

2022 WICPA TAX CONFERENCE

YOUR SOURCE FOR KEY UPDATES & INSIGHTS ON TIMELY ISSUES

THURSDAY, NOV. 3 & FRIDAY, NOV. 4
BROOKFIELD CONFERENCE CENTER
& WICPA CPE LIVESTREAM



CONFERENCE AT A GLANCE

THURSDAY, NOV. 3 | BROOKFIELD CONFERENCE CENTER | BROOKFIELD

7 – 8 a.m.

Registration & Networking
Celebration Atrium

8 – 8:15 a.m.

Welcome & Opening Remarks
Connect B

8:15 – 9:45 a.m.

GENERAL SESSION
Federal Tax Update Part 1
Connect B

9:45 – 10 a.m.

Networking Break
Celebration Atrium

10 – 11:30 a.m.

GENERAL SESSION
Federal Tax Update Part 2
Connect B

11:30 a.m. – 12:45 p.m.

Networking Lunch
Collaborate

12:45 – 1:45 p.m.

BREAKOUT SESSIONS
Cryptocurrency Taxes: Implications,
Planning & Strategies
Connect B

SMLLC to Partnership & Back:
Accounting for Rev. Rul. 99-5 &
99-6 Transactions
Connect C1

1:45 – 2 p.m.

Networking Break
Celebration Atrium

2 – 3 p.m.

GENERAL SESSION
IRS Update
Connect B

3 – 3:10 p.m.

Networking Break
Celebration Atrium

3:10 – 4 p.m.

BREAKOUT SESSIONS
Corporate Transparency Act
Connect C2

Section 1202: Understanding the
Often Overlooked Gain Exclusion
Connect B

Employee Retention Credit: Do Your
Clients Have a Refund Available?
Connect C1

4 – 4:10 p.m.

Networking Break
Celebration Atrium

4:10 – 5 p.m.

GENERAL SESSION
Hot Tax Practice Procedure &
Ethical Issues
Connect B

5 – 6:30 p.m.

Networking Social
Celebration Atrium

CONFERENCE AT A GLANCE

FRIDAY, NOV. 4 | BROOKFIELD CONFERENCE CENTER | BROOKFIELD

7 – 8 a.m.

Registration & Networking
Celebration Atrium

8 – 8:15 a.m.

Welcome & Opening Remarks
Connect Ballroom

8:15 – 9:20 a.m.

GENERAL SESSION
Wisconsin Tax Update
Connect B

9:20 – 9:40 a.m.

Networking Break
Celebration Atrium

9:40 – 10:40 a.m.

GENERAL SESSION
Wisconsin Department of Revenue
Update
Connect B

10:40 – 11 a.m.

Networking Break
Celebration Atrium

11 a.m. – 12 p.m.

BREAKOUT SESSIONS
International Tax Issues for the
General Practitioner
Connect C2

Remote Sellers Tax Update &
Physical Presence: Is It Still Relevant?
Connect C1

Medicare Planning
Connect B

12 – 1 p.m.

Networking Lunch
Collaborate

1 – 2 p.m.

BREAKOUT SESSIONS
M&A Teamwork: The CPA,
Investment Banker & Attorney
Connect C2

Family Offices Large, Medium &
Small
Connect C1

Schedules K-2 & K-3: What
Taxpayers Need to Know
Connect B

2 – 2:15 p.m.

Networking Break
Celebration Atrium

2:15 – 3:45 p.m.

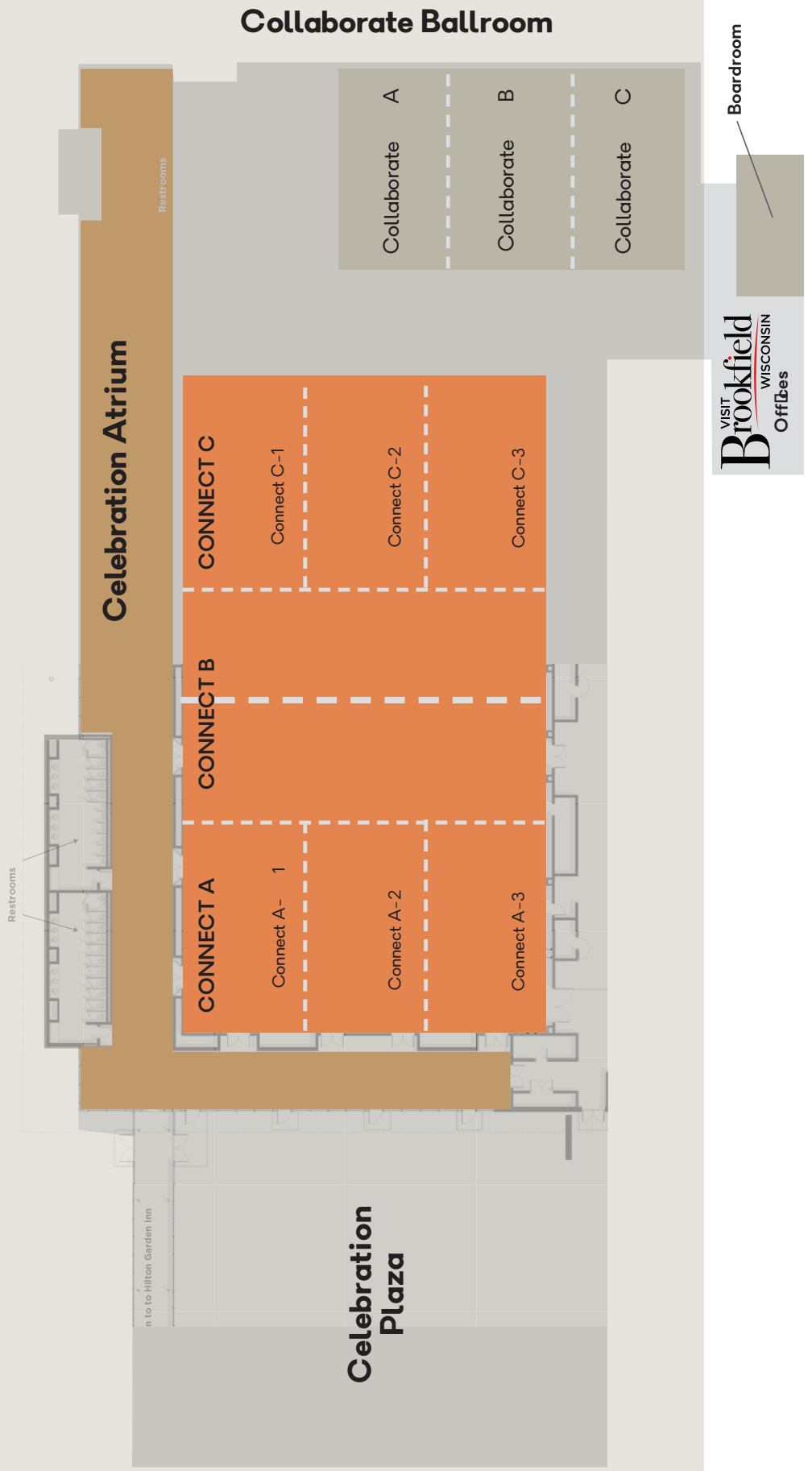
GENERAL SESSION
The SECURE Act Regulations: IRAs
After Death
Connect B

3:45 p.m.

Closing Remarks & Raffle Drawings
Connect B

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FLOOR PLANS AND CAPACITY CHARTS



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*based on 2020 Client Retention Rates

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8:15 – 9:45 a.m. and 10 – 11:30 a.m.

Federal Tax Update Part 1 & 2

Edward Zollars, CPA, Tax Partner, Thomas, Zollars & Lynch, Ltd.

Federal Tax Update 2022

Edward K. Zollars, CPA (Arizona)
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Legislative Changes

Inflation Reduction Act of 2022

- Signed into law on August 16, 2022 (Date of enactment)
- While it's clear there are Build Back Better Act roots, most of BBBA did not make this bill and many provisions in the bill are very different from BBBA versions
- Bill includes
 - Two major large corporation revenue raisers
 - Extension of Premium Tax Credit provisions added in ARPA
 - Many energy related provisions, most of which are credits

Inflation Reduction Act of 2022

- Most provisions take effect in 2023, but there are some items that impact 2022
- Looking at highlights today, not the entire act
 - Will only consider energy provisions that clients of local CPA firms might actually make use of
 - Will only very briefly discuss two key large corporation provisions (minimum tax & excise tax on stock buy-backs)

ARPA Premium Tax Credit Rules Extended Through 2025

- **Effective Date:** Extension will move the end of the special rules to December 31, 2025. Previously these rules would have expired at the end of 2022.
- ARPA provided lower percentage tables & got rid of cliff at 400% of Federal poverty line
- Otherwise subsidized premiums would have gone up in 2023
- Percentages that had just been published by IRS

Household income percentage of Federal poverty line:	Initial percentage	Final percentage
Less than 133%	1.92%	1.92%
At least 133% but less than 150%	2.88%	3.84%
At least 150% but less than 200%	3.84%	6.05%
At least 200% but less than 250%	6.05%	7.73%
At least 250% but less than 300%	7.73%	9.12%
At least 300% but not more than 400%	9.12%	9.12%

ARPA Premium Tax Credit Rules Extended Through 2025

- Table reverts to same table used in 2021 and 2022

Household income percentage of Federal poverty line:	Initial percentage	Final percentage
Up to 150%	0%	0%
At least 150% but less than 200%	0%	2.0%
At least 200% but less than 250%	2.0%	4.0%
At least 250% but less than 300%	4.0%	6.0%
At least 300% but less than 400%	6.0%	8.5%
400% and higher	8.5%	8.5%

ARPA Premium Tax Credit Rules Extended Through 2025

- Can still get credit if household income exceed 400% of FPL if second lowest cost silver policy exceeds 8.5% of household income
- Note that the “affordable” percentage for employers remains at the inflation adjusted rate.

Extension of Limitation on Excess Business Losses of Noncorporate Taxpayers

- **Effective Date:** Taxable years beginning after December 31, 2026.
- 2022 limit on excess business loss deduction is \$270,000/\$540,000
- In Tax Cuts and Jobs Act this limit was scheduled to go away after 2025 (though no one believed it would really--including Sen. Thune)
 - Was extended for one year in ARPA to raise funds for that bill
 - Got extended two more years to swap out extension of state and local tax cap (which is just as unlikely to ever go away) to pay for private equity partnership relief related to the corporate minimum tax (Thune amendment)

Raise Limit to Using \$500,000 of R&D Credit Against Payroll Taxes for QSB

- **Effective Date:** Tax years beginning after December 31, 2022
- Research and development credit allowed certain qualified small businesses (QSB) to use up to \$250,000 a year of credit against employer payroll taxes for up to 5 years
- Will add an additional \$250,000 (so raise total to \$500,000 a year) to the special employer payroll tax offset

Energy Efficient Home Improvement Credit - Extension, Expansion & Renaming of Credit

- **Effective Date:** Generally, the new and revised provisions apply to property placed in service after December 31, 2022, and before January 1, 2033. However, the bill also moves the expiration date of the old law forward by one year so that the old rules will apply to 2022 tax returns. The requirement to provide a product identification number takes effect for property placed in service after December 31, 2024.

Energy Efficient Home Improvement Credit - Extension, Expansion & Renaming of Credit

- Restores the Nonbusiness Energy Property Credit (prior name) under 2021 rules for 2022
 - For many clients they've already used up the lifetime caps (\$500 with further limits on specific areas)
 - But if there is still room for the client, can pick up any remaining amounts on 2022 returns
- 2022 - get 30% credit on two prior categories (with revisions) but also a *home energy audit*
- Note that, unlike other items, a *home energy audit* only works for principal residence

Energy Efficient Home Improvement Credit - Extension, Expansion & Renaming of Credit

- Big change - no longer lifetime limits and limits get larger
 - Limits are now annual, so taxpayers can claim a credit every year
 - For most of the items, overall annual limit of \$1,200 per year
 - Qualified energy property - \$600
 - Exterior windows and skylights - \$600
 - Doors - \$250 in the case of any single exterior door and \$500 for all exterior doors and
 - Home energy audit - \$150

Energy Efficient Home Improvement Credit - Extension, Expansion & Renaming of Credit

- Notwithstanding the above rule, the maximum credit for heat pump and heat pump water heaters & biomass stoves and boilers is \$2,000
- Modifications related to qualified energy efficiency improvements
 - New standards for some items
 - Roofs no longer qualify
 - Air sealing materials or systems are added
- Now property only has to be used by the taxpayer as a residence, but not necessarily as their principal residence (except for home energy audits)

Energy Efficient Home Improvement Credit - Extension, Expansion & Renaming of Credit

- Beginning in 2025 will have to provide a product identification number to claim a credit
 - Unique to each item to be assigned by manufacturer under rules to be proposed by the IRS
 - If number is not provided, credit will not be allowed—most likely electronic filing will reject if not provided

Extension and Modification of Residential Clean Energy Credit

- **Effective Date:** Most changes are effective for property placed in service after December 31, 2021. However, changes related to battery storage technology and the definition of that technology take effect for expenditures made after December 31, 2022.
- Applied to solar electric, solar hot water, fuel cell, small wind energy, geothermal heat pump, and biomass fuel property installed in homes prior to 2034.

Extension and Modification of Residential Clean Energy Credit

- Resets rates and extends the credit:
 - 30% for property placed in service after December 31, 2021, and before January 1, 2033,
 - 26% for property placed in service after December 31, 2032, and before January 1, 2034, and
 - 22% for property placed in service after December 31, 2033, and before January 1, 2035.
- Adds qualified battery storage technology expenditures to qualified expenditures for property placed in service after December 31, 2022

Elective Payments and Transferable Credits

- **Effective date:** These provisions are effective for taxable years beginning after December 31, 2022.
- Meant to allow tax exempt organizations and entities with insufficient income tax liabilities to still get a benefit from certain energy related credits

Elective Payments and Transferable Credits

- **Elective Payment for tax-exempt organizations - applicable entities**
 - Any organization exempt from income tax,
 - Any State or local government (or political subdivision thereof),
 - The Tennessee Valley Authority,
 - An Indian tribal government (as defined in IRC §30D(g)(9)),
 - Any Alaska Native Corporation (as defined in 43 USC 1602(m)), or
 - Any corporation operating on a cooperative basis that is engaged in furnishing electric energy to persons in rural areas
- List of eligible credits found at page 12 of materials
- Treated as a payment of income taxes (IRC §6417)

Elective Payments and Transferable Credits

- Transfer of Certain Credits - can be transferred by any taxpayer that is not an applicable entity eligible to elect to treat credits as a payment of income taxes under IRC §6417.
- List of eligible credits found at page 14 of materials
- Would allow selling the credit (at a discount) to a taxpayer with taxable income or to a more profitable entity

Other Energy Provisions Not Covered in Detail Today

- §45 Electricity produced from certain renewable resources, etc. – extended and modified
- §48 Energy credit – extended and modified
- §45Q Credit for carbon oxide sequestration –extended and modified
- §45U Zero-emission nuclear power production credit—new credit added
- §40A Biodiesel and renewable diesel used as fuel—extended
- §40 Alcohol, etc., used as fuel—extension
- §40B Sustainable aviation fuel credit—new credit added

Other Energy Provisions Not Covered in Detail Today

- §45V Credit for production of clean hydrogen—new credit added
- §179D Energy efficient commercial buildings deduction—modified
- §45L New energy efficient home credit—extended, increased and modified
- §48C Qualifying advanced energy project credit—revised
- §45X Advanced manufacturing production credit—new credit added
- §45Y Clean electricity production credit—new credit added
- §48E Clean electricity investment credit—new credit added

Other Energy Provisions Not Covered in Detail Today

- §168(e)(3)(B) Green Energy Property Classified as 5-Year MACRS Property and
- §45Z Clean fuel production credit—new credit added

Vehicle Credits

- Prior to IRA 2022 had
 - Single new qualified plug-in electric drive motor vehicle credit (subject to manufacturer unit limits) and
 - Alternative fuel refueling property credit
- IRA 2022
 - Revises and renames credit for new electric (and fuel cell) vehicles
 - Adds credit for buying a used clean vehicles
 - Adds commercial credit for clean vehicles and certain equipment
 - Extends and modifies alternative fuel refueling property credit

New Clean Vehicle Credit

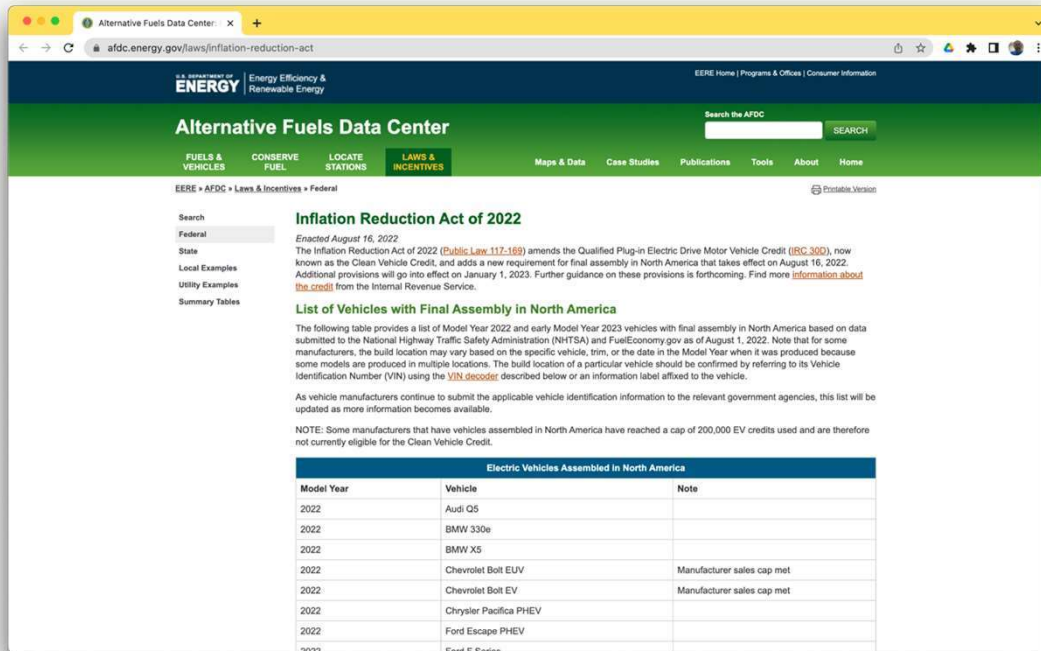
- **Effective date:** Applies to vehicles placed in service after December 31, 2022. The provision requiring final assembly take place in North America is effective for vehicles placed in service after August 15, 2022 except for vehicles eligible for the transition rule where the taxpayer makes the appropriate election.
- Renames the credit to the new clean vehicle credit

New Clean Vehicle Credit

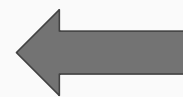
- Adds one change for remainder of 2022, with all other requirements remaining the same
- The *final assembly* of a vehicle must take place in North America for the vehicle to qualify for the credit.
 - Significant change from proposed BBBA - no prevailing wage rule and expands production to North America
 - Manufacturer unit limit rules still apply for 2022, so vehicles from Tesla and General Motors still cannot qualify (until next year)
 - Rule will continue to apply for 2023 and later years

New Clean Vehicle Credit

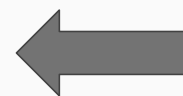
- Final assembly test applies to all vehicles
 - Placed in service after August 15, 2022 unless
 - Was subject to a binding contract by August 15, 2022 and the taxpayer elects to apply the prior rules to that vehicle
- Department of Energy has published list of vehicles with (at least some units) with final assembly in North America
 - Will be updated by the Department of Energy
 - Still must verify your particular vehicle was actually assembled in North American plant by checking VIN (some are assembled at multiple locations around the world)



Model Year	Vehicle	Note
2022	Audi Q5	
2022	BMW 3-series Plug-In	
2022	BMW X5	
2022	Chevrolet Bolt EUV	Manufacturer sales cap met
2022	Chevrolet Bolt EV	Manufacturer sales cap met
2022	Chrysler Pacifica PHEV	
2022	Ford Escape PHEV	
2022	Ford F Series	
2022	Ford Mustang MACH E	
2022	Ford Transit Van	
2022	GMC Hummer Pickup	Manufacturer sales cap met
2022	GMC Hummer SUV	Manufacturer sales cap met
2022	Jeep Grand Cherokee PHEV	
2022	Jeep Wrangler PHEV	

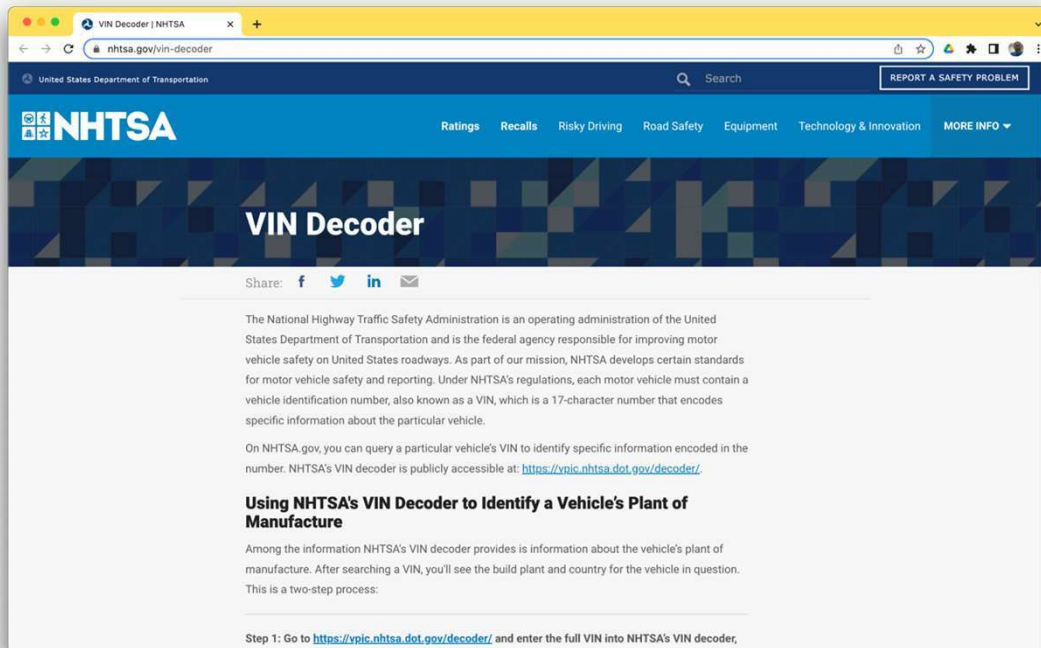
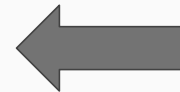


Vehicles where cap has been met don't qualify for 2022 credit



2022	Lincoln Aviator PHEV	
2022	Lincoln Corsair Plug-in	
2022	Lucid Air	
2022	Nissan Leaf	
2022	Rivian EDV	
2022	Rivian R1S	
2022	Rivian R1T	
2022	Tesla Model 3	Manufacturer sales cap met
2022	Tesla Model S	Manufacturer sales cap met
2022	Tesla Model X	Manufacturer sales cap met
2022	Tesla Model Y	Manufacturer sales cap met
2022	Volvo S60	
2023	BMW 3-series Plug-In	
2023	Bolt EV	Manufacturer sales cap met
2023	Cadillac Lyriq	Manufacturer sales cap met
2023	Mercedes EQS	
2023	Nissan Leaf	

Vehicles where cap has been met don't qualify for 2022 credit



New Clean Vehicle Credit

- Remainder of items take effect for vehicles placed in service after December 31, 2022 unless otherwise noted
- Computation of the maximum credit for a vehicle
 - \$3,750 if satisfies the *critical minerals* requirement for the tax year and
 - \$3,750 if satisfies the *battery component* requirements for the tax year
 - Total credit is \$7,500
 - Note - current DoE list does not take these requirements into account

New Clean Vehicle Credit

- Critical minerals requirement - percentage of value of applicable critical minerals which are
 - Either extracted or processed in the United States or a country we have a free trade agreement with or
 - Recycled in North America

New Clean Vehicle Credit

- Percentages
 - 2023 - 40%
 - 2024 - 50%
 - 2025 - 60%
 - 2026 - 70%
 - 2027 and later - 80%
- Beginning in 2025 no credit allowed if any critical materials extracted, processed, or recycled by a foreign entity of concern

New Clean Vehicle Credit

- Battery Component Requirement - percentage of value of components in the battery manufactured or assembled in North America is greater or equal to:
 - 2023 - 50%
 - 2024 or 2025 - 60%
 - 2026 - 70%
 - 2027 - 80%
 - 2028 - 90%
 - 2029 or later - 100%

New Clean Vehicle Credit

- For battery component requirements the foreign entity of concern ban applies beginning in 2024
- Definition of new clean vehicle
 - Minimum battery capacity is 7 kilowatt hours (not really an issue, since that's smaller than what we see today)
 - Seller must provide report to buyer and the IRS regarding the vehicle
 - Includes a qualified fuel cell vehicle
 - Must be made by a qualified manufacturer (signs up with the IRS and meets standards)

New Clean Vehicle Credit

- Modified adjusted gross income (only real adjustments are foreign/territorial income exclusions) limitations - can qualify based on year claiming the credit or the prior taxable year
 - \$300,000 - Married filing jointly and surviving spouse
 - \$225,000 - Head of household
 - \$150,000 - Single and married filing separately
- Note, this is a *cliff* test - \$1 of income can cause a \$7,500 increase in tax

New Clean Vehicle Credit

- Manufacturer's suggested retail price limitation - will not apply if manufacturer's suggested retail price is greater than
 - \$80,000 for a van, sports utility vehicle or pickup truck or
 - \$55,000 for all other vehicles
- IRS to develop classification rules using criteria similar to that employed by the EPA and Department of Transportation
- VIN will have to be disclosed on the tax return to claim this credit

New Clean Vehicle Credit

- Beginning in 2024, the taxpayer can transfer the credit to the dealer at the time of sale and get an immediate reduction in purchase price or rebate
 - Dealer must register with IRS and follow specific rules
 - Payment or reduction in price not taxable to the buyer, nor is it deductible to the dealer.
- Buyer will have to repay the credit (that is, have the amount added back as a tax) if it is determined when the buyer's tax return is filed that he/she/they don't qualify for the credit due to the MAGI limit
- The credit does not apply to vehicles placed in service after December 31, 2032

Credit for Previously-Owned Clean Vehicles

- **Effective date:** Except for the transfer of a credit to a dealer rule, the credit will apply to vehicles acquired after December 31, 2022. The transfer of credit to a dealer rule will be delayed by one year, applying to vehicles acquired after December 31, 2023.
- Credit equal to lesser of:
 - \$4,000 or
 - 30% of the sales price of the vehicle

Credit for Previously-Owned Clean Vehicles

- **Previously-owned clean vehicle defined:**
 - The model year of which is at least 2 years earlier than the calendar year in which the taxpayer acquires such vehicle,
 - The original use of which commences with a person other than the taxpayer,
 - Which is acquired by the taxpayer in a qualified sale, and
 - Which--
 - Generally, meets the requirements to be eligible for the clean vehicle credit or
 - Is a clean fuel-cell vehicle which has a gross vehicle weight rating of less than 14,000 pounds

Credit for Previously-Owned Clean Vehicles

- Qualified sale is a sale of a motor vehicle
 - By a dealer,
 - For a sales price that does not exceed \$25,000, and
 - Which is the first transfer since the date of the enactment of IRA 2022 to a qualified buyer other than the person with whom the original use of such vehicle commenced

Credit for Previously-Owned Clean Vehicles

- Qualified buyer is a taxpayer
 - Who is an individual,
 - Who purchases such vehicle for use and not for resale,
 - Who is not eligible to be claimed as a dependent by another taxpayer, and
 - Who has not been allowed a credit under this section for any sale during the 3-year period ending on the date of the sale of such vehicle.
- Note - parents can't just "not claim" the child to qualify the child for this credit
- VIN must be provided by taxpayer to claim the credit

Credit for Previously-Owned Clean Vehicles

- Lower modified adjusted gross income numbers for this credit - ½ of the ones for the new clean vehicle credit
 - \$150,000 - married filing jointly and surviving spouse
 - \$112,500 - head of household
 - \$75,000 - single and married filing separately
- MAGI computed in same manner as for the new clean energy credit

Credit for Previously-Owned Clean Vehicles

- Same rules apply for transferring the credit to the dealer (including being first available in 2024)
- Credit is no longer available for vehicles placed in service after December 31, 2032

New Credit for Qualified Commercial Clean Vehicles

- **Effective date:** The credit applies to vehicles acquired after December 31, 2022.
- Amount of the credit (initial credit) is the lesser of:
 - 15 percent of the basis of such vehicle (30 percent in the case of a vehicle not powered by a gasoline or diesel internal combustion engine), or
 - The *incremental cost* of such vehicle
- The incremental cost of a qualified commercial clean vehicle is an amount equal to the excess of the purchase price for such vehicle over such price of a comparable vehicle.

New Credit for Qualified Commercial Clean Vehicles

- Initial credit is limited to the lesser of the initial credit or:
 - In the case of a vehicle which has a gross vehicle weight rating of less than 14,000 pounds, \$7,500, and
 - In the case of a vehicle with a weight rating of 14,000 pounds or more, \$40,000.

New Credit for Qualified Commercial Clean Vehicles

- A qualified commercial clean vehicle means any vehicle—
 - That meets the definition of a new clean vehicle for purposes of the new clean vehicle credit and is acquired for use or lease by the taxpayer and not for resale
 - Either—
 - Is treated as a motor vehicle for purposes of title II of the Clean Air Act and is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails), or
 - Is mobile machinery, as defined in IRC §4053(8) (including vehicles that are not designed to perform a function of transporting a load over the public highways),

New Credit for Qualified Commercial Clean Vehicles

- A qualified commercial clean vehicle means any vehicle (continued)—
 - Either—
 - Is propelled to a significant extent by an electric motor which draws electricity from a battery which has a capacity of not less than 15 kilowatt hours (or, in the case of a vehicle which has a gross vehicle weight rating of less than 14,000 pounds, 7 kilowatt hours) and is capable of being recharged from an external source of electricity, or

New Credit for Qualified Commercial Clean Vehicles

- A qualified commercial clean vehicle means any vehicle (continued)—
 - Either (continued)—
 - Is a motor vehicle which satisfies the following requirements:
 - Which is propelled by power derived from 1 or more cells which convert chemical energy directly into electricity by combining oxygen with hydrogen fuel which is stored on board the vehicle in any form and may or may not require reformation prior to use, and

New Credit for Qualified Commercial Clean Vehicles

- A qualified commercial clean vehicle means any vehicle (continued)—
 - Either (continued)—
 - Is a motor vehicle which satisfies the following requirements (continued):
 - Which, in the case of a passenger automobile or light truck, has received on or after the date of the enactment of this section a certificate that such vehicle meets or exceeds the Bin 5 Tier II emission level established in regulations prescribed by the Administrator of the Environmental Protection Agency under section 202(i) of the Clean Air Act for that make and model year vehicle, and
 - Is of a character subject to the allowance for depreciation

New Credit for Qualified Commercial Clean Vehicles

- Certain tax exempt entities can ignore the requirement that the asset be subject to depreciation:
 - the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing,
 - an organization (other than a cooperative described in section 521) which is exempt from tax imposed by this chapter, or
 - any Indian tribal government described in section 7701(a)(40).

New Credit for Qualified Commercial Clean Vehicles

- No double benefit allowed (can't claim new clean vehicle credit on same vehicle)
- Vehicle identification number must be provided to claim the credit
- Certain clean vehicle credit rules apply
- The credit will not apply to any vehicle acquired after December 31, 2032.

Alternative Fuel Refueling Property Credit

- **Effective date:** The delay in termination for credits under this section is effective for property placed in service after December 31, 2021. For all other provisions found in IRA 2022, the provisions are effective for property placed in service after December 31, 2022. Thus, the credit continues under the rules in place for 2021 for 2022, then is revised beginning in 2023.

Alternative Fuel Refueling Property Credit

- Prior law version of credit extended through 2022
- Revised basic credit beginning in 2023
 - 6% up to a maximum credit of \$100,000 for qualified alternative fuel property subject to depreciation (business property) or
 - 30% up to a maximum of \$1,000 for any other qualified property

Alternative Fuel Refueling Property Credit

- Commercial project qualifies for higher 30% credit if either the property is part of:
 - A project the construction of which begins prior to the date that is 60 days after the IRS issues guidance on meeting the *prevailing wage* and *apprenticeship* requirements or
 - A project that meets the *prevailing wage* and *apprenticeship requirements*

Alternative Fuel Refueling Property Credit

- *Prevailing wage* requirement for a project:
 - Met for a project if the taxpayer ensures that any laborers and mechanics employed by the taxpayer or any contractor or subcontractor in the construction of any qualified alternative fuel vehicle refueling property which is part of such project shall be paid wages at rates not less than the prevailing rates for construction, alteration, or repair of a similar character in the locality in which such project is located as most recently determined by the Department of Labor, in accordance with subchapter IV of chapter 31 of title 40, United States Code.
 - Optionally can follow the correction and penalty provisions to be deemed to meet the prevailing wage requirement.

Alternative Fuel Refueling Property Credit

- *Apprenticeship* requirement for a project:
 - The rules generally require that no less than the applicable percentage of the total labor hours of the construction, alteration, or repair work (including such work performed by any contractor or subcontractor) with respect to such facility shall, subject to the apprentice to journeyworker ratio rule described at IRC §45(b)(8)(B), be performed by qualified apprentices.
 - 10% - construction begins before 2023
 - 12.5% - construction begins in 2023
 - 15% - construction begins after 2023

Alternative Fuel Refueling Property Credit

- *Apprenticeship* requirement for a project:
 - Regardless of the percentage, each taxpayer, contractor, or subcontractor who employs 4 or more individuals to perform construction, alteration, or repair work with respect to the project construction shall employ 1 or more qualified apprentices to perform such work.
 - Is a *good faith* exception if attempt to obtain apprentices but unable to do so for qualified reasons
 - A penalty provision (\$50 or \$500 per hour short on apprenticeship work) can bring project into compliance with apprenticeship requirements.

Alternative Fuel Refueling Property Credit

- Changes in qualified property
 - The *bidirectional charging equipment* provision provides that property will not fail to be treated as qualified refueling property solely because the property—
 - Is capable of charging the battery of a motor vehicle propelled by electricity, and
 - Allows discharging electricity from such battery to an electric load external to such motor vehicle

Alternative Fuel Refueling Property Credit

- Changes in qualified property
 - Electronic charging stations for 2-3 wheeled vehicles:
 - The property otherwise meets the requirements to be qualified alternative fuel vehicle refueling property under IRC §30C,
 - Is of a character subject to depreciation, and
 - Is for recharging of a motor vehicle which—
 - Is manufactured primarily for use on public streets, roads, or highways (not including a vehicle operated exclusively on a rail or rails),
 - Has 2 or 3 wheels, and
 - Is propelled by electricity

Alternative Fuel Refueling Property Credit

- Eligible census tract requirement-property must be in an eligible census tract which:
 - Is a low-income community described in IRC §45D(e), or
 - Is not an urban area.
- An urban area is “a census tract (as defined by the Bureau of the Census) which, according to the most recent decennial census, has been designated as an urban area by the Secretary of Commerce.”

Provisions Mainly Applicable to Large or Public Corporations

- 15% corporate minimum tax based on adjusted financial statement income (\$1 billion or more average)
- 1% excise tax on repurchase of corporate stock (publicly traded companies)
- While there has been a lot of discussion about these items in the financial press, most of us won't be handling this issue from a tax perspective (more likely those in financial planning would study potential economic impact)

Corporate Alternative Minimum Tax (IRC §56A, Act Section 10101)

- **Effective Date:** Tax years beginning after December 31, 2022.
- *Applicable corporation test* - corporations other than S corporations, RICs, or REITs that meet the *average adjusted financial income test* for one or more taxable years that are:
 - Prior to the current taxable year and
 - End after December 31, 2021.

Corporate Alternative Minimum Tax (IRC §56A, Act Section 10101)

- A corporation meets the average annual adjusted financial statement income test for a taxable year if the average annual adjusted financial statement income of such corporation (determined without regard to section 56A(d)) for the 3-taxable-year period ending with such taxable year exceeds \$1,000,000,000.
- The tentative minimum tax applies at a rate of 15% of the adjusted financial statement income as determined under IRC §56A over the corporate AMT tax credit for the tax year.

Corporate Alternative Minimum Tax (IRC §56A, Act Section 10101)

- The tax applies to the extent the tentative minimum tax exceeds the corporation's regular income tax for the year, including the base erosion and anti-abuse tax (BEAT) for the year
- The adjusted financial statement income begins with the net income or loss found on the taxpayer's applicable financial statement per IRC §451(b)(3).

Corporate Alternative Minimum Tax (IRC §56A, Act Section 10101)

- Various adjustments, including substituting MACRS depreciation for GAAP depreciation are made to this income.

1% Excise Tax on Repurchase of Corporate Stock (Act Section 10201)

- **Effective Date:** repurchases of stock after December 31, 2022.
- The law imposes on each covered corporation a tax equal to 1% of the fair market value of stock the corporation repurchases.
- A covered corporation is a U.S. corporation which is traded on an established securities market (as defined in IRC §7704(b)(1)), or basically a publicly traded security.

1% Excise Tax on Repurchase of Corporate Stock (Act Section 10201)

- The tax does not apply in various circumstances:
 - To the extent that the repurchase is part of a reorganization (within the meaning of section 368(a)) and no gain or loss is recognized on such repurchase by the shareholder by reason of such reorganization,
 - In any case in which the stock repurchased is, or an amount of stock equal to the value of the stock repurchased is, contributed to an employer-sponsored retirement plan, employee stock ownership plan, or similar plan,
 - In any case in which the total value of the stock repurchased during the taxable year does not exceed \$1,000,000,

1% Excise Tax on Repurchase of Corporate Stock (Act Section 10201)

- The tax does not apply in various circumstances:
 - Under regulations prescribed by the Secretary, in cases in which the repurchase is by a dealer in securities in the ordinary course of business,
 - To repurchases by a regulated investment company (as defined in section 851) or a real estate investment trust, or
 - To the extent that the repurchase is treated as a dividend for income tax purposes.

Upcoming Issues

Any Other Changes Coming?



Photo by [Virgil Cayasa](#) on [Unsplash](#)

- May still see an extenders bill later this year or early next. Items we may see include:
 - An extension of 100% bonus depreciation (scheduled to drop to 80%)
 - Restore ability to expense research and experimental expenditures under IRC §174 (now have to amortize over 5 or 15 years beginning in 2022)
 - Anything else Congress feels like extending...

Developments

IRS Delays Initial Effective Date of SECURE Act Proposed Regulations RMD Rule

- Notice 2022-53, 10/7/22
 - Relates to inherited balance in pay status at time inherited
 - Proposed regulations require annual distributions for years 1-9
 - Regulations issued in February 2022 but stated applied to 2021
 - IRS will not penalize failure to take such RMDs in 2021 or 2022
 - Will be effective no earlier than 2023

IRS Provides Automatic Relief for Certain S Corporation Problems

- Revenue Procedure 2022-19, 10/11/19
 - Agreements and Arrangements with No Principal Purpose to Circumvent One Class of Stock Requirement
 - Governing Provisions That Provide for Identical Distribution and Liquidation Rights
 - Procedures for Addressing Missing Shareholder Consents, Errors with Regard to a Permitted Year, Missing Officer's Signature, and Other Inadvertent Errors and Omissions

IRS Provides Automatic Relief for Certain S Corporation Problems

- Revenue Procedure 2022-19, 10/11/19
 - Procedures for Verifying S Elections or QSub Elections
 - Procedures for Addressing a Federal Income Tax Return Filing Inconsistent with an S Election or a QSub Election
 - Procedures for Retroactively Correcting One or More Non-Identical Governing Provisions

IRS Provides Automatic Relief for Certain S Corporation Problems

- Revenue Procedure 2022-19, 10/11/19
 - Note: IRS will now not issue PLRs in areas where this procedure offers automatic relief

Broad Beneficial Owner Reporting Rules for 2024

- RIN 1505-AB49, 9/30/22
 - Most closely held LLCs and corporations have to report in 2024
 - Report *beneficial owners*
 - More than 25% ownership interest
 - Substantial control
 - \$500 per day penalty for willful failure to file

AICPA Proposes Revisions to Statements on Standards for Tax Services

- Revised Statements on Standards for Tax Services: An Exposure Draft and Invitation to Comment, American Institute of Certified Public Accountants, 8/29/22
 - Proposed reorganization
 - Proposed data protection standard
 - Proposed tools standard
 - Proposed representation standard
 - Comments about tax practice quality control

Taxpayer Erroneously Receiving PPP Forgiveness Taxable on Forgiveness

- CCA 202237010, 9/16/22
 - Memorandum looks at taxable status if IRS discovers taxpayer did not qualify for forgiveness given
 - IRS position is that exclusion is only for qualifying forgiveness as defined by CARES Act and later amendments
 - Taxable under claim of right theory
 - Footnote suggests tax status if SBA later collects - but omits one option

Lenders Told Not to Issue 1099-Cs on Student Loan Discharges Excluded from Income by ARPA

- Notice 2022-01, 12/21/21
 - ARPA made discharge of student loans nontaxable through 2025
 - IRS notifies lenders not to issue Forms 1099-C for such discharges
 - Notes that doing so is likely to result in unnecessary notices to borrowers

Retired Pilot Subject to Tax on Flights Taken by Relatives Under Airline Program

- *Mihalik v. Commissioner*, T.C. Memo. 2022-36, 4/13/22
 - Taxpayer was a retired United Airlines pilot
 - Various family members (apparently) had access to free flights
 - Exclusion for no additional cost fringes limited to spouse and dependent children
 - Also rejected idea this was a *de minimis* fringe benefit

Management Fees Were Distributions, Not Ordinary and Necessary Business Expense

- *Aspro v. Commissioner*, Case No. 21-1996, CA8, 4/26/22
 - For at least 20 years C corporation had paid management fees to owners
 - No formal agreement
 - No method provided for how it was computed
 - Court found no evidence was ordinary and necessary business expense
 - Treated as a distribution

Contribution Deduction Lost Over Two Problems

- *Keefe v. United States*, USDC ND TX, Case No. 3:20-cv-00836, 7/6/22
 - Partnership readying to sell major asset at gain
 - Partner donates a 4% interest to DAF, but only gives rights to sales proceeds
 - Gets two documents claims they were CWA
 - Did not give entire asset
 - Also did have proper DAF CWA document

Substantial Compliance Not Relevant for Steps Mandated by Statute

- *Izen v. Commissioner*, CA5, Docket No. 21-60679, 6/29/22
 - IRC §170(f)(12) mandates acknowledgment/documentation for contribution of items
 - Taxpayer and charity did not prepare Form 1098-C

Substantial Compliance Not Relevant for Steps Mandated by Statute

- *Izen v. Commissioner*, CA5, Docket No. 21-60679, 6/29/22
 - Taxpayer argued that documents did have and actions should count as substantial compliance
 - Documents did not have TIN, a requirement under the law
 - Courts cannot use substantial compliance when actual actions are not in compliance with the law Congress wrote

Taxpayer Loses Entire Deduction Due to Defect in Documentation of Her Contribution

- *Albrecht v. Commissioner*, TC Memo 2022-53, 5/25/22
 - Taxpayer made noncash contribution to museum
 - Strict substantiation rule for contemporaneous written acknowledgment
 - Deed refers to Gift Agreement not provided - found failed to state consideration received or that none was received

AICPA Makes Recommendations on Research & Development Cost Guidance for Revised §174

- “Comments on Research & Experimental Expenditures under section 174,” Letter from AICPA Tax Executive Committee to Associate Chief Counsel Holly Porter, 5/26/22
 - TCJA changes now require amortization
 - AICPA asks for guidance to limit costs involved
 - Also need guidance for software costs

Remote Signature of Certain Plan Documents - the Final Relief?

- Notice 2022-27, 5/13/22
 - COVID relief issued in 2020 to allow for
 - Remote notarization
 - Remote signing in front of plan representative
 - Was going to expire on June 30
 - Extended until December 31, 2022
 - Most likely last extension

Proposed SECURE Act RMD Regulations Issued

- REG-105954-20, Federal Register Vol. 87, No. 37, 2/24/22
 - Effective date
 - Non-designated beneficiary
 - Designated beneficiaries other than eligible designated beneficiaries

Proposed SECURE Act RMD Regulations Issued

- REG-105954-20, Federal Register Vol. 87, No. 37, 2/24/22
 - Eligible designated beneficiaries
 - Surviving spouse issues
 - Using 10 year rule
 - Other issues

No Permission to File Form 3115 Late for Change Made Without Permission Much Earlier

- PLR 202223011, 6/10/22
 - Accounting method rules
 - The taxpayer's situation - made change to accrual without permission
 - IRS ruling - issues with asking for Form 3115 relief
 - Why was this ruling requested

Final Regulations Confirm No Signatures Needed on Section 754 Elections

- TD 9963, 8/4/22
 - Election to adjust basis in certain situations
 - Previously had to sign election, scan it and attach as PDF
 - In 2017 proposed regulations on which taxpayers could rely proposed removing signature requirement
 - The IRS has now finalized these regulations without making any changes

Final Version of Form 7203 Issued by IRS for 2020 Returns

- Form 7203, 1/19/22
 - Previously discussed this form when originally proposed and then when released in draft form
 - Now both the form and instructions are out in final form for 2020
 - Note suggestion to prepare the form even if it is not currently required

Form 7203 - Dealing With Basis for S Corporations

- Kristen A. Parillo, "New Basis Reporting Form Spotlights Role of Proper Documentation," Tax Notes Today Federal, 6/1/22
 - Why Form 7203 was created
 - Not an issue if records kept
 - When client doesn't track basis - options
 - Losses previously claimed in excess of basis - suspense account

Fact Property Is/Isn't a Real Estate Rental for Passive Rules Irrelevant for Self-Employment Income

- Chief Counsel Advice 202151005, 12/23/21
 - Is there a link between rental for §469 and self-employment income exclusion under §1402(a)(1)?
 - IRS answers no - §469 treatment as rental doesn't impact other IRC provisions
 - Looks at what is a §1402(a)(1) rental of real estate
 - Two examples discussed

IRS Extends Late Portability Election Relief to Five Years Following Date of Death

- Revenue Procedure 2022-32, 7/8/22
 - Portability election
 - Original Revenue Procedure 2017-34
 - IRS modifying late relief to attempt to get rid of PLR requests
 - Estates that qualify
 - Impact on the surviving spouse and estate
 - No letter rulings issued if this relief applies

AICPA Asks for Additional K-2 and K-3 Guidance

- AICPA Tax Executive Committee Letter, "Urgent Request for Immediate Guidance Regarding New International Reporting Requirements, Schedule K-2 and Schedule K-3 for Tax Year 2021," 8/31/22
 - Partner relevance exception
 - Partner attribute requirement
 - Removal of general presumption
 - Permanently extend FAQ 15 exception

AICPA Asks for Additional K-2 and K-3 Guidance

- AICPA Tax Executive Committee Letter, "Urgent Request for Immediate Guidance Regarding New International Reporting Requirements, Schedule K-2 and Schedule K-3 for Tax Year 2021," 8/31/22
 - Allow for consolidated Form 8082 filing
 - Simplified foreign tax credit reporting
 - Allow summary for sale of personal property

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - Statute under old TEFRA rules
 - Must file return to start statute
 - Regulations on what is a filing
 - Taxpayer contacted in 2005 by IRS agent, indicated no record of 2001 partnership filing
 - Provided agent with signed copy and certified mail receipt

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - Exam commenced and in 2007 another signed copy of the return provided to IRS counsel
 - More than 3 years after 2007 copy provided IRS issued FPAA - taxpayer complains it's late
 - IRS says no, return never filed and Tax Court agreed - so case went to Ninth Circuit

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - Taxpayer concedes cannot show return delivered to Ogden (will deal with this quirky admission later)
 - Regulations require return to be sent to designated service center and before date required to be filed
 - IRS says they never sent a copy to Ogden, so the statute never began running

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - Majority finds that the taxpayer had not met requirements for a timely return proper filing
 - However, since return was not filed timely, no regulations described how to file the return
 - So providing the returns to the IRS agent amounted to a filing under plain meaning of the term

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - Long dissent tears into the majority logic
 - Suggests was a results driven opinion with legal holdings that lead to absurd results
 - As long as taxpayer doesn't file on time, can give the return to any random IRS employee in dissent's view

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - But what about that certified mail receipt
 - But must show
 - Receipt stamped by USPS employee
 - Timely postmark
 - Properly addressed

Providing Return to IRS Agent at Agent's Request Counts as Filing, Statute Began Running

- *Seaview Trading LLC v. Commissioner*, CA9, Case No. 20-72416, 5/11/22
 - But what about that certified mail receipt
 - Appears there was some issue with the certified mail receipt
 - However, never actually presented that evidence for a ruling by the court
 - But note IRS also seemed confident it had issues

Federal Tax Update 2022

Edward K. Zollars, CPA
(Arizona)

edzollars@thomaszollarslynch.com

12:45 – 1:45 p.m.

Cryptocurrency Taxes: Implications, Planning & Strategies

Dr. Sean Stein Smith, CPA, CMA, CFE, CGMA, *Assistant Professor,
City University of New York - Lehman College*

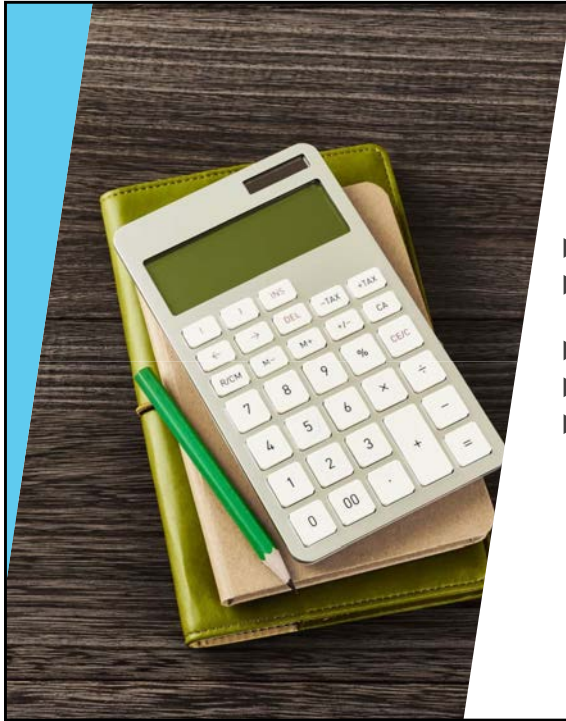
Crypto Tax Deep Dive

Dr. Sean Stein Smith
City University of New York
Wall Street Blockchain
Alliance



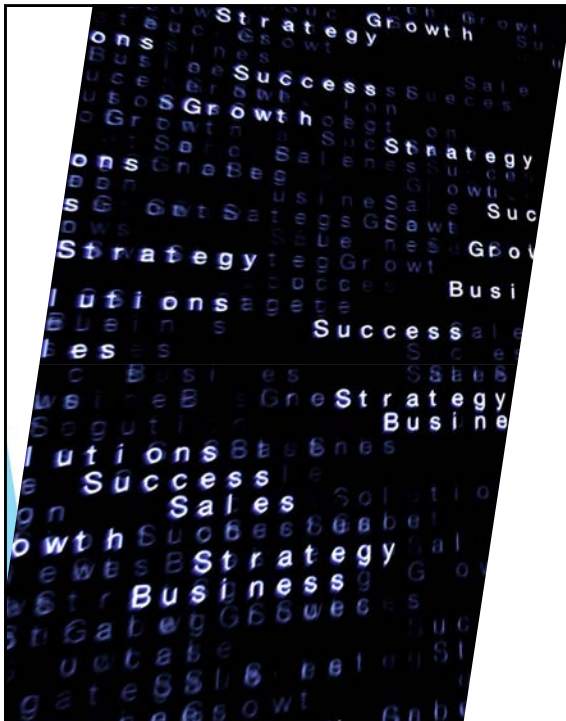
About me

- ▶ Dr. Sean Stein Smith, CPA, CMA, CGMA, CFE
- ▶ Assistant Professor, Lehman College, City University of New York
- ▶ Forbes Contributor - Crypto & Blockchain
- ▶ AICPA Outstanding CPA of the Year (2022)
- ▶ Accounting Today Top 100 Most Influential People in Accounting
- ▶ E.C. Harwood Visiting Research Fellow - American Institute of Economic Research
- ▶ Board of Advisors - Wall Street Blockchain Alliance (WSBA)
- ▶ Chair, Accounting Working Group, WSBA
- ▶ Advisory Board Member - Gilded "Crypto Accounting Made Simple"
- ▶ Strategic Advisor - Crescent City Capital
- ▶ 40 under 40 in Accounting (2017-2021)
- ▶ NJCPA Trustee (2022 FY)



Agenda

- ▶ Quick market update & FAQs
- ▶ Decentralized Finance (DeFi) activities
- ▶ Non-fungible tokens
- ▶ Stablecoins
- ▶ Taxes and organizational implications



Market update

Agenda

- ▶ U.S. GAAP cryptoasset update and open items
 - ▶ Implications for organizations holding/using crypto
- ▶ Federal and state crypto update
 - ▶ Tax planning implications
- ▶ Corporate Transparency Act
 - ▶ Introduction & overview

Ethereum merge, recap.

