32nd Annual

Tax Symposium

ROUNDUP OF RECENT TAX DEVELOPMENTS

William E. Sigler, Esq.

Maddin Hauser
Attorneys and Counselors

Maddin, Hauser, Roth & Heller, P.C.
28400 Northwestern Hwy. Southfield, MI 48034
p (248) 354-4030 f (248) 354-1422 maddinhauser.com

ROUNDUP OF RECENT TAX DEVELOPMENTS

- Individuals
- Business
- Inflation Reduction Act
- Retirement
- Estate Planning

INDIVIDUALS

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)

Background: Premium Tax Credit (PTC)

- Refundable credit design to subsidize health insurance purchased through an Exchange
- Based on percentage of income the cost of premiums represents ranging from:
  - 2% of income for those below 133% of the federal poverty line, to
  - 9.5% of income for those at 400% of the federal poverty line

IRC §36B

PREMIUM TAX CREDIT

Background: Advanced Premium Tax Credit (APTC)

- Taxpayer signs up for insurance through the exchange using prior year tax information
- Exchange then pays an amount to the health insurance provider
- Health insurance provider reduces the monthly health insurance premium paid by taxpayer
- Advance received reduces the PTC allowed on the tax return

PREMIUM TAX CREDIT

American Rescue Plan Act of 2021

- Changes the percentages to increase the affordability of health insurance for 2021 and 2022
- Also makes the PTC available to taxpayers with income above 400% of the federal poverty line if cost of premiums would exceed 8.5% of household income
- Extended for 3 years through 2025 by the Inflation Reduction Act of 2022

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

TAXATION OF STATE PAYMENTS

Background:

- On February 10, 2023, the IRS issued news release IR-2023-23 providing guidance for the 2023 tax filing season on various kinds of state payments many of which were related to COVID-19
- The news release indicated that for 2022 only, the IRS wouldn't challenge the treatment of a 2022 payment on either an original or amended return

TAXATION OF STATE PAYMENTS

Notice 2023-56:

- Issued by the IRS in response to requests for additional information on payments made in 2023 and future years
- Indicates that, in general, state payments are taxable unless a specific exclusion applies
- Examples include state tax refunds, certain welfare payments, and certain disaster relief payments

SUPERVISORY PENALTY APPROVAL

REG-121709-19

Background:

- IRC §6751(b) requires the immediate supervisor of a revenue agent to approve the determination of a penalty
- IRC §6751(b)(2) exempts penalties automatically calculated by electronic means
- Courts have been inconsistent particularly with respect to the timing of the approval requirement

SUPERVISORY PENALTY APPROVAL

Proposed regulations adopt three timing rules:

1) For penalties appearing in a pre-assessment notice, must be no earlier than the date of the notice
2) For penalties raised in the Tax Court after a petition is filed, must be obtained before the court is asked to determine the penalty
3) For penalties assessed without prior opportunity for Tax Court review, may be any time before assessment

LOOKBACK PERIOD FOR REFUND CLAIMS EXTENDED

Background:

- Refund claims must be filed by later of:
  1) Three years from when return filed; or
  2) Two years from the time the tax was paid.
- Taxes are deemed to be paid when the return is filed

Example:

A taxpayer would have until April 15, 2023 or October 15, 2023 to file a refund claim on 2019 taxes depending on whether an extension was filed

LOOKBACK PERIOD FOR REFUND CLAIMS EXTENDED

Problem:

- Notice 2020-23 postponed 2019 filing date to July 15, 2020
- Notice 2021-21 postponed 2020 filing date to May 17, 2021
- Both were “postponements,” not “extensions”
- Thus, they did not lengthen the lookback period back to the original filing date

Notice 2023-21:

- Grants relief
- Automatic (no form needs to be filed)

DIRECT-FILE PROGRAM

IR-2023-192

- Details of 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
- Arizona, California, Massachusetts and New York are preparing to integrate their state taxes into the program
- At least nine other states that have no state income tax are partnering with the IRS

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

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 ($10,000 per employee for the year including health care expenses)
  - For 2021, 70% of qualified wages ($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

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 exclusi qon 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 were based on factors involving liability, management and participation

