, Rob's estate tax is calculated using the reduced $6,800,000 lifetime exemption amount.

PROPOSED CLAWBACK REGS

- **Two exceptions to the proposed regs:**
  - Transfers where the portion subject to gift tax is less than 5% of the total value of the transfer
  - Relinquishments of interests that are triggered by either the passage of time or the death of an individual if provided for in the terms of the original instrument effectuating the transfer

PROPOSED ESTATE ADMINISTRATION REGULATIONS

Published June 28, 2022 under Section 2053:

- Provide guidance on the use of present-value principles in determining the amount deductible by an estate for funeral expenses, administration expenses and certain claims against the estate;
- Provide guidance on the deductibility of interest expense accruing on tax and penalties owed by an estate and interest expense accruing on certain loan obligations incurred by an estate;
- Amend and clarify the requirements for substantiating the value of a claim against an estate that's deductible in certain cases; and
- Provide guidance on the deductibility of amounts paid under a decedent's personal guarantee.

87 Fed. Reg. 38331 (Federal Register: Guidance Under Section 2053 Regarding Deduction for Interest Expense and Amounts Paid Under a Personal Guarantee, Certain Substantiation Requirements, and Applicability of Present Value Concepts)

INTENTIONALLY DEFECTIVE GRANTOR TRUSTS

Revenue Ruling 2023-02

Background:

- Establishing an IDGT requires the grantor to settle an irrevocable trust in which the grantor retains certain powers that cause the trust to be treated as a grantor trust for income tax purposes.
- A grantor trust is not treated as an entity separate from the grantor for income tax purposes and, therefore, the trust's income is taxed to the grantor.
- For estate and gift tax purposes, however, the trust is treated as an entity separate from the grantor.
- Generally, assets transferred to the trust are treated as completed gifts and, therefore, are not included in the grantor's estate upon death.

INTENTIONALLY DEFECTIVE GRANTOR TRUSTS

Revenue Ruling 2023-02:

- There is no basis step-up for assets in an IDGT if the assets are not included in the grantor's gross estate upon his or her death

TAX REIMBURSEMENT CLAUSE CREATES TAXABLE GIFT

ILM 202352018

- Modifying a grantor trust to add a tax reimbursement clause will constitute a taxable gift by the trust beneficiaries to the grantor
- Addition of a discretionary power to distribute income and principal to the grantor is a relinquishment of a portion of the beneficiaries' interest in the trust
- Valued in accordance with the general rule for valuing interests in property for gift tax purposes under the Section 2512 regulations

CASES

BUY-SELL AGREEMENTS & LIFE INSURANCE

Connelly, 8th Circuit Court of Appeals, June 2, 2023

Facts:

- Mike & Tom Connelly were sole shareholders
- Mike and Tom collectively owned 500 shares
  - Mike owned 385.9 shares
  - Tom owned 114.1 shares
- The IRS valued the company at $3.86 million

Facts – con't:

- Buy-sell agreement provided two ways of determining stock value:
  1) Certificate of Agreed Value
  2) Appraisal
- Neither were utilized
- Company maintained $3.5 million in life insurance, and when Mike died it paid $3 million to his estate

BUY-SELL AGREEMENTS & LIFE INSURANCE

Estate's arguments:

- The price paid for Mike's shares was determined pursuant to the buy-sell agreement
- The liability to Mike under the buy-sell agreement offsets the proceeds from the policy

Court:

- The price was not determined under the buy-sell agreement
- It was simply the result of an agreement between Tom and Mike's estate

BUY-SELL AGREEMENTS & LIFE INSURANCE

- The court's reasoning was based upon a hypothetical buyer of the company ending up with either of the following:
  - A company worth $6.86 million (assuming the proceeds are retained by the company), or
  - $3 million in cash and a company worth $3.86 million following the redemption of the portion of the shares acquired that represented Mike's interest

BUY-SELL AGREEMENTS & LIFE INSURANCE

Subsequent Developments:

- The U.S. Supreme Court granted review of *Connelly* on December 13, 2023
- Connelly created a split with other circuits, particularly the 11th Circuit in *Estate of Blount v. Commr*., 428 F.3d 1398 (2005)
- In *Blount*, the 11th Circuit held that a closely held company's obligation to redeem shares offset the life insurance proceeds

BENEFICIARIES & TRUSTEE LIABLE FOR ESTATE TAXES

United States v. Paulson, No. 21-55197 (9th Cir. May 17, 2023)