- ▶ The Ethereum merge has successfully been completed (September 2022)
 - ▶ Ethereum blockchain has converted from Proof-of-Work consensus to Proof-of-Stake consensus
 - ▶ Energy consumption will decline by approximately 99% as a result
 - ▶ Opens the door for further pivoting away from BTC to ETH as crypto market leader
- ▶ Tax accounting has not changed
 - ▶ More on that later
- ▶ Financial accounting has not changed
 - ▶ Not yet at least

Is ether a security?

- ▶ Same day as ETH merge completing, SEC chair Gary Gensler offered testimony that staked crypto could qualify as securities
- ▶ Meet criteria of the Howey Test as an “investment contract”
- ▶ <https://cointelegraph.com/news/ether-staking-could-trigger-securities-laws-gensler>

Ether staking could trigger securities laws — Gensler

Though he did not specify any particular crypto, SEC chair Gary Gensler said proof-of-stake cryptocurrencies could be subject to securities laws.



ETHPoW Fork?

- ▶ Speculated to possibly cause some issues with regards to the appetite/market post-merge
- ▶ Appealed to PoW miners looking to remain in business
- ▶ Token crashed up to 75% at worst declines following the merge
 - ▶ (24-36 hours after)
- ▶ Is showing signs of gaining popularity with some non-U.S. mining pools, etc.
- ▶ <https://cointelegraph.com/news/does-ethereum-s-new-ethpow-fork-stand-a-chance-ethw-price-falls-65-post-merge>
- ▶ <https://news.bitcoin.com/new-ethereum-pow-fork-gathers-60-terahash-from-well-known-pools-ethws-price-shudders-39-in-24-hours/>
- ▶ <https://decrypt.co/110023/ethereum-fork-ethpow-suffers-bridge-replay-exploit-token-tanks-37>

SEC Crypto Asset Office - Sept 2022

- ▶ Office of Crypto Assets will join the seven (7) existing offices that handle corporate disclosure filings
- ▶ <https://www.reuters.com/markets/us/us-sec-set-up-new-office-crypto-filings-2022-09-09/>
- ▶ *Office of Crypto Assets*
- ▶ The Office of Crypto Assets will continue the work currently performed across the DRP to review filings involving crypto assets. Assigning companies and filings to one office will enable the DRP to better focus its resources and expertise to address the unique and evolving filing review issues related to crypto assets.
- ▶ <https://www.sec.gov/news/press-release/2022-158>

Crypto Tax Focus

Everyone ready?

The 1040 Crypto Question

- ▶ Question about crypto involvement is still on the 1040, but now the language has been tweaked to include “disposed of” in the question itself
- ▶ Basically the question is now focusing on the transactions themselves versus the taxability of those transactions
- ▶ Transparency is key

2019 At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? Yes No

Question on Schedule 1

2020 At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? Yes No

Question moved to 1040, but otherwise the same

2021 At any time during 2021, did you receive, sell, exchange, or otherwise dispose of any financial interest in any virtual currency? Yes No

FBAR requirement?

- ▶ FinCEN has been going back and forth on this issue, but what exactly are we talking about?
- ▶ No requirement to report crypto held in overseas wallets - at this time
- ▶ Lots of debate over
- ▶ 1) Whether crypto will have to be reported via an FBAR at all
- ▶ 2) What is the cut-off level for this reporting (\$10,000, or something else)
- ▶ 3) Who has to report these items?
- ▶ <https://tokentax.co/blog/how-to-file-a-crypto-fbar/>
- ▶ <https://www.natlawreview.com/article/fincen-seeks-to-establish-fbar-requirement-cryptocurrency-accounts-2021>

What about FATCA? (Form 8938)

- ▶ What about it?
- ▶ Threshold for reporting (single filer) is if
 - ▶ 1) total value of foreign assets exceed \$50,000 as of last day of tax year
 - ▶ 2) total value is above \$75,000 at any point during the year
- ▶ You might have a FBAR filing requirement without FATCA, but if you file FATCA you are almost guaranteed to have an FBAR requirement
- ▶ As with everything else, a lot of uncertainty

Bipartisan Infrastructure Bill

- ▶ This bill passed in November 2021
- ▶ One minor clause now includes a change to how crypto is treated
 - ▶ Under this change, crypto is now treated as the equivalent as cash
 - ▶ Just for Section 6050I
- ▶ Any trade or business that receives \$10,000 or more in physical currency (now including crypto) has significant reporting requirements
 - ▶ Including Form 8300
- ▶ All brokers will have to file 1099 and declarations
- ▶ <https://www.wsj.com/articles/bitcoin-like-cash-crypto-currency-digital-assets-sect-60501-tax-code-infrastructure-bill-mchenry-ryan-11642449658>

But there is more

- ▶ Major concern was that miners, coders, stakers, and other developers would be lumped in as “brokers”
- ▶ Treasury came out (Spring 2022) and said that would not be the case
- ▶ No official ruling from the IRS as of yet
- ▶ <https://www.theblockcrypto.com/post/134039/us-treasury-reiterates-that-the-irs-wont-consider-crypto-miners-stakers-or-coders-to-be-brokers>
- ▶ Will also impact DeFi (more on that later)

Jarrett vs. United States

- ▶ Nothing has changed as a result of these headlines
- ▶ Trial itself is only scheduled for 2023
- ▶ Evidence gathering has just started (March 2022)
- ▶ No change to IRS guidance or FAQs
- ▶ No indication that policy changes are coming
- ▶ Conversation specific to the unique facts and circumstances of this case and complaints therein
- ▶ <https://www.natlawreview.com/article/recent-tax-developments-concerning-staking-rewards>

Reporting crypto taxable income

- ▶ Crypto income and earnings are taxable, no matter what reddit or Instagram experts say
- ▶ Capital gains and losses should be reported on form 8949
 - ▶ IRS cross checks disclosure question with form 8949
- ▶ Those gains/losses flow through to Schedule D
- ▶ Mining income is generally considered ordinary income
- ▶ Paying/being paid in crypto should be reported at FMV at the date of payment

Erroneous tax data

- ▶ Repurposing 1099-B's have been put forward as the solution to produce more crypto tax data
- ▶ Not a perfect solution
- ▶ Crypto exchanges do not always have basis data
- ▶ Interoperability and cross-chain applications can make traditional reporting more complicated
- ▶ <https://www.coindesk.com/layer2/taxweek/2022/02/23/form-1099-b-is-not-the-solution-to-your-cryptocurrency-tax-problems/>



Stablecoin

Are these taxable or what?

Stablecoin breakdown

- ▶ Have a market capitalization well in excess of \$150 billion USD
- ▶ Used for transactional purposes, and play an integral role in the DeFi economic landscape
- ▶ Issued by private organizations and are pegged to external assets
 - ▶ Fiat currencies
 - ▶ External assets (gold/oil)
 - ▶ Other cryptocurrencies
- ▶ But, are they taxable?

Stablecoin taxes?

- ▶ Stablecoins are treated the exact same way as other cryptoassets
- ▶ When used for purchases or paying for goods and services these cryptoassets must be disclosed, reported, and have any applicable taxes paid based on these transactions
- ▶ Only primary upside is
 - ▶ Lack of volatility means the tax obligations will be limited
 - ▶ Authorization by major players means that reporting/disclosure is more consistent and understandable
- ▶ Who is involved?

Does this matter?

Cryptocurrency is talked about a lot, but does it actually matter for you and your clients

Now or in the future?

Yes!

Coinbase has 80 million users worldwide, with nearly 3 million trading daily

As per most recent filings

Do these sound familiar?

- ▶ PayPal - 361 million users
- ▶ Visa - over 1 billion accounts worldwide
- ▶ Mastercard - over 700 million accounts worldwide
- ▶ Venmo - over 50 million monthly users
- ▶ CashApp - over 30 million monthly users
- ▶ They all allow crypto transactions
- ▶ Does it matter now?

Decentralized Finance

What is DeFi?

- ▶ New name and term for what was called “open finance”
- ▶ An umbrella term for a suite of blockchain projects and initiatives
- ▶ Runs primarily on Ethereum or Ethereum-based blockchains
- ▶ Increased reliance on smart contracts
- ▶ Capitalization of DeFi market grown from \$686 million in Jan 2020
- ▶ Over \$15 billion in Jan 2021
- ▶ Still \$170 billion by Q3 2022
- ▶ [https://news.bitcoin.com/total-value-locked-in-defi-reaches-250-billion-uniswap-quickswap-trader-joe-dominate-dex-volumes/#:~:text=The%20total%20value%20locked%20\(TVL\)%20in%20defi%20has%20reached%20an,value%20has%20expanded%20by%2025%25.](https://news.bitcoin.com/total-value-locked-in-defi-reaches-250-billion-uniswap-quickswap-trader-joe-dominate-dex-volumes/#:~:text=The%20total%20value%20locked%20(TVL)%20in%20defi%20has%20reached%20an,value%20has%20expanded%20by%2025%25.)

DeFi applications

- ▶ Decentralized exchanges (DEX)
- ▶ Stablecoins
- ▶ Crypto lending programs
- ▶ Wrapped bitcoins
- ▶ Prediction markets
- ▶ Yield farming
- ▶ Liquidity mining
- ▶ Composability
- ▶ Money legos

DeFi Tax Focus

- ▶ Staking
- ▶ Block rewards
- ▶ DeFi lending and liquidity pools
- ▶ Wrapped tokens
- ▶ Crypto loans and borrowing

Staking

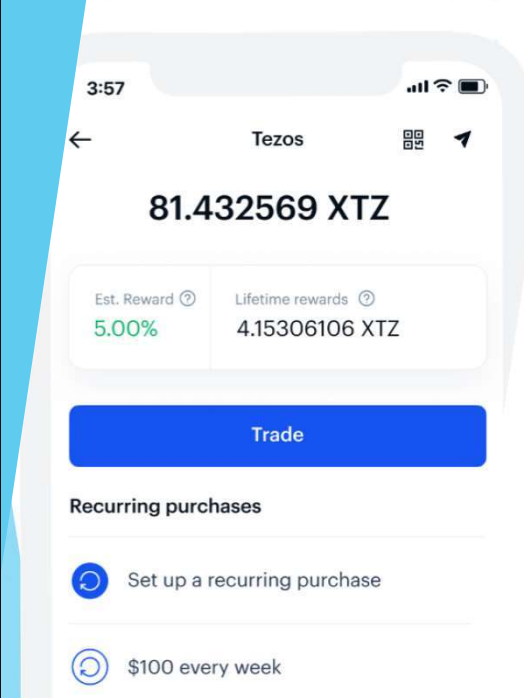
- ▶ Staking is a complicated issue that can vary depending on the investors and platforms involved
- ▶ Generally conducted as a way for investors to earn rewards for holding/investing into certain cryptocurrencies
- ▶ Crypto becomes part of a staking pool, and is utilized by the blockchain protocol for Proof-of-Stake consensus validation
- ▶ Allows taxpayers to earn crypto denominated income in a passive way
- ▶ Almost always involves a vesting or lock-up period where crypto is inaccessible

Staking taxes

- ▶ Is staking treated as ordinary income? No hard and fast answer as of yet
- ▶ Numerous lawsuits and arguments on this issue
 - ▶ Including the Jarrett v United States
- ▶ Congressional Blockchain Caucus also arguing for clearer and consistent regulation
- ▶ Also need to answer whether this meets the criteria of a trade or business?

Different crypto staking

- ▶ First question to ask is what kind of crypto staking arrangement is actually being used
 - ▶ Are the cryptos that are “locked” actually being used to validate transactions
 - ▶ Or is the arrangement more of a yield-generation one
- ▶ Actually running the node might be considered an active trade
 - ▶ Normally referred to as a validator versus a staker
- ▶ Delegated staking (usual type) is unlikely to be active



3:57

← Tezos

81.432569 XTZ

Est. Reward ☺	Lifetime rewards ☺
5.00%	4.15306106 XTZ

Trade

Recurring purchases

- Set up a recurring purchase
- \$100 every week

How widespread is it?

- ▶ What are the odds you have clients that are involved in crypto staking?
- ▶ Is it easy to get involved or super complicated
- ▶ Easy to do on your phone

How to report staking income?

- ▶ No hard and fast guidance on these issues as of right now
- ▶ Best bet is to be transparent and consistent with regards to what is reported and where it is reported
- ▶ Schedule 1 Line 8 is common location for reporting staking income
- ▶ Used as the catch-all for various types of other earnings, winnings, or types of income
- ▶ No predetermined home for staking income at the IRS

Wrapped tokens

What??

What is a wrapped token?



Bitcoin	-2.68%	Ethereum	\$2,489.64	-5.29%	XRP	\$0.719910	-2.84%	Terra	\$78.79	-6.1%
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Trying to trade bitcoin on the Ethereum blockchain is a little like trying to get a PC game to run on a Mac – it won't work unless you install special software. Thankfully, on blockchains, this process is rather simple thanks to something called a wrapped token. But what is a wrapped token exactly, and how does it work?

Put simply, a wrapped token is a token that represents a cryptocurrency from another blockchain or token standard and is worth the same as the original cryptocurrency. Unlike the original cryptocurrency, the wrapped token can be used on certain non-native blockchains and later redeemed for the original cryptocurrency.

One of the biggest benefits of wrapped tokens is they create greater interoperability between non-compatible cryptocurrencies and blockchains – opening the door for things like bitcoin lending or borrowing ether on DeFi platforms. This provides greater liquidity to decentralized services and boosts the utility of crypto assets.

▶ <https://www.coindesk.com/learn/what-are-wrapped-tokens/#:~:text=Put%20simply%2C%20a%20wrapped%20token,redeemed%20for%20the%20original%20cryptocurrency.>

▶ But what does this actually mean?

Implications of wrapped tokens

- ▶ Bitcoin is the largest and most well-known blockchain protocol and platform, but is not the most robust or even widely developed
- ▶ Ethereum and ERC-20 tokens are popular for
 - ▶ Smart contracts
 - ▶ NFTs
 - ▶ Decentralized finance
- ▶ Wrapped tokens allow holders of bitcoin (for out example) to obtain functionality on this more widely developed blockchain
- ▶ Cool, but what about taxes???

Quick take on wrapping bitcoin

- ▶ Wrapped bitcoin (wBTC) is most popular wrapped token currently
 - ▶ Well over \$10 billion
- ▶ Wrapping bitcoin involves the following steps
 - ▶ Own bitcoin (obviously)
 - ▶ Find a wBTC provider
 - ▶ Merchant sends BTC to a custodian who mints your wBTC and holds your BTC
 - ▶ Can be redeemed, and wBTC is destroyed when BTC is returned to you
- ▶ Maintains the constant level of BTC (21 million hard cap)
- ▶ Allows BTC holders to monetize crypto holdings

Taxes on wrapped tokens

- ▶ Wrapped tokens are treated the same as other virtual or digital currencies under current IRS guidance
- ▶ Ordinary income or capital gains treatment
- ▶ Same disclosure and reporting rules apply
- ▶ Earnings denominated in crypto usually reported at FMV at the date they are earned
 - ▶ Open to debate
- ▶ Question also includes whether wrapping the token represents a crypto-to-crypto swap (taxable), or just holding the same asset with a different name (non-taxable)

Bridged crypto?

How Do Blockchain Bridges Work?

Blockchain bridges can do a lot of cool stuff like converting smart contracts and sending data, but the most common utility is token transfer. For example, bitcoin and Ethereum are the two largest cryptocurrency networks and have vastly different rules and protocols. Through a blockchain bridge, bitcoin users can transfer their coins to Ethereum and do with them what they otherwise could not on the bitcoin blockchain. That can include purchasing various Ethereum tokens or making low-fee payments.

When you have bitcoin and want to transfer some of it to Ethereum, the blockchain bridge will hold your coin and create equivalents in ETH for you to use. None of the crypto involved actually moves anywhere. Rather, the amount of BTC you want to transfer gets locked in a smart contract while you gain access to an equal amount of ETH. When you want to convert back to BTC, the ETH you had or whatever's left of it will get burned and an equal amount of BTC goes back to your wallet.

If you would do this regularly, you'd have to convert bitcoin to ETH on a trading platform, withdraw it to a wallet then deposit again to another exchange. By the time it gets there, you'd have incurred more fees than probably what you planned to do in the first place.

- ▶ Think of it like how PayPal can be used to pay for almost every online transaction
- ▶ Another attempt to approve the interoperability around blockchain and cryptoassets
- ▶ Is this taxable?
- ▶ <https://blog.liquid.com/blockchain-cross-chain-bridge#HowDoBlockchainBridgesWork>

Non-fungible token focus

First things first



In order to purchase an NFT the vast majority of these tokens can only be purchased with ETH



So in order to even buy an NFT in the first place (more on that in a second)



Investors/customers need to have access to crypto in the first place



Potential doubling of taxable and reportable events

NFT, explained



Digital assets that are connected and represent an underlying asset



Every NFT contains distinctive and identifiable information that makes it distinct from any other NFT



Cannot be exchanged directly for each other



Cannot be sub-divided like bitcoin can be sub-divided in Satoshi's



Reduces the potential for fakes/forgeries due to blockchain foundation

NFT License

- ▶ Put forward by Dapper Labs
- ▶ Contract template that can be customized to specify what rights are conveyed
- ▶ Distinguishes the NFT from the underlying art or asset
- ▶ Clarifies that the NFT holder obtains a 1) personal license to use and display the art, and 2) a commercial license to merchandise and monetize the asset
 - ▶ \$100,000 gross revenue limit
- ▶ Just one example

NFT Tax Treatment

Might be a bit different from other crypto taxes, which create a taxable event every time there is a transaction involving these digital assets

Since NFTs are just digital representations of physical assets, like real estate, would the tax treatment simply mirror the tax treatment of the underlying asset?

No definitive guidance on accounting, but income streams are possible depending on the use case...

NFT tax options?

- ▶ Non-fungible tokens (NFTs) can be taxed in variety of ways
 - ▶ Ordinary income for minters/creators or taxpayers who create them
 - ▶ Can also generate capital gains if held for over 12-month period
 - ▶ Might also be taxed at collectible rate if certain conditions apply
- ▶ Generally reported on form 8949
- ▶ Key point to remember is that not all NFTs are art
 - ▶ Either by definition
 - ▶ IRS classification

What is art?

(2) COLLECTIBLE DEFINED

For purposes of this subsection, the term “collectible” means—

- (A) any work of art,
- (B) any rug or antique,
- (C) any metal or gem,
- (D) any stamp or coin,
- (E) any alcoholic beverage, or
- (F) any other tangible personal property specified by the Secretary for purposes of this subsection.

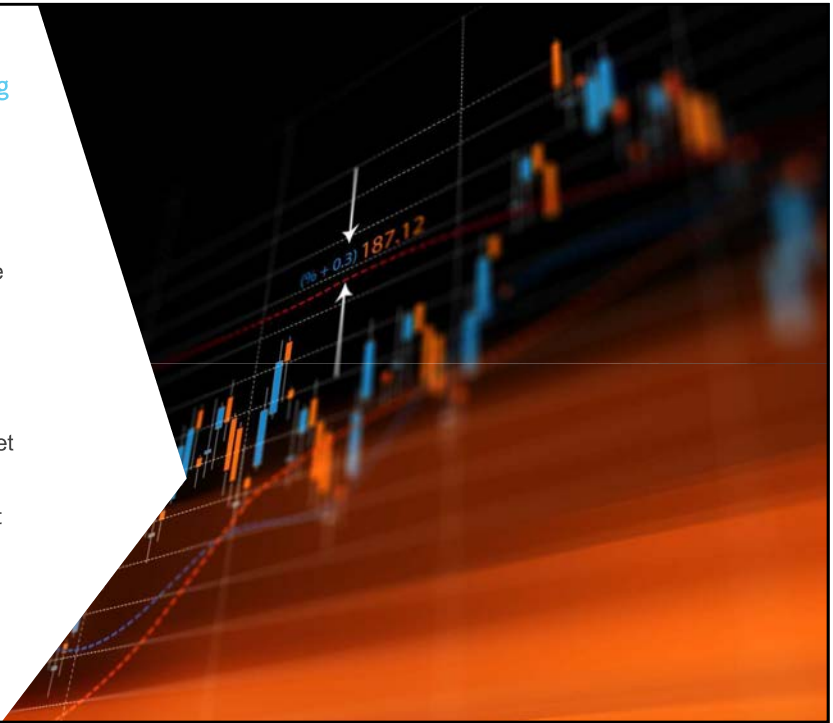
FAQ #1 - How are NFTs different from other cryptoassets?

- ▶ The primary difference between NFTs and other cryptoassets can be boiled down to two facts. Firstly, NFTs are unique and distinct assets, so this means that they cannot be exchanged for one another like bitcoin and other cryptocurrencies can be. Secondly, and since these cryptoassets represent distinct claims linked to assets, NFTs cannot be subdivided and used fractionally as a currency equivalent.



FAQ #2 - What is the accounting treatment for NFTs?

- ▶ Since there is no crypto-specific authoritative accounting guidance in the marketplace, the general rule is that cryptoassets are treated as the equivalent to indefinite lived intangible assets. That said, and something we will be exploring in more detail, depending on the underlying asset in question - as well as the process by which these NFTs are issued - the accounting treatment will change.



FAQ #3 - Is there a tax implication for NFTs?

- ▶ Generally speaking NFTs are taxed as property, which all cryptocurrency are treated and taxed as. Where the differentiation comes into play is whether or not a taxpayer is an NFT creator, or is simply buying and selling NFTs. Creators are taxed at the point in time that the NFT is sold, with any income being recognized as ordinary income. Buyers and sellers of NFTs are going to be taxed similar to how other cryptocurrencies are taxed, with long term capital gains rates, or short term (ordinary income) rates coming into play.



DAO Drilldown

What is a DAO

- ▶ A decentralized autonomous organization is a blockchain-based cooperative that is collectively owned by its members, with rules set and executed through code. DAOs replace centralized management structures with a techno-democratic approach wherein decisions are voted upon by investor-stakeholders. DAOs are built on top of blockchains (often Ethereum) and their transactions are visible on the underlying blockchain protocol.
- ▶ <https://www.gemini.com/cryptopedia/the-dao-hack-makerdao#section-what-is-a-dao>
- ▶ Decentralized, automated, and transparent
- ▶ Raises numerous tax issues based on how it is structured

Decisions are voted upon by investor-stakeholders

Driven by the issuance and holding of governance tokens

Decentralized Autonomous Organization

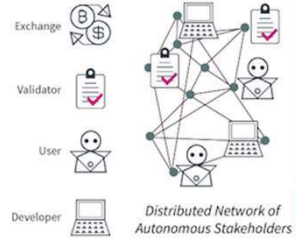
From the book "Token Economy" by Shermin Voshmgir, 2019
Excerpts available on <https://blockchainhub.net>

Machine consensus around token governance rulesets and smart contracts instead of legal employment contracts.

No centralized legal entity

Self-enforcing code (smart contracts)

Tokens act as incentive for validators



DAO Governance Highlights

DAOs can operate resembling more of a centralized organization or a traditional decentralized blockchain organization

Centralized - more like an incumbent organization/firm

Decentralized - tokens incentivize behavior

If decentralized, primarily governed by smart contracts

- Executable programmable code embedded into an underlying blockchain

Big picture issues?

- ▶ Can taxes be assessed on a DAO?
- ▶ If yes, how are those taxes paid and who pays them?
- ▶ Are payments from the DAO taxable?
- ▶ Is the receipt of governance tokens taxable?

Can taxes be assessed on a DAO

- ▶ The short answer is probably yes
- ▶ No definitive IRS DAO-specific guidance of this presentation
- ▶ Let's look at the criteria to determine whether an entity is taxable entity or not
- ▶ Entities are generally considered taxable when partners agree to work together and divide profits
- ▶ Sounds a lot like the smart contract driven governance of a DAO

Who pays these taxes?

- ▶ If a DAO earns profits from fees, investment strategies or other activities which individual or entity is liable?
- ▶ No clear cut guidance in the marketplace as of yet?
- ▶ Would every wallet-holder be liable for a proportional share of the income/earning of the DAO?
- ▶ OR, would the current IRS model for pass-through entities be followed?
- ▶ Taxes to be paid by the managing/members

Are payments from DAOs taxable?

- ▶ Yes
- ▶ Payments made from DAO controlled ETH-wallets are taxable income to those individuals/institutions that receive them
- ▶ If a user/investor funds a project, and receives a deposit from the associated DAO
 - ▶ Governed by a smart contract
- ▶ Those funds must be reported and will be subject to income taxes

Governance tokens

- ▶ What are governance tokens?
- ▶ Tokens distributed to users/managers/investors as part of a launch or as an incentive for activity on a certain protocol
- ▶ The receipt any token will generate a tax reporting and tax payment liability for the individual or institution

DAO Tax Summary

- ▶ No DAO-specific tax guidance as of yet
- ▶ DAOs could technically be classified, and have been, as taxable entities
- ▶ Assessing and collecting DAO taxes remains an open issue
- ▶ Receiving of tokens/payments from the DAO generates a tax reporting and payment item for individuals and institutions
- ▶ Contributing capital does not generate taxable events

First things first



In order to purchase an NFT the vast majority of these tokens can only be purchased with ETH



So in order to even buy an NFT in the first place (more on that in a second)



Investors/customers need to have access to crypto in the first place



Potential doubling of taxable and reportable events

Crypto Tax Planning

Qualified opportunity funds



Qualified opportunity fund

- ▶ Sec 1031 exchanges are not able to be made with cryptocurrency, BUT selling the cryptoassets and investing the gains with proceeds in a Sec. 1400Z-2(d) qualified opportunity fund (QOF) allows this divestment while allowing access to original cost basis
- ▶ Also can defer the recognition of capital gains
- ▶ Holds investments in QOF for 5 years, 10% exclusion from gross income
- ▶ 7 years, 15% exclusion from gross income
- ▶ 10 years, 100% exclusion of appreciation from gross income

Example of offering

- ▶ Not affiliated with this organization, so be sure to perform your own due diligence
- ▶ <https://bitcapital.fund/opportunity-zones/>
- ▶ Solid tax article explaining the benefits
- ▶ <https://bitcapital.fund/opportunity-zones/>
- ▶ Frequently asked questions about QOFs
- ▶ <https://www.ictsd.org/is-a-qof-partnership-considered-a-security/>



Corporate Transparency Act

What is the CTA?

- ▶ Corporate Transparency Act written as part of the Anti-Money Laundering Act (2020)
- ▶ Public comments had closed during February 2022
- ▶ No effective date as of yet
- ▶ What are the reporting requirements of this bill?
- ▶ <https://www.natlawreview.com/article/what-emerging-growth-companies-and-investors-need-to-know-about-corporate>

CTA reporting

- ▶ Requires that domestic and foreign “reporting companies”
 - ▶ Report certain identifying information concerning “beneficial owners”
 - ▶ Major equity owners
 - ▶ Managers
 - ▶ Directors
 - ▶ Senior officers
 - ▶ To FinCEN
- ▶ Failure to report can result in stiff penalties, including a \$500 per day fine

CTA exclusions

- ▶ The CTA might seem like a blanket reporting requirement, but there are exempt entities
 - ▶ Certain publicly-traded entities
 - ▶ Banks
 - ▶ Large operating entities that filed a tax return showing revenue in excess of US \$5 million per year, have over 20 FTEs, and physical operate in the U.S.
- ▶ Many crypto organizations would **not** be exempt from these reporting requirements
- ▶ What could this mean for the sector?

CTA intro wrap-up

- ▶ The CTA as currently written could create an onerous and crippling reporting requirement for crypto organizations
- ▶ Who is responsible for identifying the “beneficial owners?”
- ▶ What about DAOs?
- ▶ What about decentralized protocols, smart contracts, or other crypto-applications?

Thank you!

- ▶ Questions?
- ▶ Comments?
- ▶ Jokes?
- ▶ Twitter - @seansteinsmith
- ▶ LinkedIn - Sean Stein Smith

12:45 – 1:45 p.m.

SMLLC to Partnership & Back: Accounting for Rev. Rul. 99-5 & 99-6 Transactions

Ryan Sonnenberg, CPA, *Principal, CLA (CliftonLarsonAllen LLP)*



We'll get you there.

SMLLC to Partnership and back to SMLLC

Accounting for Rev. Rul. 99-5 & 99-6 Transactions

November 3rd, 2022

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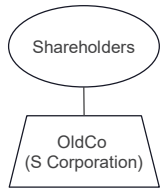


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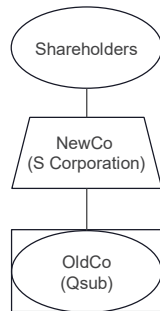
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F Reorganization With 99-5 Steps

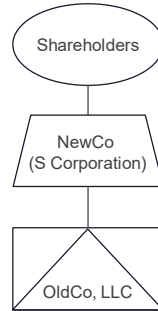
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S Corp



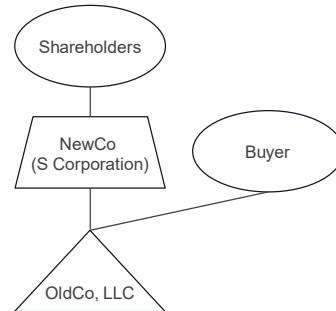
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Conversion
to LLC



Sale or Equity
Infusion



Disregarded Entity to Partnership: Rev. Rul. 99-5

Situation 1 – B
purchase 50% of A's
ownership in SMLLC

Situation 2 – B
contributes cash to A's
SMLLC in exchange for
50% ownership in
SMLLC



99-5 – Situation 1

- B purchases 50% of A's ownership in SMLLC for \$5,000
- A does not contribute any portion of the \$5,000 to the LLC
- B is treated as if they purchased a 50% interest in each of the LLC's assets
- A is treated as selling assets and recognizes gain or loss
- A and B immediately contribute their respective 50% interests in the assets to the newly-formed partnership



99-5 – Situation 2

- B contributes \$10,000 to A's SMLLC in exchange for 50% ownership in SMLLC
- The LLC uses all the contributed cash in its business
- A is treated as if they contributed the LLC's assets worth \$10,000 to the newly-formed partnership
- Neither A nor B recognize gain or loss
- A's holding period of their partnership interest includes the holding period of the assets



99-5 – Considerations

Bonus depreciation availability [Reg. § 1.168(k)-2(g)(1)(iii)]

Anti-churning rules on amortizable intangibles [§197(f)(9)]

§704(c) allocations

§743(b) applicability

“Pick and choose” applicability

Holding period on subsequent sales



99-5 – §704(c) Allocations

SIMPLIFIED BALANCE SHEET

	<u>TAX BASIS</u>	<u>VALUE</u>
PRE-TRANSACTION		
Intangible	-	10,000
POST-TRANSACTION		
Intangible - A	-	5,000
Intangible - B	5,000	5,000
	5,000	10,000

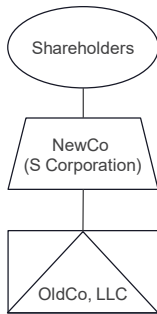
TAX AMORTIZATION DEDUCTIONS

§704(c) TRADITIONAL METHOD	<u>A</u>	<u>B</u>
Intangible - A	-	-
Intangible - B	2,500	2,500
	<u>2,500</u>	<u>2,500</u>
§704(c) REMEDIAL METHOD		
Intangible - A	(2,500)	2,500
Intangible - B	2,500	2,500
	-	5,000

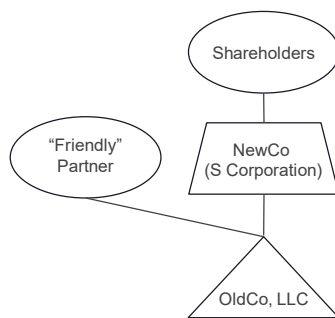


Avoiding 99-5 – Pre-form Partnership

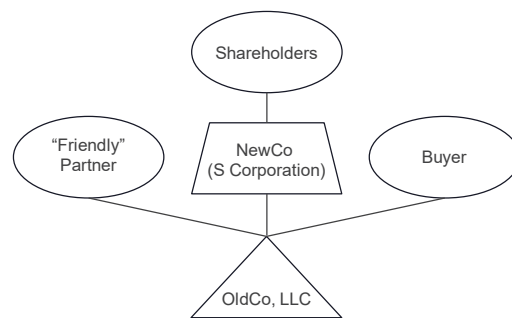
Post- F Reorg
S Corp



Pre-Form
Partnership



Sale to Buyer



Tax Return Reporting

L Partner's Capital Account Analysis	
Beginning capital account	\$ []
Capital contributed during the year	\$ []
Current year net income (loss)	\$ []
Other increase (decrease) (attach explanation)	\$ []
Withdrawals and distributions	\$ ([])
Ending capital account	\$ []
M Did the partner contribute property with a built-in gain (loss)?	
<input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," attach statement. See instructions.	
N Partner's Share of Net Unrecognized Section 704(c) Gain or (Loss)	
Beginning	\$ []
Ending	\$ []





Partnership to SMLLC

Rev. Rul. 99-6

We'll get you there.

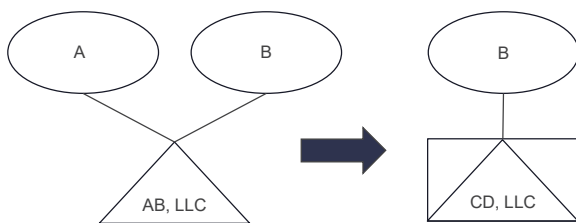
CPAs | CONSULTANTS | WEALTH ADVISORS

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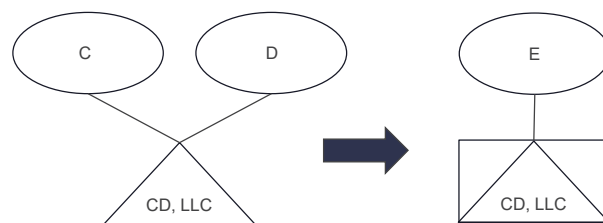
11

Revenue Ruling 99-6

Situation 1



Situation 2



Partnership to Disregarded Entity: Rev. Rul. 99-6

- Situation 1 – A & B are equal partners in AB partnership
 - B purchases all of A's ownership in AB
- Situation 2 – C & D are equal partners in CD partnership
 - C & D sell their entire interests to E



99-6 – Situation 1

- B purchases all of A's ownership in AB partnership for \$10,000
- A is treated as selling a partnership interest [\$741]
- B's treatment:
 - AB liquidates, distributing assets to both A & B
 - B acquires the assets A received in liquidation in a direct purchase from A
 - Carryover basis & holding period in the assets received on liquidation
 - \$10,000 basis & new holding period in the "purchased" assets



99-6 – Situation 2

- C & D sell their entire interest to E for \$10,000 each
- C & D are respected as selling partnership interests [§741]
- E's treatment:
 - CD liquidates, distributing assets to both C & D
 - E purchases all of the assets from C & D for \$20,000
 - \$20,000 basis & new holding period in the “purchased” assets



99-6 Tax Return Reporting

- Final partnership return
- §751(a) “hot asset” reporting – K-1 Line 20, Code AB
 - Form 8308
- No Form 8594 by partnership
 - Required by situation 2 purchaser



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CLAconnect.com



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2 – 3 p.m.

IRS Update

Michael Smith, *Senior Stakeholder Liaison, Internal Revenue Service*



2022 IRS Updates for Tax Professionals

2022 IRS Updates for Tax Professionals



IRS Stakeholder Liaison

Who we are:

- Team within IRS that establishes relationships with practitioner and industry organizations representing small business and self-employed taxpayers. We provide information about the policies, practices and procedures the IRS uses to ensure compliance with the tax laws.

What we do:

- Share IRS news and updates
- Education and outreach – (webinars, educational events, etc.)
- Issue Management Resolution System (IMRS) – tell us about IRS issues, we need your feedback!

Find us by searching “Stakeholder Liaison” on IRS.gov



Current IRS Messages

- The Gig Economy & Form 1099-K changes
- Online Account and Tax Pro Account
- Identity Protection PIN
- Tax Security Awareness
- Economic Impact Payments 1, 2 (2020) & 3 (2021)
- IRS Resources for Tax Professionals



The Gig Economy & 1099-K Changes



The Gig Economy

- What is the Gig Economy?
- Find resources at the Gig Economy Tax Center
 - Self-employed or employee?
 - Business recordkeeping
 - Rules for home rentals



Gig Economy Tax Center



Help | News | English | Charities & Nonprofits | Tax Pros

File | Pay | Refunds | Credits & Deductions | Forms & Instructions | Search

Home / File / Businesses and Self-Employed / Small Business and Self-Employed / Gig Economy Tax Center

Gig Economy Tax Center

English | Español | 中文(简体) | 中文(繁體) | 한국어 | Pycckий | Tiếng Việt | Kreyòl Ayisyen

Individuals

Businesses and Self-Employed

Small Business and Self-Employed

- Employer ID Numbers
- Business Taxes
- Reporting Information Returns
- Self-Employed
- Starting a Business
- Operating a Business
- Closing a Business
- Industries/Professions
- Small Business Events

Online Learning
6 2022 IRS Updates for Tax Professionals
Large Business

What is the Gig Economy?

The gig economy—also called sharing economy or access economy—is activity where people earn income providing on-demand work, services or goods. Often, it's through a digital platform like an app or website.

Gig Economy Income is Taxable

You must report income earned from the gig economy on a tax return, even if the income is:

- From part-time, temporary or side work
- Not reported on an information return form—like a Form 1099-K, 1099-MISC, W-2 or other income statement
- Paid in any form, including cash, property, goods, or virtual currency

What to Do

Gig Workers

Find forms, keep records, deduct expenses, file and pay taxes for your gig work.

[Manage Taxes for Your Gig Work](#)



[Your Taxes in the Sharing Economy YouTube Video](#)

Digital Platforms and Businesses

Classify workers, report payments, pay and file taxes for a digital marketplace or business.

[Manage Taxes for a Digital Platform](#)



Key Points

- Gig income is taxable income
- Employee or Self-Employed
- Keep good records
- Visit the Gig Economy Tax Center for more info



Tax Withholding Estimator

IRS.gov/withholding



Help | News CHARITIES & NONPROFITS TAX PROS

File Pay Refunds Credit & Deductions Forms & Instructions

Home / File / Individuals / Tax Withholding Estimator

Tax Withholding Estimator

Use your best estimates for the year ahead to determine how to complete Form W-4 so you don't have too much or too little federal income tax withheld.



About You

Select the information that best describes how you anticipate filing your 2019 tax return.

1 of 5: Filing Status

What filing status will you use for your tax return? ^(Required) ?



Tax Withholding Estimator

- Plain language used within the tool
- Ability to effectively target tax due or refund
- Determines self-employment tax
- Mobile-friendly design
- Taxpayers encouraged to check their withholding in January and July (at a minimum)

9 2022 IRS Updates for Tax Professionals



Form 1099-K, Payment Card and Third Party Network Transactions - Threshold Change



Understanding your Form 1099-K

Form 1099-K, Payment Card and Third Party Network Transactions, is an IRS information return used to report certain payment transactions.

- You should receive Form 1099-K from a payment settlement entity by January 31st if, in the prior calendar year, you received payment:
 - Through a payment card transaction, for example, through debit cards, credit cards, prepaid cards, gift cards, etc., and/or
 - In settlement of third party network transaction above the minimum reporting threshold for the provision of goods or services.

If you received payments from the same payor that include both payment card and third party network transactions, you should receive a separate Form 1099-K reporting the gross amount from each type.



Form 1099-K Minimum Reporting Threshold for Third Party Payment Network Transactions

For returns for calendar years prior to 2022:

- Aggregate amount of payments for goods and services exceeds \$20,000, **AND**
- More than 200 such transactions

For returns for calendar years 2022 forward:

- Aggregate amount of payments for goods and services exceeds \$600
- This is determined without regard to the number of transactions

Does not include receipt of payments from family or friends for gifts, shared trips, reimbursements, etc.



Income Reporting and Recordkeeping

- You must report all taxable income you receive on your income tax return.
- Your business's books and records should reflect your business income including amounts that may be reported on Form 1099-K.

In most cases, your business income will be in the form of:

- Cash
- Checks and Electronic Funds Transfers (EFTs)
- Debit/credit card payments*
- Payments received through third party network transactions*

*Generally reported on Form 1099-K

Form 1099-K is used to report the gross amount of total reportable transactions for the calendar year without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts, or any other amounts.



IRS.gov resources

[Understanding Your 1099-K](#)

Understand Form 1099-K, Payment Card and Third Party Network Transactions, and what you should do if you receive one.

[About Form 1099-K, Payment Card and Third Party Network Transactions](#)

Includes recent updates, related forms, and instructions on how to file.

[General FAQs on Payment Card and Third Party Network Transactions](#)

General frequently asked questions on Payment Card and Third Party Network Transactions.

[Publication 334 Tax Guide for Small Business \(For Individuals Who Use Schedule C or C-EZ\)](#)

Contains general information about the federal tax laws that apply to small business owners.


**Communications & Liaison
STAKEHOLDER LIAISON**

Online Account

A self-service tool for individual taxpayers to securely access their account information.

15 2022 IRS Updates for Tax Professionals


**IRS.gov home page takes you to
Online Account**



Access Online Account
Taxpayers can access their online account from the IRS.gov home page

Helping people understand and meet their tax responsibilities

How can we help you?

- Get Your Refund Status
- File Your Taxes for Free
- Get Answers to Your Tax Questions
- Sign In to Your Account
- Get Your Tax Record
- Apply for an Employer ID Number (EIN)
- Find Your Child Tax Credit Payment Information
- Make a Payment
- Get Economic Impact Payment Information

16 Tax Pro Account

Account Home shows key data about the taxpayer's account

STACY ELAINE STEEN | Profile | Help | Logout

Account Home | Account Balance | Payment Options | Payment Activity | Tax Records | Notices and Letters | Authorizations

Welcome STACY ELAINE STEEN

Account Status

Your 2021 Tax Return is Not Processed
If you've already filed... [Read more](#)

Total Amount Owed as of March 29, 2022:
\$330.00
[View Balance Details](#)

Payments

[MAKE A PAYMENT](#)

[View Payment Options](#)
[View Payment Activity](#)

Notifications

[Turn On Email Notifications](#)
Sign up to receive email notifications when the IRS issues new notices for your account.

[Go Paperless for Select IRS notices](#)
Update your profile to receive specific notices online only.

[IRS Notice Available](#)
View or download your notice.

Payment Plan (Installment Agreement)

This is based on recent data and is subject to change.

Status	Current
Type	Monthly Payment Plan
Monthly Payment Amount	\$100.00
Payment Day	27th of each month

[View Payment Plan Options](#)

Records

[View Tax Records For](#)

- Key information from your most recent tax return
- Advance Child Tax Credit filing information
- Economic Impact Payment filing information
- Downloadable tax records

[View Notices and Letters](#) for correspondence from the IRS.
[View Authorizations](#) for online requests from tax professionals.

17 Tax Pro Account

Notices and Letters provides digital copies of select IRS correspondence

STACY ELAINE STEEN | Profile | Help | Logout

Account Home | Account Balance | Payment Options | Payment Activity | Tax Records | Notices and Letters | Authorizations

Account Home / Notices and Letters

Notices and Letters

IRS Notices

This page has digital versions of some IRS notices.
Please continue to check your postal mail for IRS paper notices not yet available online.

Manage Your Paperless or Email Notification Preferences

[View your profile](#) to go paperless or sign up for email notifications when you have new notices available online.

1 Item Item 1 of 1 | < Previous | Next >

Subject	Date
Monthly Payment Reminder A reminder that your installment ...	03/01/2022

Monthly Payment Reminder

A reminder that your installment agreement payment is due.

Notice Date: 03/01/2022

[VIEW NOTICE \(PDF\)](#)

Get answers to your questions by calling the number on the PDF notice or viewing the [Essential](#) Asked Questions.

18 Tax Pro Account

Profile displays key taxpayer contact information – cont.

Email Notifications
Taxpayers can sign up to receive email notifications for important account information

Paperless Setting
Taxpayers can choose to go paperless for notices available online

Your Profile

Your Name
Name changes must be made through the Social Security Administration. For more information, see [name changes](#) [CF](#).

Full Name STACY ELAINE STEEN

Mailing Address
To change your mailing address, you can submit [Form 8822 \(PDF\)](#) [CF](#) by mail or get more information on [address changes](#) [CF](#).

Mailing Address 1040 MAPLE ST
HOBOKEN, NJ 07030
UNITED STATES

Email and Password
To change your email address, password, and other account details, [update your sign-in settings](#) [CF](#).

Email Address stacy754@yahoo.com

Email Notifications
To change your email notification settings, select "EDIT".
New Notices and Letters: No

Paperless Settings
To change paperless settings, select "EDIT". This may still create some paper notices by mail. Be notified when a notice is available to view online by opting into email notifications.
Notice Delivery: Digital and Paper

Paperless Settings
Modify your paperless settings, then select "SAVE". If you select "CANCEL", your updates will not be saved.
 Digital
 Digital and Paper
This new selection will be used for notices that are available digitally and those that must be mailed.

Email Notifications
By checking or unchecking this box, your selection for Email Notifications will be updated.
 Yes, send me email notifications for new notices and letters.

19 Tax Pro Account

Tax Records provides important data for tax returns

Key Data from Most Recent Tax Return
Clearly highlights key information for taxpayers from their most recent return.

Advanced Child Tax Credit Payment Info
Tax Records can find the information needed to file their 2021 tax returns.

Economic Impact Payment Info
Tax Records now show Economic Impact Payment amounts for qualifying taxpayers.

Get Transcripts
Provides access to account and return transcripts online

Tax Records

2020 Return Summary
View key information from your most recent tax return as originally filed.
Form Filed: 990
Filing Status: Head of Household
Adjusted Gross Income: \$88,235.00
Refund Amount or Taxes on Return when Filed: \$3,889.00

2021 Advance Child Tax Credit Payments Information
Use the amounts on this page to reconcile the advance payments of the Child Tax Credit on your 2021 tax return.
Total Amount You Received for 2021 Payments (See 1): \$3,950.00
If you file as Married Filing jointly, each spouse should use their own amount within their own account. All amounts must be considered Filing jointly.

Economic Impact Payment Information
Expand the years below to see your Economic Impact Payment information.
If you file as Married Filing jointly, each spouse should use their own amount within their own account. All amounts must be considered Filing jointly.

2021
Use these amounts to calculate any Recovery Rebate Credit on your Tax Year 2021 return.
The American Rescue Plan Act (ARPA) of 2021 provides for a Recovery Rebate Credit for eligible individuals.
If you're eligible, you'll report the Recovery Rebate Credit on Line 10 of your tax year 2021 return. Use the Economic Impact Payment amount on this page when calculating the amount of the credit.
To learn more, see our [Economic Impact Payments](#) [CF](#).

Type	Amount
Economic Impact Payment 3	\$3,400.00

2020

Get Transcripts Online
View, print or download information from your tax returns, account transcripts, 401k, 529s, and more.
[GET TRANSCRIPTS](#) [CF](#)

20 Tax Pro Account




Tax Pro Account




Expanding Services for Taxpayers

Expansion of Taxpayer Options for 3rd Party Authorizations launched in the summer of 2021


- Added “authorization” feature to individual Online Accounts.
- Launched Tax Pro Account on IRS.gov to allow tax professionals to initiate online POA or TIA requests.
 - Tax professional initiates a POA or TIA, uses checkbox as electronic signature for POAs.
 - POA or TIA requests automatically transfers to individual taxpayer’s Online Account.
 - Taxpayer accesses their Online Account and under the “Authorization” tab they can approve the request and use a checkbox as signature.
 - Upon approval, authorization is posted immediately to CAF.





Individual Tax Pro Account Home Page

Notional


JOHN DOE | [Profile](#) | [Logout](#)

Tax Pro Account Home
Request POA
Request TIA
Authorizations

Welcome JOHN DOE

Important Message from the IRS

Tax Professional Account is now ready for you to use to initiate a Power of Attorney or Tax Information Authorization for the taxpayer. Please read the "Before You Start" information to make this process as easy as possible.

[Read less](#)

Request Authorization for an Individual Taxpayer

Submit a request online for power of attorney (POA) or tax information authorization (TIA) for an individual taxpayer. The taxpayer can log in to their IRS account to review and electronically sign the authorization request at [www.irs.gov/account](#).

REQUEST POA
REQUEST TIA

Forms 2848 and 8821

You can also submit authorizations with forms: [Form 2848, Power of Attorney and Declaration of Representative](#) or [Form 8821, Tax Information Authorization](#).

23
Tax Pro Account





Taxpayer Approval of POA Request

Notional

Authorizations

Power of Attorney Approved

Request Approved

John Doe is authorized to represent you before the IRS and receive your confidential tax information for the matters described in this power of attorney.

Your Information	
Name	Billy Baker
Address	1000 Fountain Ave, Paris, GA, 38810
Representative Information	
Name	John Doe
CAF Number	XXXX-XXXX
Address	1111 Kings Ln, Danville, VA, 24541
Declaration of Representative	The representative signed that they are an Attorney who is not suspended or disbarred from practice before the IRS.
Signed by Representative	June 25, 2021
Tax Matters	
Tax Matter	Form 1040 Income Tax
Tax Period(s)	2019 - 2019
Notices	The representative will not receive by mail copies of notices and communications the IRS sends you for these tax matters.
Electronic Signature	
Signed By Taxpayer	June 23, 2021

24
Tax Pro Account



Tax Pro Account: Future State

- IRS will continue to expand Tax Pro Account capabilities to improve its features for authorization requests and to add functionality as resources allow.
- Here are just some of the features we are working, planning, or considering:
 - Notification to the taxpayer regarding action in their Online Account, to include pending authorization requests
 - Email alerts letting the tax professional know when taxpayer approves their authorization request
 - Taxpayer's ability to view their complete authorization history.
 - Tax professional's ability to view and manage all their active authorizations on CAF processed through all channels



The Identity Protection PIN (IP PIN)

Proactively protect your federal tax account from identity theft.



What is the IP PIN?

- An Identity Protection PIN (IP PIN), is a six-digit number that prevents someone else from filing a tax return using your Social Security number or Individual Taxpayer Identification Number
- The IP PIN helps the IRS to verify your identity when you file your electronic or paper tax return
- Even though you may not have a filing requirement, an **IP PIN still protects your account from fraudulent filings**
- An electronically filed return filed without your IP PIN, or an incorrect IP PIN, will reject, including your return and any fraudulent returns using your Social Security Number.
- Any paper returns filed without your correct IP PIN will undergo additional scrutiny and any fraudulent returns will be removed from your account. If the return verifies to be yours, we will continue to process it.



Who can obtain an IP PIN?

- Anyone who has a Social Security number (SSN) or Individual Taxpayer Identification Number (ITIN) and can verify his/her identity is eligible to enroll into the IP PIN program (**Voluntary Enrollment**)
- Victims of federal tax related identity theft are automatically enrolled into the IP PIN program (**Automatic Enrollment**)



How can a taxpayer voluntarily enroll into the IP PIN Program?