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

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

CANCELLATION OF NONRECOURSE DEBT

Parker, T.C. Memo. 2023-104

Facts:

- S corporation sold interest in real estate to unrelated third party
- Lender agreed to cancel nonrecourse debt owed by disregarded entities that the corporation controlled
- Instead, lender received partial payment from the buyer, new guarantees and an escrowed deed

CANCELLATION OF NONRECOURSE DEBT

Taxpayer:

- Argued that the nonrecourse debt was excludable cancellation of debt income under IRC §108(a)(1)(B) because the S corporation was insolvent

Court:

- Cancelled nonrecourse debt was gain realized on the sale
- Not excludable cancellation of debt income

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

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

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

INFLATION REDUCTION ACT OF 2022

Notice 2023-59:

- Outlines requirements for claiming the IRC §25C home energy audit credit 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

2023 EV CREDIT AVAILABILITY

Notice 2023-1:

- Guidance on what cars and trucks qualify for the new clean vehicle tax credits in 2023
  - Included only four manufacturers: Ford, Rivian, Stellantis, and Nissan
- Provides guidance on how it will calculate a vehicle's manufacturer's suggested retail price for purposes of qualifying for the credit
- Leaves open questions about how requirements for electric vehicle battery content will work

2023 EV CREDIT AVAILABILITY

Notice 2023-16:

- Changed the vehicle classification standards to allow more vehicles to qualify for the credit

Notice 2023-9:

- EV credit is equal to the lesser of: 15% of the basis of the vehicle (30% if the vehicle is not powered by a gasoline or diesel internal combustion engine) or the incremental cost of the vehicle
- Limited to $7,500 for a vehicle with a GVWR of less than 14,000 pounds, and $40,000 for other vehicles
- “Incremental cost” means the excess of the vehicle’s purchase price over the price of a comparable vehicle
- Treasury Department and IRS will accept a taxpayer’s use of the incremental cost published in the DOE

RETIREMENT

RMD 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.

ESTATE PLANNING

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

CASES

BUY-SELL AGREEMENTS & LIFE INSURANCE

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

Facts:

- Mike & Tom Connelly were sole shareholders
- 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 math:
  - The IRS valued the company at $3.86 million
  - Mike and Tom collectively owned 500 shares
  - Thus, the per share value was $7,720
  - After paying off Mike's estate, the company was still worth $3.86 million, but since Tom owned 114.1 shares those shares were now worth $33,800 each
- That didn't make sense to the court, so it ruled that the life insurance is included in the value of the corporation for purposes of determining the value of a decedent's stock

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 entirety of the disclosure packet should be considered
  b) Substantial compliance with the ADR was sufficient.

LEVY ON TRUST BANK ACCOUNT

Marshall F. Newman et al. v. United States et al., No. 1:20-cv-10632 (D. Mass. 2023)

Facts:

- Albert Todesca owed the IRS income taxes and trust fund recovery penalties (TFRP)
- In 2011 his dad created a trust which, at his death, called for the equal division of the trust for the benefit of his two sons, Albert and Paul
- Father passed away in 2017 and the IRS issued a bank levy thereafter to the bank holding a money market account and a checking account in the trust's name
- The trust directed the trustee to distribute "so much of the annual net income in such amount or amounts or principal as the said Albert M. Todesca may, from time to time, request, or, in the absence of such request, so much thereof as the Trustee in his sole discretion shall deem necessary for the maintenance, support and general welfare of said, Albert M. Todesca"

LEVY ON TRUST BANK ACCOUNT

Court:

- Concluded that the taxpayer's right to demand distributions was a property right to which the federal tax lien attached
- Pointed out that the taxpayer's interest in the trust's principal and interest had pecuniary value and that the spendthrift provision didn't immunize it from the federal tax lien

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THANK YOU

William E. Sigler, Esq.

Shareholder

(248) 827-1865

(248) 359-6165

wsigler@maddinhauser.com

Maddin Hauser
Attorneys and Counselors

Maddin, Hauser, Roth & Heller, P.C.

28400 Northwestern Hwy. Southfield, MI 48034

p (248) 354-4030 f (248) 354-1422 maddinhauser.com