- Defendants, who had received estate property, were within the categories of persons listed in IRC. §6324(a) and thus are liable for the unpaid estate taxes as beneficiaries and trustees
- §6324(a)(2) imposes personal liability for unpaid estate taxes on the categories of persons listed in the statute who have or receive estate property, either on the date of the decedent's death or at any time thereafter, subject to the applicable statute of limitations

ASSIGNMENT OF INCOME / GIFT SUBSTANTIATION

Estate of Scott M. Hoensheid, et al. v. Commissioner, T.C. Memo 2023-34

Facts:

- Donor donated a portion of the donor's stock in his family business to a donor advised fund at Fidelity
- Shortly after the donation, an unrelated third party purchased the shares in the Company, including Fidelity's shares
- The donor claimed a charitable deduction for the appraised value of the stock on his income tax return and did not report any capital gains on the sale of the stock

ASSIGNMENT OF INCOME / GIFT SUBSTANTIATION

Court:

- Upheld the IRS' denial of the charitable deduction for the contribution of the stock to the donor advised fund
- Held that the donor must include the capital gain from the sale of the stock in his taxable income notwithstanding the fact that the sale occurred after the date of the gift

ASSIGNMENT OF INCOME / GIFT SUBSTANTIATION

Reasoning:

- Communications between the donor, the Company, the purchaser, the donor's counsel, the appraiser, and Fidelity, made it clear that the Company would be sold to a specific buyer shortly after the donation
- The sale of the Company had progressed to the point that the sale was already a "practical certainty" by the date of the gift.
- Thus, the donor must recognize the capital gain on the sale after the date of the gift as if the donor had sold the shares before donating the shares to Fidelity.
- In addition, the appraiser was not a qualified appraiser meeting the requirements set forth in Treas. Reg. § 1.170A-13

ASSIGNMENT OF INCOME / GIFT SUBSTANTIATION

Takeaways:

- Be careful of violating the assignment of income doctrine by making gifts through a prearranged transaction where a sale of the gifted interest is sufficiently imminent and practically certain
- Keep in mind that the circumstances and timing of a sale transaction can be examined on audit, and if, like in *Hoensheid*, the gift is completed at a time when the donor's right to income has already become practically certain, the donor can incur capital gains tax on the sale
- Donors and their advisors must ensure compliance with the requirements for qualified appraisals and qualified appraisers

STATUTE OF LIMITATIONS ON GIFTS

Schlapfer v Commissioner (T.C. Memo 2023-65)

Background:

- IRC §2501(a)(1) imposes a tax on the transfer of property by gift.
- Individuals who make a gift and are subject to the gift tax are required to file a gift tax return for the year of such transfer under IRC §6019.
- Under IRC §6501(a), (c), the Commissioner generally has three years from the filing of a gift tax return to assess gift tax.
- Under Treas. Regs. §301.6501(c)-1(f)(5), this applies even if the gift disclosed is ultimately determined to be an incomplete transfer.
- However, IRC §6501(c)(9) provides that gift tax may be assessed at any time when a reportable gift wasn't reported.
- Treas. Regs. §301.6501(c)-1(f)(2) says that this exception applies unless the gift has otherwise been "reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported."

STATUTE OF LIMITATIONS ON GIFTS

Adequate Disclosure:

- Treas. Regs. §301.6501(c)-1(f)(2) (the Adequate Disclosure Regulation (ADR)) provides, in relevant part, that transfers reported on a gift tax return will be considered adequately disclosed if the return (or an attached statement) provides the following:
  1) A description of the transferred property and any consideration;
  2) The identity of, and relationship between, transferor and transferee; and
  3) A detailed description of the method used to determine the fair market value of the gift.
- The IRS argued that strict compliance with the ADR was required for a gift to be deemed adequately disclosed, and that only the Form 709 should be considered.

STATUTE OF LIMITATIONS ON GIFTS

Court:

- The court held that the limitations period began with the filing of the Form 709 for 2006 (in 2013) and concluded before the IRS issued the notice of deficiency to Schlapfer in 2019.
- The court based its conclusions on following:
  a) The Taxpayer entered the Offshore Voluntary Disclosure Program (OVDP) in 2012 and submitted a disclosure packet to the IRS in November 2013 that included, among other items, the gift tax return for 2006
  b) The entirety of the disclosure packet should be considered
  c) Substantial compliance with the ADR was sufficient

MICHIGAN

PHASE-OUT OF RETIREMENT TAX

Background:

- Signed into law on March 7, 2023
- Phases out the state's "retirement tax" over four years
- Allows taxpayers to choose between the current limitations on the deductibility of retirement and pension income or the limitations specified in the new law