Get An Identity Protection PIN (IP PIN) Online Application

- Fastest and most secure method to enroll
- Protection begins right after enrollment
- IP PIN is immediately available for filing



Find the IP PIN Program

Go to IRS.gov, keyword "IP PIN"

The screenshot shows the IRS website page for "Get An Identity Protection PIN (IP PIN)". At the top, there is a navigation bar with the IRS logo, "Help", "News", "English", "Charities & Nonprofits", and "Tax Pros". Below this is a secondary navigation bar with "File", "Pay", "Refunds", "Credits & Deductions", "Forms & Instructions", and a search bar. The main content area has a breadcrumb trail: "Home / File / Individuals / Get An Identity Protection PIN". The title "Get An Identity Protection PIN (IP PIN)" is prominently displayed. Below the title are language options: "English | Español | 中文(简体) | 中文(繁體) | 한국어 | Русский | Tiếng Việt | Кыргызстан". A left sidebar lists categories: "Individuals" (selected), "Businesses and Self-Employed", "Who Should File", "How to File", "When to File", "Where to File", "Your Information", "Students", "Employees", "Parents", "Military", and "Seniors & Retirees". The main text explains that an IP PIN is a six-digit number that prevents someone else from filing a tax return using your Social Security number or Individual Taxpayer Identification Number. It also states that if you are a confirmed victim of tax-related identity theft and have resolved your tax account issues, you will receive a CPDIA Notice with your new IP PIN each year. A "How to get an IP PIN" section notes that the fastest way is to use the online tool, which is available from mid-January through mid-November. A "Get an IP PIN" button is visible. On the right, there is a video player with the title "Get an Identity Protection PIN" and a "Transcript ASL" link. The footer of the page reads "30 2022 IRS Updates for Tax Professionals".



Other methods to enroll in the IP PIN Program?

Form 15227, Application for an IP PIN

- For taxpayers who cannot verify their identity through the Online Application
- Process can take up to 180 days to complete enrollment
- Taxpayer must include a telephone number for call back verification
- Limited to taxpayers under a certain adjusted gross income level

In-Person at a local Taxpayer Assistance Office

- For taxpayers who cannot verify their identity through the Online Application or the Form 15227 process or are ineligible to file a Form 15227
- Appointments may be limited due to availability



Get An Identity Protection PIN (IP PIN)

Other details

- IP PIN is displayed online after verification, and it can be retrieved at anytime by logging back into the application
- The IP PIN online application is generally available starting in mid-January through mid-November
- Taxpayers who have an existing IRS Online Account may be able to use their log in information to access the Get An IP PIN Application



How does a Taxpayer receive their IP PIN?

- Each December, new IP PINs are generated for the upcoming filing season for current enrollees
- CP 01A notices containing the new IP PIN are mailed from mid-December to mid-January
- Taxpayers who enrolled voluntarily online must log back into the Get an IP PIN application to retrieve their current IP PIN (These taxpayers will not receive a CP 01A notice)
- The Get an IP PIN application is available from late January to mid-November



How does a Taxpayer receive their IP PIN?

- The following taxpayers will receive a CP 01A notice each year:
 - Form 15227 applicants
 - In-person TAC applicants
 - Identity theft victims who did not enroll online (If a valid address cannot be confirmed then the CP 01A notice is suppressed)*
 - Taxpayers who enrolled online prior to January 2019

*If this happens, these taxpayers may not know they have an IP PIN until they attempt to electronically file a return and it's rejected.



What if a Taxpayer Lost or Doesn't Receive an IP PIN Notice?

Taxpayers may receive their current year IP PIN by:

- **Accessing the Get An IP PIN Application (Fastest Method)**
 - Retrieve their IP PIN by logging into their account on IRS.gov
 - If the taxpayer does not have an account, they can create an account and retrieve their IP PIN
- **Calling the IRS help line at 800-908-4490**
 - Taxpayer will need to verify their identity and current mailing address
 - After verification is completed, a 4869C notice containing their IP PIN will be mailed to the taxpayer within 21 days

Note: If the taxpayer cannot obtain their IP PIN through either option, then the best alternative is to file a paper return without their IP PIN.



Tax Security Awareness



Phishing Email Example

Dear Tax Pro,

Your electronic filing identification number (EFIN) has temporary been put on hold due to suspicious activity with your PTIN user.

Did you transmit the below 1040 form?

[Transcript\(PDF\)](#)

If this was you, please ignore this message.

If it was not you, please immediately change your password.

Failure to confirm this request will lead to EFIN suspended.

We are trying to protect your e-service and EFIN account.

Sincerely,

Carol A Campbell
IRS.gov e-service



Business Email Example

-----Original Message-----

From: Mickey Mouse <mk@mu.se>

Sent: Tuesday, January 22, 2019 1:03 PM

To: Minnie Mouse <minnie@realbusiness.org>

Subject: Request

Hi Minnie,

I need you to email me 2018 W2s of all employees.

How soon can you get me those?

Regards

Mickey Mouse

Source: www.nist.gov/cyberframework



Example: E-mail Warning Labels

From: [REDACTED] [mailto:[REDACTED]]
Sent: Tuesday, June 12, 2018 2:01 AM
To: [REDACTED] <[REDACTED]>
Subject: Final Reminder for Notice of Tax Overpayment

**** This is an EXTERNAL email. Exercise caution. DO NOT open attachments or click links from unknown senders or unexpected email. ****

1

Source: www.nist.gov/cyberframework



Signs of Client Data Theft

- Client e-filed returns begin to reject
- Clients who haven't filed tax returns begin to receive authentication letters (5071C, 4883C, 5747C) from the IRS
- Clients who haven't filed tax returns receive refunds





Data breach – Info for affected clients or employees

- IRS Pub 5027, Identity Theft Information for Taxpayers
- Place a “fraud alert” or “credit freeze” with at least one of the three credit bureaus
- File a complaint with the Federal Trade Commission
- Review FTC’s www.identitytheft.gov for additional steps



Data Compromise Action Items

Contact IRS and law enforcement

- Tax professionals contact IRS Stakeholder Liaisons immediately
- Search “stakeholder liaisons” on IRS.gov



Data Compromise Actions - continued

Contact State Agencies:

- State revenue agencies – email Federation of Tax Administrators for state agency contacts at StateAlert@taxadmin.org
- State Attorneys General

Contact experts:

- Security expert
- **Insurance company**



Data Compromise Actions - continued

Contact Clients and Other Services

- FTC for guidance for businesses
 - Email: idt-brt@ftc.gov
- Credit Bureaus
- Clients

Review guidance at [IRS.gov/identitytheft](https://www.irs.gov/identitytheft)



Reporting phishing emails

Email: phishing@irs.gov

- Forward phishing emails with federal tax related contact to this address.
- Forward phishing text messages to: 202-552-1226

File a complaint with the FBI's IC3

- Search "IC3" or Internet Crime Complaint Center



Develop a Written Information Security Plan

IR-2022-147, August 9, 2022

WASHINGTON — The Security Summit partners today unveiled a special new sample security plan designed to help tax professionals, especially those with smaller practices, protect their data and information.

The special plan, called a [Written Information Security Plan or WISP \(PDF\)](#), is outlined in a 29-page document that's been worked on by members of the Security Summit, including tax professionals, software and industry partners, representatives from state tax groups and the IRS.



Economic Impact Payments and The Recovery Rebate Credit



2020 1st Economic Impact Payment

First Economic Impact Payments were in the following amounts:

- Each eligible individual received up to \$1,200
- Married couples filing a joint return received up to \$2,400.
- People with qualifying children under age 17 at the end of the taxable year (2018 or 2019) received up to an additional \$500 for each qualifying child.



2020 2nd Economic Impact Payment

Second Economic Payments are in the following amounts:

- Each eligible individual received up to \$600
- Married couples filing a joint return received up to \$1,200.
- People with qualifying children under age 17 at the end of 2019 received up to an additional \$600 for each qualifying child.



2021 3rd Economic Impact Payment

Third Economic Impact Payment

- The third Economic Impact Payments were in the following amounts:
- Each eligible individual received up to \$1,400
- Married couples filing a joint return received up to \$2,800
- People with qualifying children received \$1,400 for each qualifying dependent



2020 and 2021 Tax Returns

Taxpayers who didn't receive their EIPs can file a tax return to claim **Recovery Rebate Credits**.

In general, taxpayers only have a three-year window from the original due date, normally the April deadline, to claim their refunds.

In general:

- For 2020 Form 1040 - **April 15th, 2024**
- For 2021 Form 1040 - **April 15th, 2025**



IRS Resources for Tax Professionals



e-News for Tax Professionals

Information about:

- Recent changes affecting tax pros
- IRS news releases and announcements
- Links to tax pro pages on IRS.gov
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IRS.gov – Search for keyword: e-News



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- Employer ID Numbers
- Business Taxes
- Reporting Information Returns
- Self-Employed
- Starting a Business
- Operating a Business
- Closing a Business

Upcoming Webinars

- World of Offer in Compromise – Follow-Up Q & A Session (September 14, 2022)
- Digital Day by IRS: Online Services (September 15, 2022)
- Quarterly Update: Program & Policy Updates from SBA, DCEO, IRS, SBAC (September 15; December 15, 2022)
- Bankruptcy and the IRS Presented by Chief Counsel (September 20, 2022)
- Understanding Form 1042-S: Foreign Person's U.S. Source Income Subject to Withholding (September 22, 2022)
- 28th Annual Tax Practitioner and IRS Fall Seminar (October 26, 2022)

World of Offer in Compromise - Follow-Up Q & A Session

This free webinar is a follow-up session that will address questions received during the May 26, 2022 webinar where the following topics were covered:

- Define an Offer in Compromise
- Describe the Offer process and lifecycle
- Provide helpful hints

Related Resources

- Practitioner Local Liaison Meetings and Seminars
- Tax Practitioner Institute Classes
- Workshops and Other Events in Spanish for Small Businesses

55 2022 IRS Updates for Tax Professionals



Stakeholder Liaison

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Stakeholder Liaison Local Contacts

English

Individuals

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Businesses and Self-Employed

Stakeholder Liaison establishes relationships with practitioner and industry organizations representing small business and self-employed taxpayers. We provide information about the policies, practices and procedures the IRS uses to ensure compliance with the tax laws. We also elevate issues that affect tax administration. To establish a relationship with us or report an issue, use this list to find a contact in your state.

Related Topics

- Partners and Stakeholders
- IRS Stakeholder Partners Headliners

56 2022 IRS Updates for Tax Professionals



Contact information

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IRS Stakeholder Liaison - Wisconsin

211 W Wisconsin Ave, Milwaukee, WI 53203

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michael.smith6@irs.gov

- **Report issues with IRS policies, practices, procedures**
- **Help navigating IRS processes**
- **Presentations/workshops on current IRS issues or tax topics**

3:10 – 4 p.m.

Corporate Transparency Act

James Howard, *Partner, Foley & Lardner LLP*

The Corporate Transparency Act

Wisconsin Institute of CPAs
November 3, 2022
James Howard



Program Outline

- Background and overview
- Reporting companies and exclusions
- Beneficial owner
- Company applicant
- Reporting requirements
- Reporting changes to information
- Other issues
- Burdens
- Q&A



Background and Overview



FinCEN

- **Financial Crimes Enforcement Network (FinCEN)**
 - Under the U.S Department of the Treasury
- **FinCEN mission**
 - Safeguard the financial system from illicit use
 - Combat money laundering and its related crimes, including terrorism
 - Promote national security through strategic use of financial authorities and the collection, analysis, and dissemination of financial intelligence

Corporate Transparency Act (CTA) Overview

- **Part of the 2021 National Defense Authorization Act**

- Enacted on Jan. 1, 2021
- Proposed in 2019

- **Places disclosure obligations on reporting companies**

- Reporting companies must submit a report to FinCEN with certain personal information of each beneficial owner and applicant.

- **Reporting company**

- Any domestic corporation, LLC, or similar entity.
- Any foreign company that registers to do business in the U.S.
- Numerous exceptions apply for companies already regulated at the federal or state level and for large companies with a U.S. operating location.



Corporate Transparency Act (CTA) Overview (Continued)

- **Beneficial owner**

- Any individual who has 25% ownership or exercises substantial control

- **Applicant**

- The person that files a document to form or register a company



CTA Penalties

- **Civil**
 - \$500/day for each day violation continues – up to \$10,000
- **Criminal**
 - Imprisonment for up to two years



FinCEN Rule-Making

- **Advance Notice of Proposed Rule-Making (ANPRM)**
 - Released April 1, 2021.
 - Comment period ended May 5, 2021.
- **Notice of Proposed Rule-Making**
 - Released December 7, 2021
 - Comment period ended February 7, 2022
- **Final Rule**
 - Published September 30, 2022



FinCEN Rule-Making—Policies and Next Steps

- **Regulations target small companies**
 - Aimed primarily at smaller, lightly regulated companies that may not be subject to other beneficial owner reporting requirements.
- **Regulations were written broadly**
 - Intended to bring as many companies as possible within the reporting requirements.
 - Drafted to promote law enforcement interests and not to minimize the burdens imposed on reporting companies, beneficial owners, and applicants.

FinCEN Rule-Making—Policies and Next Steps (Continued)

- **Exceptions were narrowly limited**
 - Exceptions apply to the narrowest subset permitted by law.
- **Current regulations just the first round of rule-making**
 - FinCEN expects two more rounds of rule-making to address specific areas of the CTA.

Effective Date

▪ **January 1, 2024**



BOSS

- FinCEN has been developing the Beneficial Ownership Secure System to receive, store and maintain beneficial ownership information (“BOI”)
- FinCEN expects BOI reports to be submitted through electronically through an online interface
- BOSS will be secured to a Federal Information Security Management Act “High” compliance level, the highest information security protection level under the Act.



Reporting Companies and Exclusions

Reporting Company

- **“Reporting company” means a corporation, LLC, or similar entity**
 - Domestic reporting company - created by filing a document with the secretary of state or similar office of a state or American Indian tribe; or
 - Foreign reporting company - Formed under the law of a foreign country and registered to do business in the U.S. by filing a document with the secretary of state or similar office of a state or American Indian tribe.
 - “similar entity” was left to FinCEN rule, but FinCEN chose not to expand on the definition.

Reporting Company Exclusions

- **CTA provides list of excluded entities**

- The CTA provides 23 specific exclusions from the definition of reporting company.
- Generally applies to regulated businesses.

- **Examples of regulated entities that are not reporting companies**

- Financial institutions.
- Companies subject to Security and Exchange Commission (SEC) regulation.
- Public utilities.
- **Accounting Firms** – any firm registered in accordance with section 102 of Sarbanes-Oxley (15 USC 7212).



Reporting Company Exclusions (Continued)

- **Large operating companies**

- An entity with more than 20 employees, filed a U.S. income tax return for the previous year showing at least \$5 million of gross receipts or sales, and has an operating presence at a physical office in the U.S.

- **Other exclusions**

- FinCEN was given authority to do so but did not exclude any types of entities in regulations other than those enumerated by the CTA.



Large Operating Company Exclusion

- **20 or more full-time employees**
 - The CTA did not clarify what constitutes an employee.
 - FinCEN looked to IRS definition of full-time employee.
 - IRS provides that a full-time employee is one who averages 30 hours per week or 130 hours per month.
- **\$5 million in US gross receipts**
 - FinCEN's final rule clarifies that gross receipts means gross receipts from U.S. income.
 - At least \$5 million in gross receipts or sales must be reported on the entity's applicable IRS form, excluding amounts from sources outside the United States.

Large Operating Company Exclusion (Continued)

- **Operating presence at a physical office within the U.S.**
 - Must be a physical office owned or leased by the company.
 - Cannot be a residence or shared space (except for affiliates).

Beneficial Owner

Beneficial Owner—CTA § 5336(a)(3)

- **Beneficial owner means an individual who**
 1. Exercises substantial control over the entity; or
 2. Owns or controls not less than 25% ownership of the entity.
- **Substantial control**
 - CTA did not define what constitutes substantial control over the entity.
- **25% ownership**
 - CTA did not define what constitutes ownership or how to calculate 25%.

Beneficial Owner—Substantial Control

▪ Substantial control includes

- Service as a senior officer of the reporting company.
- Authority over the appointment or removal of any senior officer or majority ~~or dominant minority~~ of the board of directors.
- Direction, determination, or ~~decision~~ or substantial influence over important matters affecting the reporting company.
- Any other form of substantial control over the reporting company.



Beneficial Owner—Substantial Control (Continued)

▪ Substantial control generally

- Provision is broadly drafted.
- Substantial control may be exercised directly or indirectly.
- More than one person may exercise substantial control.
- Not intended to include ordinary daily managerial decisions.



Substantial Control Factors—Important Company Matters

- Sale, lease, or transfer of principal assets of the reporting company.
- Reorganization, dissolution, or merger of the reporting company.
- Financial decisions, such as expenditures, investments, debt or budget.
- Selection or termination of business lines.
- Compensation and incentive schemes.
- Entry into, termination of, or fulfillment of significant contracts.
- Amendments of company governance documents, and significant policies and procedures.



Beneficial Owner—25% Ownership

- **Ownership interest**
 - Any equity or anything classified as stock interest.
 - A capital or profit interest in an LLC or partnership.
 - ~~Any proprietorship interest.~~
 - Any instrument convertible to equity or stock interest.
 - An option or privilege to buy or sell any of the foregoing interests without an obligation to do so.
 - Similar to IRC attribution rules, options deemed exercised for purposes of determining beneficial ownership.
 - Any other instrument, contract, arrangement, understanding, relationship or mechanism to do so.
- **Calculation of 25% ownership**
 - Aggregate of all the individual's ownership interests of any class or type that the individual owns or controls and compare the aggregated interest to the undiluted ownership interests of the company.
 - For a corporation, 25% of either vote or value will trigger.
 - If not clear, 25% of ANY class or type or ownership interest is deemed to be 25%+



Exclusions from Beneficial Owner

- **Rule mirrors exceptions in the CTA text**

- Minor child, if parent or guardian is reported under the CTA.
 - **Note: child reaching maturity is a change requiring an updated report.**
- An individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual.
- An individual acting solely as an employee, whose economic benefit or control is derived solely from the person's employment status – cannot be a senior officer.
- An individual whose only interest in the entity is through a right of inheritance.
- A creditor, unless the creditor meets the beneficial owner definition.



Exclusions from Beneficial Owner (Continued)

- **Rule provides some clarifications**

- Clarifications ensure that companies must identify real parties of interest.
- Clarifies that senior officers of a company do not fall within the employee exception.
- Clarifies that right to inheritance is a future interest.



Company Applicant

Company Applicant

- **CTA requires reporting of applicant information**

- Generally same requirements as for a beneficial owner.

- **“Applicant” means an individual who either:**

- Files an application to form a corporation, LLC, or other similar entity under the laws of a state or American Indian tribe; or
- Registers or files an application to register a corporation, LLC, or similar entity formed under foreign law to do business in the U.S. by filing a document with the secretary of state or similar office of a state or American Indian tribe.
- The individual responsible for directing or controlling the filing if more than 1 individual is involved.
 - Lawyer-paralegal = 2 applicants
 - Employee of filing service agent generally not an applicant
 - Employee of the governmental authority accepting the filing is not an applicant

Company Applicant (Continued)

- **Multiple company applicants**

- The Rule clarifies that the reporting company may need to report information for multiple company applicants.

- **Existing Reporting Companies**

- Entities existing as of 1/1/2024 need not report company applicant.
 - FinCEN recognized the challenge in tracking down applicants from years ago who may be deceased, whereabouts unknown, etc.



Reporting Requirements

Initial Report Deadlines

- **New domestic reporting companies**
 - Applies to entities formed on or after January 1, 2024.
 - Required to file initial report **within 4430 calendar days** of filing formation documents.
- **New foreign reporting companies**
 - Applies to foreign entities that register on or after January 1, 2024.
 - Required to file initial report **within 4430 calendar days** of filing registration documents.
- **Existing reporting companies**
 - Applies to both domestic and foreign reporting companies already in existence on January 1, 2024.
 - Initial report must be filed **not later than January 1, 2025**.



Company Information for Reporting Companies

- **Information to report for each reporting company**
 - Full legal name of the reporting company.
 - All trade names, fictitious names, or DBAs.
 - Business street address of the reporting company.
 - Jurisdiction of formation (state or tribal).
 - IRS taxpayer identification number (TIN).



Company Information for Reporting Companies (Continued)

- ~~If reporting company lacks a TIN at time of reporting~~

- ~~— Company must report its Dun & Bradstreet Data Universal Numbering System (DUNS), or~~
- ~~— Legal Entity Identifier (LEI).~~

- **Business street address**

- The address of a registered agent or other third party is not sufficient.



Beneficial Owner—Required Information

- **A reporting company must provide for each beneficial owner**

- Full legal name of the individual.
- Date of birth for the individual.
- Residential street address.
- A unique identifying number from certain government documents issued to the individual.
- An image of the document that provided the unique identifying number.



Beneficial Owner—Required Information (Continued)

- **Acceptable sources of unique identifying number**
 - Nonexpired passport issued by the U.S.
 - Nonexpired identification document issued by a state, local government, or Indian tribe.
 - Nonexpired drivers license issued to the individual by a state.
 - Nonexpired passport issued by a foreign government.



Company Applicant—Required Information

- **A reporting company must provide for each company applicant**
 - Full legal name of the individual.
 - Date of birth for the individual.
 - Address—see below.
 - A unique identifying number from certain government documents issued to the individual.
 - An image of the document that provided the unique identifying number that includes a photograph of the individual.



Company Applicant—Required Information (Continued)

▪ **Address for company applicant**

- If company applicant filed the formation or registration document in the course of the individual's business, the street address of such business is required.
- In all other cases, the reporting company must provide the residential street address ~~that the individual uses for tax residency purposes.~~

Reporting Changes to Information

Updates to Information Previously Provided to FinCEN

- **The CTA requires updates if reported information changes**
 - Reporting companies must update information submitted in prior reports to FinCEN not later than ~~one year~~ **30 days** after the date on which there is a change with respect to any of that information.
- **Changes requiring an updated report**
 - Who is a beneficial owner; or
 - Information reported for any particular beneficial owner; or
 - Information reported for any particular applicant; or
 - Reporting company meets requirements for an exemption.

Update Reports—Special Issues

- **Time of reportable change with respect to deceased beneficial owner**
 - Change is deemed to occur when the estate of a deceased beneficial owner is settled.
 - Updated report may still be required following date of death if the death of a beneficial owner causes another person to assume substantial control.
- **Multiple changes**
 - All changes must be reported, even if superseded by another change within the reporting window.
- **Changed or updated information reporting deadline**
 - Report must be submitted **not later than 30 calendar days after** the information changes.

Corrections to Information on Initial Report to FinCEN

- **The CTA requires a correction of incorrect information in reports**
 - Reporting companies that inadvertently submit incorrect information in a report to FinCEN must file a corrected report to avoid civil and criminal penalties.
- **Contents of corrected report**
 - All information necessary to make the report complete and accurate.
- **Corrected report deadline**
 - Corrected report must be filed **within 14 30 calendar days** after reporting company becomes aware or should have known of an error in the initial report.
 - 41Caution, safe harbor from civil and criminal penalties only applies if the corrected report is filed within 90 days after the inaccurate report was filed.

Other Issues

FinCEN Identifier

- **Issued by FinCEN to simplify reporting**

- Beneficial owner, company applicant, or reporting company may simply report its FinCEN identifier in lieu of all the information required by the CTA and regulations.

- **To obtain a FinCEN identifier**

- An individual must submit an application containing all information required for a beneficial owner or company applicant.
- An entity may obtain a FinCEN identifier when it submits a report as a reporting company or any time thereafter.

- **Limitations**

- A FinCEN identifier is specific to the individual or entity to which it is issued.
- An individual or reporting company may only obtain one FinCEN identifier.



FinCEN Identifier Issues

- **Use of FinCEN identifier**

- An individual cannot allow others to use the person's FinCEN identifier.
- Could subject the holder to civil or criminal penalties.

- **Holder of FinCEN identifier must keep information updated**

- Beneficial owner, company applicant, or reporting company shall file updated reports if any of the information contained in the application submitted to FinCEN changes.
- May not be possible for a reporting company to identify changes to company applicant information.



Reporting Violations

- **Clarifies what persons may be subject to penalties**
 - A person who controls or directs another to provide false or incorrect information or to fail to report.
- **Both individuals and reporting companies are subject to penalties**
 - FinCEN extended civil and criminal penalties to any person violating their obligations under the CTA or regulations.

Burdens

FinCEN Burden Estimates

- FinCEN estimate of existing entities in 2024 that may be subject to reporting requirements = 36,581,506
- FinCEN estimate of new companies annually thereafter = 5,616,362
- FinCEN estimates of time burden:
 - 20 minutes to read and understand the form
 - 30 minutes to identify and collect information about beneficial owners and applicants
 - 20 minutes to fill out and file the report, including attaching acceptable identification document
 - 70 minutes in total
- FinCEN estimated hourly wage rate of professional preparing form = \$56.76



FinCEN Burden Estimates (Continued)

Table 2 – Burden and cost of initial BOI reports per reporting company:

Description	Simple Structure (59%)	Intermediate Structure (36.1%)	Complex Structure (4.9%)
Read FinCE BOI documents, understand requirement, and analyze reporting company definition	40 minutes	170 minutes	300 minutes
Identify, collect and review information about beneficial owners and company applicants	30 minutes	135 minutes	240 minutes
Fill out and file report	20 minutes	65 minutes	110 minutes
Total time burden to file:	90 minutes	370 minutes	650 minutes
Avg. wage rate to file (in dollars)	\$56.76	\$56.76	\$56.76
Professional expertise cost (in dollars)	\$0	\$1,000	\$2,000
Cost per initial report:	\$85.14	\$1,350.00	\$2,614.87



FinCEN Burden Estimates (Continued)

Table 5 – Total Burden and Costs

Year 1			
Activity	Count of reports	Burden Hours	Cost
Initial BOI Reports	32,556,929	118,572,335	\$21,673,487,885.48
Updated BOI reports	6,578,732	7,657,096	\$1,038,524,428.72
FinCEN identifier applications for individuals	325,569	108,523	\$6,159,488.81
FinCEN identifier updates for individuals	12,180	2,030	\$115,218.68
FinCEN costs			\$82,000,000.00
Totals	39,473,410	126,339,984	\$22,800,287,021.69

Years 2+			
Activity	Count of reports	Burden Hours	Cost
Initial BOI Reports	4,998,468	18,204,421	\$3,327,532,419.21
Updated BOI reports	14,456,425	16,826,105	\$2,282,108,290.77
FinCEN identifier applications for individuals	49,985	16,662	\$945,666.84
FinCEN identifier updates for individuals	26,575	4,429	\$251,386.22
FinCEN costs			\$35,600,000.00
Totals	19,531,480	35,051,617	\$5,646,437,763.04



Q&A

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3:10 – 4 p.m.

Section 1202: Understanding the Often Overlooked Gain Exclusion

James DeCleene, J.D., *Senior Associate, Michael Best & Friedrich LLP*

Chris McNamara, J.D., *Associate, Michael Best & Friedrich LLP*

Hamang Patel, J.D., *Partner, Michael Best & Friedrich LLP*



1202 – Qualified Small Business Stock

Hamang B. Patel
James W. DeCleene
Christopher G. McNamara

Thursday November 3, 2022

Overview

1. Introduction

2. Benefits of QSBS

- 100% Exclusion of Gain
- 1202 "Flip" Technique
- Multiplication of Exclusion
- Sec. 1045 Deferral

3. Technical Issues

- Issuance Requirements
- Corporate Requirements
- Miscellaneous

4. State Tax Considerations

5. Current Proposals to Change QSBS Treatment

Benefits of QSBS – 100% Exclusion of Gain

- Up to 100% of the gain from the sale or exchange of QSBS held for more than 5 years may be excluded from gross income.

Benefits of QSBS – 100% Exclusion of Gain (cont'd)

The percentage of gain excluded depends on when the QSBS was acquired:

Stock Acquisition Date	Exclusion Percentage	Maximum Section 1202 Gain Rate	Maximum QSBS AMT Rate	Maximum LTCG Rate (No QSBS)
Aug. 11, 1993 to Feb. 17, 2009	50%	15.9%	16.88%	23.8%
Feb. 18, 2009 to Sept. 27, 2010	75%	7.95%	9.42%	23.8%
After Sept. 27, 2010	100%	0%	0%	23.8%

- *Lee, Comeau, Kwon, & Long, Qualified Small Business Stock: Quest for Quantum Exclusions, Tax Notes Federal (Jul. 6, 2020), at 22.*

Benefits of QSBS – 100% Exclusion of Gain (cont'd)

- **Gain exclusion is limited to the *greater of*:**
 - **\$10,000,000** (reduced by any prior gain taken into account under 1202 w/r/t the issuing corporation) OR
 - **10x the aggregate adjusted bases of QSBS** issued by the corporation and disposed of by the taxpayer *during the taxable year.*
- **Special Rules**
 - \$10M reduced to \$5M for married filing separate taxpayers.
 - If filing a joint return, each spouse is treated as having been allocated ½ of the gain for purposes of applying 1202 in future years.
 - For purposes of the 10x limit, no additions to basis after the date on which the stock was originally issued count.
 - **Practice Pointer: If additional capital contributions are to be made to the corporation, consider whether new stock should be issued in exchange for the contribution.**

Benefits of QSBS – 100% Exclusion of Gain (cont'd)

- **Limitations are applied on a per-taxpayer and per-corporation basis.**
 - Ex: Corp. A has 100 shareholders all of whom are individuals who are unrelated to each other. Each shareholder would be entitled to a separate \$10M or 10x exclusion.
 - Ex: During CY 2022, Taxpayer sells QSBS from Corp. A acquired in 2012 for \$1 at a \$5M gain and sells QSBS from Corp. B acquired in 2014 for \$1 at a \$7M gain. Assuming that the taxpayer has never excluded gain with respect to the sale of QSBS from either Corp. A or Corp. B, then all \$12M of gain would be excluded because neither the \$5M of gain from the sale of Corp. A stock nor the \$7M from the sale of Corp B. stock exceeds \$10M separately.
 - Ex: If the Taxpayer in the prior example had previously excluded \$6M of gain under 1202 on the sale of a separate lot of Corp. A stock, then gain exclusion for CY 2022 would be limited to \$4M.

Benefits of QSBS – 1202 "Flip" Technique

- **10x limit on gain exclusion is determined by reference to the "aggregate adjusted bases" of QSBS disposed of by the taxpayer during the year.**
- However, a special rule provides that, solely for purposes of 1202, the basis of QSBS shall not be less than the *fair market value* of the property exchanged for the stock.
- Idea is to wait for the LLC to build value before incorporating so that the fair market value of the property deemed contributed to the new corporation is as high as possible.
 - Ex: An LLC classified as a tax partnership with 2 50/50 members has \$100,000 of assets and no liabilities on Day 1. If the LLC incorporates on Day 1, then the basis of the stock in the hands of the two members for 1202 purposes is \$100,000 (\$50,000 each). The 10x limit would be \$500,000 for each member.
 - Ex: Same as the prior example, but the LLC incorporates on Day 2 when the LLC has \$12,000,000 of assets and no liabilities. The 10x limit would be applied to the \$12M amount since that was the fair market value of the property exchanged for the stock at the time of incorporation, which means the 10x limit for each member would be \$60M.
 - The Fair Market Value can be > \$50M. The thing to watch is the amount of cash (and 1202 basis of other assets) invested.

Benefits of QSBS – 1202 "Flip" Technique (cont'd)

- **Drawbacks to the "Flip"**
 - The 5-year holding period requirement does not begin to run until the LLC incorporates, so if a sale event is on the horizon, it may make sense to flip sooner rather than later. (Judge this relative to the ability to do an asset sale in an LLC and get buyers a step up in basis on those assets – a fact that can be used to negotiate a higher purchase price.)
 - **The special rule that the FMV of the assets contributed to the corporation counts as the QSBS's basis applies in determining gain eligible for exclusion, not just calculating the 10x benefit.**
- **Examples**
 - Ex: A owns 100% of LLC, a DRE for tax purposes, into which he has invested \$100,000. On Day 1, the LLC is worth \$100,000, but A decides to wait to incorporate. On Day 2, the LLC is worth \$8,000,000, and A decides to incorporate. The maximum amount of gain that can be excluded in a single year under the 10x limitation is \$80,000,000. However, A ends up selling LLC on Day 3 for \$10,000,000. A's basis in his QSBS is viewed, solely for purposes of 1202, as being \$8,000,000, which means only \$2,000,000 of gain is eligible for exclusion under 1202 despite A having \$9,900,000 of gain for other tax purposes. Had A incorporated on Day 1, A would have had a basis in his QSBS of \$100,000 for purposes of 1202 and the \$10M limitation would have soaked up 100% of the gain on the sale. In this situation, A loses out on \$7,900,000 of gain exclusion, which is taxed at normal LTCG and NIIT rates (23.8%) – a potential \$1.9M tax hit.
 - Ex: Same as above, but on Day 3, A sells the business for \$80,000,000. In this situation, A's basis for 1202 purposes is \$8,000,000, which means there is \$72,000,000 of gain excluded under 1202, which is \$62M more gain excluded than if A had incorporated on Day 1. The remaining \$7,900,000 of gain is taxed at normal LTCG and NIIT rates (23.8%).

Benefits of QSBS – 1202 "Flip" Technique (cont'd)

- **Practice Pointer:** The 1202 "Flip," if done correctly, can maximize the gain excluded under 1202, but it may not be prudent for companies with more modest sales expectations. Also, care should be taken to ascertain how far out a sale is so the 5-year holding period requirement isn't tripped.

Benefits of QSBS – Multiplication of Exclusion

- **With appropriate, advanced planning, it may be possible to multiply the exclusion to a substantial extent.**

Benefits of QSBS – Multiplication of Exclusion (cont'd)

- Structure ownership from the outset, either by the Founders initially or with respect to preferred stock purchased by an investor, to include a spouse, adult children, and other family members.
 - May not be tolerated by VC funds.
 - May not be desired by Founders when value is low and control issues trump future tax planning.
- Gifts to spouse
 - Technically, each spouse on a joint return is a "taxpayer."
 - If each spouse has title to separate shares of QSBS, then each spouse is likely to be able to claim a separate \$10M / 10x exclusion. This is the case even though the statute explicitly halves the \$10M exclusion for MFS returns.
 - Query: What if the shares were not originally titled in the spouse's name? Would a subsequent transfer be a "gift" for income tax purposes?
 - Query: Would the anticipatory assignment of income doctrine apply if a sale was imminent?
 - **Practice Pointer: Gifts of QSBS to a spouse should occur as soon as possible and not close to an anticipated sale.**

Benefits of QSBS – Multiplication of Exclusion (cont'd)

- Gifts to others individually, at death, or through trusts.
 - Trusts generally should be non-grantor trusts.
 - Multiple trust rules (643(f)) and substance over form doctrine may aggregate multiple, identical trust agreements for the same beneficiary.
 - Will trigger obligation to file Form 709 (Gift Tax Return) if completed gift for gift tax purposes.
 - Gifts to a QTIP trust benefiting a spouse may eliminate some of the concerns of direct gifts to a spouse.
- What is not a gift?
 - Transfers to revocable trusts.
 - Transfers to irrevocable, grantor trusts, including IDGTs, grantor CLATS, etc.
 - Any other transfer where the original owner is still treated as the owner of the property for income tax purposes.
 - LIKELY DOES NOT matter if the transfer is a completed gift for gift tax purposes.

Benefits of QSBS – Multiplication of Exclusion (cont'd)

- Operate different lines of businesses in separate corporations.
 - Might complicate a later sale.
 - Might not make operational sense if business lines are highly integrated.
 - Treasury has been directed to "prescribe such regulations as may be appropriate . . . to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise." IRC s. 1202(k). No regulations addressing this issue have been promulgated to date.

Benefits of QSBS – Sec. 1045 Deferral

- **A taxpayer who has held QSBS for > 6 months and purchases replacement QSBS within 60 days after a sale of that QSBS can elect to roll over the capital gain on the stock sold into the replacement stock.**
 - Gain will be recognized to the extent that the gain was not reinvested.
 - The basis in the purchased shares will be reduced to preserve the gain inherent in the sale transaction.
 - Ex: A purchases QSBS in Corp. A for \$1,000,000 on January 1, Year 1. On January 1, Year 2, A sells the stock in Corp. A for \$1,500,000, and on February 1, Year 2, A acquires QSBS in Corp. B for \$1,300,000. A makes a 1045 election for the sale of the Corp. A stock. A realizes \$500,000 of gain on the sale and recognizes \$200,000 of that gain. The remaining \$300,000 of realized gain reduces A's basis in the Corp. B stock such that A's basis is \$1,000,000.
- Special rules apply where the QSBS is held and sold by a partnership.

Benefits of QSBS – Sec. 1045 Deferral (cont'd)

- Making the election
 - Election is made on the taxpayer's tax return for the year in which the QSBS was sold (not the year the replacement QSBS was purchased).
 - Election is made by reporting the gain on the sale of the QSBS as if it would all be recognized and entering the unrecognized amount as an adjustment to that gain. [2021 Instructions to Schedule D, Form 1040, at D-9]
 - Special rules apply where a partnership sold the QSBS.
- **Practice Pointer: Clients selling QSBS prior to the 5-year mark (but after 6 months) may be able to defer the gain on the sale by purchasing replacement QSBS within a 60-day window. Given the short timeframe, it is beneficial to target potential investments ahead of a sale so that the new investment can be closed timely.**

Technical Issues – Issuance Requirements

- **Issuance requirements**
 - Stock must have been originally issued after August 10, 1993.
 - The corporation issuing the stock must be a "qualified small business" at the time of issuance.
 - With some exceptions, QSBS must be acquired by the taxpayer at its original issue.
 - QSBS must be received in exchange for money or other property (but not stock) or as compensation for services provided to such corporation.

Technical Issues – Issuance Requirements (cont'd)

- **The corporation issuing the stock must be a "qualified small business" at the time of issuance.**
 - Must be a domestic corporation which is a C corporation.
 - The corporation (and its predecessors) cannot have had > \$50,000,000 in aggregate gross assets at any time from August 10, 1993 through immediately after issuance (taking into account amounts received in the issuance).
 - For this purpose, you add the amounts of cash and the *aggregate adjusted bases of other property* held by the corporation.
 - But, any contributed property is treated as having an adjusted basis equal to its fair market value as of the time of such contribution. Presumably, any contributed property which is depreciable would have to track a separate amount of depreciation for 1202 purposes to determine the adjusted basis of such property over time.
 - So, you do *not* just look at the value from a third-party appraisal, especially if the corporation has significant amounts of non-cash contributed property, other property for which it took depreciation, and/or property that has appreciated significantly (e.g., goodwill).
 - Parent-subsiary controlled groups (> 50% vote or value) are aggregated in making this determination.
 - Query: Would a small corporation spun off from a much larger C corporation be permanently ineligible? If a corporation purchases all of the assets from another corporation, is the selling corporation considered a predecessor?

Technical Issues – Issuance Requirements (cont'd)

- **With some exceptions, QSBS must be acquired by the taxpayer at its original issue.**
- Exceptions include:
 - Transfers by gift or at death.
 - Transfers from a partnership to a partner, but not vice versa.
 - Transfer from an S corporation to a shareholder *is not* an exception.
 - Beware holding QSBS inside entities where ownership changes can inadvertently spoil original issuance.

Technical Issues – Issuance Requirements (cont'd)

- **QSBS must be received in exchange for money or other property (but not stock) or as compensation for services provided to such corporation.**
- Exceptions to the "in exchange for . . . stock" prohibition include:
 - Stock received solely via conversion of QSBS in the same corporation is itself QSBS.
 - A common stock for common stock exchange under 1036 seemingly doesn't count for this purpose.
 - Such an exchange may, depending on the circumstances, qualify as a Type E reorganization (a recapitalization).
 - Stock received as a stock dividend on QSBS or as part of a Type E or F reorganization is QSBS.
 - Incorporation and Reorganization Transactions.
 - If QSBS is exchanged for non-QSBS in a 351 or 368, the non-QSBS is treated as QSBS and is viewed as having been acquired on the date the QSBS was acquired. BUT, only the gain that would have been eligible for exclusion at the time of the exchange is eligible for exclusion on a later sale. 1202(h)(4)(D) requires the corporation issuing the stock in the 351 to be in 368(c) control of the old 1202 corporation immediately after the transaction.
 - If QSBS is exchanged for QSBS in a 351 or 368, then the excludible gain is not capped.
- Ex: A owns Corp. X stock which is QSBS. A purchased the stock for \$1,000,000 on Day 1. On Day 2, Corp. X is the Target entity in a reverse triangular merger meeting the requirements of IRC s. 368(a)(2)(E), and A receives Corp. Y stock worth \$5,000,000 which does not separately qualify as QSBS. On Day 3, A sells the Corp. Y stock for \$8,000,000. Despite the Corp. Y stock being treated as QSBS, just the \$4,000,000 of gain inherent in the Corp. X stock on Day 2 is eligible for exclusion under 1202. The remainder of the gain is subject to taxation at 23.8%.

Technical Issues – Corporate Requirements

- **Corporate Requirements**
 - C corporation status
 - Active business requirement
 - No disqualifying redemption transactions

Technical Issues – Corporate Requirements (cont'd)

- **C corporation status**

- At the time of the sale or exchange of QSBS, the corporation must be a C corporation. See IRC ss. 1202(a)(1) (excluding gain from the sale or exchange of "qualified small business stock"); 1202(c)(1) (defining QSBS as "any stock in a C corporation").
- Further, the issuing corporation must be a C corporation "during substantially all of the taxpayer's holding period of such stock." IRC s. 1202(c)(2)(A).
- Last, as noted above, the issuing corporation must also be a C corporation at the time of issuance.
- **Practice Pointer: Given that a corporation must be a C corporation at sale, during substantially all of the taxpayer's holding period, and at the issuance of the stock, it is generally advisable to ensure that S status is not elected for the corporation during any part of the taxpayer's holding period. Otherwise, you would have to argue that the presence of 1 or 2 intervening S years does not violate the "substantially all" requirement for which there is no current definition.**

Technical Issues – Corporate Requirements (cont'd)

- **A corporation must meet the active business requirements during "substantially all of the taxpayer's holding period for such stock."**

- No guidance on what "substantially all" means for this purpose or how it is determined.
- Usually, "substantially all" is within the 80-90% range in other contexts.
- The active business requirements are met for a period if during that period:
 - (i) the corporation is an eligible corporation AND
 - Must be a domestic corporation.
 - CANNOT be a DISC or former DISC, a RIC, a REIT, a REMIC, or a cooperative.
 - (ii) at least 80% of the corporation's assets (by value) are used in the "active conduct of 1 or more qualified trades or businesses."

Technical Issues – Corporate Requirements (cont'd)

- **Active business requirement: $\geq 80\%$ of the corporation's assets (by value) are used in the "active conduct of 1 or more qualified trades or businesses."**
 - **Qualified Trade or Business – Any trade or business other than**
 - Service trades or business in professional fields (e.g., health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services).
 - Any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.
 - Banking, insurance, financing, leasing, investing, or similar businesses.
 - Farming businesses (including raising or harvesting trees)
 - Oil/gas wells and mineral extraction.
 - The operation of a hotel, motel, restaurant, or similar business.
 - Note: Novel startups can push the limits on these categories so be careful and forewarn your client.

Technical Issues – Corporate Requirements (cont'd)

- **Active business requirement: $\geq 80\%$ of the corporation's assets (by value) are used in the "active conduct of 1 or more qualified trades or businesses."**
 - Automatic DQs – A corp does **not** meet the active business requirement for a period if
 - (i) $> 10\%$ of the total value of its assets consists of real property which is not used in the active conduct of a trade or business (dealing in, or renting of, rental property is not viewed as active for this purpose) OR
 - (ii) $> 10\%$ of the value of its **net** assets consists of portfolio stock or securities of non-subsidiary corporations which is not held to meet working capital needs.

Technical Issues – Corporate Requirements (cont'd)

- **Active business requirement: $\geq 80\%$ of the corporation's assets (by value) are used in the "active conduct of 1 or more qualified trades or businesses."**
 - Working Capital Rules
 - Assets held as part of the reasonably required working capital needs of a QTBS are counted.
 - Assets held for investment to finance R&D within 2 years are counted.
 - If corporation is > 2 years old, cannot count more than 50% of assets as reasonably required working capital.
 - Other Special Rules
 - Corporation is deemed to own ratable portion of subsidiary's ($> 50\%$ vote or value) assets and to conduct ratable portion of subsidiary's activities.
 - Assets used to conduct start-up activities or certain R&D activities are deemed to be used in the active conduct of a qualified trade or business for this purpose even if the corporation does not have gross income from such activities at the time of determination.
 - Rights to computer software which produces active business computer software royalties (IRC s. 543(d)(1)) treated as an asset used in the active conduct of a trade or business.

Technical Issues – Corporate Requirements (cont'd)

- **Practice Pointer:** Advise clients to keep records, e.g., financial statements, values of assets, etc., that could be used to show the active business requirement was met during any relevant periods.

Technical Issues – Corporate Requirements (cont'd)

• No disqualifying redemption transactions

- Redemptions within 2 years on either side of issuance
 - In general: Stock is not QSBS if, in one or more purchases during the 4-year period beginning on the date 2 years before the issuance of the stock, the issuing corporation purchases (directly or indirectly) more than a de minimis amount of its stock *from the taxpayer or from a person related* (within the meaning of section 267(b) or 707(b)) *to the taxpayer*.
 - De minimis amount: Stock acquired from the taxpayer or a related person is de minimis unless (i) the aggregate amount paid for the stock exceeds \$10,000 and (ii) more than 2 percent of the stock held by the taxpayer and related persons is acquired. The percentage of stock acquired in any single purchase is determined by dividing the stock's value (as of the time of purchase) by the value (as of the time of purchase) of all stock held (directly or indirectly) by the taxpayer and related persons immediately before the purchase. The percentage of stock acquired in multiple purchases is the sum of the percentages determined for each separate purchase.
- Examples:
 - Partnership AB purchases 150 shares of Corp. X stock on January 1, 2021. On February 28, 2021, Corp. X redeems all 150 shares of its stock owned by Partnership AB, a partnership in which A owns 75% of the capital interests and B owns 25% of the capital interests. At the time of the redemption, Partnership AB's 150 shares were worth \$15,000. On December 31, 2022, A purchases 100,000 shares of Corp. X stock for \$10,000,000. No other shareholders in Corp. X are related to either Partnership AB or A. In this situation, all 150 shares of Partnership AB's stock would be DQ'd and not treated as QSBS (and thus ineligible for any 1045 deferral) because the aggregate amount paid for the stock exceeds \$10,000 and the percentage of stock purchased was 100% ($\$15,000 / \$15,000$). Similarly, all of A's shares purchased on December 31, 2022 would similarly be DQ'd because the redemption of Partnership AB's stock was within 2 years prior to the issuance of stock to A, was for more than \$10,000, and represented 100% of the value owned by A or persons related to A at the time of the redemption.
 - Same as the prior example, but A's purchase took place on January 1, 2021 for \$10,000,000. In this situation, neither Partnership AB's stock nor A's stock is DQ'd because, at the time of the redemption of Partnership AB's stock, such stock represented <2% of the value owned by Partnership AB and A ($\$15,000 / \$10,015,000 = 1.50\%$).

Technical Issues – Corporate Requirements (cont'd)

• No disqualifying redemption transactions

- Redemptions within 1 year on either side of issuance.
 - In general: Stock is not QSBS if, in one or more purchases during the 2-year period beginning on the date 1 year before the issuance of the stock, the issuing corporation purchases more than a de minimis amount of its stock and the purchased stock has an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of the issuing corporation's stock as of the beginning of such 2-year period.
 - De minimis amount: Stock acquired is de minimis unless (i) the aggregate amount paid for the stock exceeds \$10,000 and (ii) more than 2 percent of all outstanding stock is purchased. The percentage of the stock acquired in any single purchase is determined by dividing the stock's value (as of the time of purchase) by the value (as of the time of purchase) of all stock outstanding immediately before the purchase. The percentage of stock acquired in multiple purchases is the sum of the percentages determined for each separate purchase.
- Example:
 - On December 31, 2020, Corp. X has a value of \$1,000,000. On July 1, 2021, Corp. X has a value of \$2,000,000, and Individual A has \$20,000 of Corp. X stock redeemed. On December 31, 2021, Corp. X issues \$10,000 of stock to each of C, D, E, F, and G as compensation for services. On November 1, 2022, Corp. X has a value of \$3,050,000, and Individual B has \$35,000 of Corp. X stock redeemed. In this situation, all of the stock issued to C, D, E, F, and G are DQ'd and not treated as QSBS because the aggregate amount paid for all redemptions in the 2-year period exceeded \$10,000 (total of \$55,000), such redemptions totaled 2.15% ($\$20,000 / \$2,000,000 + \$35,000 / \$3,050,000$) as of the time of the respective purchases, and the aggregate amount paid for all redemptions exceeded 5% of the aggregate value of all of the corporation's stock as of December 31, 2020 ($\$55,000 / \$1,000,000$), the date 1 year prior to the issuance of the stock.
 - Query: What happens if a corporation is incorporated on January 1, 2022, issues stock on July 1, 2022, and a redemption takes place for 3% of the stock worth \$100,000 on November 1, 2022? The 2-year period begins on July 1, 2021. Since the corporation wasn't formed at that time, should the value be \$0 for purposes of applying the "5 percent of the aggregate value" test?

Technical Issues – Corporate Requirements (cont'd)

- **Practice Pointer: Be wary of any purchases by a corporation of its own stock if 1202 status is intended to be preserved, especially within the first year of incorporation.**

Technical Issues – Corporate Requirements (cont'd)

- **No disqualifying redemption transactions**

- **Certain purchases are disregarded:**

- If a shareholder transfers stock to a service provider of the Company, the transfer is not treated as a purchase by the Company even if Treas. Reg. s. 1.83-6(d) would recharacterize the transfer as a transfer of the stock to the Company followed by a transfer from the Company to the service provider. NOTE, however, that the stock received would not be at original issuance.
- Termination of Services
 - Employee / Director – A purchase of stock by a Company is disregarded if (i) the stock was received by an employee or director in connection with the performance of services and (ii) the stock is purchased in connection with the "retirement" or "other bona fide termination" of such services.
 - Independent Contractor – NO SIMILAR EXCEPTION.
- Death
 - A purchase of stock by a Company is disregarded if prior to decedent's death, stock was held by decedent or spouse, decedent and a joint tenant, or a revocable trust established by the decedent or decedent's spouse AND
 - (i) The stock is purchased from the decedent's estate, beneficiary (whether by bequest or lifetime gift), heir, surviving joint tenant, or surviving spouse, or from a trust established by the decedent or decedent's spouse AND
 - (ii) The stock is purchased within 3 years and 9 months from the date of the decedent's death.
- Disability / Incompetency – Disregarded if purchase was incident to the disability or mental incompetency of the selling shareholder.
- Divorce - Disregarded if purchase was incident to the divorce (within the meaning of section 1041(c)) of the selling shareholder.

Technical Issues – Corporate Requirements (cont'd)

- **Practice Pointer:** Be wary of any repurchase of the stock of an independent contractor since such purchases are not disregarded when applying the disqualifying redemption rules.

Technical Issues – Miscellaneous

- **Miscellaneous**

- Only non-corporate taxpayers, e.g., individuals, trusts, and estates, can exclude gain under 1202.
- Stock must have been held for > 5 years.
 - Tacked holding periods generally do not apply except in the case of QSBS acquired as a gift, at death, from a partnership to a partner, through the conversion of other QSBS, or in certain 351 or 368 transactions.
 - If stock is received from the conversion of convertible debt or from the exercise of stock options or warrants, the holding period for this purpose does not begin until the date of the conversion or exercise.
 - The holding period for stock received as compensation for services begins when income for the award is taken into account under section 83 of the Code. So, if stock is subject to vesting, generally, the holding period for 1202 purposes does not start until the stock vests UNLESS an 83(b) election is made, in which case the holding period commences on the transfer date.

Technical Issues – Miscellaneous (cont'd)

- **Miscellaneous**

- Pass-thru entities (partnerships, S corporations, RICs, and common trust funds) may own QSBS with their partners/members/shareholders receiving the benefit of any exclusion provided certain requirements are met:
 - (i) The entity must have held the QSBS for > 5 years and acquired it in a manner that would have given benefit to an individual AND
 - (ii) The taxpayer must have held the interest in the pass-through entity at all times from and after the date the pass-through entity acquired the QSBS.
 - Ex: Partnership AB holds QSBS which it acquired for \$1,000,000 on Day 1. On Day 1, A owns 25% of Partnership AB. On Day 2, A purchases 25% of the interests in Partnership AB from B such that A owns 50% of the entity. On Day 3, Partnership AB sells the QSBS for \$6,000,000. All applicable requirements are met for gain exclusion under 1202. In this situation, 50% of the \$5,000,000 of gain [\$2,500,000] would pass through to A, but A would only be able to exclude \$1,250,000 of that because ½ of A's ownership in Partnership AB was acquired after the Partnership acquired the QSBS.

Technical Issues – Miscellaneous (cont'd)

- **Miscellaneous**

- Off-setting short position
 - Gain exclusion is denied if taxpayer has an offsetting short position with respect to QSBS.
 - A taxpayer has an offsetting short position IF
 - (i) Taxpayer made a short sale of substantially identical property.
 - (ii) Taxpayer acquired to sell substantially identical property at a fixed price OR
 - (iii) To the extent provided in regulations, the Taxpayer has entered into a transaction which substantially reduces the risk of loss from holding such QSBS.
 - Election - Taxpayer can still exclude gain IF QSBS was held for 5 years prior to the offsetting short position AND the taxpayer elects to recognize gain as if the stock were sold on the date the offsetting short position arose.
 - Taxpayer includes anyone related to the taxpayer (within the meaning of 267(b) or 707(b)).

State Tax Considerations

	Wisconsin	Illinois*	D.C.*	Colorado*	North Carolina*	Texas*	Utah*
Conformity with IRC.	Weird. See next slide.	Yes. Illinois conforms to 1202. 35 ILCS 5/102.	Yes. D.C. conforms to 1202. D.C. Code s. 47-1803.02(a).	Yes. Colorado conforms to 1202. Colo. Rev. Stat. S. 39-22-104.	Yes. North Carolina conforms to 1202. N.C. Gen. Stat. s. 105-153.4(a).	No. Texas does not impose an individual income tax.	Yes. Utah conforms to 1202. Utah Code s. 59-10-103(1)(a)(I)(A).

- * Per BNA IRC Conformity Chart

State Tax Considerations (cont'd)

- **Wisconsin**

- Partially follows 1202
 - No exclusion for QSBS acquired on or before December 31, 2013.
 - 50% exclusion for QSBS acquired on or after January 1, 2014 (Wis. Stat. s. 71.98(5)).
 - Report the ineligible exclusion as an adjustment to federal AGI on Schedule I (for individuals). Pub 103 Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, and Trusts -- January 2022.
- Wisconsin separately provides tax benefits with respect to investments in "qualified Wisconsin businesses," which may allow a taxpayer to exclude or defer 100% of certain capital gains. (Wis. Stat. s. 71.05(25)-(26)).
 - See Thomas J. Nichols & James W. DeCleene, *Investing in Qualified Wisconsin Businesses: A Closer Look*, available at Business Law Section Blog: Investing in Qualified Wisconsin Businesses: A Closer Look: (wisbar.org).
 - Involves registering with the DOR among other requirements.

Appendix – Authorities Interpreting Code Sec. 1202

- Cases

- *Holmes v. Comm'r*, T.C. Memo. 2012-251 (aff'd by 9th Cir. in 593 Fed. App'x. 693)
 - Taxpayer failed to report \$2M+ dollars of gain from the sale of stock despite not having made an election to defer gain under 1045. It was unclear whether the stock was acquired at its original issue and whether the business met the active conduct requirement.
 - The Tax Court found insufficient the Taxpayer's general statement that the company never had > \$50M in gross assets where the Taxpayer failed to introduce balance sheets or other financial documents to support that statement.
- *Natkunanathan v. Comm'r*, T.C. Memo. 2010-15 (aff'd by 9th Cir. in 479 Fed. App'x 775)
 - Taxpayer had received options to purchase stock of his old employer, which became options to purchase stock of Intel after a merger of his old employer into Intel.
 - The Tax Court held that Taxpayer was not entitled to QSBS exclusion because (1) he introduced no evidence to support that the company was a QSBS, (2) he did not show he held QSBS for > 5 years, and (3) he held options, not stock.
- *Owen v. Comm'r*, T.C. Memo. 2012-21
 - No 1045 deferral because the active conduct requirement was flunked. Taxpayer had deposited nearly \$2M in cash to a company account and only used \$150,000 of it to purchase inventory.
 - The presence of such a large proportion of the company's assets being cash meant that less than 80% of the company's assets were being used in the active conduct of a qualified trade or business.

Appendix – Authorities Interpreting Code Sec. 1202

- IRS Guidance

- CCA 202204007 (Jan. 28, 2022) – Definition of "brokerage services"
 - Corporation operates a website on which potential lessees may use the website to make nonbinding reservations for the use of certain facilities at specified rental rates from facility lessors that are included in the website data base. Corporation has no authority to enter into or sign leases on behalf of the potential lessors or lessees. A legally binding rental agreement for the use of a facility does not arise until the potential lessor and the potential lessee enter into a lease agreement. Corporation's website will show a user that is considering leasing one or more facilities in a particular location the facilities in that area that are included in the website data base.
 - Potential lessees do not pay any fee to Corporation for the use of Corporation's website. Lessors pay in exchange for being listed on Corporation's website.
 - IRS ruled that the Corporation's activities extended beyond merely advertising and constituted "brokerage services."
 - In doing so, the IRS eschewed resort to some definitions of brokerage services under the Code (particularly 199A) and reasoned that, since 1202 is an exception from the general rule that all income be included in gross income, the exceptions to what businesses are qualified trades or businesses should be interpreted broadly.
 - In line with that broad interpretation, the IRS said that the definition of a "broker" under 6045 (information reporting) should apply. That definition refers to a "broker" as "any person who regularly acts as a middleman with respect to property or services (including real estate) that the Secretary determines should be subject to reporting."
 - Here, the Corporation went beyond providing "mere" advertising services and acted as an intermediary between the lessors and the lessees. While Corporation was paid a flat fee for listings, it also received commission fees.

Appendix – Authorities Interpreting Code Sec. 1202

- IRS Guidance (cont'd)
 - PLR 202221006 – Business that operates pharmacies is engaged in a qualified trade or business and is not involved in the performance of services in the field of health or have as its principal asset the skill/reputation of one of its employees. 1202(e)(3).
 - PLR 202144026 - Tech company develops and commercializes software to assist medical providers in providing medical treatment to patients was engaged in a qualified trade or business and was not involved in the performance of services in the field of health and did not have as its principal asset the skill/reputation of one of its employees. 1202(e)(3).
 - PLR 202125004 – Manufacturer of certain prescription products was engaged in a qualified trade or business and was not involved in the performance of services in the field of health and did not have as its principal asset the skill/reputation of one of its employees. 1202(e)(3).
 - PLR 202114002 - Business labeled as insurance agent/broker viewed as not engaging in "brokerage services," which IRS ruled should be interpreted according to its plain meaning, i.e., "one who acts as an intermediary: such as a: an agent who arranges marriages b: an agent who negotiates contracts of purchase and sale." IRS ruled that Business's role was not that of a mere intermediary because the Business was required to perform a number of admin services, including reporting incidents, claims, suits, and notices of loss to the insurance company. No attempt made to view a portion of the Business as qualified and a portion as unqualified. 1202(e)(3).

Appendix – Authorities Interpreting Code Sec. 1202

- IRS Guidance (cont'd)
 - PLR 201717010 - Develop of tool used to provide complete and timely information to healthcare providers was engaged in a qualified trade or business and was not involved in the performance of services in the field of health and did not have as its principal asset the skill/reputation of one of its employees. 1202(e)(3).
 - PLR 201636003 - Membership interests in an LLC that had converted from a corporation considered to be QSBS despite not formally being "stock". 1202(c), (f), and (h).
 - PLR 201603010 – PLR 201603014 - Conversion of corporation to LLC treated as Type F Reorg, and interests in the LLC continued classification as QSBS. 1202(h).
 - PLR 201436001 - Company commercialized experimental drugs and performed R&D functions considered engaged in a qualified trade or business not involved in the performance of services in the field of health or have as its principal asset the skill/reputation of one of its employees. 1202(e)(3).
 - PLR 200906009 - Taxpayer not allowed to make late election to defer gain under 1045 during course of audit.
 - PLR 200521021 - Taxpayer allowed to make late election to defer gain under 1045 prior to any examination by the Service.
 - PLR 9810010 - Proportionate amount of Controlled stock received in exchange for Distributing stock in 355 spin-off transaction viewed as QSBS.

Presenters



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Questions?

3:10 – 4 p.m.

Employee Retention Credit: Do Your Clients Have a Refund Available?

Edward Zollars, CPA, Tax Partner, Thomas, Zollars & Lynch, Ltd.

Employee Retention Credit: Do Your Clients Have a Refund Available?

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Overview of the Various ERC Versions

Employee Retention Credit

Reality vs. Marketing

- No, not every business qualifies for a check equal to \$26,000 per employee
- But many businesses who do clearly qualify for some amount of this credit have not filed for the credit
- Today we hope to help you
 - Keep your clients from falling for the “too good to be true” hard sell ERC “consultants” that may leave them exposed to major problems down the road
 - Identify any clients that should be filing for this credit

Key IRS Guidance to Review

- Notice 2021-20 – provides overall guidance on the credit. While tied to 2020 version, it applies to all other periods unless specifically changed by the law. So we start here.
- Notice 2021-23 – limited to impact for first six months of 2021 version of the ERTC
- Notice 2021-49 – second most important guidance, provides information on final ERTC versions but also clarifies issues for prior periods (including the no living relative rule)

2020 Employee Retention Credit (After CAA Changes)

Distress Period	Covered Wages	Claiming Credit
<ul style="list-style-type: none">• Receipts < 50% of same quarter in 2019 until quarter after return to > 80%• Full or partial suspension	<ul style="list-style-type: none">• 50% of wages and medical plan costs per employee up to \$10,000 for 2020• Not used for PPP forgiveness• If more than 100 full time employees in 2019, then cannot perform services	<ul style="list-style-type: none">• Form 941-x is the only remaining option for 2020 credits• Statute would be open generally through April 15, 2024

Full/Partial Suspension

- See Section III.D of Notice 2021-20 for IRS position – some “ERC shops” are pushing positions far outside this guidance but not telling their customers
- Question 12 – Supplier issues – not all (or most) supply chain restrictions qualify as a partial suspension
- Question 13 – Customers stay at home – not a qualifying suspension
- Question 14 – Voluntary suspension by a business not a qualifying suspension

Full/Partial Suspension

- Question 17 – If only closed/restricted for certain purposes, only a partial shutdown if
 - *More than a nominal portion* of the business is impacted *and*
 - Restriction has *more than a nominal effect on business operations* (mask and vaccine requirements don't qualify)
 - 10% safe harbors
- Note – must also show
 - Specific state/local order that imposed the restriction (and must be mandatory, not advisory)
 - Must document beginning and ending date of the restriction

2021 ERC Through June 30 (CAA)

Distress Period	Covered Wages	Claiming Credit
<ul style="list-style-type: none">• Receipts <80% of same quarter in 2019 (can use prior quarter to test)• Full or partial suspension	<ul style="list-style-type: none">• 70% of wages per employee and medical plan costs up to \$10,000 for each quarter• Not used for PPP forgiveness• If more than 500 full time employees in 2019, then cannot perform services	<ul style="list-style-type: none">• Form 941-x is the only remaining option for first 6 months of 2021 credits• Statute would be open generally through April 15, 2025

2021 ERC Through September 30 (ARPA)

Distress Period	Covered Wages	Claiming Credit
<ul style="list-style-type: none">• Receipts <80% of same quarter in 2019 (can use prior quarter to test)• Full or partial suspension• Recovery startup business (began after 2/15/20)	<ul style="list-style-type: none">• 70% of wages and medical plan costs per employee up to \$10,000 for each quarter• Not used for PPP forgiveness• If more than 500 full time employees in 2019, then cannot perform services unless revenue down by over 90%	<ul style="list-style-type: none">• Form 941-x is the only remaining option for quarter 3 2021 credits• Q4 could still use reduce deposits and advance refund• Statute would be open generally through April 15, 2025

2021 ERC Fourth Quarter (IIJA)

Distress Period	Covered Wages	Claiming Credit
<ul style="list-style-type: none">• Recovery startup business (began after 2/15/20)	<ul style="list-style-type: none">• 70% of wages and medical plan costs per employee up to \$10,000 for each quarter• Not used for PPP forgiveness• If more than 500 full time employees in 2019, then cannot perform services unless revenue down by over 90%	<ul style="list-style-type: none">• Q4 can still use reduce deposits and advance refund• Statute would be open generally through April 15, 2025

Change to 4th Quarter ERC Found in IIJA

- The Infrastructure Investment and Jobs Act removed the 4th quarter ERC for most employers
- Only recovery start-up businesses will receive the credit for the fourth quarter of 2021

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Planning Concepts with the ERC

Employee Retention Credit

Keep in Mind

- Same dollar of wages cannot be used for ERC and loan forgiveness
- PPP forgiveness is more valuable than ERC but...don't want to use \$1 more of ERC wages to get full PPP loan forgiveness than have to
 - Payroll costs should only be 60% of PPP loan unless have no other choice
 - Use non-wage payroll costs in full and also wages that don't qualify for ERC
 - Controlling interest shareholders and relatives
 - Wages in excess of \$10,000
 - Maximize other expenses that qualify for the PPP on the application
- Also remember some other credits can't be used on ERC wages (research credit especially).

IRS Guidance Details

Employee Retention Credit

PPP Loan Forgiveness and the Gross Receipts Test

- Revenue Procedure 2021-33, 8/10/21
 - What to do with forgiveness as a gross receipts for
 - 50%/80% test for 2020
 - 20% test for 2021
 - IRS rules that PPP forgiveness does count as gross receipts
 - Congress references §448(c) whose regulations include tax exempt income
 - Would create a problem for many taxpayers, inflating gross receipts for the quarter when forgiveness is obtained.

From the Revenue Procedure

“Although the amount of forgiveness of a PPP Loan is not included in gross income, that forgiveness amount would be included in gross receipts under § 448(c) of the Code and § 1.448-1T(f)(2)(iv), or § 6033 of the Code and § 1.6033-2(g)(4), as applicable. Similarly, the amount of an ERC-Coordinated Grant received by a taxpayer is not included in gross income, but the amount would be included in gross receipts.”

Example – PPP Proceeds as Gross Receipts

“TN, Inc. received a PPP loan of \$200,000 in 2020. TN, Inc. has determined that the loan forgiveness income was triggered for income tax purposes on June 15, 2021. For the second quarter of 2021, TN, Inc. had gross receipts, other than receipts from forgiveness, of \$750,000. In the second quarter of 2019, TN, Inc. had gross receipts of \$1,000,000. With PPP forgiveness included in gross receipts for the second quarter of 2021, TN, Inc.’s gross receipts for that quarter under IRC §448(c) are \$950,000, or 95% of the gross receipts for the same quarter in 2019. Thus, the amount is not less than 80% of the same quarter in 2019.

Assuming TN, Inc. was not subject to a full or partial shutdown in the second quarter of 2021 and that there was not a 20% drop in gross receipts from the first quarter of 2021 as compared with the first quarter of 2019, the inclusion of the PPP forgiveness in gross receipts would deny TN, Inc. the ability to claim the ERC in the second quarter of 2021. As well, it also could deny TN, Inc. any ERC in the third quarter of 2021, since TN, Inc. could not rely on a 20% drop in gross receipts in the immediately prior quarter to qualify for the ERC in the third quarter of 2021.”

IRS Gives Taxpayers a Break

- Despite finding the amounts are gross receipts per the law, felt it was contrary to what Congress would want
 - Allow taxpayers to exclude PPP forgiveness, shuttered venue operator grants, and restaurant revitalization grants
 - Must do so consistently if elect to do so
 - Normally will be to the advantage of the employer to make this election
 - Can also reverse this election (though not sure why you would)?
- IRS likely feels they can do this because it is their regulation that had held tax-exempt income was part of gross receipts

Reason to Allow Per Revenue Procedure

“Section 2301(g) of the CARES Act and § 3134(h) of the Code set forth a coordination rule providing that the employee retention credit does not apply to so much of the qualified wages paid by an eligible employer as are taken into account as payroll costs in connection with forgiveness of a PPP Loan or, in the case of § 3134(h), an ERC-Coordinated Grant (relief programs). This rule demonstrates a congressional intent that an employer be able to participate in the relief programs and also claim the employee retention credit, provided that the same dollar of wages that are paid for or reimbursed with relief program funds may not be treated as qualified wages for purposes of the employee retention credit. Including the amount of the forgiveness of a PPP Loan or the amount of an ERC-Coordinated Grant in gross receipts for determining eligibility to claim the employee retention credit could frustrate this congressional intent.”

Reason to Allow Per Revenue Procedure

“Specifically, an employer that participated in one or more of the relief programs and that otherwise has the requisite percentage decline in gross receipts might be precluded from claiming an employee retention credit with respect to a calendar quarter in which there is the decline in gross receipts solely because its participation in the relief program resulted in a temporary increase in gross receipts within the meaning of the tax law.”

Example of Using the Safe Harbor

If TN, Inc. decides to elect the use of this Revenue Procedure, the company will now have gross receipts that are 75% of those in the same quarter in 2019 (750,000/1,000,000). Thus, TN, Inc. will qualify to claim the ERC in the second quarter of 2021 based on this decline.

As well, TN, Inc. will also automatically qualify to claim the ERC in the third quarter of 2021, since now the immediately preceding quarter had a greater than 20% decline in gross receipts.

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Notice 2021-49 – Key ERC Guidance

Employee Retention Credit

Notice 2021-49, 8/4/21

- IRS guidance on
 - 3rd & 4th quarter ERC found now at IRC §3134
 - Open questions remaining about the ERC in general
- Second largest IRS guidance package on the ERC - initial package at Notice 2021-20 still is the largest package and applies to the extent not modified by later notices
 - Updated 2020 IRS FAQ and formalized it
 - The place to look for details on full and partial suspension of business
- Notice 2021-23 (released for 1st six months of 2021 ERC) from April applies as well to the extent it is consistent with 3rd & 4th quarter program

Related Parties and the ERC

- Guidance confirms what we had indicated was the plain text reading of the ERC's reference to IRC §51(i)(1)
- Creates the “no living relative” test
 - Note that the JCT has restated this conclusion in initial description of markup for reconciliation bill
 - Document x-43-21, page 178, regarding availability of WOTC per §51(i)(1)'s limits: “The credit is not allowed for wages paid to a relative or dependent of the taxpayer. No credit is allowed for wages paid to an individual who is a more than 50-percent owner of the entity.”
 - This duplicates the PATH Act committee report we discussed in June 2 session-and is still really technically wrong, but right from a practical perspective for 99% of clients

Text of the Statutory Provisions

- **CARES Act §2301(e):** “For purposes of this section, rules similar to the rules of sections 51(i)(1) and 280C(a) of the Internal Revenue Code of 1986 shall apply.”
- **IRC §51(i)(1)(A):** “No wages shall be taken into account under subsection (a) with respect to an individual who— (A) bears any of the relationships described in subparagraphs (A) through (G) of section 152(d)(2) to the taxpayer, or, if the taxpayer is a corporation, to an individual who owns, directly or indirectly, more than 50 percent in value of the outstanding stock of the corporation, or, if the taxpayer is an entity other than a corporation, to any individual who owns, directly or indirectly, more than 50 percent of the capital and profits interests in the entity (determined with the application of section 267(c)),...”

Text of the Statutory Provisions

- **IRC §154(d)(2)(A)-(G):** “(A) A child or a descendant of a child.
(B) A brother, sister, stepbrother, or stepsister.
(C) The father or mother, or an ancestor of either.
(D) A stepfather or stepmother.
(E) A son or daughter of a brother or sister of the taxpayer.
(F) A brother or sister of the father or mother of the taxpayer.
(G) A son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.”

Text of the Statutory Provisions

- **IRC §267(c):** “(c)Constructive ownership of stock

For purposes of determining, in applying subsection (b), the ownership of stock—

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

Text of the Statutory Provisions

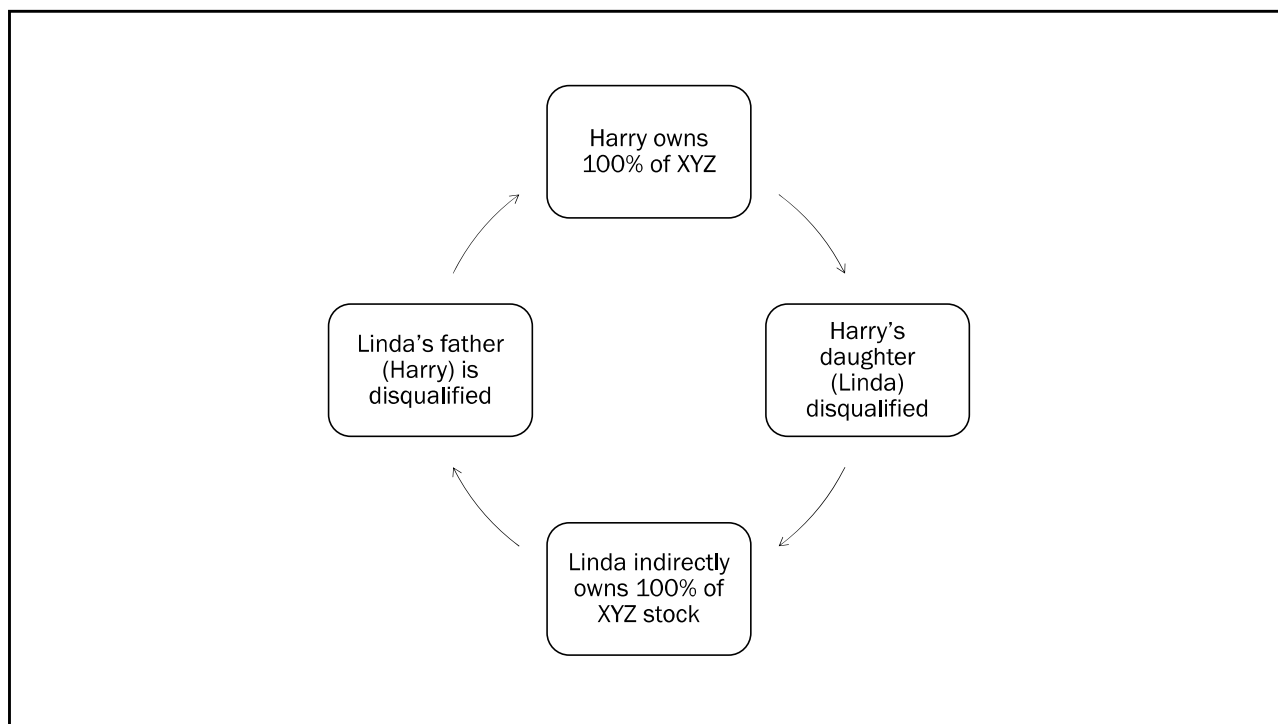
- **IRC §267(c):** “(c)Constructive ownership of stock

For purposes of determining, in applying subsection (b), the ownership of stock—

...

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

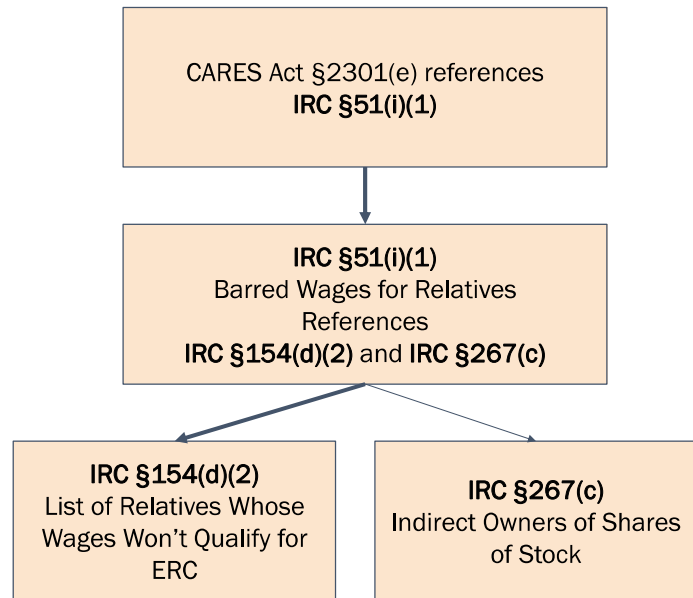


Applying the Rules

- Assume I own 100% of a corporation
- If my brother is an employee the corporation cannot claim a credit for his wages
 - I control the corporation (100% owner)
 - My brother has a relationship to me listed in §51(i)(1)

Applying the References

My brother is in my list of relatives so any wages to him will not qualify for ERC.



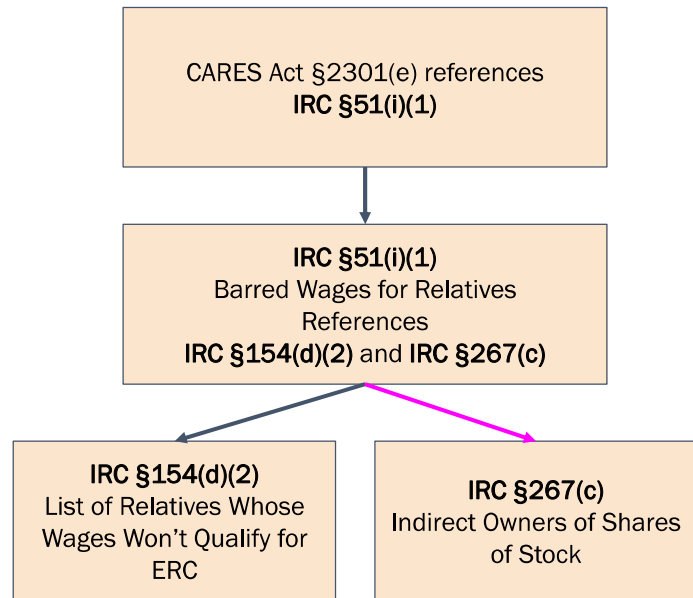
Applying the Rules

- My brother indirectly owns 100% of the corporation under §267(c)
- If his sister-in-law is employed by my corporation I'm also barred from claiming the credit
 - My brother indirectly owns 100% of my S corporation
 - His sister-in-law has an impermissible relationship to him
 - So corporation can't claim the credit

Applying the References

Under §267(c) my brother is treated as owner of 100% of shares

His sister-in-law is on his list of barred relatives, so her wages won't qualify for the ERC in my corporation.



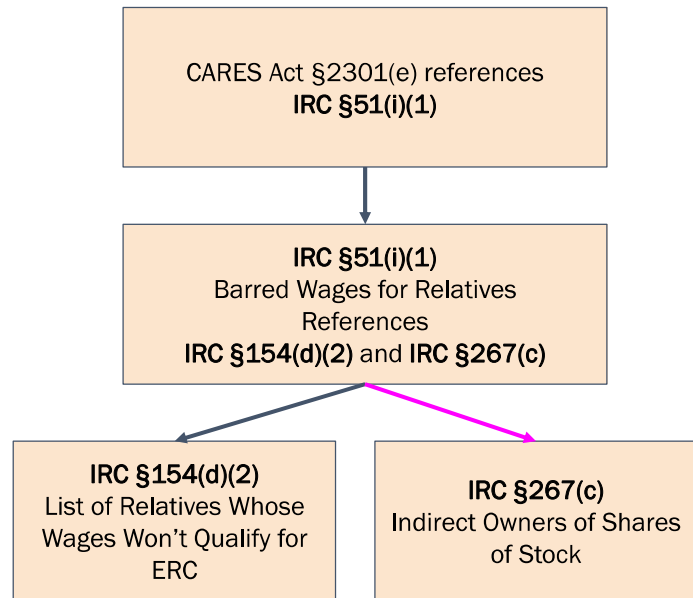
Applying the Rules

- But I have a similarly listed relationship to my brother
- So if I'm paid by my corporation (seems likely)
 - I'm the brother of an indirect 100% owner
 - Note this works even if my brother has nothing to do with my corporation—just needs to be alive

Applying the References

Again, my brother under §267(c) owns 100% of the stock.

And now I'm on the relative list for my brother, so wages paid to me are no longer eligible for



IRS Ruling Confirms This View

- Generally, wages paid to an individual (and their spouse) who owns interest that control over 50% of a corporation or partnership do not qualify for the ERC
 - Will be the case if there is a living §267(c) relative other than the spouse (ancestor, descendant, or sibling)
 - Only if there is no living relative will these wages qualify
- The result is directly taken from the statute:
 - Ownership is “determined with the application of section 267(c)..” §51(i)(1)(A)
 - Thus descendant, ancestor or sibling will end up constructively holding the same shares as the controlling interest holder (what §267(c) provides)
 - Controlling interest holder will be on the “relative list” from §152(d)(2)(A)-(G) of that constructive controlling owner.
 - There is no ambiguity to be resolved, thus it matters not what “Congressional intent” was (see Justice Thomas’ opinion on that issue)

Connecticut National Bank v. Germain, 503 US 249, 253-254 (1992)

““In any event, canons of construction are no more than rules of thumb that help courts determine the meaning of legislation, and in interpreting a statute a court should always turn first to one, cardinal canon before all others. We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. See, e. g., *United States v. Ron Pair Enterprises, Inc.*, 489 U. S. 235, 241-242 (1989); *United States v. Goldenberg*, 168 U. S. 95, 102-103 (1897); *Oneale v. Thornton*, 6 Cranch 53, 68 (1810). When the words of a statute are unambiguous, then, this first canon is also the last: "judicial inquiry is complete." *Rubin v. United States*, 449 U. S. 424, 430 (1981); see also *Ron Pair Enterprises*, supra, at 241.

Germain says that legislative history points to a different result. But we think that judicial inquiry into the applicability of § 1292 begins and ends with what § 1292 does say and with what § 158(d) does not.”

Example 1 from Ruling – Parent and Child Shareholder

Corporation A is owned 80 percent by Individual E and 20 percent by Individual F. Individual F is the child of Individual E. Corporation A is an eligible employer with respect to the first calendar quarter of 2021. Both Individual E and Individual F are employees of Corporation A. Pursuant to the attribution rules of section 267(c) of the Code, both Individual E and Individual F are treated as 100 percent owners of Corporation A. Individual E has the relationship to Individual F described in section 152(d)(2)(C) of the Code, and Individual F has the relationship to Individual E described in section 152(d)(2)(A). Accordingly, Corporation A may not treat as qualified wages any wages paid to either Individual E or Individual F because both Individual E and Individual F are each related individuals for purposes of the employee retention credit.

Example 2 – Child Not Involved in Business

Corporation B is owned 100 percent by Individual G. Individual H is the child of Individual G. Corporation B is an eligible employer with respect to the first calendar quarter of 2021. Individual G is an employee of Corporation B, but Individual H is not. Pursuant to the attribution rules of section 267(c) of the Code, Individual H is attributed 100 percent ownership of Corporation B, and both Individual G and Individual H are treated as 100 percent owners. Individual G has the relationship to Individual H described in section 152(d)(2)(C) of the Code. Accordingly, Corporation B may not treat as qualified wages any wages paid to Individual G because Individual G is a related individual for purposes of the employee retention credit.

Example 3 – No Living Relative Rule

Corporation C is owned 100 percent by Individual J. Corporation C is an eligible employer with respect to the first calendar quarter of 2021. Individual J is married to Individual K, and they have no other family members as defined in section 267(c)(4) of the Code. Individual J and Individual K are both employees of Corporation C. Pursuant to the attribution rules of section 267(c), Individual K is attributed 100 percent ownership of Corporation A, and both Individual J and Individual K are treated as 100 percent owners. However, Individuals J and K do not have any of the relationships to each other described in section 152(d)(2)(A)-(H) of the Code. Accordingly, wages paid by Corporation C to Individual J and Individual K in the first calendar quarter of 2021 may be treated as qualified wages if the amounts satisfy the other requirements to be treated as qualified wages.

Example 4 – Sibling Owners

Corporation D is owned 34 percent by Individual L, 33 percent by Individual M, and 33 percent by Individual N. Individual L, Individual M, and Individual N are siblings. Corporation D is an eligible employer with respect to the first calendar quarter of 2021. Individual L, Individual M, and Individual N are employees of Corporation D. Pursuant to the attribution rules of section 267(c) of the Code, Individual L, Individual M, and Individual N are treated as 100 percent owners. Individual L, Individual M, and Individual N have the relationship to each other described in section 152(d)(2)(B) of the Code. Accordingly, Corporation D may not treat as qualified wages any wages paid to Individual L, Individual M, or Individual N.

Is This Notice Correct?

- My view – the reference to §267(c) defines who is an owner, which creates the splashback
- Congressional intent is not relevant in that case
- Even if it was, though
 - No evidence Congress did not intend splashback to work
 - Congress has twice put out committee reports indicating splashback exists in the ERC
 - The PATH Act report previously mentioned
 - Recent committee report on the House draft of the reconciliation bill
- Congress has the right to pass absurd laws...

Is This Notice Correct?

- But only the courts can say for sure.
- Filing position rules
 - If have reasonable basis authority under the §6662 regulations, can take position with disclosure
 - If you believe the authority is substantial authority, then (and only then) you can take without disclosure
- Should likely advise clients when taking a position not in line with the Notice and if already filed with a position contrary to this Notice.

Full Time Employees/Full Time Equivalents

- Although the law refers to the ACA employee definitions in the provision used for testing for ALE, don't use ALE number of "employees"
- The specific reference is only to the full time employees provision
- Thus full time equivalents do not count in determining the 500/100 employee count for average 2019 employees and the "large employer" classifications for ERC

Tips and §45B Credit

- Tips count as ERC wages despite the fact the employer does not pay them
- The law references wages per IRC §3121
 - That includes cash tips received by an employee
 - Only exception is if the total is \$20 or less
- Same result takes place if tip credit claimed by employer under IRC §45B, as Congress did not put that credit in the list that bars the use of the ERC for the same wages

Timing of Deduction Disallowance

- ERC requires the employer to reduce the deduction for wages by the amount of ERC allowed on those wages
- IRS decides that this language requires going back to the year the wages were deducted on the income tax return
- Thus 2020 ERC refund claims will often require the taxpayer to amend a previously filed tax return that covered the quarter in question
- IRS does not provide a different result for those on the cash basis, so can't wait for the refund to be received

Alternative Quarter Election

- 2021 we started using a different reduced gross receipts calculation for ERC
- Also obtained option to test the prior instead of current quarter to qualify
- IRS rules that consistency is not required by the law
 - If elect prior quarter for Q1 2021 (that is, tested Q4 2020 vs. Q4 2021 to obtain 20% reduction)
 - Do not have to use Q1 2021 to see if qualify for Q2 2021 (so not a problem if Q1 2021's receipts are not down 20% from Q1 2019, so long as Q2 2021 shows that decrease vs. Q2 2019)
- Also means if have a 20% drop in Q1 or Q2 of 2021, will automatically qualify for at least two quarters, which is roughly what was true in 2020 (once you qualified in a quarter, you would be in through at least the next one)

Extended Statute of Limitations on Assessing Tax

- For the 3rd/4th quarter ERC, the IRS has five years to assess taxes related to ERC credits claimed
- This rule only applies to the 3rd/4th quarter - the standard three year period applies to other ERC credits
- Note that due to the longer statute, an employer who claimed too much for ERC may not be able to go back and claim a refund related to an increased wage deduction if the IRS comes in after the year the wages were paid is closed for a claim for refund for income tax purposes.

Questions?

Employee Retention Credit

4:10 – 5 p.m.

Hot Tax Practice Procedure & Ethical Issues

Michael Goller, J.D., *Shareholder & Tax Department Chair, Reinhart
Boerner Van Deuren s.c.*

HOT TAX ETHICS, PRACTICE AND PROCEDURAL ISSUES

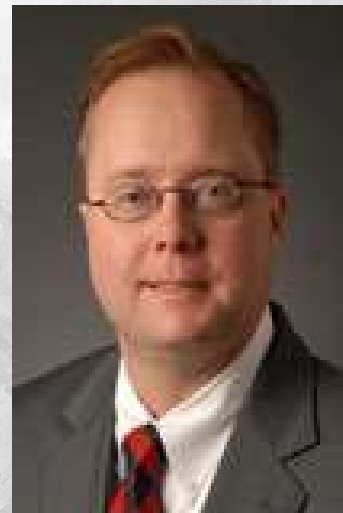
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1

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Michael G. Goller is a shareholder in Reinhart's Tax, Litigation and Business practices. He focuses on tax controversy and tax litigation, as well as tax and estate planning. His clients range from large public corporations to midsized, privately held businesses and their owners. Michael works on behalf of his clients in disputes with the IRS, the Department of Justice and various other taxing authorities.



2

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Table of Contents

- Part I - **Hot** Practice and Procedure Issues
- Part II - The Very **Hot** Research Credit, What is New, How to Handle the Audit and Appeal
- Part III - **Hot** Ethics Issues
- Part IV - **Hot** High Net Worth and Family Office Issues
- Part V - **Hot** Employment Tax Issues

PART I Hot Practice and Procedure Issues

- The IRS is going to receive a lot of money. How will it be spent?
- What are the hot audit issues?

Hot Issues - Which Will Get Hotter

- Partnership Audits
- High Net Worth Audits
- Estate and Gift - Valuation Issues
- Net Operating Loss and Basis Issues
- Passive Losses and the Real Estate Professional
- Section 183 - “Hobby” Loss Cases
- Refund Claim Traps
- Employment Tax Audits
- Penalty Issues

5

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PARTNERSHIP AUDITS

New Partnership Audit Program and related high net worth audit program are **HOT** in FY 2022, and beyond.

Source: Tax Notes (9/20/21)

6

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Overview

The BBA, among other things, eliminates the so-called TEFRA Unified Partnership Audit Procedures¹ and the Audit Procedures for Electing Large Partnerships.² It also creates a more streamlined partnership audit approach, thus making it easier for the IRS to audit a partnership.

1 These were first created in the Tax Equity and Responsibility Act of 1982.

2 Created as part of the Taxpayer Relief Act of 1997.

7

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Neutral Revenue Raiser

- The BBA was promoted as a “neutral” revenue raiser (*i.e.*, a revenue raiser in disguise); in that an increase in partnership audits will raise revenue without increasing taxes.
- It is expected that the new audit procedures and increased audits will yield \$9.3 billion of additional revenue over ten years. As such, the law gained quick approval in Congress.

8

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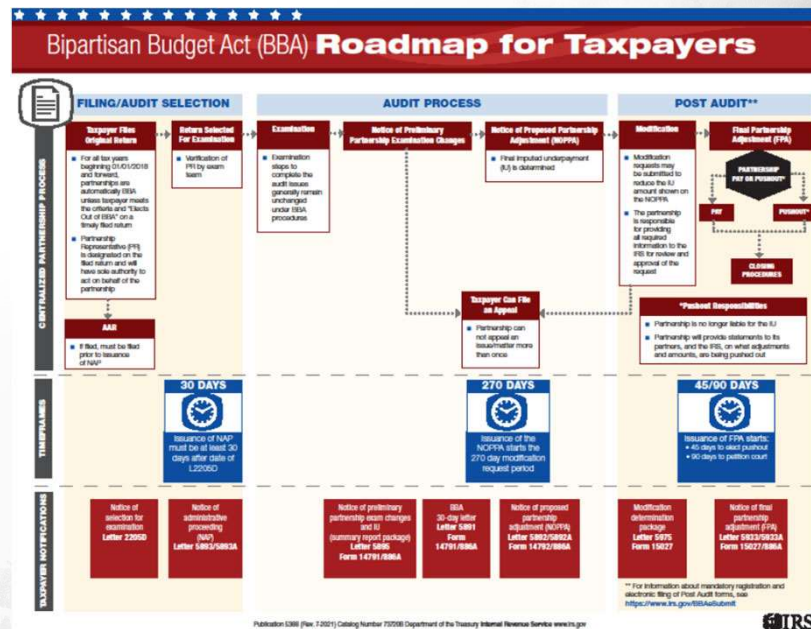
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Partnership Audit Road Map

9

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10

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Current Status

- These audits seem to be off to a slow start
- IRS is asking for lengthy statute extensions

Airplane Cases

- Partnership or corporate structure
 - Personal Entertainment v. Non-Personal Entertainment
- SIFL or §274-10(e)
- Schedule C Structure - CCA 202117012 (4/30/21)
- Depreciation and the Section 280F trap
- Entertainment Facility trap

Auditing Net Operating Losses

- What are the rules of the road
- Many traps - the statute of limitations is an issue

Comment: The five year net operating loss carry back has made this very relevant

Statute of Limitations Issues

- A statute of limitations is a law that specifies the amount of time within which an act must be performed to be legally binding.
- Normally, the IRS must make any assessment of additional tax within three years of the time a return is filed.
- Assessment is nothing more than a bookkeeping entry made on the records of the Internal Revenue Service. Specifically, section 6203 provides that an "assessment shall be made by recording the liability of the taxpayer in the Office of the Secretary [of the Treasury]"
- A determination as to when the IRS made an assessment can be made by reviewing an IRS transcript of account.

Statute of Limitations Issues (cont.)

There are a few significant intricacies about the statute of limitations on assessment

- A. A return filed prior to the due date is treated as filed on the due date
- B. If the return is filed after the due date, then the actual date of filing is used
- C. A return required to be filed return is deemed filed when it is postmarked, if the return is timely filed
- D. If the return is not filed when due, then the filing date, for limitations purposes, is the date it is actually received by the IRS. When a return is filed with the wrong Service Center, the statute does not begin to run until the redirected return is received by the correct Service Center

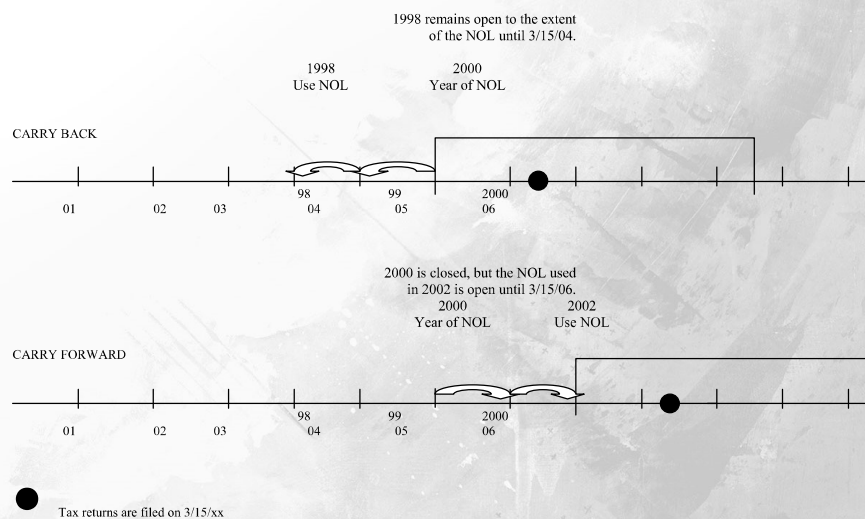
Statute of Limitations Issues (cont.)

- E. When calculating the 3-year period, the date that the return is actually filed is excluded
- F. When the due date falls on a Saturday, Sunday, or legal holiday, the return is considered timely filed if it is filed on the next business day. In such an instance, the statute of limitations begins to run on the actual date of filing.
- G. The statute of limitations on assessing estate tax cannot be extended. See § 6501(c)(4)(A)

Exception to Three-Year Rule for Items Carried Forward or Back

- A. A deficiency attributable to the carry-forward of a net operating loss, capital loss, or unused tax credit may be assessed within 3 years of the date of filing the return for the year the loss or credit is used, even though such date may be well beyond the normal statute of limitations for the year to which the loss or credit originally arose
- B. The statute of limitations on a carryback runs from the year of the loss, not the year in which the benefit of the loss is put to use

Net Operating Losses and The Statute of Limitations on Assessment § 6501



IRS Attach on Cost Segregation Studies

- Publication 5653 (Rev. 6-2022) “Cost Segregation and Audit Technique Guide”
- Revisions were not large but whenever the IRS revises an audit manual, there will be audits

Sample IDR

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 006
To: [REDACTED]	Subject: Activity Log	
[REDACTED]	Submitted to: [REDACTED]	
	Dates of Previous Requests: N/A	

Description of Documents Requested:

1. Please complete and sign the attached log forms (Exhibit A for calendar year 2019 and Exhibit B for calendar year 2020) for each real estate activity for which Taxpayer claims to have materially participated.
 - a. List all hours and services performed for the 2019 and 2020 calendar years. Provide detailed explanations of services or activities performed.
 - b. Provide documents to support hours claimed. This can include, but is not limited to, calendars, diaries, or other documents that reflect services provided and hours attributable to those services.

Where documents exist in electronic format, please provide in original electronic format.

Draft Date: 9/16/2022
Due Date: 11/7/2022

Information Due By 11/7/22 At Next Appointment Mail In

Name and Title of Requestor: Hwang, Yujin Internal Revenue Agent	Badge Number: 1003822997 Phone: 312-292-3152 Fax: 855-330-7359 Email: Yujin.hwang@irs.gov	Date: 9/16/2022
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FROM Office Location:
Internal Revenue Service; Mail Stop 4171
LB&I:ECPA:1113; 230 S. Dearborn; Chicago, IL 60604

Form 4564 Page 1 of 1

Passive Losses and the Real Estate Professional

- Section 469
- Rental Real Estate
- Real Estate Professional
- Proving Material Participation
- Make a Grouping Election - watch limited partnership trap

21

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Section 183 “Hobby” Loss Cases

- Section 183
- Recent case - Walters v. Comm’r, T.C. Memo 2022-17 “Green Home” was a for profit venture

22

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PART II

The Very Hot Research Credit

23

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The Section 41 Research Credit

- Background of the Research Credit
- Different types of Research Credits
 - Regular Credit--20% of current year's expenses over base period expenses. Must prove up fixed base percentage.
 - Alternative Simplified Credit--credit ranges from 1.65% to 3.75% and is a function of three prior years' sales

24

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The four tests:

- Elimination of Uncertainty for each New or Improved Business Component Test
- Technological in Nature Test--discover information that is technological
- Process of Experimentation Test--Experiment in the "scientific" sense
- Business Component Test--needs some level of functional improvement to a new or improved Business Component

Examples

- Software development
- Improving the manufacturing process
- New technology exploration
- A great deal of manufacturing can qualify, but look closely at the four tests

IRS Concerns

- A great deal of manufacturing can qualify, but look closely at the four tests
- IRS believes there is widespread abuse
- Discovery Requests- very broad
- A Second (or Third) Tour - very common
- Funded Research - a hot issue
- Base Period Substantiation-Traditional Credit
- IRS “Upping the Ante” by Amending the IRS’s Tax Court Answer to Disallow all QRE and Assert a Penalty
- New IRS policy on refund claims

27

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Uncertainty Test

- “Activities intended to discover information that would eliminate uncertainty concerning the development of improvement of a product.”
- Uncertainty exists if the information available to the taxpayer at the start of the project does not establish the method of improving or designing the component.
- Uncertainty must be as to technical ability, not economic or business uncertainty.
- Focus is on activities being conducted to address the uncertainty.

28

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Technological in Nature Test

- “Activities undertaken for the purpose of discovering information which is *technological in nature*.”
 - Technological in Nature
 - Relies on the principles of hard sciences, such as engineering and physical, biological, or computer sciences.
 - May apply existing technologies or principles to eliminate uncertainty.
 - Patent safe harbor- rebuttable presumption that test is met if there is a patent.

Process of Experimentation Test

- Substantially all (i.e. 80%) of the activities constitute a process of experimentation.
- Hypothesis, Test, Retest
 - Factors indicating experimentation:
 - Testing and analyzing alternative hypotheses
 - Significant scientific testing, and
 - Evaluation of numerous of complex technical tests

Business Component Test

- Development of a product and/or process
- A business component is “a product, process, computer software, technique, formula, or invention” that is held for sale, lease or license or is used by the taxpayer in a trade or business.
- Section 41(d)(2)(B)
- Research relating to process improvements must qualify separately from the research relating to the product produced
- There must be some level of functional improvement
- Shrink Back Rule
 - If an entire product or process does not meet the test, the components of the product or process may be considered and some of the costs may qualify.

31

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IRS Exam, Appeals and Litigation Process

- Involvement of the examination function at appeals is now common
- IRS "engineer"--often not an engineer
- Hazards of litigation
- Document IRS concessions (i.e., the "engineer" agrees an item has been documented)
- IRS attorney will often try to raise a "New Issue" (i.e., a penalty, funded research, disallow all QRE, look closer at the "Substantially All" test)

32

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The IRS “Engineer”

- May not be an engineer
- Often “drives the bus”

33

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Good Credit Study

- Allocate costs by New or Improved Business Component
- Avoid repeated "boiler plate" language
- Study should summarize findings, not repeat statements (hearsay issue)
- The author of the credit study summarizes his or her investigation and then opines that:
 - The four tests are met
 - None of the exclusions apply (e.g., funded research or undocumented contract research)

34

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IRS Standard Information Document Request ("IDR") Traps

- The IRS typically issues a "standard" IDR in all research credit cases. Think about these questions before the return is filed.
- Traps to watch for
- Don't confuse "Projects" with "New or Improved Business Components"
 - Each New or Improved Business Component must meet the four tests
- Each question is a potential trap/admission

The IRS Tour

- Usually a Fishing Expedition
- IRS Insists on These in Most Cases
- Manage the Interview - witness prep is key

Witness Tips-Research Credit Cases

Explain the Following to the Witness

- To qualify for the R&D credit, activities must meet all of the following four tests.
 - **Elimination of Technical Uncertainty** - The research is intended to **eliminate technical uncertainty** as it relates to any of the following:
 - Capability uncertainty - can we do what is asked?
 - Methodology uncertainty - how will we do what is asked?
 - Design uncertainty - can we design the actual solution?

Witness Tips-Research Credit Cases (cont.)

- **Technological in Nature** - The research must be designated to discover information that is “**technological in nature**”. The research activities must rely on the **principals of science, such as engineering, physical, biological, or computer science.**
- **Process of Experimentation** - The research must involve a process of **experimentation** intended to eliminate the technical uncertainty (**hypothesis, test, retest**).

Witness Tips-Research Credit Cases (cont.)

- **New or Improved Business Component** - The research must be intended to develop or improve the **performance, function, quality, or reliability of a product, process or system** (i.e. new or improved business component).

Common Interview Questions/Themes

General

- What is your educational/technical background?
- What was your role on the project? The IRS is looking to disqualify wages not related to the research activities (e.g., sales, day-to-day operational support, management activities).
- How did you calculate the research expenses (e.g., time tracking system, calendar meetings, other records)?
- Do you contract with third parties who perform research?
- Maintenance activities can be research activities-but you may need to explain this.

Common Interview Questions/Themes (cont.)

- Business Component (i.e., project) specific questions:
 - What was the goal of the project?
 - What were the specific research activities?
 - What were the steps in the development of the new or improved product, process, or system?
 - Why was there uncertainty
 - When did research cease (i.e., when was the technical uncertainty eliminated?)?
 - Wasn't this just "pure math"

Common Interview Questions/Themes (cont.)

- What risk of loss existed when you undertook this research
- What rights did you retain in your research (be prepared to address language in a contract)

Tips for Answering Questions

- Don't minimize your involvement in research projects. This is not a time for humility.
- Provide specific examples of your technical involvement in research projects.
- Avoid words and phrases like “tweak,” “refigure,” “modify,” “we know we could do it”
- Mention specific challenges, problems, obstacles, uncertainties, and failures (**failure is a good thing for purposes of the credit**) and the steps undertaken to try to arrive at a solution (e.g., hypothesis, testing, retesting, prototyping, modeling).