PHASE-OUT OF RETIREMENT TAX

Tax Year	Retiree Date of Birth	Phase-In Subtraction
2023	Jan 1, 1946 - Dec 31, 1958	up to **25%**
2024	Jan 1, 1946 - Dec 31, 1962	up to **50%**
2025	Jan 1, 1946 - Dec 31, 1966	up to **75%**
2026	N/A	up to **100%**

PHASE-OUT OF RETIREMENT TAX

2023 Tax Year

- **Those born in 1945 or before:** There is no change. You can still deduct the full amount of the allowable deduction. For the 2023 tax year, it's $61,518 for single returns and $123,036 for joint returns.
- **Those born between 1946-1952:** You can choose between the maximum deduction of
  a) $20,000 for single returns and $40,000 for joint returns (the previous provisions of the Income Tax Act of 1967), or
  b) Up to 25% of the maximum amount of the allowable deduction for those born in 1945 or before, which for the 2023 tax year would equal a deduction of $15,379.50 for a single return and $30,759 for a joint return.

PHASE-OUT OF RETIREMENT TAX

2023 Tax Year

- **Those born between 1953-1958 who are 67 years of age or older:** You can choose between the maximum deduction of
  a) $20,000 for single returns and $40,000 for joint returns (the previous provisions of the Income Tax Act of 1967), or
  b) Up to 25% of the maximum amount of the allowable deduction for those born in 1945 or before, which for the 2023 tax year equals $15,379.50 for a single return and $30,759 for a joint return.
- **Those born between 1953-1958 who are 66 years of age or younger:** You are not eligible for a deduction under the Income Tax Act of 1967 but do qualify under Public Act (PA) 4 of 2023 to deduct up to 25% of the maximum amount of the allowable deduction for those born in 1945 or before, which for the 2023 tax year equals $15,379.50 for a single return and $30,759 for a joint return.
- **Those born in 1959 and after:** You are not eligible for a deduction in the 2023 tax year.

FLOW-THROUGH ENTITY TAX

Background:

- Allows owners of Flow-Through Entities (S-Corporations & Partnerships) the option to pay and deduct their state and local income taxes at the business-entity level instead of individually.
- Mirrors the so-called State and Local Tax (SALT) cap workaround enacted by several other states and is designed to avoid the $10,000 federal limit on individual itemized deductions for state and local taxes.

Developments:

- Because of the reduction in the personal income tax rate for tax year 2023, the FTE tax rate is likewise reduced to 4.05% for all flow-through entities with tax years beginning in 2023.
- According to a notice issued on April 14, 2023, taxpayer must apply for an extension of time to file its annual flow-through entity tax return, even if the taxpayer was granted an extension on their federal return.

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

- L. 2022, S248 (P.A. 148) ("2022 Public Act 148") (see *State Tax Update*, 07/21/2022), created Chapter 18 within Part 3 of the Income Tax Act
- Generally, Chapter 18 requires final federal adjustments that arise from a partnership level audit or administrative adjustment request subject to the federal Bipartisan Budget Act (BBA) of 2015 to be reported and paid in one of two ways:
  - The partnership may report adjustments to members, who must then separately report and pay their share of the applicable Michigan income tax due (i.e., the "push out" method) or,
  - The partnership may elect to report and pay any applicable Michigan income tax on behalf of its members (i.e., the "pay up" method")

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

Reporting Deadlines:

- A 90-day deadline:
  - For partnerships that "push out" adjustments, to report to each direct partner their share of the adjustments and, if applicable, pay any Michigan income tax on behalf of direct partners previously included on a composite return; and
  - For all partnerships to report certain preliminary information about the adjustments to the Department if it will be making the "pay up" election
- A 180-day deadline:
  - For direct members of a partnership under the “push out” method, to report their share of adjustments to the Department and to pay the Michigan income tax owed on those adjustments; and
  - For a partnership that made the "pay up" election, to pay the collective Michigan income tax owed on those adjustments

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

Effective Date:

- Chapter 18 is generally applicable for the reporting of certain federal adjustments for tax years beginning on and after January 1, 2018
- Because PA 148 was also given retroactive effect, Chapter 18 also applies to federal adjustments that have a “final determination date” both prior to and after its date of enactment
- The 90-day and 180-day deadlines referenced above were treated as beginning on January 1, 2023, for any federal adjustment subject to Chapter 18 that had a "final determination date" prior to that date

Notice Regarding the Implementation of 2022 Public Act 148, Mich. Dept. Treas., 08/26/2022

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

Michigan Treasury Update, Mich. Dept. Treas., 09/01/2023

Annual Report:

- The Michigan Federal Adjustments Report ("FAR") for Partnerships and Other Flow-through Entities (“FAR for partnerships”) must be used by partnerships subject to PA 148 to report information and adjustments to Treasury.
- The FAR for partnerships is an interactive Excel document that collects the necessary information about adjustments and partners and reports the partnership’s tax due or refund.
- It is expected that completed reports will be uploaded through Michigan Treasury Online (MTO) beginning in 2024.