Tips for Answering Questions (cont.)

- Mention the risk of loss you faced
- Words and phrases like “scientific,” “uncertainty,” “test and retest,” “measure data,” “solution,” “new or improved product,” “new or improved process,” “new or improved system” are helpful
- It's OK to say “I don't know, we will get back to you”
- Be honest
- Avoid going off topic

IRS Acknowledgement IDR-- Happens at the end of the audit

- IRS issues to most LB&I taxpayers an IDR that attempts to box the taxpayer into certain facts
- How to respond to the IDR?
- Why noncompliance is not an option:
 - Burden of proof issues
 - Rule of evidence issues (must make info available to opponent)
 - Penalty issues--arguing reasonable cause
 - IRS appeals uses a nonresponse as a basis for not appealing
 - Qualified Offer issues

Cooperation Issues

- Consider if you are eligible to switch the burden of proof to the IRS
 - Cooperation is important
 - Adequate records are important
- Noncooperation leads to admissions (e.g., statements or inferences that are later used against you)

Acknowledgement IDR

- Use the acknowledgement IDR to support your case

Form 4564 (Rev. September 2008)	Department of the Treasury — Internal Revenue Service Information Document Request	Request Number AOF-1
Name of Taxpayer and Company Division or Branch [REDACTED]		Subject Acknowledgment of Facts AOF Number [REDACTED] Issued To [REDACTED] Date of Previous Request [REDACTED]
Please return Part 2 with related documents to requester identified below		
Description of documents requested The purpose of this Acknowledgment of Facts (AOF) Information Document Request (IDR) is to ensure that all relevant facts necessary to arrive at an accurate tax determination have been identified and considered before the Form 5701, Notice of Proposed Adjustment, is issued. Responding to this IDR presents the taxpayer an opportunity to provide additional relevant facts and may lead to the resolution of the issue at the examination level. Another potential benefit of a thorough response to this IDR is preventing a delay in your case should it be returned from Appeals. The presentation of new facts in Appeals generally will require that the case be returned to Examination. Therefore, it is beneficial to ensure that all relevant facts are provided to the LBSI issue team before the Form 5701 is issued. Taxpayers are not prevented from providing additional facts in their written protest or in Appeals, but the expectation is that all relevant facts will be presented during the audit so that LBSI can make an accurate tax determination. While the interpretation of the law or the amount of the proposed adjustment may be unagreed, all relevant facts should be included in the attached draft Form 886-A.		
Requested Items Your response to the facts does not indicate agreement to the issue or any proposed tax adjustment 1. Please review the attached draft Form 886-A and respond accordingly in writing to the LBSI issue team by the response date. Also, limit your response to reviewing relevant facts, advising if relevant facts are excluded, and not providing stylistic or editorial changes.		
Information Due By: 01/11/2019	At Next Appointment <input checked="" type="checkbox"/>	Mail In <input type="checkbox"/>
Name and Title of Requester [REDACTED]	Employee ID number [REDACTED]	Date (mm/dd/yyyy) [REDACTED]
Office Location [REDACTED]	Telephone Number [REDACTED]	
Catalog Number 231496	www.irs.gov	Part 1 - Taxpayer's File Copy
		Form 4564 (Rev. 9-2008)

2. Please check the box(es) that apply:
- a. The taxpayer agrees that all relevant facts are documented in the attached draft Form 886-A.
 - b. The taxpayer does not agree with specific facts documented in the draft Form 886-A. The taxpayer will identify the specific facts that are in dispute, and will provide documents to support those specific facts by the response date of this IDR that will permit the issue team to make an accurate tax determination.
 - c. The taxpayer does not agree that all relevant facts are documented in the draft Form 886-A. The taxpayer will identify all omitted relevant facts, will provide the documents upon which the taxpayer relied to support those additional facts that will permit the issue team to make an accurate tax determination, and will provide the additional facts by the response date of this IDR.
 - d. Other, please explain.

Information Due By: 01/11/2019 At Next Appointment: Mail In:

Name and Title: [Redacted] Requestor Employee ID number: [Redacted] Date (mm/yyyy): [Redacted]

Internal Revenue Agent: [Redacted]

From: Office Location: [Redacted] Telephone Number: [Redacted]

OMB Number 221406 www.irs.gov Part 1 - Taxpayer's File Copy Form **4564** (Rev. 9-2009)

IRC §41 – Credit for Increased Research Activities

A taxpayer may claim credit for certain increased research or experimental activities in connection with its trade or business. Research or experimental expenditures are expenditures incurred in the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense (for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product). The computation of the Research Credit ("RC") is based upon Qualified Research Expenditures ("QREs"), specifically defined as wages, supplies, and contract research incurred in the research process.

Issue

In tax years 201612 - 201712 for [Redacted] with the expenses used to compute the Research Credit, and the Credit amount correct and in accordance with IRC §41?

No. The correct Research Credit amounts for increasing research activities are reflected in the following table.

	2016	2017
Credit per Return	\$ [Redacted]	\$ [Redacted]
per IRS Audit	\$ [Redacted]	\$ [Redacted]
Adjustments to Credit	\$ [Redacted]	\$ [Redacted]

Please note the above credit amounts were determined using the Alternative Simplified Credit. The IRC § 280c reduced credit election was made in both years.

I, [Redacted], IRS Engineer, wrote this report.

Form 886-A	Explanation of Items	Page 3 of 9
Name of Taxpayer	Tax Identification Number	Issue No.
		Tax Period Ended 201612-201712

Facts

was founded in designs and manufactures

When this case was first assigned as a consultation the focus was on 201612. As the audit progressed the IRS audit team decided to add the 201712 tax year as well. For the tax years 201612 and 201712, prepared the returns, conducted a Research Credit study and aided in the credit computations.

On September 21, 2018, provided a tour of their facility WI to gain a better understanding of its operations and the extent of research conducted. In addition, we interviewed to understand how jobs/projects are taken from order receipt to passing the necessary components along to the construction contractor for installation at the customer site.

does not track QREs by project, instead determines qualified wages on an employee-by-employee basis. evaluate projects, activities and costs to make determinations on the what percentage is appropriate given the law under IRC Section 41.

The following table summarizes the recent QRE history of

	2013	2014	2015	2016	2017
Wages					
Supplies					
Contract Research					
Total QREs					

Form 886-A	Explanation of Items	Page 3 of 9
Name of Taxpayer	Tax Identification Number	Issue No.
		Tax Period Ended 201612-201712

Applicable Law

Section 41(b)(1) provides that the term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer: (A) in-house research expenses, and (B) contract research expenses.

Section 41(b)(2) provides, in relevant part, that in-house research expenses include any wages paid or incurred to an employee for "qualified services" performed by such employee, and any amount paid or incurred for supplies used in the conduct of qualified research.

Section 41(b)(2)(B) provides that qualified services means, for purposes of both in-house and contract expenses, (i) engaging in qualified research, or (ii) engaging in the direct supervision or direct support of research activities which constitute qualified research.

Treas. Reg. §1.41-2(c)(1) provides that engaging in qualified research for purposes of performing qualified services means the actual conduct of qualified research (as in the case of a scientist conducting laboratory experiments).

Treas. Reg. §1.41-2(c)(2) provides that direct supervision for purposes of performing qualified services means the immediate supervision (first-line management) of qualified research (as in the case of a research scientist who directly supervises laboratory experiments, but who may not actually perform experiments). Direct supervision does

Form 886-A	Explanation of Items	Page 4 of 9
Name of Taxpayer	Tax Identification Number	Issue No. Year/Period Covered 201612-201712

not include supervision by a higher-level manager to whom first-line managers report, even if that manager is a qualified research scientist.

Treas. Reg. §1.41-2(c)(3) provides that direct support for purposes of performing qualified services means services in the direct support of either (i) persons engaging in actual conduct of qualified research, or (ii) persons who are directly supervising persons engaging in the actual conduct of qualified research.

Under Treas. Reg. §1.41-2(c)(3)(i), however, direct support of research activities does not include general administrative services, or other services only indirectly of benefit to research activities.

Section 41(d)(1) defines the term "qualified research" as research,

(A) with respect to which expenditures may be treated as expenses under section 174,

(B) which is undertaken for the purpose of discovering information—

(i) which is technological in nature, and

(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose related to a new or improved function, performance, or reliability or quality, and not for a purpose related to style, taste, cosmetic, or seasonal design factors.

Form 886-A Department of the Treasury - Internal Revenue Service

Form 886-A	Explanation of Items	Page 5 of 9
Name of Taxpayer	Tax Identification Number	Issue No. Year/Period Covered 201612-201712

Section 41(d)(4), includes specific exclusions, or activities that are not allowable under the Research Credit. This includes internal-use software.

The application of qualified research is intended to be useful in the development of a new or improved business component of the taxpayer. I.R.C. §41(d)(1)(B)(i). The business component is defined as any product, process, computer software, technique, formula, or invention held for sale, lease or license, or used by the taxpayer in its trade or business. I.R.C. §41(d)(2)(B).

Taxpayer's Position

As of the date of this draft report, [REDACTED] has not had discussions with the IRS regarding the conclusions of the report.

Argument

During the interview process, [REDACTED] provided an overview of how a project progresses from start to finish. Typically, [REDACTED] is contacted by a customer who is in need of [REDACTED]. This customer may or may not have their own drawings of what the end product will look like. For the sake of this example I will refer to it as an [REDACTED]. The customer knows they need a [REDACTED] to span over and around their process equipment. The customer provides detailed drawings of the installation location (including location of columns, utilities, etc.), along with the size and location of their process equipment. [REDACTED] then embarks on designing the [REDACTED] to fit the application, utilizing computer software to both lay out the design and components dimensionally but also can test stresses. The software package to test

Form 886-A Department of the Treasury - Internal Revenue Service

Form 886-A	Explanation of Items	Page 6 of 9
Name of Taxpayer	Tax Identification Number	Issue No. Year/Period Ended 2016-12-31/1712

stresses is not always utilized. Mainly an Excel spreadsheet is consulted based upon prior knowledge of the materials and components [REDACTED] uses in its projects. This spreadsheet aids in the analysis of each connection.

As the project progresses [REDACTED] discusses the design of the [REDACTED] with the customer and the customer provides feedback. This feedback can be in the form of approval, changes in the design due to communication issues, change in customer requirements, or changes in the design due to a change in their own installation/design of the manufacturing process this [REDACTED] will fit in. The customer will provide head and width clearances, along with any loads the structure will need to bear. There is roughly a 20% scope creep on 95% of the projects.

One of the specific examples discussed was a project for [REDACTED]. This project involved creating a structure around a large machine, in a location on a fault line. Therefore, additional bracing needed to be added. The customer took care of the floor and footings for the machine. The challenges discussed were the weight of the machine, access for machine set-up, site conditions and the phasing of the project. Again, [REDACTED] tested the loading in software and utilized the Excel spreadsheet to verify spans and loads were safe. When asked, it was mentioned experience plays a large factor in the design of their structures. Then, [REDACTED] tests and validates.

During the IRS audit process concern has arisen the information provided thus far does not demonstrate the activities described pass the four-part test of IRC Section 41. In IDR 6, as part of question 7, the IRS requested "what activities are being conducted that constitute research activities?" In response, [REDACTED] stated that qualified research occurred through all four phases of their development work: Sales/Quotation,

Form 886-A	Explanation of Items	Page 7 of 9
Name of Taxpayer	Tax Identification Number	Issue No. Year/Period Ended 2016-12-31/1712

Conceptual Design, Detailed Design and Installation. In the following paragraphs each phase will be analyzed.

Sales/Quotation - [REDACTED] argues each of their projects is unique and they must work through vague/conceptual customer information during this phase. This forces [REDACTED] to have a series of meetings with the customer to better define project specifications. Engineering and sales work together to prepare the quotation. Refining the design with a specific customer is not inherently qualified for the research credit. Furthermore, because engineers and technical discussions were involved with the customer does not by default mean the activities qualify. More specifically, these activities do not describe or indicate a process of experimentation was required. For purposes of Section 41(d), a process of experimentation is a process designed to evaluate one or more alternatives to achieve a result where the capability or the method of achieving that result, or the appropriate design of that result, is uncertain as of the beginning of the taxpayer's research activities. Given [REDACTED] capabilities of designing such [REDACTED] there is no evidence of uncertainty in their capability of designing custom structures for other customers.

Conceptual Design - [REDACTED] argues each structure is custom designed and engineered to the customer's needs. Further, they argue the technical variables are unique to each project. Yet, an Excel spreadsheet, based upon prior knowledge and design, is consulted to determine proper spans and stress levels on each structure. It is my opinion that, based on the facts provided thus far, [REDACTED] adapts its business components to each customer's unique needs. According to IRC Section 41(d)(4)(B) adaptation of an existing business component, namely these steel structures, is specifically disallowed by law. Furthermore, many of the problems described are merely business risks, not technological risks, such as phasing of the project.

Form 886-A	Explanation of Items	Page 8 of 9
Name of Taxpayer	Tax Identification Number	Issue No.
		Year/Period Ending 2016/2-2017 12

Detailed Design – [REDACTED] argues the CAD, drawing work, structural detail work in a 3D environment are qualified activities per Section 41. Furthermore, [REDACTED] argues validation of design to ensure buildability and potential revisions would also be qualified. However, none of these activities are inherently qualified. It is important to remember that iterations alone do not qualify activities for the credit. Just because a Taxpayer revised drawings and changes its designs does not mean a process of experimentation has occurred to arrive at the revisions. During the interviews, and reviewing Taxpayer information provided, no factual evidence has been provided to show problems or technical uncertainties existed that required a true process of experimentation to resolve. [REDACTED] simply moves hole locations or beams to allow access, provide support, or fit within the construction envelope.

Installation – [REDACTED] states: "During the Installation Phase, installation drawings are created and drawings are back checked (a routine quality control function at this point). The Engineering department is not involved at this stage of the project unless there are installation issues. Any revisions made in the field are completed by the drafters." This statement encapsulates the fact that revisions alone do not require a process of experimentation per IRC Section 41.

Therefore, as of this draft report, no facts have been provided to demonstrate a process of experimentation has occurred, as per IRC Section 41. Furthermore, given [REDACTED] utilizes their expertise in designing and developing [REDACTED] to adapt to each customer's specific needs, IRC Section 41(d)(4)(B) adaptation of an existing business competent would be applicable. In other words, IRC Section 41 specifically disallows the activities described by [REDACTED]. As a result, no expenses related to the activities presented will be allowed.

Form 886-A	Explanation of Items	Page 9 of 9
Name of Taxpayer	Tax Identification Number	Issue No.
		Year/Period Ending 2016/2-2017 12

Conclusion

After touring [REDACTED] facility in [REDACTED] interviewing two employees who qualified employee wages, and reviewing documentation provided to substantiate the activities as qualified I do not find enough evidence to demonstrate the activities required a process of experimentation. In addition, the activities engaged by [REDACTED] appear to be specifically disallowed per IRC Section 41(d)(4)(B) or adaptation of an existing business competent.

The table below summarizes my conclusions:

	2016	2017
Credits per Return	\$ [REDACTED]	\$ [REDACTED]
per IRS Audit	\$ [REDACTED]	\$ [REDACTED]
Adjustments to Credit	\$ [REDACTED]	\$ [REDACTED]

The Appeals Office and the Research Credit

- Ex Parte Rule - Not really
- IRS Engineer is present
- Which projects to discuss - can you limit the scope
- Do I extend the assessment statute or refuse to extend, docket the case in Tax Court and then go to Appeals

Getting to Appeals

- 30 day letter
- Protest - Skinny or fat - pros and cons
- Do an FOIA request
- Exam's "T-letter"

Settling the Case at Appeals

- Hazards of litigation
- Does the IRS have uniform settlement guidelines?
- What to do if you hit a “brick wall”?

61

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Which Court to go to

- U.S. Tax Court
- Federal District Court (refund)
- U.S. Court of Federal Claims (refund)
- Issues to consider
 - Precedent
 - Discovery issues and cost
- IRS v. DOJ

62

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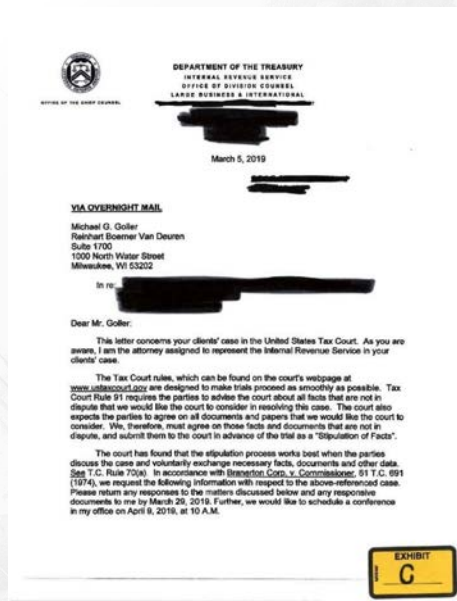
The Current IRS Litigation Position

- Centralized handling of research credit cases
 - Taxpayer loses the advantage of a full Tax Court calendar
- Settlement options
- Common "hot" items--funded research; contract research; Internal Revenue Code section 6662 penalty; proof of the fixed base percentage, the process of experimentation test is always key

IRS Attorneys Requests for Information

- IRS attorneys have a set of standard questions
- Need to be able to address these questions in a cost-effective manner
- Trap - the failure to respond can lead to formal discovery or deemed admissions

Research Credit Branerton Letter



TL-20815-18

2

Definitions:

"Petitioners" mean [REDACTED]

Unless otherwise specified, the requests concern the taxable years ending December 31, 2012 and December 31, 2013 for Petitioners, and the taxable years ending September 30, 2012 and September 30, 2013 for [REDACTED].

"Entity" means a corporation, partnership, limited liability company, trust, estate, or any other body recognized under domestic law, including those disregarded for Federal income tax purposes, and any equivalent body recognized under foreign law.

"Person" means an individual and any Entity.

Requests

General:

1. Provide copies of Petitioners' Forms 1040 for the tax years ending 12/31/2012 and 12/31/2013 and the Forms 1120S for the tax years ending 9/30/2012 and 9/30/2013 for [REDACTED].
2. Please provide Petitioners' books and records for the tax year ending December 31, 2012 and December 31, 2013 for both financial accounting and tax purposes, including audited financial statements, any unaudited financial statements, the trial balance, balance sheet, cash flow statement, the general ledger, the certified income statement, the uncertified income statement, and the reconciliation of book to tax.
3. Please provide [REDACTED] books and records for the tax year ending September 30, 2012 and September 30, 2013 for both financial accounting and tax purposes, including audited financial statements, any unaudited financial statements, the trial balance, balance sheet, cash flow statement, the general ledger, the certified income statement, the uncertified income statement, and the reconciliation of book to tax.
4. Please identify, by name, address, and telephone number, the name of the individual(s) and or firm that audited all and/or any portion of petitioner's and [REDACTED] financial statements for years at issue;
5. Please identify Petitioners' and [REDACTED] bookkeeper(s) for the years at issue
6. The following questions relate to adjustments made to Petitioners' distributive share of income based on Respondent's adjustments to [REDACTED] Forms 1120S;

- a. [REDACTED]
- b. [REDACTED]
- c. [REDACTED]
- d. [REDACTED]
- e. [REDACTED]
- f. [REDACTED]
- g. [REDACTED]
- h. [REDACTED]

Research Credit:

- 7. Please separately list each entity in which Petitioners held an interest, that paid or incurred qualified research expenses pursuant to I.R.C. § 41 for the tax years ending December 31, 2012 and December 31, 2013.
- 8. Please confirm that [REDACTED] is the only entity whose expenses are included for purposes of the qualified research credit, which Petitioners are claiming qualified research credit.
- 9. Please identify the individual(s) and/or firm by name, address and telephone number, upon whom Petitioners and/or [REDACTED] relied when claiming the qualified research credit on its Form 1120e and Form 1040 for the relevant tax years.

- 10. Provide all documents, including memoranda, from any individual(s) or firm that advised Petitioners and/or [REDACTED] regarding its claimed qualified research credit for the tax years at issue.

Computation and qualification of research credit:

- 11. Please provide all documents showing how [REDACTED] calculated its research credit for the taxable years at issue.
- 12. If [REDACTED] undertook sampling to compute any portion of the research credit, please state what sampling technique was used.
- 13. Please provide a list of projects or activities for which Petitioners claim [REDACTED] incurred qualified research expenses.
- 14. For each project or activity identified above in question 13, please list the business component(s) for which Petitioners claim section 41 is applicable.
- 15. Please confirm that Petitioners are claiming [REDACTED] only incurred in-house research expenses as qualified research expenses for purposes of calculating the section 41 research credit.
- 16. For each business component for which Petitioners claim [REDACTED] incurred qualified research expenses, please provide all documents that support Petitioners' position that [REDACTED] undertook qualified research during the taxable years at issue.
- 17. This request pertains to each business component for which Petitioners claim [REDACTED] incurred qualified research expenses. Please organize your response by business component.
 - a. All contracts between [REDACTED] and the customer, including:
 - i. Bid packages;
 - ii. Change orders;
 - iii. Amendments and modifications;
 - iv. Contract drafts;

- v. A complete copy of the contract, grant or other agreement, including, but not limited to, the contract, attachments or exhibits to the contract, all related prime contract(s), and change orders;
- vi. The project/contract name and client name;
- vii. The dollar amount and date of the contract;
- viii. Identification of the specific terms, clauses, conditions and/or laws relied upon in determining that the project was not funded by another person or entity within the meaning of I.R.C. § 41 including, but not limited to:
 1. Payment terms, clauses, conditions and/or laws;
 2. Inspection terms, clauses, conditions and/or laws;
 3. Acceptance terms, clauses, conditions and/or laws;
 4. Terms, clauses, conditions and/or laws addressing changes or modifications to the contract, grant or agreement;
 5. Warranty terms, clauses, conditions and/or laws;
 6. Termination terms, clauses, conditions and/or laws;
 7. Standard of care terms, clauses, conditions and/or laws; and
 8. Property rights terms, clauses, conditions and/or laws.
- b. For each business component, please identify the individual(s) who negotiated the contract(s) on behalf of [REDACTED] as well as the customer.
- c. Please provide copies of documentation showing the receipt of all payments for each job, including invoices, receipts, cancelled checks, wire transfers, etc.
- d. With respect to each business component:
 - i. Identify the request/parameters provided to [REDACTED] by the customers and provide any supporting documentation;
 - ii. Identify the individual(s) that determined the product specifications;

- iii. Identify each area of technical uncertainty for which qualified research was necessary;
- iv. Identify the individual(s) that identified the areas of technical uncertainty;
- v. Identify the individual(s) and/or entities that designed the equipment. If someone other than an employee of [REDACTED] provided a design (even if that design was ultimately modified or rejected), please identify that individual;
- vi. Please provide copies of all design specifications, draft specifications, and documents of a similar nature created with respect to this job and identify the individual(s) responsible for their creation;
- vii. Please identify the individual(s) responsible for resolving these areas of uncertainty and describe with specificity the actions taken;
- viii. Please provide any employee records/logs to support the resolution of uncertainty (if any) and the actions taken with respect to the uncertainty;
- ix. To the extent that the individual(s) engaged in modeling, simulation, systematic trial and error to resolve areas of uncertainty, please describe the steps taken by the employee and identify any software used; and
- x. For each area of uncertainty, please identify the hypothesis and/or alternatives to be tested or evaluated, records/note showing the results of each of those tests, and describe the individual(s) conclusions regarding the best and/or viable alternative(s).
- e. For each business component Petitioners claim [REDACTED] incurred qualified research expenses, please identify each employee of [REDACTED] that performed "qualified services" pursuant to I.R.C. § 41(b)(2)(B) on the job.
 - i. For each of the employees identified, please provide documentation to show the wages that each received during the years at issue;

- ii. Please explain the compensation agreement for each employee (for example, whether the employee is salaried or received hourly wages);
 - iii. Please provide the job title and the job description maintained internally for each employee at the time of hiring or, if the employee was promoted after hiring, at the time of the employee's most recent promotion;
 - iv. Identify how many hours each employee spent working each job during the relevant years, and provide all substantiating documentation (employee logs, records, timecards, etc.):
 - 1. Of those hours spent working each job, please identify how many hours were spent on "qualified services" pursuant to I.R.C. § 41(b)(2)(B);
 - 2. Describe the activities that comprise the "qualified services" pursuant to I.R.C. § 41(b)(2)(B) that were performed by each employee for each job;
 - v. Identify how many hours each employee spent performing services for [REDACTED] generally during the relevant tax years;
18. For each business component for which Petitioners claim [REDACTED] incurred qualified research expenses, please provide all documents supporting the amounts paid or incurred by [REDACTED] for supplies, if any, used in the conduct of qualified research during the years at issue.

Base Years:

- 19. Please identify the first taxable year of [REDACTED] in which the [REDACTED] had qualified research expenses pursuant to I.R.C. § 41.
- 20. Please identify the first taxable year in which [REDACTED] had gross receipts.
- 21. Please identify all taxable years in which [REDACTED] had both gross receipts and qualified research expenses pursuant to I.R.C. § 41.
- 22. Please identify the gross receipts of [REDACTED] for tax years ending 9/30/08, 9/30/09, 9/30/10 and 9/30/11, and provide documentation to support those figures.

Instructions:

Please see the enclosed Internal Revenue Service Production Specifications for Electronically Stored Information and Hard Copy Documents. Petitioner's responses to our requests should comply with these specifications.

Petitioners should regard these requests as continuing in nature and supplement its responses as required under Tax Court Rule 102.

If any portion of any document is withheld on the grounds of privilege, please state, with respect to each portion withheld:

- (a) Name and title of the document;
- (b) Individual and institutional author(s);
- (c) Date of the document;
- (d) Names, titles, and addresses of all recipients of the documents and/or copies thereof;
- (e) Subject matter of the document;
- (f) Privilege claimed; and
- (g) Number of the request(s) to which the production of the document would otherwise be responsive.

If you have any questions, or, if the suggested conference date or time is inconvenient, please write or call me at [REDACTED]

Sincerely,

[REDACTED]
Attorney
(Large Business & International)

Contract and Funded Research (Opposite Sides of the Same Coin)

- In cases of research, where the taxpayer does the research but does not have the risk of loss (i.e., funded research)--does not qualify for the credit. Treas. Reg. § 41(d)(4)(H).
- In cases of contract research where the taxpayer pays for the research, need to be able to show that payment is not contingent on the result. Treas. Reg. § 1.41-2(e)(2).
 - **Have a contract and make it part of the audit record**

Funded Research

- Watch out for funded research
 - Who is really at risk--amounts paid for the product or the success of the research are not treated as funding research. Treas. Reg. § 1.41-4A(d)(1).
 - **Documentation is often difficult in the context of manufacturing. IRS regulations state all "agreements" between the taxpayer and other persons are to be considered when determining if research is funded. Treas. Reg. § 1.41-4A(d).**
 - Who keeps the right to the research? Treas. Reg. § 1.41-4A(d)(2).

Funded Research (cont.)

- Purchase Order/Terms and Conditions/Master Purchase Agreement “Trap”.
 - Possible Solution
 - A taxpayer retains the right to use the research results without making payments to the payer (the U.S. Government) who obtained the right to use and disclose the technical data from the taxpayers research. Lockheed Martin Corp. v. U.S., 210 F.2d 1338 (Fed. Cir. 2008)

CASES OF INTEREST

- Populous Holdings v. Comm’r, T.C. Dkt No. 405-17 (2/5/21)
 - Fixed fee contract has an inherent risk of loss
- Meyer, Borgman & Johnson, Inc. v. Comm’r, Dkt No. 7805-16 (unpublished order, 11/19/20, Judge Holmes). A Motion for Reconsideration is pending.
- Little Sandy Coal v. Comm’r, T.C. Memo 2021-5. Appeal pending. Substantially all test (80% of research activity must be a process of experimentation, excludes direct support in the numerator).
- Perficent, Inc. v. Comm’r, DKTs 5467-17, 7600-18 (T.C. 2002). Partial Motion for Summary Judgement is pending: IRS is arguing that contracts were for the purchase of research services (i.e., Funded Research). Taxpayer is arguing that the contracts were for the purchase of products. **IRS is also arguing that warranty provisions in the contracts are not sufficient to the taxpayer has a risk of loss.**

IRS Likes to Add a Section 6662 In Research Credit Cases

- If there is a low income or a loss year, the math is very pro-IRS

Penalty Avoidance Matrix

	Reasonable Basis §1.6662-3(b)(3)	Reasonable Cause §6664 §1.6664-4(b)	Disclosure §6662(d)(2)(B) §1.6662-3(a)	Substantial Authority §1.6662-4(d)
Negligence	Yes	Yes	No ¹	Yes ²
Disregard of the Rules or Regulations	Yes ⁴	Yes	Yes ³	Yes ⁵
Substantial Understatement of Income Tax	No	Yes	Yes ⁶	Yes
Substantial Valuation Misstatement (Income)	No	Yes ⁷	No	No
Substantial Valuation Misstatement (E&G)	No	Yes	No	No
Gross Valuation Misstatement (Income)	No	No ⁷	No	No
Gross Valuation Misstatement (E&G)	No	Yes	No	No

1. § 1.6662-7(b).

2. There must also be a reasonable basis for the position, adequate records must be kept and the position must be properly substantiated. §1.6662-3(c). In a case where there is substantial authority for a position, since this standard is higher than the reasonable basis standard (which negates negligence), there is no negligence. §1.6662-3(b)(3).

3. There must be reasonable basis and the taxpayer must keep adequate books, records and substantiation. § 1.6662-3(c)(1).

4. The disregard can be careless, reckless or intentional. § 1.6662-3(b)(2). The first two (careless and reckless) are for all practical purposes, the same as negligence, meaning reasonable basis would negate these two triggers. Further, however, if a position is intentionally contrary to a rule or regulation, reasonable basis would not be enough. However, see the disclosure election.

5. A position that is contrary to a Revenue Ruling or Notice is not treated as disregarding the ruling or notice if the contrary position has a realistic possibility of being sustained (a standard that is lower than substantial authority § 1.6662-3(b)(2). It is technically possible to have substantial authority that is contrary to a Treasury Regulation, which means the penalty could apply. In this case the taxpayer should be sure to make a disclosure.

6. There must also be a reasonable basis for the tax treatment of the disclosed item. §6662(d)(2)(B)(ii).

7. There is no reasonable cause exception for a gross valuation misstatement with respect to charitable deduction property and the exception only applies to a substantial valuation statement when there is a qualified appraisal and the taxpayer made a good faith investigation of the value of the property. § 6664(c)(3).

What is a Substantial Understatement of Income Tax?

- What is an Understatement of Tax?
 - Excess of the amount required to be shown on the return.
Section 6662(d)(2)(A)
- Non-corporate taxpayer
 - Exceeds the greater of 10% of the tax required to be shown on the return or \$5,000
- Corporation other than S Corporation or Personal Holding Company
 - Exceeds the lesser of one of the following:
 - 10% of the tax required to be shown on the return (or if greater, \$10,000); or
 - \$10 Million §6662(d)(1)

79

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What is a Substantial Understatement of Income Tax (cont.)

- Thus, for a corporation, there is no S.U. penalty if the understatement is under \$10,000.
- If 10% of the amount required to be shown on the return excludes \$10,000 there is a S.U.
- However, once the understatement exceeds \$10,000, there is always an S.U., even if \$10,000 is less than 10% of the amount required to be shown on the return (e.g. amount reported is \$102,000,000, amount omitted is 9.9%, \$12,870,000). This is not a 10% omission, but there is still a S.U. penalty.

80

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Research Credit Refund Claims

- Treas. Reg. 301.6402-2(b)(1) - a Claim for Refund “must set forth in detail each ground upon which a ... refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof.”
- Premier Tech v. U.S., 2021-2 U.S. Tax Case (CCH), 2021 WL 2982064 (D. Utah 2021) year 2014, Form 1120X, Taxpayer win

Research Credit Refund Claims (cont.)

- FAA 20214101F (10/15/21)
 - Huge amount of detail required
 - Transitional Relieve until 2024 (45 days to supplement “incomplete” refund claims)
 - Refund Claims made while under audit are reviewed by the Exam team. Other claims go to the Utah Service Center and subject matter “experts.”

Research Credit Take Aways

- Handling the Audit, Appeals and Litigation
- Funded Research
- Section 6662 Accuracy Related Penalty

83

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State Credit Issues Example - Wisconsin

- Wisconsin credit for research--looks to the federal credit requirements
- Wisconsin sales and use tax exemption for qualified research.
Wis. Stats. § 77.54(57d)(b).

84

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PART III

Ethics

85

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Partnership Ethical Concerns

- Conflicts of Interest
 - Who is my client
 - Need a good engagement letter
 - Do I opt-out if I can
 - Do I push out
 - The modification process
 - What does the operating agreement say

86

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Ethical Obligation to Talk About Penalty Avoidance

- Under IRS Circular 230, practitioners must advise the client of any penalties that are reasonably likely to apply and the practitioner must discuss the possibility of penalty avoidance via disclosure. §10.34(c)

The Office of Professional Responsibility

- There is often a tendency to assume that the Department of the Treasury's Circular No. 230 (Circular 230) pertains solely to preparing tax returns, tax opinions or dealings with the IRS
- The conventional wisdom is that a violation Of Circular 230 must mean a practitioner has engaged in some sort of outrageous behavior
- The reach of this ethical code is far greater than one might think
- A violation can (and does) occur in many more situations than practitioners might otherwise expect

A Violation of Circular 230 Is a Serious Matter

- Public discipline for violating Circular 230 usually involves obvious misconduct such as one's own failure to file or pay tax, or the conviction of a criminal offense
- We have been seeing more cases that pertain to alleged “bad tax practice,” such as a lack of due diligence, failure to give sound tax advice, conflicts of interest or other issues that indicate a tax practitioner's lack of fitness to practice before the IRS

Who Is Subject to Circular 230? Section 10.3 (Revised June 9, 2014)

- Circular 230 applies to those who “practice before the IRS”
- “Practice before the IRS” comprehends all matters connected with a practitioner's presentation to the IRS with respect to a taxpayer's rights, privileges or liabilities under the tax law, including
 - Preparing or filing documents, correspondence and communicating with the IRS
 - Rendering written advice with respect to an entity plan or arrangement that has a potential for tax avoidance or evasion
 - Representing a client at IRS conferences and hearings

Who Is Subject to Circular 230? Section 10.3 (Revised June 9, 2014)

- Attorneys and CPAs (including in-house practitioners) who are not under suspension or disbarment from practice before the IRS may file a Power of Attorney (POA) (Form 2848)
 - This permits them to and practice before the IRS and makes them subject to Circular 230
- One need not file a POA to provide written tax advice, however, providing written tax advice constitutes practice before the IRS
 - *i.e.*, makes the individual subject to Circular 230

When Is Conduct Sanctionable?

- Generally, a practitioner may be sanctioned if the practitioner:
 - Is incompetent or disreputable;
 - Intentionally misleads a client so as to defraud that client; or
 - Is acting with a specific mental state or competency standard (*i.e.*, willful, reckless or gross incompetence), fails to comply with key provisions of Circular 230

AICPA Rules

- Statements on Standards for Tax Services

Statement on Standards for Tax Services
No. 1, *Tax Return Positions*

- Interpretation No. 1-1, Reporting and Disclosures
- Interpretation No. 1-2, Tax Planning

Statement on Standards for Tax Services
No. 2, *Answers to Questions on Returns*

93

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AICPA Rules

Statement on Standards for Tax Services
No. 3, *Certain Procedural Aspects of
Preparing Returns*

Statement on Standards for Tax Services
No. 4, *Use of Estimates*

Statement on Standards for Tax Services
No. 5, *Departure from a Position Previously
Concluded in an Administrative Proceeding
or Court Decision*

94

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AICPA Rules

Statement on Standards for Tax Services
No. 6, *Knowledge of Error: Return
Preparation and Administrative Proceedings*

Statement on Standards for Tax Services
No. 7, *Form and Content of Advice to
Taxpayers*

ABA Model Rules of Professional Conduct

- Some Version of the MRPC has been adopted in almost all states.
- Rules are mandatory.
- Comments to the rules are aspirational (not mandatory).

Traps for the Tax Practitioner

- Other traps for the unwary practitioner
 - malpractice claims
 - breach of fiduciary duty
 - breach of contract
 - rules of evidence-waiver of the attorney/client privilege
 - disqualification to practice, suspension-disbarment by the State Bar or the Internal Revenue Service
 - reasonableness of fees
 - regulation on advertising
 - invalidation of estate plan
 - violation of rules relating to signing and non-signing tax preparers

97

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Concerns for the Tax Planner

98

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Who is My Client?

- Related Issues
 - What is my duty to my client?
 - What are my possible conflicts of interest?
 - Multiple Client Issues
 - Representing spouses
 - Representing a closely-held business
 - Representing fiduciaries (*i.e.*, the trustee or personal representative)

What Are the Scopes of the Services to Be Performed?

- Importance of a Good Engagement Letter
- Conflict Waivers
- Relationship Between Scope of Services and Diligence and Care Required from the Practitioner

Is My Client Competent?

- Realities of Modern Life -
- Babyboomers' parents are in their 80s or 90s
- Older babyboomers are in their 70s
- Due to an increase in divorce, more families have step-parents. This can give rise to tension between surviving spouses and stepchildren.
- More people own their own retirement accounts as opposed pensions which are not transferable to the next generation. Thus, a conflict can arise over the disposition of those funds.
- Life expectancies are increasing. Providing adequate health care and concerns over making sure a client has the funds necessary to cover expenses becomes far more difficult to plan for.
- Diseases like Alzheimer's are expected to increase dramatically in the upcoming years
- The interplay between dementia, lack of capacity and susceptibility to undue influence is a potential "perfect storm" for litigation.

101

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Is My Client Competent? (cont.)

- When does a person have capacity to execute a will or estate planning document?
 - "The testator must have mental capacity to comprehend the nature, the extent and the state of affairs of his property. The central idea is that the testator must have a general, meaningful understanding of the nature, state and the scope of his property, but does not need to have in his mind a detailed itemization of every asset; nor does he need to know the exact value of his property. A perfect memory is not an element of a testamentary capacity. The testator must know and understand his relationship to persons who are or who might naturally or reasonably be expected to become the objects of his bounty for which he must be able to make a rational selection of his beneficiaries. He must understand the scope and general effect of the provisions of his will in relation to his legatees and devisees. Finally, the testator must be able to contemplate these elements together for a sufficient length of time, without prompting, to form a rational judgment in relation to them, the result of which is expressed in the will."
O'Brien v. Lumphrey, 50 Wis. 2d 143, 183 NW. 2d 133 (1971)
 - Practical comments.

102

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Role of the Tax Advisor when Dealing with a Client of Potentially Diminished Capacity

- Document that what you are drafting is valid and defensible
- Make sure there are witnesses to the execution of documents
- Confirm that the client consents to disclosure of the contents of the document, however, if there is something unusual it is often a good idea to confirm that item in the presence of the witness (*i.e.*, confirm in front of the witness that a child is being disinherited)

Role of the Tax Advisor when Dealing with a Client of Potentially Diminished Capacity

- Prepare a contemporaneous memorandum to the client's file
- Consider a video recording or a verbatim transcript in cases where a will contest is expected
- Ask your client about his or her health before executing the testamentary documents. Document this discussion

Sources of Authority

- ABA Model Rules of Professional Conduct 1.2 scope of representation
- ACTEC Commentary on Model Rule 1.2
- Relationship to Model Rule 1.6 Confidentiality
- Fiduciary Exemption to Rule 1.6, not in existence in every state

Exculpatory Clauses

- What is an exculpatory clause?
- Model Rule 1.8(h)(i) cannot limit an attorney's liability unless the client is represented when executing the limiting document
- Seeking a release of claims in a proper manner

Representing Fiduciaries

- ABA Formal Opinion 94-30
- ACTEC Commentary to MRPC 1.2
- Real life examples
 - Residual Beneficiaries versus specific beneficiaries—a trap for the unwary

Conflicts

- Conflicts of Interest with Current or Former Clients and Obtaining Waivers - Conflict Traps for the Unwary

Who is My Client?

- Model Rule 1.18, Duties to Prospective Client
 - A person will be considered a prospective client if the person discusses with the lawyer "the possibility of forming a client/lawyer relationship." ABA Model Rule 1.18(a)
 - If the relationship does not come to fruition, the lawyer must still treat the person as a former client for conflict purposes. ABA Model 1.18(b)
 - A problem may arise if the lawyer seeks to represent one party first and then looks to represent another party. A lawyer may not represent an adversary in the same or substantially related matter if "the lawyer receives information from the prospective client that could be significantly harmful to that person in the matter." ABA Model Rule 1.18(c)

Define Who Will Be The Client

- ABA Model Rule 1.7 (CMT No. [27]) notes that:
 - Conflict questions may arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such as husband and wife, and depending on the circumstances, a conflict of interest may be present In order to comply with conflict of interest rules, the lawyer should make clear the lawyer's relationship between the parties. *Id.*
 - Need a Good Engagement Letter

Defining the End of the Client Relationship

- Does retention of documents make what would otherwise be a former client, a current client?
 - The ACTEC Commentaries recognize a concept of "dormant representation." The rules provide:
 - The execution of estate planning documents and the completion of related matters, such as changes in beneficiary designations and the transfer of assets to the trustee of a trust, normally ends the period during which the estate planning lawyer actively represents an estate planning client. At that time, unless the representation is terminated by the lawyer or client, the representation becomes dormant, awaiting activation by the client. (See ACTEC Commentary on MRCP 1.7 Conflicts of Interest: Current Clients.)

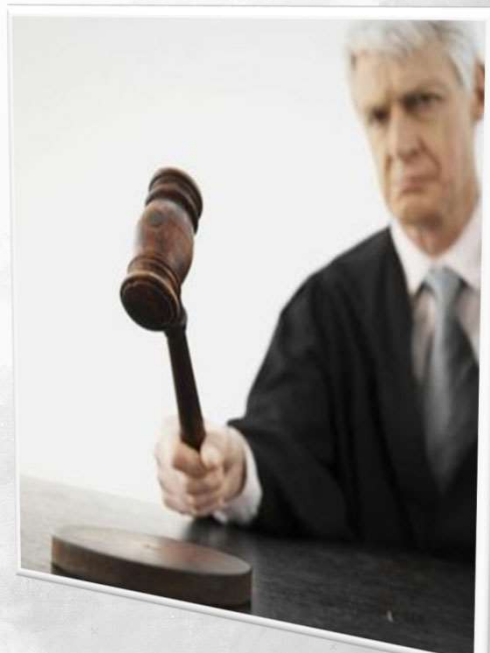
Defining the End of the Client Relationship (cont.)

- The ACTEC Commentaries explain as follows:
 - The retention of the client's original estate planning documents does not itself make the client an "active" client or impose any obligation on the lawyer to take steps to remain informed regarding the client's management of property and family status. Similarly, sending a client periodic letters encourages the client to review the sufficiency of the client's estate planning or calling the client's attention to supplemental legal developments does not increase the lawyer's obligations to the client. ACTEC Commentary on MRCP 1.4 (Communication)
- Comment:
 - The ACTEC Commentaries do not seem to go as far as calling the client a former client, but rather "a dormant client." While many commentators would treat such client as a former client, may be, especially, with older estate planning clients, that they will have the expectation that "You were my lawyer," even if they haven't spoken to you for some time.

Joint Representations

Circular 230 Conflicts of Interest Section 10.29

- A major cause of malpractice claims, especially for Estate Planners



A Conflict of Interest Exists If

- The representation of one client will be directly adverse to another client; or,
- There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or third person, or by the personal interest of the practitioner.

Comment: Rule is very similar to Model Rule 1.7

Other Authority

- ACTEC Commentary to Model Rule 1.7

Conflict Waivers - Circular 230 10.29



- The client must provide a written consent waiving the conflict within 30 days of giving verbal consent.
- The written waiver must be retained for at least three years after the conclusion of the representation of any affected client.

117

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Obtain a Waiver

- Where a conflict exists, a practitioner may still handle the matter if the practitioner reasonably believes that he/she will be able to provide competent and diligent representation to each affected client, the representation will not otherwise violate the law and each affected client waives the conflict in an informed consent at the time the conflict is discovered by the practitioner.

118

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Traps for the Unwary

- Representing spouses
- Personal interest of the lawyers
 - penalty issues
 - lawyer as a fiduciary
- Lawyer paid by a third party
- Innocent spouse relief issues

Tax Court Rule 24(g)

- The Rule goes beyond the normal conflict definition and states that if Counsel of Record was involved in planning or promoting a transaction at issue before the Court, that attorney must either obtain a consent or withdraw from the case.
 - This is a trap for the unwary.

Comment: More cases are becoming docketed in Tax Court due to the IRS insistence that a year or more remain on the assessment statute. The estate tax statute on assessment cannot be extended. Thus, the application of Rule 24(g) will come up more often in estate tax cases.

Why are more and more estate planners finding it necessary to docket a case in Tax Court?

- Two reasons
 - IRS budget cuts
 - Section 6501(c)(4)(A) provides that the statute of limitations on assessment can be extended with regard to "any tax imposed by this title, except *the estate tax . . .*" (emphasis added)
 - Practical Comments

Additional Trap for the Unwary

- Tax Court Petition is due before an executor is appointed (presumably an income tax issue that pertains to a pre-death year).
- Petition is filed in the name of Joe Smith, Deceased.
- Under Rule 60, must ratify Petition or the case may be dismissed.
- Dismissal of your Tax Court Petition means the IRS assessment stands.

Comment: If the estate has multiple beneficiaries, does the estate and a surviving spouse have a conflict?

More Conflict Traps for the Unwary

The Practitioner's Own Interest

- A common conflict, which is often overlooked, is the situation where a practitioner prepares a tax return, either as a signing or nonsigning preparer, and then handles the subsequent tax audit or appeal.
- In this situation, there may be a conflict if the practitioner has a personal interest that conflicts with the client's interest.
- For example, if the IRS asserts an accuracy-related penalty, will the practitioner be hesitant to argue that the penalty should not apply because of the taxpayer's good-faith reliance on the practitioner's tax advice?

Comment: The estate and gift tax valuation penalties are mathematical triggers. Thus, if value is too low the trigger (and thus a possible conflict) could arise without much warning.

More Conflict Traps for the Unwary (cont.)

Representing Both Spouses

- Another common conflict exists when the practitioner represents both a husband and wife, and the two spouses' interests become adverse.
- In such a situation, the practitioner may be unable to represent either spouse.
- Example – clients divorce and there is a pending Tax Court case. Does one spouse have a claim for relief under Section 6015 (i.e., innocent spouse and similar relief)?

OBTAINING A "GOOD" VALUATION REPORT - The Do's and Don'ts Obtaining a "Good" Report

- How to retain an expert
 - Kovel letter
- Does my expert understand the tax law?
 - Section 2703
 - Tax affecting earnings
 - Use of a weighted average when there are multiple valuation methods
- Reliance
- Privilege waiver
- Tax Court Requirements - T.C. Rule 143(g)
- Ethically - What can I tell my experts?

Switching the Burden of Proof to the IRS

- Burden of proof can be important in valuation cases.
- This is especially so if the IRS does not obtain a good valuation report.
- Thus, failure to shift the burden can be a significant malpractice issue.

Comment: Given IRS budget issues, it is more difficult for the IRS to obtain a solid valuation report.

Make Sure During the Audit That the Burden of Proof Will Switch at Trial

- Burden to IRS
 - In most civil controversies, a rebuttable presumption existed that the IRS's determination of tax liability is correct
 - *i.e.*, the taxpayer has the burden of proving the IRS is wrong
 - Section 7491 switched the burden to the government in any non-criminal court proceedings, regarding a factual issue, if the taxpayer introduces credible evidence, which is relevant to determination of its liability.

Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- Qualification
 - Code Section 7491, which switches the burden of proof to the IRS, applies only to litigation in the courts between the taxpayer and the IRS;
 - In order to obtain a shift in the burden of proof, the taxpayer must first comply with all requirements of the code section;
 - Comply with substantiation requirements contained in the Code and Regulations;
 - Cooperate fully with the IRS;
 - Exhaust all administrative remedies available to the taxpayer, such as going to the IRS Appeals office; and
 - Produce credible evidence at trial.

Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- The requirement to prove credible evidence means that the burden technically starts out on the taxpayer, but shifts to the government unless the taxpayer produces evidence that would enable the court to find in favor of the taxpayer, absent any contrary evidence being produced by the IRS and ignoring the judicial presumption of IRS correctness.

Make Sure During the Audit That the Burden of Proof Will Switch at Trial (cont.)

- Finally, the shift in the burden of proof applies to all income, gift, estate, generation-skipping, taxes and all penalties in addition to tax
 - However, it does not apply to corporations, partnerships or trusts with the net worth exceeding \$7 million (book value)

Can a Taxpayer 'Up the Ante' in a Valuation Case

- Can the taxpayer argue that the value was different from the amount reported on the tax return?
- Yes, a taxpayer can, however, the return position is an admission against interest, and the taxpayer is required to produce "cogent proof" that the value on the return is wrong.
- See *Estate of Gallagher v. Commissioner*, T.C. Memo 2011-148

Ethical Traps that Arise When the IRS Attempts to Collect Tax Due

- Collection issues are not common in the estate and gift tax context
- Lien and Levy
 - Lien - The invisible lien
 - Who is liable for the estate tax
 - Gift tax - the Section 6324(b) lien and secondary donee liability
 - Levy
 - Beware of frivolous collection due process appeals

Intake

- Is this a good client?
- Consider Conflicts of Interest
- What is scope of the engagement?
- Am I competent? Do I need help?

Reliance on Others

- Subordinates – care in hiring and delegating
- Experts – care in hiring
 - Is reliance reasonable?
- Protecting client confidentiality – how to retain an expert

135

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Document Drafting

- Written tax advice
- Delegation to a subordinate
- Due Diligence
- Stay up on changes in the law – draft what the client wants – Listen

136

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Return Preparation

- Client communication
- Do I disclose?
- Penalty discussions

137

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Privilege Waiver Issues

- Preparing a tax return
- Valuation experts
 - Is this a good valuation report?
 - Consider penalty thresholds when planning
- Other experts

138

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Common Tax Planning Traps

- Failure to know who is the client.
- Failure to clarify the scope of services.
- Not asking all the right questions – gather as much information as you can.
- Draft what the client wants.
- Know your limits.
- Ask is the client competent.
 - Remember the due care, due diligence, and competency

Obligations of the CPA Firm If There Is a Data Breach

- CPA Firms Need to Collect Data
- Tax
- Statement on Standards for Tax Services ("SSTS") No. 3, Certain Procedural Aspects of Preparing Returns
 - "Even though there is no requirement to examine underlying documentation, a member [CPA] should encourage the taxpayer to provide supporting data where appropriate"

Obligations of the CPA Firm If There Is a Data Breach (cont.)

- New AICPA Rule
 - Code of Professional Conduct Rule 1.700.001, and Interpretation 1.700.005 provide that "a member would be considered in violation of the Confidential Client Information Rule [1.700.001] if the member cannot demonstrate that safeguards were applied that limited or reduced significant threats to an acceptable level"

How Could This Happen to Me?

- The theft of an unencrypted laptop
- The loss of an unencrypted thumb drive
- Theft by a disgruntled employee
- E-mail to the wrong e-mail address
- Data breach at a cloud-based provider
- Hacker attack on a firm
- Failure to shred old client records

Obligations of the CPA Firm If There Is a Data Breach (cont.)

- State Laws — most states have laws and regulations which require notification in the case of a data breach
- If you possess client medical data, HIPAA becomes relevant
- Notify clients

Failure to Obtain PTIN Section 10.8(a)

- Any individual who, for compensation, prepares or assists in the preparation of all or substantially all of a tax return or claim for refund must have a PTIN
- Generally, one must be a licensed attorney, certified public accountant, enrolled agent or registered return preparer to obtain a PTIN

Need both a PTIN and a Data Security Plan

Resources:

- [IRS.gov](#)
- [Frequently Asked Questions](#)
- [Annual Filing Season Program](#)
- [Enrolled Agent Information](#)
- [Pay.gov System](#)
- [Online PTIN System](#)
- [Back to top](#)

Dear Tax Professional,

Summer is over, and it won't be long until you're sitting down at your computer to renew your preparer tax identification number (PTIN) for 2020. In mid-October when renewal season begins, you will notice a *data security responsibilities statement* has been added to the PTIN renewal process. It serves as a reminder of your legal responsibility to have a data security plan and to provide data and system security protections for all taxpayer information. When completing your PTIN renewal, a checkbox will be available to confirm your awareness of these data security responsibilities.

Data security continues to be a hot topic. That's because tax professionals remain a top target of identity thieves and data breaches continue to affect tax professionals at an alarming rate. Cybercriminals use sophisticated and ever-evolving techniques to gain access to your systems. These criminals steal sensitive taxpayer data to file fraudulent tax returns and create financial havoc for your clients. There are simple steps you can incorporate in your daily operations to minimize your vulnerability and protect client data, including:

- Protect email accounts with strong passwords and two-factor authentication if available.
- Install an anti-phishing tool bar to help identify known phishing sites.
- Use anti-phishing tools that are included in security software products.
- Use security software to help protect systems from malware and scan emails for viruses.
- Never open or download attachments from unknown senders, including potential clients. They should instead make contact first by phone.
- Send only password-protected and encrypted documents when files must be shared with clients over email.
- Never respond to suspicious or unknown emails.
- Back up sensitive data to a safe and secure external source.
- Properly dispose of old computer hard drives that contain sensitive data.

You should also make sure to have a written data security plan in accordance with the Federal Trade Commission's [Safeguard Rule](#). Remember, protecting your clients is not only good for business, it's also the law. While the hope is that you're never the victim of a data breach, preparation and education will go a long way in helping to protect your clients and yourself.

More information:
[Publication 4557](#), Safeguarding Taxpayer Data

[Publication 5293](#), Data Security Resource Guide for Tax Professionals
[Identity Theft Information for Tax Professionals](#)

[Back to top](#)

Firm Management Procedures to Ensure Circular 230 Compliance Section 10.36 (Revised June 10, 2014)

- The IRS appears to be attempting to create a “culture of compliance”
- Practitioners in a position of authority must do more than ensure their own compliance with Circular 230
- Supervising practitioners must ensure that all individuals they supervise comply with Circular 230 as it pertains to the preparation of returns, claims for refund or other documents submitted to the IRS

Section 10.36

- A practitioner responsible for implementation of Circular 230 compliance procedures will be subject to disciplinary action if:
 - 1(a) The responsible practitioner, through willfulness, recklessness or gross incompetence, does not take reasonable steps to ensure that the firm has adequate procedures to comply with Circular 230; and
 - 1(b) One or more individuals who are members of, associated with, or employed by the firm are, or have engaged in a practice in connection with their practice with the firm of failing to comply with Circular 230;

Section 10.36

- 2(a) The responsible practitioner, through willfulness, recklessness or gross incompetence, does not take reasonable steps to ensure that firm procedures in effect are properly followed; and
- 2(b) One or more individuals who are members of, associate with, or are employed by the firm or have engaged in a pattern or practice, in connection with their practice with the firm of failing to comply with Circular 230; or

Section 10.36

- 3(a) The responsible practitioner knows or should know that one or more individuals who are a member of, associated with, or employed by the firm are, or have engaged in a pattern or practice in connection with their practice with the firm that does not comply with Circular 230, as applicable; and
- 3(b) The responsible practitioner, through willfulness, recklessness or gross incompetence, fails to take prompt action to correct the noncompliance.

Written Tax Advice Form Section 10.35 and Section 10.37(a) Revised June 9, 2012

- The Covered Opinion Rules (Former §10.35)
 - These have gone away — Proposed regulations were issued on September 14, 2012
 - Final regulations were issued June 9, 2014 and became effective on June 12, 2014



151

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Old Rules

- Certain burdensome requirements existed if one issued one of the following:
 - A listed transaction opinion;
 - Principal purpose opinion is tax avoidance; or
 - Significant purpose to avoid tax opinion PLUS the opinion is one of the following opinions
 - Reliance Opinion
 - Marketed Opinion
 - Opinion subject to conditions of confidentiality
 - Opinion subject to contractual protection

152

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Ramifications of the Withdrawal of the Covered Opinion Rules

- No more legends on our e-mails
- Issuing a tax opinion may be more complex than before
- It is clear under the new rules that government submissions on matters of general policy and continuing education presentations are not considered written tax advice

Requirements for Written Tax Advice Section 10.37(a) (Revised June 9, 2014)

- The Practitioner must
 - Base written advice on reasonable factual and legal assumption
 - Including assumptions as to future events
 - Reasonably consider all relevant facts and circumstances the practitioner knows or reasonably should know
 - Use reasonable efforts to identify and ascertain the facts relevant to written advice on each federal tax matter

Requirements for Written Tax Advice Section 10.37(a) (Revised June 9, 2014)

- Not rely upon representations, statements, findings or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance upon them would be unreasonable
- Relate applicable law and authorities to the facts; and not, in evaluating a federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit

Further, reliance upon a representation, statement, finding or agreement is specifically unreasonable if the practitioner knows or reasonably should know that one or more representations or assumptions on which any representation is based is incorrect, incomplete or inconsistent

Reliance on Others Section 10.37(b) Revised June 9, 2014

- The practitioner may only rely on the advice of another person if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances
- Reliance is specifically not reasonable when
 - The practitioner knows or reasonably should know that the opinion of the other person should not be relied upon;
 - The practitioner knows or reasonably should know that the other person is not competent or lacks the necessary qualifications to provide the advice; or
 - The practitioner knows or reasonably should know that the other person has a conflict of interest in violation with Circular 230
 - e.g., the conflict has not been properly waived

Standard of Review

Have I Complied with the Rule?

- In evaluating whether a practitioner's written tax advice complies with Section 10.37, the IRS will apply a "reasonable practitioner" standard, considering all facts and circumstances, including, but not limited to the scope of the engagement and the type and specificity of the advice sought by the client

Standard of Review

Have I Complied with the Rule?

- In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner in promoting, marketing or recommending a transaction, a significant purpose of which is the avoidance or evasion of tax, the IRS will apply an elevated "reasonable practitioner" standard. Emphasis will be given to the additional risk, caused by the practitioner's lack of knowledge of the specific taxpayer's particular circumstances (*i.e.*, when tax advice is going to be used to promote a transaction to a third party, the IRS will apply an elevated standard of care).

Due Diligence

Section 10.22 (Revised June 9, 2014)

- Practitioner Must Exercise Due Diligence
 - Every practitioner must exercise due diligence when practicing before the IRS
 - This includes exercising diligence in preparing documents relating to IRS matters and verifying the correctness of oral and written presentations made to both the IRS and one's client with regard to any matter administered by the IRS
 - A practitioner's duty to be diligent is a very broad concept
 - A lack of diligence would seem to exist in most instances of deficient practice-related conduct

Due Diligence

Section 10.22 (Revised June 9, 2014)

- The concept of diligence seems to require more than the mere belief that a presentation is correct the moment it is submitted to the IRS or a client
 - The implied approval of past incorrect statements would seem to be a violation of Section 10.22
 - If a practitioner fails to correct an incorrect statement made to the IRS or a client, knowing full well that the recipient continues to rely on that statement
 - A failure to correct the error is inconsistent with the practitioner's obligation to be diligent

Reliance on Others



A practitioner will be presumed to have exercised due care if the practitioner relies on the work product of another person so long as the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking into account the nature of the relationship between the practitioner and the other person

161

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Diligence as to Accuracy §10.22

- Trap for the unwary – FBAR (FinCin 114) and foreign bank accounts



162

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Use of Estimates

- AICPA Statement on Standards for Tax Services No. 4, Use of Estimates
 - Unless prohibited by statute or by some other rule, a CPA may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the CPA determines that the estimates are reasonable based on the facts and circumstances known to the CPA
 - The taxpayer's estimate should be presented in a manner that does not imply greater accuracy than exists

Am I Bound by the Prior Audit or Court Case?

- AICPA Statement on Standards for Tax Services No. 5, Departure from a Position Previously Concluded in an Administrative Proceeding or Court Decision
 - A conclusion in an audit or court proceeding does not restrict a CPA from recommending a different position in a later year unless a taxpayer is bound to a specified treatment by a formal closing agreement or some other method
 - However, the CPA must still satisfy the normal standards for preparing a tax return. See SSTs No. 1, Tax Return Positions.

Am I Bound by the Audit or Prior Court Case?

- Thus generally, the result of the audit or court case will indicate how to treat the item in a later year
 - There could be exceptions, for example
 - If the prior decision was due to nothing more than a lack of documentation;
 - If the taxpayer yielded in an administrative proceeding for settlement purposes, but has a legitimate basis for not adopting the position; or,
 - New court decisions, rulings or other authorities have been promulgated since the prior proceeding.

Preparer Penalty Standards Under I.R.C. Section 6694(a)

Standard	Preparer Duty
Frivolous ¹	Cannot prepare tax return
Reasonable basis ²	Can prepare tax return with disclosure ³
Substantial authority ⁴	Need not disclose unless a tax shelter or a Section 6662A Reportable Transaction ⁵
Reasonably believe more likely than not (i.e., more than 50%)	Need not disclose

¹ The percentage of comfort is perhaps 5% or less

² Reasonable basis is defined in Section 1.6662-3(b)(3); the percentage of comfort is perhaps 20%

³ Use Form 8275 or 8275R, or disclose pursuant to annual revenue procedure (e.g., Rev. Proc. 2015-16)

⁴ "Substantial authority" is defined in Section 1.6662-4(d). It is a comfort level of perhaps 40% or more

⁵ A tax shelter is an arrangement that has a significant purpose of avoidance or evasion of income tax. Section 6662(d)(2)(C)(iii). See Notice 2009-5 for how, in limited situations, to lower the standard to substantial authority for a tax shelter (basically educate the taxpayer about penalty exposure and document this fact)

Competence – Section 10.35 (Revised June 9, 2014)

- A practitioner must possess the necessary competence to engage in practice before the IRS
- Competent practice requires knowledge, skill, thoroughness and the preparation necessary for the matter at issue
- A practitioner may become competent through various methods such as consulting with experts or studying the relevant law

Comment: Sections 10.35 and 10.36 together mean that managers have a duty to ensure that their subordinates have the requisite knowledge and skill and that they appropriately use that knowledge and skill

AICPA Rules

- AICPA Code of Professional Conduct, Section 50, Article V, Due Care
- “... Members should be diligent in discharging responsibilities to clients, employers and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards ...”

MRPC -1.3

- A lawyer shall act with reasonable diligence and promptness in representing a client

Prompt Disposition of Matters and Responses to Requests for Information §10.20 and §10.23

- If the IRS makes a proper request for records or information, a practitioner must promptly respond to the request unless the practitioner reasonably has the good-faith belief that the information is privileged
- A practitioner may not unreasonably delay the prompt disposition of any matter before the IRS



Prompt Disposition of Matters and Responses to Requests for Information §10.20 and §10.23

- The practitioner must make a reasonable inquiry of the practitioner's client as to who has possession or control of the requested information
 - However, a practitioner need not make inquiry of any other persons or verify information provided by the client

Comment: Consider these rules when responding to a "wealth squad" IDR, a detailed LB&I IDR or a very broad discovery request.

Prompt Disposition of Matters and Responses to Requests for Information §§10.20 and 10.23

- Where the documents or information requested by the IRS are not in the possession of the practitioner or client, the practitioner must promptly provide the IRS employee seeking the information with any information the practitioner has about who has possession or control of the requested information

Comment: This rule certainly seems to raise Section 7525 and attorney-client concerns

What Are the Scopes of the Services to Be Performed?

- Importance of a Good Engagement Letter
- Conflict Waivers
- Relationship Between Scope of Services and Diligence and Care Required from the Practitioner

Privilege Waiver Issues

- Preparing a tax return
- Valuation experts
 - Is this a good valuation report?
 - Consider penalty thresholds when planning
- Other experts

Privileges In a Tax Setting

- Federal Rules of Evidence - Rule 501- Privileges in General
 - Rule 501 provides that common law governs a claim of privilege unless provided otherwise by the Constitution, a federal statute, or rules prescribed by the Supreme Court. In a civil case, state law governs.
- There are a Number of Relevant Privileges
 - Attorney-Client
 - Accountant-client or practitioner privilege
 - Work Product Doctrine
 - Each can be waived
 - There are exceptions to each Recent case law
 - Spousal Privilege

Attorney-Client Privilege (cont.)

The Kovel Letter

- The Privilege Can Extend Communications with the Attorney's Agents
- So long as a client's communication is made to an agent of an attorney (*i.e.*, a CPA that has been retained by the attorney) in confidence, for the purpose of obtaining Legal Advice from the lawyer, it is privileged. *United States v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989).
- What is a *Kovel* Letter?
- This rule, generally known as the *Kovel* rule. The application of the *Kovel* rule can be difficult in situations where non-legal services, such as preparing a tax return, are provided with legal services because it is difficult to distinguish between communications made for the preparation of a tax return and those made for the provision of legal services. Because the *Kovel* rule rests on the attorney-client privilege, the protection of the *Kovel* rule is lost anytime the attorney-client privilege is lost.
- When to use a *Kovel* Letter.

Comment: The key is the facilitation of communication between the lawyer and client

PART IV

High Net Worth And Family Off Issues

- FY 2022 Audit Campaign Issue
- High-income taxpayers will continue to receive audit attention (the audit rate is approximately 9% for those reporting income of \$1 Million to \$5 Million)
 - These taxpayers often have income and losses from flow-through entities
 - Thus, the audit of an individual will often lead to the examination of various related entities

High Net Worth Issues (cont.)

- The audit process involves a review of not only the taxpayer's personal income tax return, but also related partnership tax returns, fiduciary income tax returns, and estate and gift tax returns
- The audit is a complete review of the taxpayer(s) (*i.e.*, the IRS uses LB&I Audit Methods and Techniques)

High Net Worth Issues (cont.)

- Responding to Information Document Requests can be very burdensome, with a number of practical and ethical concerns
- IRS Counsel is often involved through the audit
- Often if information is not produced by the IDR deadline the IRS will issue a pre-summons letter and then an IRS summons

High Net Worth Issues (cont.)

Some examples of the broad scope of high net worth audits include

- Estate and Gift tax issues
- **Valuation issues**
- Executive Compensation
- C corporation and S corporation issues
- Noncash charitable contributions
- **Partnership and LLC issues**
- Passive activity losses
- Foreign Trusts
- Foreign Bank Account reporting
- Basis and At-Risk issues
- Transfer Pricing Issues
- **Private airplane issues**

Department of the Treasury
Internal Revenue Service
LB&I/ECPA-NorthCentral:1721
230 South Dearborn M/S 4172
Chicago, IL 60604

Date:
10/08/2021
ID number (last 4 digits):
[REDACTED]
Form:
1040
Tax periods:
201912
[REDACTED]
[REDACTED] number:
[REDACTED]
[REDACTED]
[REDACTED] part:

Dear Mr. [REDACTED] and Mr. [REDACTED]:

Your federal return for the period(s) shown above was selected for examination.

What you need to do

Please call me on or before October 29, 2021. You may contact me from 8:00am to 3:00pm at the telephone number provided above.

During our telephone conversation, we'll talk about the items I'll be examining on your return, the types of documents I'll ask you to provide, the examination process, and any concerns or questions you may have. We'll also set the date, time, and agenda for our first meeting.

Someone may represent you

You may have someone represent you during any part of this examination. If you decide you want representation, the representative you authorize will need a completed Form(s) 2848, *Power of Attorney and Declaration of Representative*, before we can discuss any of your tax matters.

If you choose to have someone represent you, please provide a completed Form 2848 by our first appointment. You can mail or fax the form to me or have your representative provide it at the first appointment, if you won't be present. You can obtain Form 2848 from our office, from our web site, www.irs.gov or by calling (800) 829-3676.

If you filed a joint return, you and your spouse may attend the examination. If you and/or your spouse choose not to attend with your representative, you must provide completed Form(s) 2848. You should provide a separate Form 2848 for each spouse if you filed jointly even if you use the same representative.

Your rights as a taxpayer

We have enclosed Publication 1, *Your Rights as a Taxpayer* and Notice 609, *Privacy Act Notice*. The Declaration of Taxpayer Rights found in Publication 1 discusses general rules and procedures we follow in examinations. It explains what happens before, during, and after an examination, and provides additional sources of information.

A video presentation, "Your Guide to an IRS Audit," is available at <http://www.irsvideos.gov/audit>. The video explains the examination process and will assist you in preparing for your audit.

Thank you for your cooperation and I look forward to hearing from you by [date]

Sincerely,

[Signature]
[REDACTED]
Internal Revenue Agent

Enclosures:
Publication 1
Notice 609

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: and	Subject: Initial IDR - Form 1040 - 201912	
	Submitted to:	
	Dates of Previous Requests: N/A	

Description of Documents Requested:

The purpose of this Information Document Request (IDR) is to obtain information relevant to your Form 1040 filed for the tax year ending December 31, 2019.

Please provide the following documentation:

1. Copies of any amended Forms 1040 (including all schedules/attachments) filed for the tax year ending December 31, 2018, December 31, 2019, and December 31, 2020.
2. Copies of any correspondence from the Internal Revenue Service concerning Form 1040 for the tax year ending December 31, 2019 excluding the Letter 2205 (initial contact letter) sent by _____.
3. Copies of all audit reports issued by any federal or state agency for tax year ending December 31, 2019.
4. Personal net worth and/or financial statement(s) as of December 31, 2019, if available. This should include the method of accounting used to compile them, net worth computations or other financial data regarding your assets, liabilities, net worth, income and losses, and cash flows from all sources within and without the United States, including all underlying documents and any applicable exhibits and/or footnotes associated therewith, and if not apparent, please identify the preparer of such documents. If not available, provide a negative written response.
5. A brief summary of your business and investment activities, including items reported on the Form 1040, Schedule E. For activities identified as non-passive, elaborate on your involvement and day-to-day role with each entity.
6. Provide a copy of the worldwide legal organization chart as of January 1, 2019 and December 31, 2019 including all domestic and foreign affiliates, places and dates of incorporation and their relationship to the reporting partnership/LLC for the entities you have greater than 50% control of through the rules of attribution. This chart should include all entities to which the Taxpayer is related within the meaning of Section 267.

Information Due By 11/05/21 At Next Appointment Mail In

Name and Title of Requestor: Internal Revenue Agent	Badge Number: Phone: Fax: Email:	Date: 10/8/2021
FROM Office Location: Internal Revenue Service; Mail Stop 4171 LB&I-ECPA:113; 230 S. Dearborn; Chicago, IL 60604	Page 1 of 3	

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: [REDACTED] and [REDACTED]	Subject: Initial IDR - Form 1040 - 201912	
	Submitted to:	
	Dates of Previous Requests: N/A	

Description of Documents Requested:

The following should be included in the chart:

- a. Name of each entity,
- b. Employer Identification Number,
- c. Ownership percentage in each entity,
- d. U.S. tax treatment of entity,
- e. Country in which the entity was created or organized,
- f. Country in which the entity operates, and
- g. Business activity of the entity.

If there is a difference in entities reported at January 1, 2019 and December 31, 2019, please provide an explanation.

7. Tax return workpapers and reconciliation schedules used to prepare the Form 1040 (original and amended, if applicable) for the tax year ending December 31, 2019.
8. For all disregarded entities with activities reported on the Taxpayer's (each spouse) individual tax returns for the tax year ending December 31, 2019, please provide:
 - a. Detail General Ledger Transaction file (Lowest level transaction detail that can be reconciled to the Year-end Trial Balance amounts),
 - b. Year-end Trial Balance file showing beginning of the tax period balances and end of the tax period balances,
 - c. Chart of Accounts (GL Account Number, GL Account Name, Account Type),
 - d. LLC Operating Agreements,
 - e. Check-the-box elections (Form 8832), and
 - f. Reconciliation of the Profit and Loss records to the Form 1040 tax return.
9. Provide all Schedule K-1s issued to [REDACTED] and its disregarded entity/entities (flowing into Form 1040) for tax year ending December 31, 2019. Provide any Schedule K-1 workpapers and reconciliation to the 2019 tax return.

Information Due By 11/05/21 At Next Appointment Mail In

Name of Requestor: Internal Revenue Agent	Badge Number: Phone: Fax: Email:	Date: 10/8/2021
FROM Office Location: Internal Revenue Service; Mail Stop 4171 LB&I-ECPA:113; 230 S. Dearborn; Chicago, IL 60604	Page 2 of 3	

Form 4564	Department of the Treasury Internal Revenue Service Information Document Request	Request Number 001
To: [redacted]	Subject: Initial IDR - Form 1040 - 2019	
	Submitted to:	
	Dates of Previous Requests: N/A	

Description of Documents Requested:

10. Any other tax returns filed for the tax years ending December 31, 2019, including Excise Tax, 1099, 1098, W-2, 940, 941, Schedule H, and Gift or Estate Tax returns.
11. Copies of any gift or estate tax returns filed for the tax year ending December 31, 2019.
12. Did you make gifts in excess of \$15,000 during the tax year ending December 31, 2019? If yes, specify the amount of the gift, when it was made, and the name(s) of the recipient(s).

When responding to this IDR, please identify each response to each item requested in this IDR by labeling each response with the corresponding number or letter listed in the IDR. This will help facilitate an efficient review of the information provided and decrease the likelihood of additional follow up questions. Where documents exist in electronic format, please provide in original electronic format.

Due Date: 11/09/2021

Information Due By	11/09/21	At Next Appointment	<input type="checkbox"/>	Mail to	<input type="checkbox"/>
Name of Requestor:	Badge #	Phone	Date: 10/8/2021		
Internal Revenue Agent	Fax:	Email:			
FROM:	Office Location: Internal Revenue Service; Mail Stop 4171 LB&I:ECFA:113; 230 S. Dearborn; Chicago, IL 60604				

Form 4564

Page 3 of 3

Lender Mgmt LLC V. Comm'r, T.C. Memo 2017-25

- Family office takes a profits interests in investments and is treated as a trade or business.

PART IV

Employment Tax Issues

- New Audit Program
- Three Main Issues -
 - Employee/Independent Contractor
 - Fringe benefit issues
 - Deduction issues

October 1, 2021 - A very interesting day

Fringe Benefit Issues

- Executive compensation issues in general
- Vehicle and tool *per diem* issues
- IRS is looking at the issue of whether employees are attempting to turn “wages” into taxable *per diem* allowances
 - Carefully scrutinize what expenses can be included in a *per diem*
- Comment: Contractors who have a large amount of unreimbursed business expenses are asking for increased per diems due to the nondeductability of these expenses.

Section 530 of the Revenue Act of 1978



- Generally allows taxpayer to treat worker as not being an employee for employment tax, but not income tax or other purposes
- Must have reasonable basis and meet certain requirements

Section 530 of the Revenue Act of 1978 (cont.)

- *Reasonable basis* for treating a worker as an independent contractor exists if the taxpayer reasonably relied on
 1. Past IRS audit practice with respect to the taxpayer, or
 2. Published rulings or judicial precedent, or
 3. Long-standing recognized practice in the industry of which the taxpayer is a member, or
 4. If the taxpayer has any "other reasonable basis" for treating a worker as an independent contractor.

Section 530 of the Revenue Act of 1978 (cont.)

Comment: When section 530 relief is at issue, the IRS is supposed to consider the application of this relief before determining if an employment relationship existed.

Section 530 of the Revenue Act of 1978 (cont.)

- Additional requirements
 1. The taxpayer must not have treated the worker as an employee for any period
 2. All federal tax returns, including information returns, must have been filed on a basis consistent with treating such worker as an independent contractor
 3. The taxpayer (or a predecessor) must treat all workers holding substantially similar positions consistently for purposes of employment taxes
 - The "similar worker consistency requirement"

Statute of Limitations in Employment Tax Cases

Section 6513 governs when a return is deemed to be filed for purposes of Section 6511 (i.e., for purposes of whether a claim for refund is timely filed). Subsection (c) pertains to Social Security Taxes and Income Tax Withholding (i.e., the taxes reported on a Form 941). Section 6513(c) provides that:

If a **return** for any period ending with or within a calendar year is filed **before April 15** of the succeeding calendar year, such return shall be considered filed on April 15 of such succeeding calendar year.

§ 6513(c)(1). (Emphasis added.)

Thus, when a Form 941 for a period is filed before April 15 of the following period, the tax return is considered filed on April 15 of that following year.

Interest-Free Adjustments

- Generally, for employment tax (i.e., Form 941 obligations), if the adjustment to the Form 941 (i.e., the tax deficiency) is
 - paid on or before the due date of the 941 for the period in which the error is "ascertained,"
 - the amount of the underpayment shall be paid without interest being charged.
- An error is ascertained when resolved at examination or with appeals.

Interest-Free Adjustments (cont.)

- If, however, the case is not resolved at Appeals and the taxpayer receives a notice and demand for payment from the IRS, the adjustment will not be interest free.
- In addition, the taxpayer will not be allowed an interest free adjustment where a prior audit found that additional tax was due with respect to the same issue.

Valuation Issues

197

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Traps for the Unwary When Obtaining Valuation/ Appraisal Reports

- *Exelon v. Comm'r*, 906 F.3d 513 (7th Cir. 2018)
 - SILO tax shelter
 - Appraisal of power plant found to lack credibility because the attorney interfered with the integrity and independence of the appraiser by providing wording and conclusions the lawyer expected to see so that the lawyer could issue a tax opinion
 - Loss on (1) valuation issue; and (2) reasonable cause defense to a penalty
- Need an appraiser who understands the process
- Be careful about "educating" an appraiser
- Assume whatever is sent to the expert will be made available to the IRS

198

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Valuation Checklist

- The Cover Letter - Summary
 - Who is the retaining party and other intended users?
 - Use the Correct Definition of Fair Market Value ("FMV"), FMV for a gift, Treas. Reg. Section 25.2512-1 defines fair market value as
 - [T]he price at which property would change hands between a willing buyer and a willing seller, Neither being under any compulsion to buy or sell and both having reasonable knowledge of the Relevant facts

Valuation Checklist (cont.)

- The "as of" or date
- Purpose of the valuation and intended use (e.g. estate and gift tax purposes)
- Type of asset and interest being valued (i.e. a minority interest . . .)
- Control Rights - in any
- Access to Liquidity
- The Scope of Work
- Information Considered
- Methodologies Utilized
- Fair Market Value Conclusion

Valuation Checklist (cont.)

- The Report- Body
 - Standard of value - Define FMV again
 - Purpose of the valuation
 - What is being valued?
 - Prior transactions if any
 - What interest is being valued
 - Economic overview / market conditions
 - Company specific information
 - Methodologies used to determine FMV (Holding Company v. Active Business).

Valuation Checklist (cont.)

- Discounts. Do not rely only on case law. Berg Estate v. Comm'r, T.C. Memo 1991-279
- Explain the weight given to each methodology used. Otherwise if one methodology is rejected, the whole report may fail. True Estate v. Comm'r T.C.Memo 2001-167 aff'd., 390 F.3d 1210 (10th Cir 2004)
- Tax Affecting Earnings if an S Corp. or Partnership. Calculation both ways. Recent Cases, Kress, Estate of Jones. If do not tax affect, can the marketability discount be increased.

Reliance and Reasonable Cause

- Ordinary business care and prudence
- Three part test when relying on a professional advisor.
 1. The advisor was competent and had sufficient expertise;
 2. The taxpayer provided the necessary and adequate information to the advisor; and
 3. The taxpayer relied in good faith on the advisor.

Neonatology Assocs., P. A. v. Comm'r, 115 T.C. 43 (2000)

Valuation Penalties

- The determination whether a penalty applies is made on a property by property basis
 - Thus, different penalties could apply to different pieces of property
 - See *Estate of True v. Commissioner*, T.C. Memo 2001-67, aff'd, 390 F.3d 1210 (10th Cir. 2004)

Valuation Penalties (cont.)

- Four Penalties - two in the gift tax context and two in the income tax context. These "triggers" are mathematical:
 - Substantial Valuation Misstatement (income tax)¹
 - Substantial Estate or Gift Tax Valuation Understatement²
 - Gross Valuation Misstatement (income tax)³
 - Gross Estate or Gift Tax Valuation Understatement⁴

-
1. Return value is 150% or more of the correct value - 20% penalty.
 2. Return value is 65% or less of the correct value - 20% penalty.
 3. Return value is 200% or more of the correct value - 40% penalty.
 4. Return value is 40% or less of the correct value - 40% penalty.

Taxpayer Valuation Penalties

- Estate and Gift Tax Understatement of Value
 - Substantial Valuation Misstatement
 - There is a 20% penalty of the portion of the underpayment of tax attributed to undervaluation if the value on the estate or gift tax return is 65% or less of the amount determined to be correct
 - Section 6662(a), (b)(5), (g)
- Gross Valuation Misstatement
 - There is 40% of the tax attributable to the undervaluation if the amount reported on the estate or gift tax return is 40% less of the value determined to be correct
 - Section 6662(h)(1), (2)(C)
 - There is no penalty if the underpayment of tax is \$5,000 or less
 - Section 6662(g)(2)

Disclosure

- There is no disclosure exception for any of the valuation misstatement penalties
- Comment
 - A disclosure exception would be "too good to be true"
 - The penalty would rarely apply (*i.e.*, I am disclosing the fact that the value on a form is likely wrong)
- Reasonable cause exception can apply

Reasonable Cause

- A showing of reasonable cause and good faith avoids the estate and gift tax penalties
 - Section 6664(c)(1)

Income Tax Overstatement of Value e.g., a Charitable Contribution

- Substantial Valuation Misstatement
 - There is a 20% penalty applicable to any underpayment attributable to a Substantial Valuation Misstatement
 - Section 6662(b)(3)
 - A substantial valuation misstatement occurs if the value (or adjusted basis) of any property claimed on a return claimed income is 150% or more of the correct amount
 - Section 6662(e)
 - The penalty is not imposed unless the misstatement results in an underpayment of greater than \$5,000 (\$10,000 for a C-corporation)
 - Section 6662(b)(2)

209

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Gross Valuation Misstatement

- There is a 40% penalty in the case of a Gross Valuation Misstatement.
- A Gross Valuation Misstatement occurs if the value of the property is 200% or more of the correct value section.
- The standard is automatically met if the correct value is zero.
 - Treas. Reg. Section 1.6662-5(g).
- Example
 - Donor claims a deduction under Section 170 for the donation of property to a qualified charity

210

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Reasonable Cause and the Income Tax Valuation Penalties

- A reasonable cause exception under Section 6664 can apply when the underpayment is attributable to a substantial (but not a Gross) understatement with regard to a charitable contribution if the following occurs:
 - The claimed value of the property is based upon a qualified appraisal by a qualified appraiser;
 - The taxpayer also made a good faith investigation of the value of the contributed property; and
 - The taxpayer acted with reasonable cause and in good faith
 - Section 6664(c)(3)

Comment: Review the definitions of a qualified appraiser and appraisal in Treas. Reg. Section 1.170A-13(c)(3) and (5)

Penalty for Erroneous Refund Claims – Section 6676

Penalty for Erroneous Refund Claims (Section 6676)

- Penalty equal to 20% of the excessive amount claimed unless:
 - It is shown that there is reasonable cause for the claim for the excessive amount.
 - Assume reasonable cause is the same as under Section 6664.

Comment: Reasonable cause is a defense.

CONCLUSION

8:15 – 9:20 a.m.

Wisconsin Tax Update

Kristina Somers, J.D., *Shareholder, Reinhart Boerner Van Deuren s.c.*

Wisconsin Tax Update 2022 WICPA Tax Conference November 4, 2022

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1

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Overview

- Sales/Use Tax
- Income/Franchise Tax and Pass-Through Withholding
- Property Tax and Real Estate Transfer Fees
- Miscellaneous

2

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Sales/Use Tax

Recent Laws, Cases, Other Guidance

3

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Brown County Sales/Use Tax Ordinance - Upheld

- *Brown County v. Brown County Taxpayers Association* (Brown Co. Cir. Ct. March 24, 2020).
- Sales and use tax ordinance created 0.5% sales/use tax on sales/purchases in Brown County.
 - Wis. Stat. § 77.70 permits imposition of county sales/use taxes - only for the purpose of directly reducing the property tax levy.

4

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Brown County Sales/Use Tax Ordinance - Upheld (cont'd)

- The ordinance mandated the tax be used only to reduce the property tax levy by funding nine specific capital projects.
- The Brown County Taxpayers Association argued the ordinance was void - because the property tax levy did not decrease by the sales/use tax raised.

5

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Brown County Sales/Use Tax Ordinance - Upheld (cont'd)

- The Court held that a dollar-for-dollar reduction is a permissible interpretation of Wis. Stat. § 77.70.
 - The statute could also be interpreted to defray the cost of any budget item which can be funded by a countywide property tax.
- Motion for reconsideration.
- Appealed to the Court of Appeals - which certified to the Wisconsin Supreme Court.

6

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Brown County Sales/Use Tax Ordinance - Upheld (cont'd)

- Wisconsin Supreme Court affirmed, upholding the ordinance and 0.5% county sales/use tax:
 - Found Wis. Stat. § 77.70 “broadly sets out what the goal of a of a county sales and use tax must be, i.e., direct reduction of the property tax levy.”
 - Leaves “the means to accomplish that purpose up to the county.”

7

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Brown County Sales/Use Tax Ordinance - Upheld (cont'd)

- Brown County Finance Director stated:
 - If the County tax remained, property taxes on the median home value in the County would decrease by \$140.20 between 2018 and 2023.
 - If the County instead borrowed money, issuance of general debt obligations would cause taxes on same median property to increase by \$356.48.
 - Saves the median Brown County property owner \$496.68.

8

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Trailer Type Vehicles - Do Qualify for Sales/Use Tax Exemption for “Truck Bodies”

- *William Becker v. Wisconsin Department of Revenue* (WTAC Dec. 29, 2020).
- **Wis. Stat. § 77.54. General Exemptions.** There are exempted from the taxes imposed by this subchapter:
 - (5)(a)4. Motor vehicles or **truck bodies** sold to persons who are not residents of this state and who will not use such motor vehicles or trucks for which the truck bodies were made in this state otherwise than in the removal of such motor vehicles or trucks from this state.

9

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Trailer Type Vehicles - Do Qualify for Sales/Use Tax Exemption for “Truck Bodies” (cont’d)

- **Wis. Admin. Code § Tax 11.83. Motor Vehicles.**
 - (4) PURCHASES BY NONRESIDENTS.
 - (a) The sales price for the sales of motor vehicles or **truck bodies** to nonresidents of Wisconsin, including members of the armed forces, who will not use the vehicles or trucks for which the truck bodies were made in Wisconsin other than their removal from Wisconsin is exempt. Truck bodies include semi-trailers. However, the separate sale of a “slide-in” camper to a nonresident is taxable if the sale is sourced to Wisconsin as provided in § 77.522.
- **Trailer type vehicles sold:**
 - Single Axle
 - Tandem Axle
 - Gooseneck

10

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Trailer Type Vehicles - Do Qualify for Sales/Use Tax Exemption for “Truck Bodies” (cont’d)

- Prior case (*Dep’t of Revenue v. Trudell Trailer Sales, Inc.*, 104 Wis. 2d 39, 42, 310 N.W.2d 612 (1981)) held:
 - A semitrailer is built to and does carry the cargo. Without it or some other unit to carry the load, a tractor, which is the power unit, serves little or no purpose. When the two pieces of equipment are joined, the semitrailer is the “truck body,” and it fits that definition and purpose when constructed and sold. No basis exists for distinguishing that type of truck body from one with a self-contained motor.
- All trailers designed to haul cargo ≠ “truck bodies.”
- Must be a symbiotic relationship between (i) trailers sold and (ii) motor vehicles that power their movement.
- Here, automobiles and pickup trucks do not require “truck bodies.”
- **Wisconsin Tax Appeals Commission** concluded: trailers did not qualify for exemption.

11

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Trailer Type Vehicles - Do Qualify for Sales/Use Tax Exemption for “Truck Bodies” (cont’d)

- Circuit Court (La Crosse County):
 - Reviewed whether semitrailer definition extends to other trailers that require the support of a motor vehicle to hold cargo.
 - Concluded trailers = exempt “truck bodies”
 - Reversed (decision dated June 27, 2022) the Wisconsin Tax Appeals Commission.
 - Appealed by the Wisconsin Department of Revenue to the Court of Appeals.

12

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Lease Payments - Aircraft Maintenance Services / Parts Exemption -> Does Not Apply

- *Citation Partners, LLC v. Wisconsin Department of Revenue*, (WTAC Dec. 4, 2019).
- Citation Partners owns a Cessna Citation aircraft.
- 2013 Wis. Act 185 provided sales tax exemption for:
 - Parts used to modify or repair aircraft.
 - Aircraft maintenance services.

13

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Lease Payments - Aircraft Maintenance Services / Parts Exemption -> Does Not Apply (cont'd)

- Wisconsin Tax Appeals Commission found:
 - Lessor was obligated to arrange for and pay all repair and maintenance.
 - Lease payments were not partial reimbursement for repair and maintenance parts or services.
 - Exemption did not apply -> lease payments = fully taxable.

14

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Lease Payments - Aircraft Maintenance Services / Parts Exemption -> Does Not Apply (cont'd)

- Wisconsin Tax Appeals Commission did note that lessor's purchases of aircraft maintenance and repair services = exempt.
- Dodge County Circuit Court (Case No. 19-CV-612; August 20, 2020) - reversed in favor of the taxpayer.
 - Citation = agent of lessees.
 - Exemption applied, as it would apply to any direct purchaser of repairs, maintenance, or parts.

Lease Payments - Aircraft Maintenance Services / Parts Exemption -> Does Not Apply (cont'd)

- Reversed by the Wisconsin Court of Appeals on November 23, 2021 (2020AP1683).
 - Lease payments subject to tax.
 - "Sales tax cannot be avoided by dividing up a lease price into categories or affixing labels."

Lease Payments - Aircraft Maintenance Services / Parts Exemption -> Does Not Apply (cont'd)

- Plain language of the statute (Wis. Stat. § 77.52(2)(a)10) exempts “the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection, and maintenance of any aircraft or aircraft parts”
- The plain language “does not exempt a lease from sales tax.”
- Exemptions are strictly construed.

Wisconsin Tax Appeals Commission Website

- Found at ->
<https://taxappeals.wi.gov/Pages/home.aspx>
- WTAC decisions dating back to 1984.
- Higher court outcomes.
- Common appeal issues.
- Filing appeals.

Purchases of Go-Karts (and parts and maintenance supplies) - Do Not Qualify as Exempt Purchases for Resale

- *SPA Indoor Speedway, LLC v. Wisconsin Department of Revenue* (WTAC Jan. 24, 2022).
- Indoor racetrack with go-carts.
- SPA does not charge an admission fee to enter its building or racetrack.
- SPA collects rental amounts and sales tax from its customers.
- SPA sought declaratory ruling from the Wisconsin Department of Revenue that no sales tax was due on SPA's purchases of go-carts.

19

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Purchases of Go-Karts (and parts and maintenance supplies) - Do Not Qualify as Exempt Purchases for Resale (cont'd)

- WDOR Declaratory Ruling = SPA is the end user of the go-carts (and, therefore, must pay tax on the go-cart purchases).
- Appealed to the Wisconsin Tax Appeals Commission.
 - Question = “whether the central activity being paid for by the customer is the rental of a go-cart or admission for access to the speedway racing experience, for which rental of a go-cart is incidental.”

20

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Purchases of Go-Karts (and parts and maintenance supplies) - Do Not Qualify as Exempt Purchases for Resale (cont'd)

- SPA does not offer rentals to customers to take the go-carts offsite.
- SPA offers a racing experience = taxable service.
- The go-carts are incidental to the experience & SPA = end user.
- Label given to the charge: “go-cart rental fee” is not determinative.
- Taxing purchase and rental (even though involving the same items) is not double taxation.

21

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Online Learning Plans and Internet Advertising Revenue - Taxable?

- Private Letter Ruling W2201001 (Oct. 13, 2021).
- Taxpayer provided:
 - Online learning platforms
 - Streaming video lessons = Taxable specified digital goods (digital audiovisual works).
 - Not taxable if transferred incidentally with an educational service.
 - ❖ Participant evaluated by an instructor or tutor
 - ❖ Participants connected to online tutor to explain grading while assessing homework assignments

22

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Online Learning Plans and Internet Advertising Revenue - Taxable? (cont'd)

- Brief video lessons
 - Primary objective = nontaxable tutoring instructions.
- Taxable and nontaxable products
 - Taxable - Access to digital audio works, digital audiovisual works, digital books, online quizzes and customizable lesson slides by the teacher-subscriber (prewritten computer software).

Online Learning Plans and Internet Advertising Revenue - Taxable? (cont'd)

- Nontaxable - Historical record of course completion, transcript, PDF copy of quiz questions, live tutoring sessions, student progress tracking, access to group learning activities
- Bundled transaction - if taxable products = 10% or more of sale price:
 - All taxable

Online Learning Plans and Internet Advertising Revenue - Taxable? (cont'd)

- If can determine, by reasonable and verifiable standards using books and records portion of the sales price attributable to nontaxable products ->
 - Option to collect and remit sales tax on portion of sales price attributable to just taxable products

Online Learning Plans and Internet Advertising Revenue - Taxable? (cont'd)

- Bundled transaction - if taxable products < 10% of sale price:
 - All nontaxable
- Taxpayer also provided online marketing services related to internet advertising management:
 - Nontaxable

Nonprofit Organization Occasional Sale Exemption - Entertainment Threshold Increased

- 2021 Wis. Act 167 (effective June 1, 2022).
- Sales by nonprofit organizations are exempt if three standards are met:
 1. Nonprofit organization is not engaged in a trade or business.
 - Sales of otherwise taxable products occur on 75 days or less during calendar year; or
 - Sales of otherwise taxable products are \$50,000 or less per calendar year.

27

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Nonprofit Organization Occasional Sale Exemption - Entertainment Threshold Increased (cont'd)

2. Entertainment is not involved at an event for which admissions are charged.
 - Prior law: Entertainment was not involved if the total amount paid to all entertainers was \$10,000 or less (including expense reimbursements).
 - Current law: Entertainment is not involved if the total amount paid to all entertainers is \$50,000 or less (including expense reimbursements).
3. Nonprofit organization does not have, and is not required to have, a seller's permit.

28

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Certificate of Exempt Status - Modifications & New Numbers

- Exemption for purchases - Prior law (Wis. Stat. § 77.54(9a)(f)):
Any corporation, community chest fund, foundation or association organized and operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, except hospital service insurance corporations under s. 613.80 (2), no part of the net income of which inures to the benefit of any private stockholder, shareholder, member or corporation.
- Current law - Modified to include all organizations described under IRC § 501(c)(3).
Any corporation, community chest, fund, or foundation that is exempt from federal income tax under section 501 (c) (3) of the Internal Revenue Code and has received a determination letter from the internal revenue service. The exemption under this paragraph applies to churches and religious organizations that meet the requirements of section 501 (c) (3) but are not required to apply for and obtain tax-exempt status from the internal revenue service.

29

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Certificate of Exempt Status - Modifications & New Numbers (cont'd)

- Organizations must have 501(c)(3) determination letter.
 - Exception for churches and religious organizations
- Wisconsin Department of Revenue issued new 15-digit Certificate of Exempt Status (“CES”) numbers.
 - 6-digit CES numbers no longer acceptable - since July 1, 2022.
 - Record CES:
 - Bill of sale
 - Exemption certificate (Form S-211 or S-211E)

30

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Certificate of Exempt Status - Modifications & New Numbers (cont'd)

- Out-of-state entities:
 - Still do not need CES number
- 2021 Wis. Act 1 (effective February 20, 2021).

Premier Resort Area Tax - Village of Ephraim

- Effective January 1, 2022
- 0.5%

Economic Nexus - Remote Sellers

- 2021 Wis. Act 1 (effective February 20, 2021).
- Prior Law:
 - Remote seller had to register and collect Wisconsin sales/use taxes if it had **200 or more** separate sales transactions into Wisconsin **OR exceeded \$100,000** in gross sales into Wisconsin in the remote seller's previous or current taxable year for federal income tax purposes.
- Current Law:
 - 200-transaction threshold eliminated.
 - Calendar year must be used to determine activity for the previous or current year.
 - Remote seller is only required to register and collect tax if its **gross sales into Wisconsin exceed \$100,000** in the previous or current **calendar** year.

Reminder: Pandemic Nexus Relief Expired December 31, 2021

- No nexus for out-of-state businesses if only Wisconsin activity was having an employee work temporarily from the employee's home during the national emergency (COVID-19.)
- Sales/use tax nexus.
- Income/franchise tax nexus.

Income/Franchise Tax Pass-Through Withholding

Recent Laws & Cases

Income Taxable for Online Sales Platform

- *ASAP Cruises, Inc. v. Wisconsin Department of Revenue* (WTAC May 23, 2022).
- ASAP Cruises provides online platform through which independent travel agents book travel for their customers.
- Tax Years 2012-2017.

Income Taxable for Online Sales Platform (cont'd)

- Wisconsin Tax Appeals Commission concluded that:
 - ASAP Cruises sold travel services.
 - ASAP Cruises used the services of Independent Travel Consultants (who were paid commissions).
 - ASAP Cruises was doing business in Wisconsin.
 - Travel services are not tangible personal property.
 - Travel services are not protected by Public Law 86-272.

Gambling Winnings Taxable

- *Julie Chier v. Wisconsin Department of Revenue* (WTAC March 23, 2022).
- Tax Years 2012-2017.
- Not a professional gambler -> Gambling losses not deductible.
 - No separate bank account.
 - Activity not tracked on computer spreadsheet.
 - No business plan.
 - Gambling activity not conducted in a professional manner.

Gambling Winnings Taxable (cont'd)

- Wisconsin taxes gambling activity by “session.”
 - Wisconsin Department of Revenue used casino records.
 - Wisconsin Tax Appeals Commission found Taxpayer’s testimony and documentation not credible.
 - Taxpayer testified she never once left the casino with any winnings (i.e., gambled every session down to zero) - and she forgot or chose not to use her player’s card while losing money.
 - Testimony regarding crab leg dinners at the casinos.
 - Notes not contemporaneous with gambling activity?
 - Notes lacked time details as to the beginning and end of sessions.

Pass-Through Withholding Filings Required - Based on Wisconsin Income

- *RADS Partnership et al. v. Wisconsin Department of Revenue* (WTAC Aug. 16, 2022).
- Watermark Wisconsin LP = California limited partnership with principal offices in California.
 - Invested in Watermark Montclair Wisconsin Hotels LLC - which invested in real estate in Wisconsin.
- Taxpayers (CA/DE limited partnerships, partnership, and trust with principal location in California) = limited partners in Watermark Wisconsin LP.
 - All partners of the partnerships and beneficiaries of the trust = California residents.

Pass-Through Withholding Filings Required - Based on Wisconsin Income (cont'd)

- Mostly ordinary losses for tax years 2006-2013.
- Income (section 1231 gain) for 2013.
- Wisconsin Department of Revenue assessed:
 - Pass-through withholding tax (plus interest, underpayment interest, penalties, and late filing fees) for the pass-through entities.
 - Fiduciary tax (plus interest, penalties, and late filing fees) for the trust.

Pass-Through Withholding Filings Required - Based on Wisconsin Income (cont'd)

- Wis. Stat. § 71.775(2)(a):

For the privilege of **doing business in this state** or **deriving income from property located in this state**, a **pass-through entity** that has **Wisconsin income** for the taxable year that is **allocable to a nonresident partner, member, shareholder, or beneficiary** shall pay a **withholding tax**.
- Wis. Stat. § 71.775(1)(b):

“Pass-through entity” means a **partnership**, a limited liability company, a tax-option corporation, an estate, or a **trust** that is treated as a pass-through entity for federal income tax purposes.

Pass-Through Withholding Filings Required - Based on Wisconsin Income (cont'd)

- Wis. Stat. § 71.775(3):

(3) EXEMPTIONS

- (a) A nonresident partner's, member's, shareholder's, or beneficiary's share of **income** from the pass-through entity that is attributable to this state shall not be included in determining the withholding under sub. (2) if any of the following applies:

* *

- 2. The partner's, member's, shareholder's, or beneficiary's share of **income** from the pass-through entity that is attributable to this state is less than \$1,000.

Pass-Through Withholding Filings Required - Based on Wisconsin Income (cont'd)

- Wis. Stat. § 71.80(25):

(25) Net operating and business loss carry-forward and carry-back.

- (a) No offset of Wisconsin income may be made under s. 71.05(8)(b)1., 71.26(4)(a), or 71.45(4)(a) unless the incurred loss was computed on a return that was filed within 4 years of the unextended due date for filing the original return for the taxable year in which the loss was incurred.

Pass-Through Withholding Filings Required - Based on Wisconsin Income (cont'd)

- Wisconsin Tax Appeals Commission concluded:
 - Income triggered pass-through withholding and obligation/trust (fiduciary tax) filing and payment obligation
 - Failure to submit required forms within 4 years of the unextended due date of the 2013 return (April 15, 2018) resulted in obligation to pay pass-through withholding/fiduciary tax.

Pass-Through Withholding Required - For Software Licensed to Wisconsin Customers

- *MacKinney Systems, Inc. v. Wisconsin Department of Revenue* (WTAC Mar. 16, 2022).
- Taxpayer:
 - Subchapter S corporation
 - Shareholders = Nonresidents of Wisconsin
 - Employees = Residents of Missouri
 - Licensed computer software for use on mainframe computers to business end users (prewritten computer software).

Pass-Through Withholding Required - For Software Licensed to Wisconsin Customers (cont'd)

- Wis. Stat. § 71.775(2)(a):

For the privilege of **doing business in this state** or **deriving income from property located in this state**, a **pass-through entity** that has **Wisconsin income** for the taxable year that is **allocable to a nonresident partner, member, shareholder, or beneficiary** shall pay a **withholding tax**.

- Wis. Stat. § 71.22(1r):

“Doing business in this state” includes, except as prohibited under P.L. 86-272 . . . regularly selling products or services of any kind or nature to customers in this state that receive the product or service in this state . . .

• •

Pass-Through Withholding Required - For Software Licensed to Wisconsin Customers (cont'd)

- Wisconsin Tax Appeals Commission concluded:

- MacKinney = Pass-through entity with nonresidents shareholders.
- Licensed prewritten software and provided technical support, new releases, enhancements, and fixes to the software - received in Wisconsin = “doing business in this state.”
- MacKinney = Subject to pass-through withholding tax.

Manufacturing Credit Calculation - Depreciation Recapture and 4797 Gain Not Includable

- *The Graphic Edge v. Wisconsin Department of Revenue* (WTAC Dec. 30, 2021).
- Taxpayer = commercial printing company.
- 2014 = manufacturer, including for purposes of the Manufacturing and Agriculture Credit.
- Sold/disposed of two pieces of printing equipment.
 - Subject to depreciation recapture.

49

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Manufacturing Credit Calculation - Depreciation Recapture and 4797 Gain Not Includable (cont'd)

- Reported gain on Form 4797.
- Printing equipment had been purchased by Taxpayer and used in its business.
- Taxpayer claimed MAC in the amount of \$4,950.
- Notice of Office Amount Due -> WDOR disallowed MAC.
- Production Gross Receipts - Cost of Goods Sold - Direct Costs - Indirect Costs x production gross receipts factor = Qualified Production Activities Income.

50

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Manufacturing Credit Calculation - Depreciation Recapture and 4797 Gain Not Includable (cont'd)

- Printing equipment was not manufactured by the taxpayer \neq Production Gross Receipts.
- Taxpayer alternatively treated as negative costs.
 - Not Cost of Goods Sold allocable to Production Gross Receipts.
- Not part of Taxpayer's Qualified Production Activities Income.
- No MAC.

51

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Credits Includable in Apportionable Income

- *American Honda Motor Co., Inc. v. Wisconsin Department of Revenue* (WTAC Nov. 29, 2021).
- Taxpayer:
 - Distributes Honda products in the United States, including automobiles.
 - Earned credits for (i) fleets that are more fuel efficient than Corporate Average Fuel Economy standards (“CAFE Credits”) and (ii) fleets that are less polluting than applicable EPA Greenhouse Gas Emissions standards (“GHG Credits”).