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

Payments or Refund Claims:

- Under the "Pay Up" method, tax, penalty, and interest due from partnerships are paid using MTO.
- Under the "Push Out" method, partnerships are responsible for paying or seeking a refund on behalf of all partners that participated in a composite return (Form 807) filed for the reviewed tax year.
- These partnerships should use Partnership Audit Adjustments Payment Voucher (Form 5839) to make payments.

REPORTING ADJUSTMENTS FROM PARTNERSHIP LEVEL AUDITS

Reporting obligations of partners:

- Partners (or members of another flow-through entity in a tiered structure) that receive pushed-out Michigan adjustments from their partnership or other flow-through entity will have reporting obligations to Treasury.
- In addition, partners will pay tax, penalty and interest to Treasury or make a refund request, whichever is applicable.
- Information about these pushed-out adjustments comes from the partnership; there is no associated Treasury form.
- Partners should then fulfill their obligations to Treasury under the procedures specific to the partner's income tax.
- For a partner subject to the Corporate Income Tax (CIT), the partner should file an amended CIT return (Form 4892) for the reviewed tax year and pay tax or request a refund as they would for any other CIT amended return.
- For a partner subject to the individual income tax—including individuals, trusts, and estates and excluding anyone who participated in a composite return for the reviewed tax year—tax, penalty, and interest due should be paid using a paper check and the Form 5839 voucher.

APPORTIONING INCOME FROM AN ASSET SALE

Vectren Infrastructure Services Corp. v. Department of Treasury,
Mich. S. Ct., Dkt. No. 163742, 07/31/2023

Background:

- Sale of a Michigan business (Vectren) to a Minnesota company (ML) structured as an asset sale
- Issue involved the apportionment of the sales proceeds

Supreme Court:

- To calculate the sales factor, ML's total sales in Michigan during the tax year must be compared to ML's total sales "everywhere" during the tax year.
- "Sales" is defined as "stock in trade," property that can be inventoried, and services sold.
- It does not include the sale of a company.
- Therefore, while the asset-sale income generated from the sale of ML to Vectren is "business income" and includable in the tax base, it is inappropriate to include the asset sale in either the sales-factor numerator or denominator.

CITY OF DETROIT

ELECTRONIC PAYMENTS

News release, Mich. Dept. Treas., 02/07/2023

- City of Detroit individual income taxpayers can now pay by eCheck or debit or credit card their estimated payments, annual return payments, proposed tax due payments, 10-day demand payments, assessment payments or audit payments.
- Payment of city income taxes by eCheck or with a debit or credit card must be made by the due date of the payment.
- The State's eCheck system does not accept payments for Detroit property taxes and other fines.
- Those looking to pay property taxes can continue to do so in-person, by mail or online.

WITHHOLDING

News & Events Digest: August 2023, Mich. Dept. Treas., 08/31/2023

- State law requires that a withholding employer in any city where the Michigan Department of Treasury (Treasury) administers taxes must file a return and pay the tax withheld for each calendar month by the end of the 15th day of the following month.
- Effective January 1, 2024, employers will be required to file and pay their City of Detroit withholding tax monthly.
- State law also requires employers to file an annual City of Detroit Income Withholding Reconciliation (Form 5321) before February 28 of the immediately following calendar year.
- City Withholding Tax forms and documents will be updated to reflect the new monthly filings. The forms will only be available online or through applicable software vendors. Paper forms and booklets will no longer be printed and mailed to employers.

WITHHOLDING

- Treasury is working to implement an electronic payment system that will accept debit and credit cards or Automated Clearing House (ACH) or Electronic Fund Transfer (EFT) payments.
- Debit and credit card payments will have a service fee, while ACH or EFT payments will not. Taxpayers interested in using a fee-free EFT payment method must submit a City of Detroit Electronic Funds Transfer Debit Applications, Account Update (Form 5473), which will be available by December 31, 2023.

Breakfast Bites®

THANK YOU

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