52

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Credits Includable in Apportionable Income (cont'd)

- CAFE Credits and GHG Credits could be:
 - Used to offset performance deficits in the future; or
 - Sold or traded to other automakers that did not meet the applicable CAFE or GHG standards.
- Some of the vehicles generating these CAFE Credits and GHG Credits were sold to dealers in Wisconsin, who in turn sold these vehicles within Wisconsin.
- Credit sale activity was conducted from California.

53

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Credits Includable in Apportionable Income (cont'd)

- Issue: Were the Credits includable in Wisconsin apportionable income?
 - Wis. Stat. § 71.25(5) Corporations engaged in business both within and without the state.
 - (a) *Apportionable income*. . . . Income gain or loss from the sources listed in this paragraph is presumed apportionable as **unitary** or **operational income** or other **income that has a taxable presence in this state**.
- * * *
3. Sale of scrap and by-products.
 9. Interest and dividends
 10. Sale of intangible assets if the operations of the company in which the investment was made were unitary with those of the investing company, or if those operations were not unitary but the investment activity from which that gain or loss was derived is an integral party of a unitary business

54

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Credits Includable in Apportionable Income (cont'd)

- Wisconsin Tax Appeals Commission concluded:
 - Credits are not “scrap or by-products.”
 - Credits are not stocks, bonds, securities, corporate investments, dividends or interest.
 - Key = Whether the Credits are “unitary or operational income or other income that has a taxable presence in this state.”
 - Credit sales are conducted from California and none of the participants have sufficient ties to Wisconsin -> Income from Credit sales does not have taxable presence in Wisconsin.

Credits Includable in Apportionable Income (cont'd)

- Wisconsin Tax Appeals Commission concluded:
 - As to operational v. investment function, key question is whether the asset “is an integral part of an enterprise.”
 - Taxpayer earned the Credits through its manufacture and distribution of fuel-efficient and low-polluting vehicles.
 - Credits are inextricably tied to, that is integral to, the automaking operations.
 - Income from sale of Credits = Operational income -> Apportionable.

Credits Includable in Apportionable Income (cont'd)

- Wisconsin Tax Appeals Commission concluded:
 - As to unitary analysis, was the Credit income earned from “unrelated business activity” which constitutes a “discrete business enterprise?”
 - In other words, was the Credit income from activities unrelated to the manufacture and distribution of vehicles?
 - Credit income = Unitary income.

Capital Loss Deduction - Increased

- 2021 Wis. Act 157.
- Current Law:
 - Capital loss deduction - not to exceed \$500/year.
 - Excess can be carried forward.
- New Law (effective for taxable years beginning after December 31, 2022):
 - Capital loss deduction increased to \$3,000/year (\$1,500 for married persons filing separately).
 - Also applies to partnerships and S corporations making the entity-level election.
 - Excess can be carried forward.

Restaurant Revitalization Fund Grants/Expenses - Income/Franchise Tax Exemption/Deduction

- 2021 Wis. Act 156 (effective for taxable years beginning after December 31, 2020).
- Grants from the restaurant revitalization fund (under Section 5003 of the federal American Rescue Plan Act of 2021, Public Law 117-2):
 - Exempt from Wisconsin income/franchise tax.
- Amounts otherwise deductible that are paid (directly or indirectly) with the grant money:
 - Deductible even though grant money is not taxable.

P.L. 86-272 - MTC Guidance, California, and Industry Trade Association Legal Action

- Multistate Tax Commission issued guidance on P.L. 86-272.
- California adopted MTC guidance, issuing TAM 2022-01, providing the following activities do not fall within the protections of P.L. 86-272:
 - A business has a website that invites viewers in California to apply for non-sales positions with the business, and enables viewers to fill out and submit an online application as well as upload a cover letter and resume;
 - A business regularly provides post-sale assistance to California customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website;

P.L. 86-272 - MTC Guidance, California, and Industry Trade Association Legal Action (cont'd)

- A business places Internet “cookies onto the computers or other electronic devices of California customers, which “cookies” gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale;
- A business solicits and receives online applications for its branded credit card via the business’s website from California customers, and the issued card will generate interest income and fees for the business;
- A business remotely fixes or upgrades products previously purchased by California customers by transmitting code or other electronic instructions to those products via the Internet;

61

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P.L. 86-272 - MTC Guidance, California, and Industry Trade Association Legal Action (cont'd)

- A business offers and sells extended warranty plans via its website to California customers who purchase the business’s products;
- A business contracts with a marketplace provider that facilitates the sale of the business’s products on the facilitator’s online marketplace, and the marketplace facilitator maintains inventory, including some of the business’s products, at fulfillment centers in various states where the business’s customers are located;
- A business contracts with California customers to stream videos and music to electronic devices for a charge;

62

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P.L. 86-272 - MTC Guidance, California, and Industry Trade Association Legal Action (cont'd)

- A business's employee telecommutes on a regular basis from within California, performing business activities that do not solely consist of soliciting orders for tangible personal property or that are otherwise entirely ancillary to such solicitation.
- The American Catalog Mailers Association - filed legal action against the California FTB in San Francisco County Superior Court
 - Arguing TAM 2022-01 and Publication 1050 are invalid as (i) they contradict P.L. 86-272 and the U.S. Constitution and (ii) the FTB did not properly follow the required rulemaking process.
 - Alternatively seeks judicial declaration that guidance prospective.

Property Tax and Real Estate Transfer Fees

Recent Laws, Cases, Other Guidance

Action Against Board of Review Re: Excessive Assessment

- *Conway v. Frazer et al.*, 2021AP1788 (Ct. App. Apr. 12, 2022) (unpublished).
- 2020 property tax assessment - set by the Village of Fox Point at \$597,000 and affirmed by the Board of Review (in a 4-2 decision).
 - Found assessor's valuation to be correct, taxpayer did not overcome the presumption of correctness, comparables not sufficiently adjusted, and "some of the comps were not strong enough on either side to rely heavily on them."
- Taxpayer appealed to the Wisconsin Department of Revenue under Wis. Stat. § 70.85.
 - Assessment must be "radically out of proportion"

Action Against Board of Review Re: Excessive Assessment (cont'd)

- After informal hearing, the Department of Revenue concluded:

"After review of this information, it is determined the appellant and appellant's representative applied better methodology to the sales comparison approach, having selected **sales with a more comparable location and view**. The comparable sales chosen by the appellant's representative were much more proximate to the subject and two of the comparable sales reflected similar commercial or high density residential/institutional views/location. The comparable sales chosen by the assessor were less proximate to the subject and none of the comparable sales reflected a high density residential/institutional view or location, similar to the subject."
- DOR reduced value to \$487,800.

Action Against Board of Review Re: Excessive Assessment (cont'd)

- Taxpayer filed a small claims action in circuit - against the four Board of Review members who voted to sustain the assessment.

- Wis. Stat. § 70.502:

Any member of the board of review of any assessment district who shall intentionally fix the value of any property assessed in such district, or shall intentionally agree with any other member of such board to fix the value of any of such property at less or more than the true value thereof prescribed by law for the valuation of the same . . . or shall otherwise intentionally violate or fail to perform any duty imposed upon the member by law relating to the assessment of property for taxation, shall forfeit to the state not less than \$50 nor more than \$250.

- Wis. Stat. § 70.503:

If any assessor . . . Or any member of the board of review of any assessment district is guilty of any violation or omission of duty as specified in ss. 70.501 and 70.502, such persons shall be liable in damages to any person who may sustain loss or injury thereby, to the amount of such loss or injury; and any person sustaining such loss or injury shall be entitled to all of the remedies given by law in actions for damages for tortious or wrongful acts.

67

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Action Against Board of Review Re: Excessive Assessment (cont'd)

- Defendants filed motion to dismiss.
- The Circuit Court granted the motion:
 - Concluding there was no “reasonable interpretation of the facts under which [Conway could] recover” and that the taxpayer did not “plead any sort of intent to commit any sort of nefarious act.”
 - Noted that in communications the taxpayer presumed good faith on the part of the village officials and Board of Review.
 - Concluding governmental statutory immunity would apply.

68

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Action Against Board of Review Re: Excessive Assessment (cont'd)

- The Court of Appeals reversed:
 - Concluding “intentional conduct within Wis. Stat. § 70.502 does not require malice or scienter.”
 - Concluding the taxpayer set forth “a plain statement describing that the Board of Review members intentionally sustained an assessment of the Property that was above its true value.”
 - Concluding the taxpayer “sufficiently pleaded a cause of action and the circuit court erred to dismiss the action for failure to state a claim upon which relief may be granted.”
 - Concluding statutory governmental immunity did not apply.
 - Remanding for further proceedings as to the intent of the Defendants.

69

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Primary Jurisdiction - Wisconsin Tax Appeals Commission First to Review?

- *Wisconsin Property Tax Consultants, Inc. and Wisconsin Manufacturers and Commerce, Inc. v. Wisconsin Department of Revenue*, 2022 WI 51.
- Wis. Stat. § 70.111(27) - Machinery, tools, and patterns exemption.
 - Wisconsin Department of Revenue (“WDOR”) interpretation.
 - Wisconsin Manufacturers and Commerce filed declaratory judgment action - seeking declaration that the WDOR’s interpretation is invalid.
 - Circuit Court dismissed - based on the primary jurisdiction doctrine - deferring to the Wisconsin Tax Appeals Commission’s expertise.
 - Court of Appeals affirmed.
 - Wisconsin Supreme Court reversed.

70

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Late Property Tax Payments - Not Permitted for 2022

- 2022 - No legislation permitting late property tax payments.
- 2021 Wis. Act. 80
 - Payment by October 1, 2021 OR any installment date for which taxes are due after October 1, 2021.
 - Waiver of interest and penalties.
 - Refund claims can be maintained.

71

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Property Tax Excessive Assessment Appeal - Trial Court Findings Insufficient

- *Mayfair Mall LLC v. City of Wauwatosa*, 2019AP1232 (Ct. App. May 18, 2021) (unpublished).
- 2013, 2014, and 2015 assessments.
- Trial court held the assessments were not excessive.
- Findings of trial court insufficient
 - Failed to provide and explain its bases for the findings.
 - Court did not make specific findings regarding the basis for the rents considered.
 - Trial court found City's experts to be more credible.
 - Did not explain why they were more credible.

72

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Property Tax Excessive Assessment Appeal - Trial Court Findings Insufficient (cont'd)

- Deduction of capital expenditures.
- Court of Appeals reversed.
 - Remanded for further fact finding.
 - No appeal to the Wisconsin Supreme Court.
 - Different trial judge.

Manufacturing, Tools, and Patterns Personal Property Exemption - Some MTP Owned/Use by Manufacturers May Qualify

- *Masters Gallery Foods, Inc. v. Wisconsin Department of Revenue* (WTAC Jan. 28, 2022).
- Machinery, tools and patterns (“MTP”) exemption (Wis. Stat. § 70.111(27)) does not apply to MTP “used in manufacturing.”
- WDOR interpretation - does not apply to MTP:
 - Owned by a manufacturer.
 - Located at a manufacturing facility.
 - Used in any way by a manufacturer for any purpose, including a non-manufacturing use.

Manufacturing, Tools, and Patterns Personal Property Exemption - Some MTP Owned/Use by Manufacturers May Qualify (cont'd)

- Taxpayer interpretation: Legislature intended to exempt all MTP owned or used by manufacturers that did not qualify for the manufacturing exemption.
- Wisconsin Tax Appeals Commission decision - middle ground:
 - Manufacturers' MTP exempt if not used directly/indirectly or exclusively/non-exclusively in the manufacturing process.
 - Not every activity a manufacturer engages in is manufacturing: E.g., administrative activities, HR, marketing, and groundskeeping.

Manufacturing, Tools, and Patterns Personal Property Exemption - Some MTP Owned/Use by Manufacturers May Qualify (cont'd)

- Not exempt MTP includes:
 - Maintenance equipment used in part to repair or maintain production equipment (b/c used indirectly in manufacturing).
- Exempt MTP includes:
 - Forklifts (and similar equipment) used to unload raw materials or take finished product from storage to vehicles for transport (b/c not used in the production process).
 - Lunchroom refrigerators and coffee makers

Manufacturing, Tools, and Patterns Personal Property Exemption - Some MTP Owned/Use by Manufacturers May Qualify (cont'd)

- Copiers (e.g., in an HR office)
- Snowblowers, yard maintenance equipment, and similar equipment
- Fans which maintain temperature in the first place of storage of the finished goods
- Items used for general cleaning and maintenance of the plant
- Machinery tangentially related to the production process, such as equipment that sanitizes worker clothing, certain thermal imaging cameras (e.g., to detect overheating in the building electrical system), electric generators, and air sanitizing equipment.

77

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Manufacturing, Tools, and Patterns Personal Property Exemption - Some MTP Owned/Use by Manufacturers May Qualify

- *Masters Gallery Foods, Inc. v. Wisconsin Department of Revenue* (Sheboygan Co. Cir. Ct. Sept. 21, 2022).
- Reversed Wisconsin Tax Appeals Commission.
- Machinery, tools and patterns exemption (Wis. Stat. § 70.111(27)) does not apply to manufacturers.
- Statute ambiguous?
- Reliance on legislative history
 - 2019 legislation (introduced).

78

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Real Estate Transfer Fee Exemption - Not Applicable to Transfer from LLCs to Another LLC

- *Mequon Reserve, LLC v. Wisconsin Department of Revenue* (WTAC October 21, 2021).
- Property owned by five (5) LLCs:
 - Mequon Reserve Kennedy, LLC
 - Mequon Reserve L&P 2, LLC
 - Mequon Reserve County Seat, LLC
 - Mequon Reserve WAH, LLC
 - Mequon Reserve Dakota, LLC

79

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Real Estate Transfer Fee Exemption - Not Applicable to Transfers from LLCs to Another LLC (cont'd)

- Property transferred to Mequon Reserve, LLC (via Quit Claim Deed):
 - Land and improvements valued at \$16,077,100.
- Wis. Stat. § 77.25(6m) exemption claimed - stating, “Other (Converting Entity).”
- Conversion - from one business entity to another:
 - Property held as tenants-in-common.
 - Not a business entity.

80

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Real Estate Transfer Fee Exemption - Not Applicable to Transfers from LLCs to Another LLC (cont'd)

- Conversion exemption only available for specific conversions (do not include tenancies-in-common)
- No certificate of conversion was filed with the Wisconsin Department of Financial Institutions.
- Statutory conversion process was not followed.
- Grantor LLCs could have merged, but did not.
- Not exempt from the Wisconsin real estate transfer fee.

81

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Real Estate Transfer Fee Exemption - Not Applicable to Transfers from LLCs to Another LLC (cont'd)

- Petitioner = Grantee (Mequon Reserve, LLC).
- Real Estate Transfer Fee: Imposed on the grantor, not the grantee.
- Petitioner not the aggrieved party -> lacked standing to challenge the real estate transfer fee assessment.

82

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Property Tax Exemption for Municipal Property and Property of Certain Districts - Expanded

- 2021 Wis. Act 151 (effective for property tax assessments as of January 1, 2022).
- Property tax exemption - in Wis. Stat. § 70.11(2) - for:
 - Municipalities
 - Other jurisdictions, such as school districts, metropolitan sewerage districts, certain municipal water districts
 - Expanded to include a “**regional planning commission created under s. 66.0309**”

Property Tax Exemption for Municipal Property and Property of Certain Districts - Expanded (cont'd)

- Limited to property that the commission owned prior to October 1, 2021.
- Or, if exempt property sold, applies to property purchased if the total size of all property owned by the commission is substantially similar to size of total property owned prior to October 1, 2021.
- Property owned in excess of size restriction = Taxable.

Sale of Tax Delinquent Property - Distributions of Proceeds

- 2021 Wis. Act 216 (first applies to tax deeds acquired on April 2, 2022).
- Tax delinquent property:
 - County acquires by tax deed and sells.
 - County treasurer notifies former owner that may be entitled to a share of the proceeds of a future sale.
- Prior Law:
 - Former owner had to request payment - within 60 days and in writing.
 - Otherwise would forfeit all claim to the proceeds.
 - If payment requested, county would send to the former owner the proceeds minus (i) delinquent taxes, interest, and penalties and (ii) the greater of (a) \$500 plus 50% of net proceeds after actual costs or (b) 2% of sale price plus actual costs and property taxes.

85

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Sale of Tax Delinquent Property - Distributions of Proceeds

- Current Law:
 - Owner not required to request payment.
 - Owner does forfeit rights to net proceeds if the county cannot locate the former owner within 5 years.
 - Proceeds due to former owner = minus actual costs plus delinquent taxes, interest, and penalties plus actual costs and property taxes that would have been owed on the property for the year during which the sale occurs.

86

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Tax Incremental District - Town of Gibraltar

- 2021 Wis. Act 233.
- Allows Town of Gibraltar (Door County) to create a Tax Increment District.
 - District must terminated no later than September 30, 2032.
 - Developer's agreement must include a letter of credit guaranteeing repayment of the debt service on the project costs.

Tax Incremental District No. 3 in City of Wisconsin Dells; Annual TID Reports

- 2021 Wis. Act 142.
- Tax Increment District No. 3 - in City of Wisconsin Dells.
 - Project cost expenditures can be made through January 3, 2031 (prior expenditure period ended May 2020).
 - Termination date = December 31, 2036 (prior mandatory termination date was 2045).

Tax Incremental District No. 3 in City of Wisconsin Dells; Annual TID Reports (cont'd)

- Annual TID reports:
 - Required by municipalities.
 - Must include the value of new construction in the TID, less the value of improvements removed from the TID.
 - Analysis of the impact on property taxes and levy limits.
 - Changes effective January 1, 2023.

Tax Incremental District No. 1 in Marathon City - Life / Tax Increment Allocation / Project Cost Expenditure Periods Extended

- 2021 Wis. Act 94.
- Tax Increment District No. 1 - in Marathon City.
 - Extended to 33 years after the district was created.
 - Project cost expenditures can be made through January 3, 2023.

Miscellaneous

Recent Laws, Cases, Other Guidance

Video Gaming Machines - Gambling Machines (“Contraband”) Subject to Seizure

- *JD Prime Games Kiosk, et al. v. Wisconsin Department of Revenue*, 2022 WI App 6.
- June 2017 - Wisconsin Department of Revenue issued removal orders to establishments with machines considered to be gambling machines and therefore “contraband” subject to seizure.
- Circuit Court reversed, finding in favor of JD Prime.
- Court of Appeals reversed, finding in favor of the Wisconsin Department of Revenue.

Video Gaming Machines - Gambling Machines (“Contraband”) Subject to Seizure (cont’d)

- Video gaming machines:
 - Traditional slot themed symbols, such as bar, cherries, and sevens.
 - Players wager credits to play; if they win, the credits accumulate and can be redeemed for cash.
 - Have a “preview feature,” which allows patrons to “determine in advance the outcome of any particular game[.]”
 - Can determine if would be a winner before playing the game.

Video Gaming Machines - Gambling Machines (“Contraband”) Subject to Seizure (cont’d)

- “Gambling machine” =

“a contrivance which for a consideration affords the player an opportunity to obtain something of value, the award of which is determined by chance, even though accompanied by some skill and whether or not the prize is automatically paid by the machine.” Wis. Stat. § 945.01(3)(a).
- JD Prime asserted that due to the preview feature, there is no element of chance and therefore not = gambling machine.
 - Players do not need to utilize the preview feature -> outcome determined by chance.

Video Gaming Machines - Gambling Machines (“Contraband”) Subject to Seizure (cont’d)

- Players may “voluntarily take a loss” to continue playing.
- JD Prime admitted it obtains revenues.
 - Therefore, players are losing money in the aggregate.
- Unlike pinball machines and Pac Man- specifically excluded from the definition of “gambling machine” - which does not include:

“[a]ny amusement device if it rewards the player exclusively with one or more nonredeemable free replays for achieving certain scores and does not change the ratio or record the number of the free replays so awarded.”
Wis. Stat. § 945.01(3)(b)2.

Water Impact Fee - Found To Be Reasonably Related to Service

- *Greywolf Partners, Inc. v. Village of Windsor* (WTAC Aug. 16, 2022).
- Village of Windsor:
 - Issued Water Needs Assessment - to establish water impact fees for new storage tank and well facility.
 - Estimated costs for new well, well house, and storage tank = \$2,835,000.
 - Adopted resolution titled Water Facilities Needs Assessment and Impact Fees (the “Policy”).
 - Under the Policy, the Equivalent Residential User Fee for multifamily/senior family residence = \$3,000.

Water Impact Fee - Found To Be Reasonably Related to Service (cont'd)

- Greywolf Partners - Assisted Living Facility (the Legacy of DeForest):
 - 22 Community-Based Residential Facility (“CBRF”) units
 - 32 Residential Care Apartment Complex (“RCAC”) units
 - Water impact fee calculation = \$108,000
 - Projects to which fee was applied included: (a) \$2,000,000 reservoir, (b) \$2,000,000 well (well #3), and (c) \$2,000,000 water tower.
 - Two projects predated the Legacy.
 - Third project in progress when the Legacy was being built.

97

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Water Impact Fee - Found To Be Reasonably Related to Service (cont'd)

- Wis. Stat. § 66.0628 Fees imposed by a political subdivision:
 - (4)(a) Any person aggrieved by a fee imposed by a political subdivision because the person does not believe that the **fee bears a reasonable relationship to the service for which the fee is imposed** may appeal the reasonableness of the fee to the tax appeals commission . . .
 - (b) With regard to an appeal filed with the tax appeals commission under par. (a), **the political subdivision shall bear the burden of proof** to establish that a reasonable relationship exists between the fee imposed and the services for which the fee is imposed.

98

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Water Impact Fee - Found To Be Reasonably Related to Service (cont'd)

- Wisconsin Tax Appeals Commission concluded:
 - Actual water usage (including minimal water use habits of the elderly) not relevant to whether the water impact fee was reasonable - at the time it was imposed.
 - Water impact fee could be the same for a car wash and a yarn store.
 - Municipal water impact fee classification system can be comprised of as many (or as few) classes as desired.
 - Fee of \$108,000 not unreasonable in relation to costs of \$6,000,000.

Leasing of Taxicabs - Subject to Rental Vehicle Fee

- *Green Cab of Wisconsin, Inc. v. Wisconsin Department of Revenue* (WTAC Mar. 10, 2022).
- Time periods: January 1, 2013 - May 31, 2019.
 - Notice of Field Action and Field Audit Report (1/1/2013-12/31/2016): Additional rental vehicle fees of \$859.26 + interest of \$223.92 = \$1,083.18.
 - Refund requested of \$341,898.65 (rental vehicle fees paid from 1/1/2013-12/31/2016).
 - Refund requested of \$166,053.57 (rental vehicle fees paid from 1/1/2017-5/31/2019).

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Wisconsin Rental Vehicle Fee:

Wis. Stat. § 77.995(2) There is **imposed a fee at the rate of 5 percent of the sales price on the rental**, but not for the rental as a service or repair replacement vehicle **of Type 1 automobiles, as defined in s. 340.01(4)(a) . . . by establishments primarily engaged in short-term rental of vehicles without drivers**, for a period of 30 days or less, unless the sale is exempt from the sales tax under s. 77.54(1), (4), (7)(a), (7m) or (9a). There is also imposed a fee at the rate of 5 percent of the sales price on the rental of limousines.

* * *

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Wis. Stat. § 340.01(4)(a): Type 1 is a motor vehicle designed and used primarily for carrying persons but which does not come within the definition of a motor bus, motorcycle, moped or motor bicycle.
- Wis. Stat. § 77.995(1)(b): “Limousine” does not include taxicabs, hotel or airport shuttles or buses, buses employed solely in transporting school children or teachers, vehicles owned and operated without charge or remuneration by a business entity for its own purposes, vehicles used in car pools or van pools”

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Taxpayer - Facts:
 - Green Cab leased taxicabs and equipment to drivers - who were limited to providing taxicab services to customers in the general public.
 - Green Cab's drivers = independent contractors (kept taxicab ride fares).
 - No driver had the right to use a particular taxicab.
 - The taxicabs had a uniform Green Cab logo and color scheme that identified the vehicles as being used in Green Cab's taxicab business.

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Taxpayer - Facts:
 - Green Cab stored and maintained all taxicabs at its business premises.
 - Green Cab was issued a Taxicab Company License by the City of Madison.
 - Green Cab paid an annual airport taxicab fee of \$4,800 annually as a regulated taxicab company.

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Taxpayer - Arguments:
 - Taxicab company.
 - Not in a business primarily engaged in short-term rental of vehicles without drivers, for a period of 30 days or less.
 - Limousines are subject to the 5% rental vehicle fee.
 - Taxicabs are not limousines.
 - Structured its business to obtain advantage for unemployment insurance obligations.
 - Legislature could not have intended for taxicab companies to be subject to the rental vehicle fee.

Leasing of Taxicabs - Subject to Rental Vehicle Fee (cont'd)

- Wisconsin Tax Appeals Commission - rental vehicle fee applies:
 - Green Cab maintained a fleet of vehicles, which it licensed as taxicabs.
 - Lease Agreement.
 - A business structure which avoids one type of business-related expense (unemployment insurance) should not necessarily escape another (rental vehicle fees).
 - Separate transactions:
 - Lease of driverless Type 1 vehicles to independent contractor taxi drivers.
 - Passenger pays fare to driver for the ride.
 - Legislature could have exempted rental of taxicabs to drivers (but it did not).

Appeal to the Wisconsin Tax Appeal Commission - Not Timely

- *Angel and Matilde Zumba v. Wisconsin Department of Revenue* (WTAC Mar. 7, 2022).
- Timing:
 - Oct. 23, 2020: Wisconsin Department of Revenue issued Notices of Amount Due for 2013, 2014, and 2015
 - Petition for Redetermination filed
 - August 17, 2021: Notice of Action issued (denying the Petition for Redetermination)
 - **August 19, 2021**: Taxpayer received Notice of Action
 - **October 18, 2021**: Expiration of 60-day appeal window
 - **October 22, 2021**: Wisconsin Tax Appeals Commission received Petition for Review by regular USPS mail
- Statutory jurisdictional deadlines cannot be extended.

Unclaimed Property - Updates & Voluntary Disclosure

- Updates include:
 - Confidentiality
 - Interest and penalties
 - Holder appeal rights and obligations
 - Business-to-business exemption
 - Decreases certain abandonment periods (e.g., money orders from 7 years to 5 years)
- 2021 Wis. Act 87 (effective November 7, 2021).

Unclaimed Property - Updates & Voluntary Disclosure (cont'd)

- Voluntary Disclosure:
 - Effective through February 28, 2023.
 - Eligible if:
 - Unclaimed property to report from any of the 5 most recent reporting periods.
 - Not audited for unclaimed property since July 1, 2016 or received notice of upcoming audit.
 - No balance due on unclaimed property holder account.

Unclaimed Property - *MoneyGram* Case

- Before U.S. Supreme Court
- “Official checks” issued by MoneyGram
 - Purchaser pays face value of the check to the selling bank plus fees. Bank sends the funds to MoneyGram. Purchaser gives the check to the payee, who can cash the check at a bank, which will then be reimbursed by MoneyGram.
 - “Money orders” or “similar written instruments”?
 - Escheat to states where instruments purchased.
 - Substance v. labels?

Unclaimed Property - *MoneyGram* Case (cont'd)

- Or “third party bank checks”?
 - Escheat to state where company is incorporated.
 - MoneyGram = incorporated in Delaware.
- Substance over form?

Maryland Digital Advertising Tax - Violated Internet Tax Freedom Act and Constitution

- Maryland digital advertising tax
- Circuit Court granted summary judgment for Comcast, finding tax violated:
 - Internet Tax Freedom Act
 - Dormant Commerce Clause of the Constitution
 - First Amendment
- Court found the law clearly targeted out-of-state companies “particularly in the manner in which the tax is calculated, which has nothing to do with even advertising, just gross revenue.”

Streaming Companies - Not Subject to Tax Under Illinois' Cable and Video Competition Law

- East St. Louis filed lawsuit against video streaming services.
 - Claimed owed fees, up to 5% of gross revenue.
- Court dismissed the action
 - Found only the Illinois attorney general had enforcement authority under the Cable and Video Competition Law of 2007 (requires video and cable service providers to register with the state)
 - East St. Louis also argued claims of trespassing, unjust enrichment and ordinance violations.

Colorado - Livestreaming Viewer Credits Not Taxable

- Users of live video streaming platforms purchased virtual credits.
- Credits could be redeemed by viewers to make their chats more visible and show support.
- Colorado Department of Revenue concluded credits are not subject to Colorado sales tax. (PLR 22-005; July 22, 2022.)
 - Akin to gift cards.
 - Also not taxable upon redemption - b/c do not provide tangible personal property or services.

Cincinnati - Remote Worker Tax Constitutional?

- H.B. 197 (passed in 2020) - mandated that work performed from March 2020 to December 31, 2020 would be considered to have occurred at an employee's principal place of work (regardless of the employee's physical location).
- Authority to tax nonresidents based on work performed outside the city?
 - Lower courts said yes (General Assembly had the power to make changes to the local income tax rules).
 - Before the Ohio Supreme Court.

Cleveland - City Cannot Collect Municipal Income Tax from Nonresident

- H.B. 197 (passed in 2020) - mandated that work performed from March 2020 to December 31, 2020 would be considered to have occurred at an employee's principal place of work (regardless of the employee's physical location).
- Authority to tax nonresidents based on work performed outside the city?
 - Cuyahoga County Court of Common Pleas, in *Morsy v. Dumas*, said no.
 - Unconstitutional as applied - Morsy lived out of state.

Questions?

Thank You!

This presentation provides information of a general nature. None of the information contained herein is intended as legal advice or opinion relative to specific matters, facts, situations or issues. Additional facts and information or future developments may affect the subjects addressed in this presentation. You should consult with a lawyer about your particular circumstances before acting on any of this information because it may not be applicable to you or your situation.

9:40 – 10:40 a.m.

Wisconsin Department of Revenue Update

Nate Weber, CPA, Director, Wisconsin Department of Revenue



Wisconsin Tax Update

WI Dept of Revenue | Division of Income, Sales, and Excise Tax
Fall 2022

Updated 10-25-2022



Mission

Strengthen Wisconsin through fair tax and lottery administration, while educating and serving the public, our customers and communities.

Vision

To be the premier agency in providing innovative, accessible resources, and exceptional customer service built on a foundation of trust, inclusivity and creativity.

Values

- Integrity
- Innovation
- Inclusivity
- Knowledge
- Empathy
- Security



Topics

- ▷ Income/Franchise Tax Update
- ▷ Sales/Use Tax Update
- ▷ Unclaimed Property Update
- ▷ Processing, Procedures, and Projects
- ▷ My Tax Account (MTA) Updates
- ▷ Performance Metrics



Income/Franchise Tax Update

- ▷ Internal Revenue Code Update
- ▷ Wisconsin Income/Franchise Tax Law Changes
- ▷ Pass-Through Entity Auditing – 2021 Wis. Act 262
- ▷ Litigation
- ▷ Other Updates & Reminders
- ▷ Form Updates



Internal Revenue Code Update



5

Internal Revenue Code (IRC) Update

Tax Year 2022

- ▷ Wisconsin follows the IRC as of December 31, 2020, with certain exceptions
- ▷ Wisconsin computes depreciation and amortization using IRC in effect on January 1, 2014, with certain exceptions
- ▷ Wisconsin has not adopted federal bonus depreciation provisions
- ▷ Wisconsin follows changes to IRC section 179 expensing



6

IRC Update

- ▷ Federal laws that have passed since December 31, 2020, that Wisconsin has not adopted:
 - Public Law 117-2 – American Rescue Plan Act of 2021
 - Public Law 117-6 – PPP Extension Act of 2021
 - Public Law 117-44 – Surface Transportation Extension Act of 2021
 - Public Law 117-52 – Further Surface Transportation Extension Act of 2021
 - Public Law 117-58 – Infrastructure Investment and Jobs Act
 - Public Law 117-103 – Consolidated Appropriations Act, 2022
 - Public Law 117-167 – Supreme Court Security Funding Act of 2022
 - Public Law 117-169 – Inflation Reduction Act of 2022



IRC Update

Tax Year 2022

- ▷ Medical expense itemized deduction floor is 7.5% of AGI (same as federal).
- ▷ Federal charitable contributions are considered normal itemized deductions on Schedule A. There is no longer a below-the-line deduction on Form 1040. Same applies for Wisconsin's itemized deduction credit.
- ▷ Federal itemized deduction limitations for charitable contributions apply for Wisconsin.



IRC Update – Not Adopted

- ▷ Public Law 117-2 (American Rescue Plan Act)
 - Earned income credit (EIC)
 - Raised investment income limit to \$10,000 beginning in 2021 (adjusted annually)
 - Wisconsin investment income limit is \$3,800 for 2022
 - Allows certain married individuals to claim EIC
 - Files separate from spouse, and
 - Lives apart from spouse for last 6 months of year, or
 - Has divorce or separation agreement by end of the tax year



IRC Update – Not Adopted

- ▷ Public Law 117-2 (American Rescue Plan Act)
 - Excess business loss limitation under IRC 461(l) applies through December 31, 2026
 - Limitation is further extended through December 31, 2028
(Public Law 117-169 Inflation Reduction Act of 2022)
 - Wisconsin never adopted the limitation



IRC Update – Not Adopted

- ▷ Public Law 117-2 (American Rescue Plan Act)
 - Student loan forgiveness
 - Certain student loans discharged under sec. 108(f)(5), IRC, in tax years 2021 through 2025 are not included in FAGI
 - Wisconsin follows the old sec. 108(f)(5), IRC (as of 12/31/20), which excludes student loan discharges on account of death or total and permanent disability
 - Wisconsin allows exclusion under sec. 108(f)(1) for individuals who work for a certain period of time in certain professions (e.g., Public Service Loan Forgiveness program)



11

IRC Update – Not Adopted

- ▷ Public Law 117-2 (American Rescue Plan Act)
 - Repeal election to allocate interest, etc., on a worldwide basis, which was set to begin in 2021
 - Repeal of election does not apply for Wisconsin



12

IRC Update – Not Adopted

▷ Public Law 117-2 (American Rescue Plan Act)

○ Deduction Limitation for Highly-Paid Employees

Federal –A publicly-held corporation may not deduct more than \$1,000,000 of compensation paid to any covered employee for the performance of services as provided in IRC sec. 162(m). The definition of a covered employee is expanded to include the principal executive officer and principal financial officer. (Public Law 115-97). For taxable years beginning after December 31, 2026, the definition of a covered employee is expanded to include an employee that is among the 5 highest compensated employees for the taxable year. (Public Law 117-2).

Wisconsin – The changes to the definition of “covered employee” by Public Law 115-97 and 117-2 do not apply for Wisconsin



IRC Update – Not Adopted

▷ Federal provisions not adopted by Wisconsin

○ Public Law 117-58 – Infrastructure Investment and Jobs Act

▪ Extensions

- Treats multiple declarations of federally declared disasters as a separate incident period allowing for a 60-day extension for each incident period. Previously, if a subsequent federally declared disaster occurred during a current disaster period, the extension would extend 60 days beyond the first day of the incident period for the subsequent disaster.
- Added "significant fires" to the list of reasons certain deadlines may be extended.

- Certain contributions received from any person by a regulated public utility which provides water or sewerage disposal services is included in the definition of a "contribution to the capital of the taxpayer" for purposes of excluding the contribution from gross income of a corporation.



IRC Update – Not Adopted

- ▷ Federal provisions not adopted by Wisconsin
 - Public Law 117-58 – Infrastructure Investment and Jobs Act
 - The interest from the following bonds is exempt from federal income tax
 - Qualified broadband projects exempt facility bonds
 - Qualified carbon dioxide capture exempt facility bonds
 - Public Law 117-103 – Consolidated Appropriations Act, 2022
 - Extension applies for treating a plan as a high deductible health plan even if it fails to have a deductible for telehealth and other remote care services, effective for months beginning after March 31, 2022, and before January 1, 2023. For Wisconsin, a deduction from gross income for contributions made may not be allowed.



15

IRC Update – Not Adopted

- ▷ Federal provisions not adopted by Wisconsin
 - Public Law 117-169 – Inflation Reduction Act of 2022
 - The amount of the federal aviation fuel credit is included in gross income, effective for fuel sold or used after December 31, 2022.
 - Energy efficient commercial buildings deduction – In the case of a real estate investment trust corporation, for purposes of computing the earnings and profits, the deduction is allowed in the year the property is placed in service as opposed to over a period of 5 taxable years.
 - Certain taxpayers (not tax-exempt entities) are allowed a one-time transfer of certain tax credits. Any payments received in exchange for the transfer of credits are excluded from income, and any amounts paid to obtain a transferred credit cannot be deducted from income, effective for taxable years beginning after December 31, 2022.
 - Federal excise tax on stock buy-backs and federal corporate alternative minimum tax do not apply to Wisconsin.



16

Wisconsin Income/Franchise Tax Law Changes



17

Restaurant Revitalization Grants Exclusion

- ▷ 2021 Wisconsin Act 156
- ▷ Income received in the form of a grant from the restaurant revitalization fund under sec. 5003 of P.L. 117-2 (ARPA) is exempt from Wisconsin income and franchise tax
- ▷ Expenses paid directly or indirectly with the grant money remain deductible
- ▷ Effective for taxable years beginning **after December 31, 2020**



18

New Additional Child and Dependent Care Tax Credit

2021 Wis. Act 58

- ▷ Effective for tax year 2022
- ▷ Subtraction no longer available
- ▷ Credit allowed equal to 50% of the federal child and dependent care tax credit under IRC 21
- ▷ Not available to nonresidents or part-year residents
- ▷ If married, must file a joint return unless considered not married



19

Capital Loss Deduction

2021 Wisconsin Act 157

- ▷ Capital loss deduction increased from \$500/year to \$3,000/year (\$1,500 for married persons filing separately)
- ▷ Applies to individuals and partnerships and tax-option (S) corporations making the entity-level tax election
- ▷ Effective for taxable years beginning **after December 31, 2022**



20

2021 Wisconsin Act 258

- ▷ 2021 Wisconsin Act 258 became effective on April 17, 2022.
- ▷ Various changes for partnerships, corporations, and limited liability companies were made in chs. 178, 179, 180, 181, and 183, Wis. Stats.
- ▷ The following income/franchise tax laws were revised to provide that the new provisions in the Act are treated for state tax purposes in the same manner as they are treated for federal tax purposes:
 - Section 71.80(21), Wis. Stats., *Business Entity Conversion*
 - Section 71.80(21m), Wis. Stats., *Business Entity Interest Exchange*
 - Section 71.80(22), Wis. Stats., *Business Entity Merger*
 - Section 71.80(22m), Wis. Stats., *Business Entity Domestication*



2021 Wisconsin Act 258 (cont.)

- ▷ The Act provides that the changes in the Act applicable to liquidations, reorganizations, and business entity formations follow the general sales and use tax provisions relating to liquidations, reorganizations, and formations (sec. 77.61(15), Wis. Stats.)
- ▷ Income, franchise, sales, and use tax liabilities from a DOR assessment may be claimed against a dissolved limited liability partnership, limited partnership, or limited liability company (secs. 178.0807, 179.0806, and 183.0704, Wis. Stats.),



Pass-Through Entity Auditing

2021 Wis. Act 262



23

2021 Wisconsin Act 262

- ▷ Effective April 17, 2022
- ▷ The Act includes the following provisions:
 - Pass-through definitions
 - Pass-through entity audits
 - Pass-through entity appeals
 - Pass-through entity elections
 - Pass-through entity representative
 - Confidentiality
 - Internal Revenue Service partnership audit adjustments
 - Other



24

Pass-Through Definitions

- ▷ "Pass-through entity" means a partnership, a limited liability company, a tax-option (S) corporation, an estate, or a trust that is treated as a pass-through entity for federal income tax purposes.
- ▷ "Pass-through item" means an item of income, gain, loss, deduction, credit, or any other item that originates with a pass-through entity and is required to be reported by one or more pass-through members.
- ▷ "Pass-through member" means a person who is a partner in a partnership, member of a limited liability company, shareholder in a tax-option (S) corporation, beneficiary of an estate or a trust, or any other person whose tax liability under ch. 71, Wis. Stats., is determined in whole or in part by taking into account the person's share of pass-through items, directly or indirectly, from a pass-through entity.



Pass-Through Entity Audits

- ▷ Audit provisions provided under sec. 71.745, Wis. Stats.
- ▷ The department may assess and collect additional tax from a pass-through entity (PTE) on income otherwise reportable by its pass-through members. Tax rates for entity-level audit assessments are as follows:
 - 7.65% for income otherwise reportable by **direct** owners that are individuals, estates, and trusts
 - 7.9% for income otherwise reportable by all other **direct** owners (e.g., corporations and partnerships)



Pass-Through Entity Audits (cont.)

- ▷ The department may issue a refund to a PTE.
 - Refunds only issued to PTE for overpayment of tax from payments made by PTE.
 - Overpayment of tax from payments not made by PTE must be claimed by pass-through members (PTMs) on an amended return for each reviewed year.
 - PTMs may claim their proportionate share of overpayment within one year after the date the determination of the overpayment becomes final or within four years of the unextended due date of the PTMs' return as provided in sec. 71.75, Wis. Stats., whichever is later.



27

Pass-Through Entity Audits (cont.)

- ▷ The department may assess or adjust a credit under sec. 71.07, 71.28, or 71.47, Wis. Stats.
 - Assessment to reduce or recover a credit may be issued to PTE if PTE previously computed the credit and reported the credit to its PTMs.
 - Many WI credits are added to income. The Act provides that an assessment may be reduced by the tax effect from removing the credit from income, if the income modification occurs in a taxable year under review in the audit. Income modification may not be claimed by the PTMs.



28

Pass-Through Entity Audits (cont.)

- ▷ The department may assess or adjust a credit under sec. 71.07, 71.28, or 71.47, Wis. Stats. (cont.)
 - Adjustment to increase a credit may offset additional tax assessed to PTE.
 - Excess credit not used to offset additional tax may not be claimed by or refunded to the PTE.
 - PTMs may file an amended return for each reviewed year to claim their proportionate share of excess credit.
 - Claims may be made within one year from the date the determination becomes final or within four years of the unextended due date of the PTMs' return as provided in sec. 71.75, Wis. Stats., whichever is later.



29

Pass-Through Entity Audits (cont.)

- ▷ Statute of limitations, interest, and penalties under secs. 71.77, 71.82, and 71.83, Wis. Stats., apply to determinations made at the PTE level without regard to the action or inaction of PTMs.
 - Example:* If a partner does not file a return (no statute of limitations), the entity-level assessment must be made within 4 years from the unextended due date of the partnership's return.
- ▷ Audit provisions under sec. 71.745, Wis. Stats., do **NOT** apply to partnerships and tax-option (S) corporations making the entity-level tax election under sec. 71.21(6)(a) or 71.365(4m)(a), Wis. Stats.



30

Pass-Through Entity Appeals

- ▷ Under sec. 71.745(6)(b), Wis. Stats., PTE may, within 60 days after receipt of determination, petition the department for redetermination.
- ▷ The department shall make a redetermination on the petition within 6 months after the date on which the petition is filed.
- ▷ If no timely petition for redetermination is filed with the department, the department's determination is final and conclusive.



31

Pass-Through Entity Appeals (cont.)

- ▷ PTE may, within 60 days after receipt of redetermination, appeal the redetermination to the Wisconsin Tax Appeals Commission (TAC) as provided in sec. 71.88(2), Wis. Stats.
- ▷ If no timely petition is filed with the TAC, the department's redetermination is final and conclusive.



32

Pass-Through Entity Elections

- ▷ PTE may elect, under sec. 71.745(8), Wis. Stats., to reduce an audit assessment at the entity level if all the following apply:
 - Election made within 60 days after the entity-level determination becomes final.
 - PTE reports to the department and its PTMs the adjustments for each PTMs' proportionate share of pass-through items for each taxable year.
 - PTMs report and pay within 60 days of the election any resulting tax due from the adjustments to the pass-through items.



33

Pass-Through Entity Elections (cont.)

- ▷ PTE may elect, under sec. 71.745(9), Wis. Stats., to have the department assess each of the PTMs if all the following apply:
 - PTE has 25 or fewer PTMs for all years under review.
 - PTE does not have a PTM that is a PTE for any year under review.
 - Election made within 60 days after the entity-level determination becomes final.
- ▷ If election is made, sec. 71.77(7)(c), Wis. Stats., provides the department may assess the PTMs within one year from the date of the election.
- ▷ Election does not relieve pass-through entity representative's powers and duties for extension agreements, appeals, and requirement to provide the department with sufficient information to identify each PTM and the capital, profit, and loss interest of each PTM.



34

Pass-Through Entity Representative

- ▷ Under sec. 71.80(26)(a), Wis. Stats., each PTE must designate a PTM or other person with substantial presence in the United States as the pass-through entity representative (PTR).
- ▷ PTR may be different than federal representative.
- ▷ If PTE did not designate a PTR, the department will send a written request for a PTR.
- ▷ If PTE does not designate a PTR within 60 days of the department's request, the department may designate a PTR and notify, in writing, the PTE.
 - PTE may at any time provide a written statement to the department designating a new PTR.



35

Pass-Through Entity Representative (cont.)

- ▷ 2022 Form 2 (fiduciary, estates, trusts), Form 3 (partnerships), and Form 5S (tax-option (S) corporations) have been updated to include a section for the PTE to designate a PTR.
 - More detail provided in Form Updates section of presentation.
- ▷ PTE may also designate a PTR by submitting a Form PT-R, *Pass-Through Entity Representative*, or a separate statement, that includes all the information requested on Form PT-R, signed by an authorized agent of the PTE.
- ▷ **The department will treat the most recently appointed PTR as the sole active PTR under sec. 71.80(26), Wis. Stats.**



36

Pass-Through Entity Representative (cont.)

- ▶ Form PT-R or a written statement designating a PTR are sent to:
 - DORAuditPassThrough@wisconsin.gov, or
 - MS 6-81
Wisconsin Department of Revenue
Pass-Through Audit Unit
PO Box 8906
Madison, WI 53708-8906



37

Pass-Through Entity Representative (cont.)

- ▶ PTR powers and duties as provided under sec. 71.80(26)(b), Wis. Stats.
 - Act as the sole authority on behalf of the PTE and its PTMs with respect to an entity-level audit determination under sec. 71.745, Wis. Stats.
 - File appeals of notices of PTE adjustments.
 - Enter into extension agreements with the department on behalf of the PTE for purposes of extending the periods of limitation for issuing assessments and claiming refunds.
 - Enter into settlement agreements and bind PTMs to adjustments relating to pass-through items.
 - Receive notices of PTE adjustments.



38

Pass-Through Entity Representative (cont.)

- ▷ PTR powers and duties as provided under sec. 71.80(26)(b), Wis. Stats. (cont.)
 - Provide the department sufficient information to identify each PTM and the capital, profit, and loss interest of each PTM.
 - Notify all PTMs of their share of corrections and adjustments made to pass-through items within 60 days after an entity-level audit determination becomes final or after receipt of notice of approval for a partnership to pay tax on behalf of the partners after being issued a final audit determination at the partnership level from the Internal Revenue Service (IRS partnership adjustment treatment explained later).
- ▷ PTR may delegate powers and duties in sec. 71.80(26)(b), Wis. Stats., to an authorized agent of the PTE (e.g., Power of Attorney (POA)), as provided under sec. 71.80(26)(c), Wis. Stats.



Pass-Through Entity Representative (cont.)

- ▷ PTR powers and duties vs. POA authority for audit determinations at the entity level under sec. 71.745, Wis. Stats.

Authority for Pass-Through Entity Audit Determination	Power of Attorney	Pass-through Entity Representative
Enter into an agreement to extend the limitation period to make an audit determination	No	Yes
Enter into settlement agreements and bind pass-through members to adjustments in audit determination	No	Yes
File an appeal of the audit determination	No	Yes
Elect to reduce an audit assessment under sec. 71.745(8), Wis. Stats.	No	Yes
Elect to have an audit assessment assessed to the pass-through members under sec. 71.745(9), Wis. Stats.	No	Yes



Confidentiality

- ▷ As provided under sec. 71.78(11), Wis. Stats., if the department audits a PTE for income or franchise taxes of its PTMs, including when an election to pay tax at the entity level is made under sec. 71.21(6)(a) or 71.365(4m)(a), Wis. Stats., the department may disclose the following:
 - **To a PTM:** PTE is under audit or was audited, if the disclosure is necessary to explain any amounts assessed or refunded to the PTM or to obtain information necessary to determine the proper amount of adjustment to make at the PTE level.
 - **To a PTE:** Identities of one or more of its PTMs who have failed to report pass-through items originating with the entity on their Wisconsin returns, if the disclosure is necessary to explain any amounts assessed or refunded to the PTM or to obtain information about a PTM's return in order to determine the proper amount of adjustment to make at the PTE level.



IRS Partnership Audit Adjustments

- ▷ If a partnership receives an IRS audit adjustment at partnership level, partnership may request to amend Wisconsin partnership returns and pay tax on behalf of PTMs. Request must be made within 60 days after final determination by the IRS.
 - If department approves the request, partnership must amend the Wisconsin partnership returns for each reviewed year, as defined under section 6225 of the IRC, to report such changes within 180 days from the date the department approves the request. Partnership must pay tax at the highest tax rate computed under sec. 71.745(2)(a), Wis. Stats., as follows:
 - 7.65% for income otherwise reportable by direct owners that are individuals, estates, and trusts
 - 7.9% for income otherwise reportable by all other direct owners (e.g., corporations and partnerships)



IRS Partnership Audit Adjustments (cont.)

- ▷ If department denies the request, partnership and its PTMs must file amended Wisconsin returns for each reviewed year, as defined under section 6225 of the IRC, to report such changes within 180 days from the date the department denies the request.



43

Other

- ▷ Adjustments to pass-through items made in a PTE audit determination are attributable to each PTM in a manner, and for the taxable year, that is consistent with the treatment of the pass-through items as if a determination was not made at the entity level. For example, a PTM may increase basis in partnership interest by the PTM's proportionate share of additional income determined in the partnership audit assessment.
- ▷ If the department determines that a tax liability exists and that the liability may be owed by more than one PTM of a PTE, the department may assess any PTM of the PTE for their allocated portion of additional tax otherwise due.



44

Other (cont.)

- ▷ If any PTE required to file a return under ch. 71, Wis. Stats., files an incomplete or incorrect return, the department, upon a showing by the department under sec. 73.16(4), Wis. Stats., may assess the PTE an amount equal to 25 percent of the amount of the tax assessed under sec. 71.745, Wis. Stats. The amount shall be assessed, levied, and collected in the same manner as additional normal income or franchise taxes.



Resources

- ▷ Pass-Through Entity Level Audits Under 2021 Wis. Act 262 common questions
 - <https://www.revenue.wi.gov/Pages/FAQS/ise-pte-audit.aspx>
- ▷ Partnerships common questions numbers 3 and 4
 - <https://www.revenue.wi.gov/Pages/FAQS/ise-pship.aspx>
- ▷ Form PT-R, *Pass-Through Entity Representative*
 - <https://www.revenue.wi.gov/dorforms/ptrf.pdf>
- ▷ Form PT-R instructions
 - <https://www.revenue.wi.gov/dorforms/i-ptr.pdf>



Income/Franchise Tax Litigation



47

Litigation – Gambling Losses

- ▷ *Julie Chier v. Wisconsin Department of Revenue: Wisconsin Tax Appeals Commission, March 22, 2022*
- ▷ Claimed to be a professional gambler
- ▷ Taxpayer records:
 - Separate bank accounts not kept
 - Activities were not tracked on computer spreadsheet or similar document
 - Contemporaneous notes were not kept
 - No business plan
 - Gambling not carried on in a business-like manner
 - Utilized player's cards and casino gaming records to substantiate portion of winnings



48

Litigation – Gambling Losses

- ▷ IRS notice stated taxpayer did not qualify as professional gambler
- ▷ Tax Appeals Commission concluded:
 - Disallowed status as professional gambler (disallowed business loss on Schedule C)
 - Allowed gambling losses under the session method of reporting that were substantiated in part with casino records
- ▷ Session winnings are reported as other income on Form 1040
- ▷ Session losses are reported as misc. itemized deductions on Schedule A
- ▷ Note: Wisconsin law does not allow gambling losses for itemized deduction credit



49

Litigation: Apportionable Income – Environmental Credit Sales

- ▷ *American Honda Motor Co., Inc.*: Wisconsin Tax Appeals Commission, November 29, 2021
- ▷ American Honda earns and resells environmental credits from producing vehicles that exceed emission standards
- ▷ American Honda has nexus with Wisconsin and files a Wisconsin combined return
- ▷ American Honda reported the credit sales as non-apportionable Wisconsin income because the business activities related to the credit took place in California
- ▷ The Commission agreed with the department's position that the credit sales are apportionable income because they represent unitary and operational income integral to Honda's business and were not mere investments
- ▷ American Honda has appealed



50

Litigation: Manufacturing Credit

- ▷ *The Graphic Edge, Inc.*: Wisconsin Tax Appeals Commission, December 20, 2021
- ▷ Graphic Edge is a printing company located in Wisconsin and was classified for property tax purposes as a manufacturer by the Department of Revenue
- ▷ Graphic Edge computed the manufacturing credit by including depreciation recapture and Form 4797 gain on the sale of business equipment in production gross receipts but did not allocate any expenses as direct and indirect costs
- ▷ The department removed depreciation recapture and Form 4797 gain from production gross receipts
- ▷ The Commission agreed with the department because the printing equipment that was sold was not manufactured by Graphic Edge
- ▷ Graphic Edge did not further appeal



51

Litigation: Nexus - Foreign Corporation Selling Travel Services

- ▷ *ASAP Cruises, Inc.*: Wisconsin Tax Appeals Commission, May 23, 2022
- ▷ ASAP is a Florida corporation that sells travel services to individuals and businesses across the U.S. via independent travel consultants
- ▷ ASAP receives income from the sale of travel services by independent travel consultants and in turn pays them a commission
- ▷ ASAP was a party to around 100 independent travel consultant agreements with individuals and businesses located in Wisconsin
- ▷ ASAP did not file Wisconsin income or franchise tax returns, so the department issued estimated assessments



52

Litigation: Nexus - Foreign Corporation Selling Travel Services

- ▷ ASAP argued:
 - Nexus protection under Public Law 86-272 because they were selling tangible software
 - They were not engaged in business in Wisconsin because they were selling software services (SaaS) and solicitation of WI customers was conducted remotely and electronically from Florida
- ▷ The Commission concluded ASAP was engaged in business in Wisconsin through its sales of travel services to Wisconsin customers through their independent travel consultants
- ▷ ASAP appealed to Dane County Circuit Court



53

Litigation: Pass-Through Withholding Tax – S-Corporation Without Physical Presence

- ▷ *MacKinney Systems, Inc.*: Wisconsin Tax Appeals Commission, March 16, 2022
- ▷ MacKinney is a Missouri tax-option (S) corporation without a physical presence in Wisconsin
- ▷ All shareholders are nonresidents of Wisconsin
- ▷ MacKinney delivers prewritten software to customers via download and provides technical support and maintenance services from Missouri
- ▷ MacKinney received over \$100,000 per year from customers in Wisconsin but did not file/pay income or franchise tax returns or pass-through withholding taxes



54

Litigation: Pass-Through Withholding Tax – S-Corporation Without Physical Presence

- ▷ The department issued a pass-through withholding assessment, which was appealed to the Commission
- ▷ The Commission sustained the assessment and concluded that MacKinney met the definition of doing business in Wisconsin under sec. 71.22(1r), Wis. Stats., because some of the customers received the product and services in Wisconsin
- ▷ The Commission also noted that withholding tax is different from income or franchise tax – withholding tax is required even if the nonresidents do not have an income tax filing requirement in Wisconsin



55

Litigation: Pass-Through Withholding

- ▷ *RADS Partnership, Via Cresta, L.P., Laughing Cow, LP, Finger Living Trust, and Westmar LTD (Petitioners) v. Wisconsin Department of Revenue: Wisconsin Tax Appeals Commission, July 26, 2022*
- ▷ All Petitioners are pass-through entities, except Finger Living Trust
- ▷ Petitioners did not file withholding returns in 2013
- ▷ Petitioners claimed they did not have to file withholding returns because they had losses from prior years
- ▷ Petitioners did not timely file returns for years in which losses were incurred



56

Litigation: Pass-Through Withholding

- ▷ *RADS Partnership, Via Cresta, L.P., Laughing Cow, LP, Finger Living Trust, and Westmar LTD (Petitioners) v. Wisconsin Department of Revenue: Wisconsin Tax Appeals Commission, July 26, 2022*
- ▷ Commission concluded:
 - Pass-through entities are required to file a timely pass-through withholding form in each year where there is "Wisconsin income" (i.e., not allowed to use prior years' losses)
 - Adding the word "taxable" to "income" under sec. 71.775(2)(a) and (3)(a)2., Wis. Stats., changes the meaning of the statute
 - Pass-through entities must use WI Form PW-1 as the pass-through withholding form
- ▷ Petitioners appealed the decision



57

Other Income/Franchise Tax Updates & Reminders



58

Other Updates and Reminders

- ▷ College savings account subtraction
 - \$3,560 (\$1,780 if married filing separately)
 - 2021 amount was \$3,380
- ▷ Wisconsin tuition and fees subtraction
 - Subtraction – increased from \$6,973 to \$6,976
 - Includes fees for course related books if paid to institution as condition of enrollment or attendance
 - Phase-out
 - Single or head of household - \$60,380 to \$72,460
 - Married filing joint - \$96,600 to \$120,760
 - Married filing separate - \$48,300 to \$60,380



59

Other Updates and Reminders

- ▷ Mileage rates - 2022
 - 58.5 cents per mile for business miles, up from 56 cents for 2021
 - 18 cents per mile for medical or moving purposes, up from 16 cents for 2021
 - 14 cents per mile in service of charitable organizations
- ▷ Educator expense deduction
 - Wisconsin follows increased federal deduction amount
 - Increased to \$300 for 2022, up from \$250 for 2021



60

Active Duty Military Pay Subtraction

2021 Wis. Act 58

- ▷ Created sec. 71.05(6)(b)56., Wis. Stats., effective for tax year 2021
- ▷ Basic, special, or incentive pay income received from federal government under 37 USC chapters 3 and 5 while the individual is on active duty in the U.S. Armed Forces
- ▷ For 2022 tax year:
 - Subtraction allowed for military pay received **for** active duty
 - Subtraction not allowed for inactive duty training (drill pay)
- ▷ Publication 128, *Wisconsin Tax Information for Military Personnel and Veterans*



61

Credit for Tax Paid to Another State

- ▷ Credit for tax paid to reciprocal states
 - Wisconsin has income tax reciprocity with Illinois, Indiana, Kentucky, and Michigan
 - Reciprocity generally only applies to income earned as an employee (wages)
 - Wisconsin resident may not claim a credit for tax paid to another state on the Wisconsin return if the income reportable on the other state's tax return is subject to reciprocity
 - If Wisconsin resident earns income in reciprocal state and income tax is withheld for the other state, resident must file an income tax return with that state to obtain a refund of the withheld tax



62

Schedule RT – Related Party Expenses

- ▷ Taxpayers must disclose on Schedule RT if the total deduction for all related party payments reduce Wisconsin taxable income, after apportionment, by \$100,000 or more:
 - Interest Expenses
 - Rent Expenses
 - Management Fees
 - Intangible Expenses
- ▷ Due on or before the extended due date of the return



63

Schedule RT – Related Party Expenses

- ▷ If the Department discovers that related party expenses were not disclosed timely on Schedule RT, the expense deduction may be disallowed (sec. 71.80(23)(b), Wis. Stats.)
- ▷ Schedule RT is not required for transactions between members of a combined group of corporations that file a combined return and eliminate the intercompany transactions in the computation of combined unitary income.



64

Reorganizations

- ▷ Taxpayers must have the same taxable year for federal and Wisconsin purposes (e.g., if a short-period return must be filed for federal purposes, a short-period return must also be filed for WI purposes).
- ▷ A reorganization may result in a continuation of the old entity. For example:
 - A merger of two or more partnerships that meets the requirements in sec. 708(b)(2)(A), of the Internal Revenue Code (IRC).
 - A tax-option (S) corporation's change in identity, form, or place of organization under sec. 368(a)(1)(F), IRC.
- ▷ Continuation may impact the resulting entity's estimated tax payments and underpayment interest (check boxes added to Partnership and S corp forms).



65

Entity-Level Tax Elections

- ▷ 2017 Wisconsin Act 368 created an election for partnerships and tax-option (S) corporations to pay tax at the entity level on behalf of their pass-through members.
- ▷ **Reminder:** The election or subsequent revocation of the election under sec. 71.21(6)(a) or 71.365(4m)(a), Wis. Stats., **must** be made by the extended due date of the entity's income or franchise tax return.
 - Calendar year partnership extended due date: 9/15
 - Calendar year tax-option (S) corporation extended due date: 10/15



66

Entity-Level Tax Elections – Filing Stats

Tax-Option (S) Corporations (Form 5S)	2019	2020	2021
Returns filed	81,517	80,602	76,437
Entity-level tax elections filed	2,992	4,076	5,281
Percent of entity-level tax elections filed	3.67%	5.06%	6.91%

Partnerships (Form 3)	2019	2020	2021
Returns filed	79,885	80,432	79,366
Entity-level tax elections filed	1,495	2,010	2,654
Percent of entity-level tax elections filed	1.87%	2.50%	3.34%



67

Qualified Wisconsin Business (QWIB) – Income Exclusion / Deferral

▷ Capital Gain Exclusion / Deferral

- Long-term capital gain from investments made after December 31, 2010, in a qualified Wisconsin business and held for at least five uninterrupted years are excluded from Wisconsin income
- Exclusion does not apply to any portion of gain due to amount of gain deferred at time of investment
- See Schedule QI, *Sale of Investment in a Qualified Wisconsin Business*



68

Qualified Wisconsin Business (QWIB) Registration

- ▷ A business may register as a QWIB if, in the business's tax year ending immediately before the date of registration:
 - The business has at least 2 full-time employees,
 - The amount of payroll compensation paid by the business in WI is at least 50% of all payroll compensation paid by the business, and
 - The value of real and tangible personal property owned or rented and used by the business in WI is at least 50% of the value of all real and tangible personal property owned or rented and used by the business.
- ▷ Business must register each year it desires to be a QWIB (sec. 73.03(69), Wis. Stats.)
 - Registration for 2022 must be completed by January 2, 2023.



69

QWIB Registration (cont.)

- ▷ Registration for 2022 must be completed by January 2, 2023.
- ▷ To register your business with the department, use the department's online application here:
 - https://tap.revenue.wi.gov/QualBus/_/
- ▷ A list of QWIBs can be found on the department's website here:
 - <https://www.revenue.wi.gov/Pages/Report/qualified-businesses.aspx>



70

Qualified Opportunity Fund (QOF)

- ▷ Certain taxpayers who invest in a QOF may qualify for federal tax benefits:
 - Defer paying tax on capital gains by investing the gains in a QOF
 - Reduce the taxable amount of the deferred capital gains by
 - 10% if QOF investment is made prior to Jan. 1, 2022, and is held for at least 5 years
 - 15% if QOF investment is made prior to Jan. 1, 2020, and is held for at least 7 years
 - Exclude all gains from the sale of a QOF investment by holding the QOF investment for at least 10 years.
- ▷ See sections 1400Z-1 and 1400Z-2 of the Internal Revenue Code (IRC)
- ▷ WI follows the federal tax benefits



71

WI Qualified Opportunity Fund (WQOF)

- ▷ A WQOF means a QOF that holds at least 90% of its assets in WI qualified opportunity zone property
- ▷ For taxable years beginning on or after January 1, 2020, a WQOF is required to file WI Form WQOF with the department and provide a copy to each investor by January 31 of the year following the close of the WQOF's taxable year.
- ▷ In addition to the federal QOF tax benefits, certain taxpayers who defer paying tax on their capital gains by investing in a WQOF may qualify for a WI subtraction or basis modification



72

WQOF (cont.)

- ▷ The WI subtraction or basis modification is
 - 10% of the deferred capital gain if
 - The WQOF investment was held for at least 5 years and
 - The taxpayer qualifies for the 10% federal QOF exclusion
 - 15% of the deferred capital gain if
 - The WQOF investment was held for at least 7 years and
 - The taxpayer qualifies for the 15% federal QOF exclusion
- ▷ **Note:** Any failure by a WQOF may result in the WI subtraction or basis modification being denied for investors



73

WQOF (cont.)

Resources:

- ▷ Common Questions:
<https://www.revenue.wi.gov/Pages/FAQS/ise-qualified-zones.aspx>
- ▷ Fact Sheet 1121:
<https://www.revenue.wi.gov/DOR%20Publications/1121opportunityzone.pdf>
- ▷ 2022 Form WQOF instructions:
<https://www.revenue.wi.gov/TaxForms2022/2022-FormWQOF-inst.pdf>
- ▷ Sections 71.05(25m), 71.26(3)(vm), 71.34(1k)(p), and 71.45(2)(a)21., Wis. Stats.



74

Form Updates



Form Changes

- ▷ Form 1, *Wisconsin Resident Income Tax Return*
 - Added new lines
 - Line 1 – Federal adjusted gross income (FAGI) from Form 1040, line 11
 - Line 2 – Adjustments to FAGI from Schedule I, line 3
 - Line 14 – Additional child and dependent care tax credit (nonrefundable)
 - Rearranged lines
 - Moved UPI line up before "AMOUNT YOU OWE" as UPI is included in the total



Form Changes

- ▷ Form 1NPR, *Nonresident and Part-Year Resident Income Tax Return*
 - Added new line 40 for additional child and dependent care tax credit (nonrefundable)
 - Moved UPI line up before "AMOUNT YOU OWE" as UPI is included in the total
 - Moved all additions and subtractions to Schedule M
- ▷ Schedule AR, *Explanation of Amended Return*
 - Added check boxes for amending for a pass-through entity audit
 - Created separate instructions for each amendment reason
- ▷ Schedule CS, *College Savings Accounts*
 - Combined Parts I and II to correctly apply subtraction limitation to both instances of when you contribute to an account you own and to an account owned by someone else for the same beneficiary
 - Eligible carryover is now Part II



77

Form Changes

- ▷ Schedule OS instructions, *Credit for Net Tax Paid to Another State*
 - Added instructions to clarify whether to compute the credit in Part II or Part III of the form when the individual is a member of a pass-through entity that pays tax at the entity level in another state, but does not elect to pay tax at the entity level in WI.



78

Form Changes

▷ Form 2, *Wisconsin Fiduciary Income Tax for Estates and Trust*

- Simplified the layout for computing an amount due.
 - Changed line 23 from **BALANCE DUE** to **AMOUNT UNDERPAID** and created line 25, **AMOUNT DUE**.

23	If line 19 is less than line 11d, subtract line 19 from line 11d AMOUNT UNDERPAID	23	_____	.00
24	Underpayment interest. Fill in exception code – See Schedule U _____	24	_____	.00
25	Add lines 23 and 24. This is the AMOUNT DUE	25	_____	.00



Form Changes

▷ Form 2, *Wisconsin Fiduciary Income Tax for Estates and Trust*

- Updated the "Mail your return to:" section on page 4 to separate out the mailing address for returns with a "tax due" or a "refund or no tax due".

Mail your return to: Wisconsin Department of Revenue
If tax duePO Box 8918, Madison WI 53708-8918
If refund or no tax duePO Box 8965, Madison WI 53708-8965



Form Changes

- ▷ Form 2, *Wisconsin Fiduciary Income Tax for Estates and Trust*
- ▷ Form 3, *Wisconsin Partnership Return*
- ▷ Form 5S, *Wisconsin Tax-Option (S) Corporation Franchise Income Tax Return*

Section added to designate a pass-through entity representative

Pass-Through Entity Representative

Representative's last name		Representative's first name	
Email address		Phone number ()	
Mailing address		Apt. no.	
City		State	Zip code

81

Form Changes

- ▷ Form 3, *Wisconsin Partnership Return*
- ▷ Form 5S, *Wisconsin Tax-Option (S) Corporation Franchise Income Tax Return*

Added a check box, Item M (Form 3) and Item A9 (Form 5S), for taxpayers to indicate the entity reorganized during the tax year and what type of reorganization (e.g., sec. 708(b)(2)(A) or 368(a)(1)(F), of the Internal Revenue Code).

82

Power of Attorney (POA)

- ▷ Instructions updated to state that separate POA forms must be completed when:
 - Multiple individuals named in Part 3B, **and**

Part 3B – Individual			
Individual's last name		Individual's first name	
Email address			Phone number () -
Mailing address			Apt. no.
City		State	Zip code



Power of Attorney (POA)

- Each individual has been granted different authority in Part 4

Part 4 – Full or Limited Authority (check one)			
<input type="checkbox"/> I grant full authority to the representative(s) - The representative(s) named above has full authority to perform any act with respect to matters before the department that the taxpayer(s) can and may perform, including receiving confidential Wisconsin tax information. Note: If granting full authority, do not check any boxes below.			
<input type="checkbox"/> I grant limited authority to the representative(s) - (check only items below for which you are granting authority.) The representative(s) named above has authority to perform any act, with respect to the items checked below, that the taxpayer(s) can and may perform, including the authority to receive confidential Wisconsin tax information.			
Authority	Period(s) (optional)	Authority	Period(s) (optional)
<input type="checkbox"/> Income or Franchise Taxes	_____	<input type="checkbox"/> Employer Withholding Taxes	_____
<input type="checkbox"/> Sales and Use Taxes	_____	<input type="checkbox"/> Pass-Through Withholding Taxes	_____
<input type="checkbox"/> Excise Taxes	_____	<input type="checkbox"/> Nontax Debt	_____
<input type="checkbox"/> Property Taxes	_____	<input type="checkbox"/> Other (describe below)	_____



Form 1098-F New Requirements

- ▶ The Tax Cuts and Jobs Act of 2017 (sec. 13306 of P.L. 115-97) requires certain government entities (e.g., WI DOR) to file Form 1098-F if:
 - The government entity is a party involved in a suit or agreement with respect to a violation of any law over which the government entity has authority,
 - The suit or agreement becomes binding on or after January 1, 2022, and
 - The aggregate amount involved in all court orders and agreements is \$50,000 or more
- ▶ Due Date
 - File with IRS by Feb. 28 (Mar. 31 if filed electronically) following calendar year in which suit or agreement becomes binding
 - Provide a copy to payor by Jan. 31 following calendar year in which suit or agreement becomes binding



85

Form 1098-F New Requirements (cont.)

Example:

- ▶ WI DOR issues a notice of amount due (NOAD) to a corporation because of a violation of tax law:
 - Tax \$40,000
 - Interest 10,000
 - Penalties 5,000
 - Total \$55,000
- ▶ If NOAD becomes binding on October 10, 2022, DOR must:
 - File Form 1098-F with IRS by Feb. 28, 2023 (Mar. 31 if electronically)
 - Provide a copy to the corporation by Jan. 31, 2023
- ▶ Form 1098-F will show \$55,000 in box 1 and \$5,000 in box 2



86

Sales and Use Tax Update



87

Nonprofit Occasional Sale Exemption

- ▷ 2021 Wis. Act 167
 - Entertainment standard for the nonprofit occasional sale exemption increased from \$10,000 to \$50,000
 - If a nonprofit organization charges an admission for an event, the nonprofit organization may qualify for the occasional sales exemption (if all other standards are met), if the total amount that all entertainers are paid is \$50,000 or less
 - Applies to entertainment admission events occurring on and after June 1, 2022



88

Publication 240 Updates

- ▷ Publication 240, *Digital Goods* was updated November 2021
- ▷ Major changes:
 - Clarified treatment of pre-recorded webinars
 - Clarified "other news or information products"
 - Clarified examples of taxable and nontaxable digital goods
 - Updated bundled transaction example



89

Pre-Recorded Webinars

- ▷ Sales of pre-recorded webinars are taxable specified digital goods if they are not provided incidentally with an education service
- ▷ Reminder: Pre-recorded webinars are provided incidentally with an education service if one of the following occurs:
 - The participant is evaluated by an instructor
 - The participants are connected to other participants and presenters via internet or other networks, allowing the participants to provide, receive, and discuss information together by live interaction, contemporaneous with the presentation
 - The pre-recorded webinar is certified by a branch of government for the participant to receive continuing education credits to obtain or remain in good standing with their government-issued license



90

"Other News or Information Products"

- ▷ "Additional digital goods" means all of the following, if they are transferred electronically:
 1. Greeting cards.
 2. Finished artwork.
 3. Periodicals.
 4. Video or electronic games.
 5. Newspapers or **other news or information products**.
- ▷ [Section 77.51\(1a\)\(a\)](#), Wis. Stats.



91

"Other News or Information Products"

- ▷ Prior Publication 240 had the following examples of taxable and nontaxable digital goods:
 - Taxable - Access to a website that provides real time information of commodity or stock prices.
 - Taxable - Access to a website that provides a listing of current job opportunities
 - Nontaxable - Access to an on-line database of information that allows the user to perform searches of the database and view and/or download the information retrieved as a result of the search



92

"Other News or Information Products"

- ▷ Clarify that "other news or information products" are products that disseminate news or information, both current and historical
- ▷ Updated Publication 240 has the following examples of taxable additional digital goods:
 - Access to an online database or website of current or historical information that allows the user to view and/or download the information.
 - Listing of job opportunities
 - Construction plans and construction plan information
 - Price or valuation information
 - Personal information, such as address, age, or phone numbers



93

"Other News or Information Products"

- ▷ Examples of taxable additional digital goods (cont.):
 - Information alerts sent by email
 - Newsletters transferred electronically
 - Online news services
 - Instructional guides



94

Temporary Events

- ▷ DOR is continuing education campaign for event operators
- ▷ New listserv for Temporary Event Operators – see "E-News" page on our website
- ▷ Operators must report certain information about event within 10 days of event close
- ▷ Most sellers are required to have seller's permit UNLESS exemption applies
- ▷ Redesigned Wisconsin Temporary Event Report (S-240); no longer accepting old format / spreadsheets
- ▷ New S-240 is a fillable PDF. If operator has numerous events, can update and save PDF form as needed (e.g., update event details, add or delete vendors).



Temporary Events - S-240 Revised

Form S-240	Wisconsin Temporary Event Report <small>(Completed and submitted by the Event Operator)</small>		Page 1 of <input type="text"/>
Part A: Event Operator Information			
Doing Business As (DBA) Name (if applicable)		Wisconsin Tax Number (15 digits starting with 640, 456, or 600)	
Legal Business Name (if not sole proprietor)		Full FEIN (Business)	
Event Operator Name (Last)	Event Operator Name (First)	Full SSN (Individual or Sole proprietor)	
Mailing Address		Email Address	
City	State	Zip	Contact Phone Number
Part B: Temporary Event Information			
Event Start Date <small>Month Day Year</small>	Event End Date <small>Month Day Year</small>	Number of Vendors	
Temporary Event Name		Minimum Vendor Booth Fee	
Street Address		Customer Admission Fee	
City	State WI	Zip	County
<small>I declare that the information on this form is true and correct to the best of my knowledge and belief, and that I'm authorized to sign this form.</small>			
Signature			Date



Temporary Events - S-240 Revised

Part C: Vendor Information

If the vendor does not have a Wisconsin seller permit number and claims their sales are tax exempt, enter the exemption code number provided by the vendor.

- 1 - Exempt sales only or display only
- 2 - Multi-level marketing company pays sales tax
- 3 - Nonprofit occasional sales exemption
- 4 - Exempt occasional sales

Wisconsin Seller's Permit Number (15 digits starting with 456) 456- -		SSN (last 4 digits)	FEIN (last 4 digits)	Exemption Code
Legal Business Name (if not sole proprietor)		Doing Business As (DBA) Name (if applicable)		
Vendor/Contact Name (Last)	Vendor/Contact Name (First)	Vendor Phone Number		
Mailing Address		Email Address		
City	State	Zip	Multi-Level Marketing Company (if claiming Code 2 above)	



97

Utilities Providing Outdoor Lighting

- ▷ Customer-owned lighting
 - Utilities that provide electricity to customers who own their own lighting equipment are selling electricity (taxable unless an exemption applies, or the utility has received a fully completed exemption certificate from its customer)
- ▷ Utility-owned lighting
 - Utilities that provide lighting equipment and electricity are selling a nontaxable outdoor lighting service (not a taxable equipment rental since customer generally does not have control of lighting equipment)
- ▷ More details in the October 2022 *Wisconsin Tax Bulletin*



98

Non-Fungible Tokens

- ▷ Non-fungible token (NFT) is a unique digital identifier that is recorded in blockchain
- ▷ Used to certify authenticity and ownership of a particular product
- ▷ Sale of an NFT may be taxable if underlying product or service is taxable in Wisconsin
- ▷ For example, if the NFT entitles the purchaser to receive a digital audio work, prepared food, artwork, or an admission to athletic or entertainment event, the NFT is taxable



99

Successor Liability

- ▷ A purchaser of a business is called a successor
- ▷ A successor is liable for any unpaid sales and use taxes (but not penalties or interest) of the business they are purchasing
- ▷ To avoid successor liability, a successor must withhold enough of the purchase price to cover any taxes due
- ▷ Successor liability may not be avoided by agreements or contracts between the seller and purchaser



100

Successor Liability – Prior to the Sale

- ▷ Determine how much to withhold from the purchase price.
 - Ask the seller if there are any outstanding sales/use tax liabilities or if there are unfiled sales and use tax returns
 - Ask the department for information about the seller. The department may provide:
 - Summary of sales and use tax returns, including missing and/or estimated periods
 - Summary of outstanding sales and use tax liabilities



101

Successor Liability – Prior to the Sale

- ▷ The request to the department must be in writing and include the following:
 - Seller's business name
 - Seller's address
 - Seller's federal employer identification number (FEIN) or Wisconsin Tax Account Number (WTAN)
 - Purchaser's business name
 - Purchaser's address



102

Successor Liability – Prior to the Sale

- ▷ The request to the department must also include one of the following:
 - An offer to purchase, copy of purchase agreements, or letter of intent to purchase or sell the business. This must be signed by both the seller and purchaser.
 - A letter signed by the seller that acknowledges the purchaser or potential purchaser
- ▷ A copy of the requested information will be provided to both the seller and the purchaser



103

Successor Liability – After the Sale

- ▷ After the sale is complete, the purchaser should request a clearance certificate from the department
- ▷ A clearance certificate protects the purchaser from incurring successor liability by ensuring that the seller has filed all sales and use tax returns and paid all sales and use taxes due. Note: A clearance certificate is only for sales and use tax.
- ▷ The request must be made in writing, either by mail, email, or fax
- ▷ The department must act within 90 days of receiving the request by issuing the clearance certificate or issuing a notice of potential successor liability



104

Successor Liability – After the Sale

- ▷ A request for a clearance certificate should include the following:
 - Legal name of seller
 - Business name of the seller
 - Seller's tax account number, if known
 - Seller's current mailing address
 - Name of the purchaser
 - Purchaser's tax account number
 - Purchaser's mailing address
 - Date of sale
 - Sale price
- ▷ See common questions on [Successor Liability and Clearance Certificates](#)



105

Disregarded Entity's Business Assets

- ▷ A single-owner entity that is disregarded as a separate entity for Wisconsin income and franchise tax purposes under Ch. 71, Wis. Stats., is disregarded as a separate entity for sales and use tax
- ▷ Transactions between the owner and its disregarded entity are disregarded for sales and use tax purposes (i.e., not a "sale" transaction)
- ▷ Caution: A sale of an interest in a disregarded entity may be treated as the sale of business assets and subject to tax, unless an exemption applies. See Fact Sheet 2110, *Occasional Sales of Business Assets*.



106

Marketplace Providers

- ▷ October 1, 2018 – Wisconsin began collection on out-of-state retailers with no physical presence in Wisconsin, unless they meet small seller exception
- ▷ January 1, 2020 – Wisconsin law clarified to provide that "marketplace providers" are also retailers and responsible for collecting and remitting taxes to DOR. Law also provides that marketplace sellers may not be audited and held liable for transactions facilitated through marketplace provider (certain exceptions apply).
- ▷ Marketplace providers may request a waiver from the marketplace provisions in the law (DOR has granted 4 waivers to date for unique situations – 3 waivers have been denied).



107

Premier Resort Area Tax (PRAT)

- ▷ Village of Ephraim in Door County adopted 0.5% PRAT
- ▷ Effective January 1, 2022
- ▷ Imposed on certain sellers making taxable sales sourced to a premier resort area
- ▷ Reported in My Tax Account on premier resort area tax return
- ▷ Resources:
 - Premier Resort Area Tax Common Questions
 - Fact Sheet 2500



108

Licensed/Common Carrier Exemption

- ▷ Section [77.54\(5\)\(b\)](#), Wis. Stats. exempts sales of motor trucks, truck tractors, road tractors, buses, trailers, and semitrailers from sales and use tax
- ▷ Also applies to accessories, attachments, parts, supplies and materials assigned to such vehicles and trailers
- ▷ Must be sold to common or contract carrier who uses the items *exclusively* as a common or contract carrier:
 - Hauls goods of others for hire or
 - Transports passengers as defined in sec. [71.38](#)

Caution: Holding an LC or MC number does not by itself fulfill the requirements of this exemption. The equipment must be used exclusively to haul goods of others for hire or to transport passengers.



109

Motor Vehicle Dealer Plates

- ▷ WI licensed motor vehicle dealers may pay use tax on a fixed \$ amount per plate per month for motor vehicles used by the dealership and also held for sale in the regular course of business
- ▷ Effective Jan 2023 amount subject to use tax increases to **\$191** per plate per month (increased from \$175 for 2022)
- ▷ Amount subject to tax is adjusted annually per sec. [77.53\(1m\)](#), Wis. Stats.



110

Litigation

- ▷ *Citation Partners, Inc.*: Court of Appeals, November 23, 2021
 - Issue - Is the total amount paid for an aircraft lease taxable or is the portion attributable to aircraft maintenance and engine maintenance excluded from tax?
 - Tax Appeals Commission (TAC) ruled the cost of maintenance services and repair parts is expense of lessor which is included in the "sales price" of the leases.
 - Circuit Court overturned TAC decision
 - Court of Appeals reversed the Circuit Court decision stating tax cannot be avoided by dividing up lease price into categories or affixing labels
 - Wisconsin Supreme Court is reviewing



111

Litigation

- ▷ *Brown County vs Brown County Taxpayer's Association*: WI Supreme Court, March 4, 2022
 - Issue - Whether sales and use tax enacted by Brown County directly reduces the property tax levy as required by sec. [77.70](#), Wis. Stats., if proceeds fund new capital projects that together exceed levy limits but could be funded through borrowing.
 - Circuit Court concluded sec. 77.70 is an enabling statute whose purpose is to directly reduce the property tax levy, not a restriction on how sales and use tax is to be spent
 - Wisconsin Supreme Court affirmed the Circuit Court decision stating the County's ordinance directly reduces the levy by funding projects that would otherwise have been paid for through additional debt obligations.



112

Litigation

- ▷ *SPA Indoor Speedway, LLC*: WTAC, January 24, 2022
 - Issue - Is taxpayer renting go-carts or selling a taxable admission?
 - Customers enter without charge. Only customers who rent or lease a go-cart are charged. The speedway is only available to rented go-carts.
 - The Commission concluded:
 - SPA offers a speedway racing experience to its customers, which is a taxable admission.
 - SPA's provision of go-carts is incidental to SPA's business, and therefore, no part of the charge for the admission may be deemed a rental of tangible personal goods.
 - SPA is the end user of the go-carts it purchases. SPA purchases of go-carts, go-cart parts, and go-cart repairs and maintenance are taxable.
 - Taxpayer did not appeal this decision.



113

Litigation

- ▷ *William Becker*: La Crosse County Circuit Court, June 27, 2022
 - Issue - Are trailers "truck bodies" for purposes of sales tax exemption under sec. [77.54\(5\)\(a\)\(4\)](#), Wis. Stats.
 - Taxpayer sold single-axle, tandem-axle, and gooseneck trailers designed to be used with a motor vehicle (car or pickup truck)
 - WTAC ruled trailers did not qualify for the exemption:
 - *Trudell* decision limits "trucks and truck bodies" exemption to combinations of power unit vehicles and trailers that if not combined serve little or no purpose
 - Trailer type vehicles sold by Becker have no trucks for which the truck bodies were made
 - Circuit Court found trailers sold are "truck bodies" and qualify for the exemption
 - DOR has appealed this decision



114

Litigation

- ▷ *Green Cab of Wisconsin, Inc.*: WTAC, March 10, 2022
 - Issue - Are lease of taxicabs subject to 5% state rental vehicle fee under sec. [77.995\(2\)](#), Wis. Stats.
 - Commission concluded:
 - Taxicabs are Type 1 motor vehicles
 - Taxpayer's primary business is rental of driverless vehicle to independent contractor, licensed taxi drivers
 - Rental of driverless vehicles licensed as a taxicab to a driver holding a valid taxicab driver's permit is subject to the state rental vehicle fee
 - Taxpayer has appealed.



115

Litigation

- ▷ *Oshkosh Corporation*: WTAC, October 10, 2022
 - Issue – Whether indirect materials (office equipment and supplies) used in fulfilling contracts with the federal government were purchased by the taxpayer for resale if only the title to, but not possession of, the indirect materials passes to the federal government.
 - Commission concluded:
 - "Sale" in sec. 77.51(14), Wis. Stats., includes the transfer of ownership of, title to, possession of, or enjoyment of tangible personal property
 - Title transfer alone is sufficient to constitute a sale
 - DOR is deciding whether to appeal decision



116

Unclaimed Property Update



117

Unclaimed Property

- ▷ Unclaimed property is generally a financial asset that belongs to someone else that hasn't had owner activity for a specified time period and the holder cannot contact the owner of the property
- ▷ Examples include uncashed payroll checks, loan collateral, deposits, credit balances, refunds, etc.
- ▷ Reports are due November 1 each year for property that met the dormancy period in the previous fiscal year
- ▷ Holder report guide (Publication 82) and webinars are available on our website if you have questions



118

Unclaimed Property

- ▷ 2021 Wis. Act 87
- ▷ Effective November 7, 2021
- ▷ Substantial revision to update and modernize Chapter 177 to model after the Revised Uniform Unclaimed Property Act
- ▷ Key provisions:
 - Creates a voluntary disclosure program
 - Adopts confidentiality provisions for unclaimed property records
 - Eliminates interest and revises penalties for holders who fail to report or deliver property
 - Provides appeal rights to holders
 - Clarifies the business-to-business exemption



Unclaimed Property - VDA

- ▷ Applications must be submitted by February 23, 2023
- ▷ Application is online on the unclaimed property homepage
- ▷ Under the agreement, late fees and penalties will not be assessed to property reported under the program
- ▷ Eligibility:
 - You have unclaimed property to report from any of the five most recent reporting periods
 - You have not been audited for unclaimed property since 7/1/2016, or received notice of an upcoming audit
 - You do not have a balance on your unclaimed property holder account



Unclaimed Property - VDA

- ▷ Terms of the agreement:
 - Attempt to contact owners of the property within 30 days of execution of the agreement. Notification letters must be sent to owners of properties worth \$50 or more.
 - Within 120 days of entering into the agreement, electronically file a report and deliver property for at least the five previous reporting periods. A reporting period is July 1 through June 30.
 - Continue to report and deliver all unclaimed property for at least four future annual reporting periods.
- ▷ 283 agreements completed as of mid October; over 10,900 started



121

Unclaimed Property – Holder Changes

- ▷ Holders are required to provide the social security number or taxpayer identification number on holder reports, if known or readily available
- ▷ Holder notices sent to apparent owners must contain specific facts and statements that are provided in the law
- ▷ Holder reimbursements may be set off against debts of state agencies or municipalities
- ▷ Late filed reports have a \$150 penalty
- ▷ Interest is eliminated. Payments made after the due date are assessed a penalty equal to 15% of the value of the property.



122

Processing, Procedures, and Projects



123

Filing Season Opening / Due Date

- ▷ Individual income tax due date is April 18, 2023
- ▷ The IRS has not yet announced the opening dates for Modernized eFile
- ▷ Many 2022 Wisconsin draft forms have been posted to our website



124

2021 Filing Season Statistics

Tax Type	Returns Filed	eFile Rate
Corporation Franchise (4, 4H 5S, 6)	43,830	88.2%
Fiduciary (2, 4T, Schedule CC)	61,552	75.1%
Individual Income (1, 1NPR, Schedule H, H-EZ and X-NOL)	3,286,892	90.7%
Pass-Through (1CNS/1CNP, 3, 5S, PW-1)	202,845	96.3%
Sales (ST-12)	956,904	97.2%
Withholding (WT-6, WT-7)	488,441	97.8%



125

2022 Filing Season Tips – Income/Franchise Tax

- ▷ Be sure to include all forms, schedules and attachments with return
 - Software providers are required to allow attachments to e-filed returns
- ▷ Verify estimated payments and credit carryforward prior to filing
- ▷ Review adjustment notices from prior year to ensure you are using the most updated information



126

2022 Filing Season Tips – Individual Income Tax

- ▷ Include Schedule U, *Underpayment of Estimated Tax*, on individual income tax return if income earned unevenly throughout the year AND has underpayment interest
 - Example: Taxpayer took a large distribution from a retirement account in November and did not have withholding. DOR will assume income is earned evenly throughout year for purposes of computing underpayment, UNLESS Schedule U is filed.
- ▷ Check FEINs on W-2s to ensure they are accurate. FEINs autofill in software from year to year, but businesses (employers) may change FEIN.
- ▷ Verify certificate of compliance number entered for farmland preservation claims & don't include dashes in number



127

2022 Filing Season Tips – Individual Income Tax

- ▷ Omit nontaxable wages from married couple credit calculation (e.g., military pay subtraction)
- ▷ Returns claiming credits passed through from a partnership or S-Corp may be held if partnership or S-Corp has not yet filed
- ▷ Make sure appropriate documentation for contributions or adjustments from pass-through entities (SB lines 43-49) are included with return submission



128

TY2022 – Communicating Electronically

- ▷ New for 2022: For those who file electronically, DOR is requesting an e-mail address for both prime & spouse, along with consent to contact taxpayer via e-mail. The reason is to reduce paper mailing costs and to more efficiently communicate with taxpayer.
- ▷ This is in addition to the request for an email address to consent to receiving Form 1099-G electronically from DOR.



129

2022 Filing Season Tips – Pass-Through Entities

- ▷ Attach credit schedules when filing electronically (e.g., attach Schedule FC/FC-A, *Farmland Preservation Credit*, to the Form 2, *Fiduciary Income Tax for Estates and Trusts*)
- ▷ Form 2 for periods longer than 12 months are not accepted
- ▷ Forms 1CNP/CNS, Composite Partner/Shareholder Individual Income Tax Returns: Do not duplicate SSNs on Schedule 2



130

2022 – Filing Season Tips - Manufacturing & Ag Credit

- ▷ Schedule MA-M: If box C or D is checked, enter qualifying parcel number
- ▷ Schedule MA-A & MA-M: Direct costs allocable to production gross receipts (line 3) should never be negative



131

Make a Payment Page Expansion

- ▷ Rolled out [Make a Payment page](#) last year for individuals
- ▷ Expanding next year to include other major tax types, including corporation franchise tax, partnership, sales, withholding, pass-through withholding and fiduciary
- ▷ Page includes all appropriate payment methods by tax type AND links to the vouchers for those tax types
- ▷ Quick Pay button takes user DIRECTLY to MTA screen for making unregistered payments for individual income tax, fiduciary income tax, occasional consumer use tax, and non-tax debt; will be rebranding this slightly



132

Make a Payment Page - Currently

Make a Payment

Quick Pay

Make a Payment +

Individuals can make a payment via the methods below. Businesses should make their payments through [My Tax Account](#).

- Automatic Withdrawal +
- Credit or Debit Card +
- Check or Money Order +
- Cash +

Can't Pay in Full? +

Estimated Payments and Prepayment of Tax +

133

Payments & Software Providers

- ▷ Requiring software vendors to provide links to [Make a Payment](#) page in their software AND on the return summary page
- ▷ Software used by tax professionals for individual income tax filing will continue to provide payment vouchers
- ▷ For most tax types (EXCEPT individual income tax), vouchers will be produced from our website instead of your software
- ▷ DOR is trying to increase number of payments made electronically due to substantial processing delays with check processor

134

Credit Card Processor

- ▷ DOR is switching to a new credit card vendor
- ▷ Credit card payments will be much easier under new system
- ▷ Look/feel of credit card screens will be much closer to existing DOR branding from MTA/DOR website
- ▷ Fees will be reduced slightly as well



Sample Screens - Credit Card Payments

Wisconsin Department of Revenue

1 Payment Type 2 Customer Info 3 Payment 4 Submit Payment

Transaction Detail

The following amounts will be remitted back to the agency.

SKU	Description	Unit Price	Quantity	Amount
Convenience Fee	Convenience Fee	\$1.00	1	\$1.00
WINPAS Fee	WINPAS Fee	\$100.00	1	\$100.00
Total				\$101.00

Transaction Summary

Convenience Fee	\$1.00
WINPAS Fee	\$100.00
TOTAL	\$101.00

Need Help?

Select Payment Method and Continue to proceed with payment.

Payment

Payment Type



Sample Screens - Credit Card Payments

The screenshot displays the Wisconsin Department of Revenue's online payment interface. The main header is 'Revenue'. The page is divided into several sections:

- Payment Type:** 'Credit/Debit Card' with a green checkmark.
- Customer Information:** Includes fields for Address (123 Main St., Madison, WI 53703), Phone Number (601-...), Country (United States), and Email Address (...@egov.com). An 'Edit' button is present.
- Transaction Summary:**

Convenience Fee	\$1.00
WINPAS Fee	\$100.00
Service Fee	\$2.27
TOTAL	\$103.27
- Need Help?:** A message stating: 'You have selected to pay by credit card. Complete Customer Billing Information and enter Credit Card Information.'
- Payment Information:** Fields for 'Credit Card Number *' and 'Credit Card Type'. A note says 'Complete all required fields [*]'.

137

Filing Tips – Sales & Withholding

- ▷ Include county sales tax, if applicable
- ▷ 1099s with withholding must be filed to DOR by January 31st! Combined fed-state cannot be used in this case
- ▷ \$10 penalty issued for failing to file W-2s/1099s, filing late, or failing to file electronically if 10 or more filed on paper

138

Customer Service: Upcoming Projects

- ▷ Chatbot (virtual assistant)
 - Coming in 2023
 - Another method for customers to find answers
- ▷ Small business outreach
 - <https://www.revenue.wi.gov/Pages/Businesses/Seminars-home.aspx>
 - Seeking organizations to host seminars and webinars covering:
 - Business tax registration
 - Withholding tax
 - Sales and use tax
 - Other business taxes
 - My Tax Account
 - Compliance tips
 - Resources for business owners: webpages, contact information, etc.



New Audit Web Page

Audits and Credit Reviews



Audit Web Page

- ▷ <https://www.revenue.wi.gov/Pages/ISE/audit.aspx>
- ▷ Links to frequently referenced topics
 - Tax program web pages
 - Common Questions
 - Publications
 - My Tax Account
 - My Case Manager



141

Audit Web Page

- ▷ Audit-specific forms
 - Sales and use tax - Sample customer/vendor contact letters
- ▷ Instructions for communicating and transferring files electronically with auditor
 - Using My Case Manager
 - Using Secure File Transfer
 - Using DocuSign



142

My Tax Account (MTA) Updates

143

MTA: Personal Users

- ▷ Encourage clients to register for My Tax Account (MTA) as personal users
 - Benefits: electronic notice delivery, make/view/cancel estimated payments, check refund status, and more
 - No third-party access yet - when it goes live, your client must have MTA to be able to grant you access, and you must have a valid POA on file with us
 - Email Form A-222 to DORPOA@wisconsin.gov or fax to 608-267-1030
- ▷ WI Identity Protection (IP) PIN
 - Ensures someone cannot file a WI return in your client's name
 - Enrollment is optional and completed via MTA
 - Once enrolled, must list PIN on all future returns (2021 and forward)
 - Different from IRS IP PIN

144

MTA: Replacing WI e-file

- ▷ Gradually removing functionality from WI e-file and adding it to MTA
 - WI e-file is outdated and difficult to support
- ▷ Personal users who meet specific requirements can file 2022 Form 1 in registered MTA
 - Focusing on single and head of household (not married) and relatively simple returns this year
- ▷ Homestead credit filers may no longer file electronically using WI e-file; certain claimants may use unregistered MTA to file 2022 Schedule H electronically



145

MTA: My Case Manager

- ▷ My Case Manager is available to help you and your clients make the audit process smoother. You can:
 - Follow the progress of the audit
 - Review requests and deadlines
 - Send secure messages back & forth with the auditor
 - Send documents securely (up to 30 MB)
 - Locate the supervisor's contact information
- ▷ Resources:
 - [Publication 701, My Case Manager User Guide](#)
 - [My Case Manager Common Questions](#)



146

MTA: Manufacturing Property Assessment

- ▷ Electronic filing of Manufacturing Property Assessment Returns (M-Forms) will be through MTA in 2023
 - The former e-filing system was the Manufacturing Assessment System (MAS)
 - Most manufacturing returns are e-filed
 - A paper filing option will be limited
- ▷ M-Forms will be live in MTA in mid-January
- ▷ Historical filings will still be available for review in MAS



147

MTA: Utility Annual Filing

- ▷ Annual utility reports moving into MTA for the 2023 filing season
 - Municipal Light Heat and Power
 - Private Light Heat and Power
 - Rural Electric Cooperative
 - Carline
 - Air Carrier
 - Railroad
 - Pipeline (Gas and Oil)
 - Conservation and Regulation
 - Association of Municipal Electrics
- ▷ Will be available mid-January

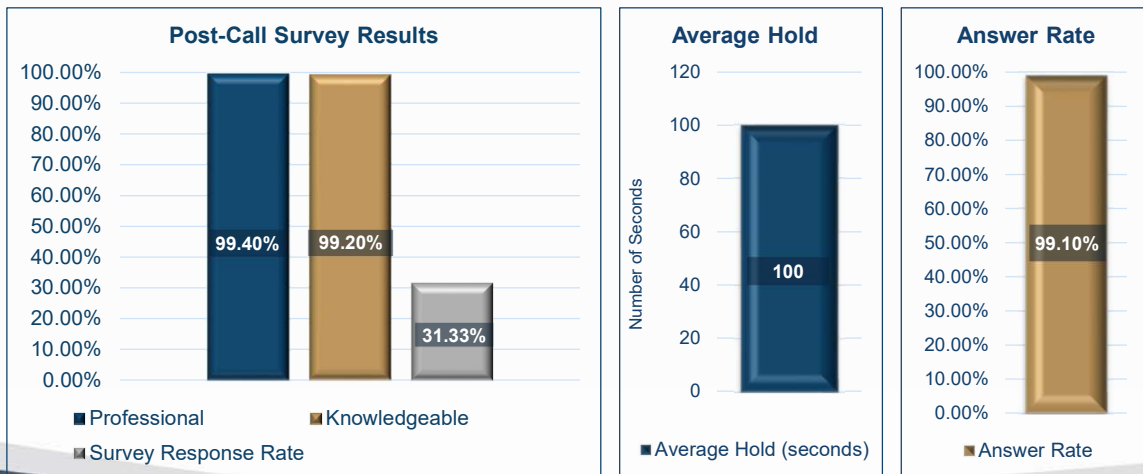


148

Statistics

FY22 IS&E Division Phone Statistics

▷ 659,687 calls answered



DOR Initiatives – ID Verification

	FY22	FY21	FY20	FY19
Returns Evaluated	3,150,305	3,010,713	2,875,034	3,087,501
Quizzes Required	4,360	2,029	3,083	2,591
PINs Required	56,373	36,078	36,480	49,919
ID Docs Required	6,870	2,746	4,931	7,725
ID Docs Reviewed	5,760	2,186	6,597	8,959
Total ID Verification Actions Required	67,603	40,853	44,944	60,235
% of Returns Evaluated Requiring ID Verification	2.15%	1.36%	1.55%	1.95%
Refunds Denied for Failure to Verify ID	10,985	2,854	12,198	23,481



151

DOR Initiatives – Bad Refunds Stopped

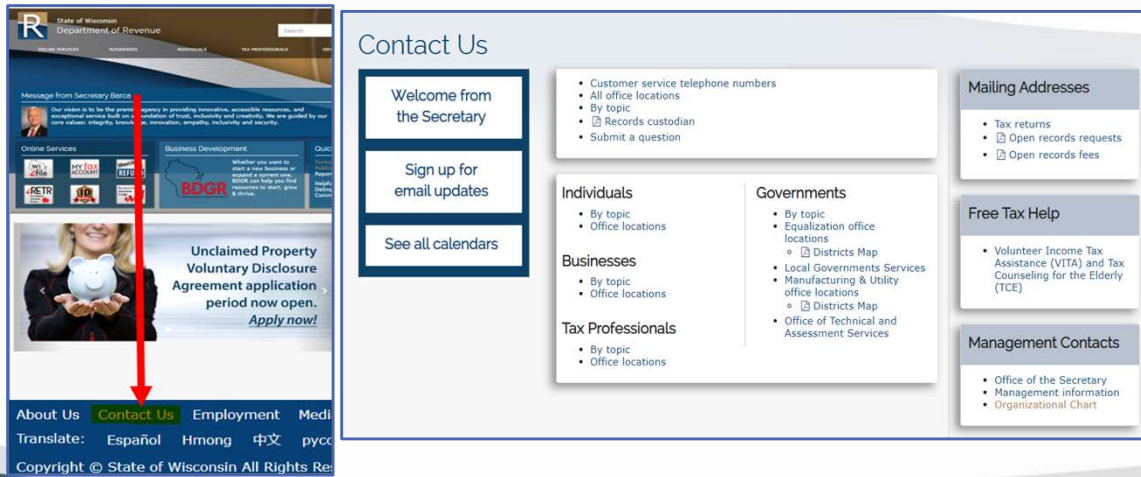
Bad Refunds Adjusted/Stopped	Fraud Detection With Analytics	Processing Fraud - OCI	Processing Fraud - Tax Ops	Earned Income Credit	Homestead Credit	Total for Specific Initiatives
FY22	\$5,705,235	\$10,571,743	\$6,662,514	\$23,387,279	\$23,197,939	\$69,524,710
FY21	\$3,190,632	\$9,878,995	\$4,631,190	\$19,748,512	\$24,148,497	\$61,597,826
FY20	\$5,613,849	\$7,940,577	\$2,656,902	\$8,123,852	\$4,776,598	\$29,111,778
FY19	\$8,595,686	\$5,970,625	\$6,020,804	\$20,436,036	\$14,358,603	\$55,381,754
FY18	\$7,052,669	\$5,869,413	\$5,628,995	\$17,943,046	\$14,862,551	\$51,356,674
FY17	\$9,300,745	\$6,059,255	\$8,044,070	\$20,134,976	\$16,046,799	\$59,585,845
FY16	\$11,149,599	\$8,092,817	\$6,849,591	\$19,946,592	\$17,004,928	\$63,043,527
FY15	\$11,050,119	\$7,335,531	\$6,889,513	\$16,682,990	\$15,828,093	\$57,786,246
FY14	\$3,550,473	\$4,904,089	\$8,195,222	\$17,710,656	\$15,299,425	\$49,659,865
FY13		\$3,434,613		\$14,257,838	\$12,480,794	\$30,173,245
FY12		\$1,702,300		\$9,341,511	\$14,694,458	\$25,738,269
FY11		\$3,324,200		\$13,510,224	\$12,219,984	\$29,054,408
Total						\$582,014,147



152

Contact Us

Use the "Contact Us" page to find contact information for various areas of DOR



The screenshot shows the Wisconsin Department of Revenue website. The 'Contact Us' page is highlighted with a red arrow. The page content includes:

- Welcome from the Secretary**
- Sign up for email updates**
- See all calendars**
- Customer service telephone numbers**
 - All office locations
 - By topic
 - Records custodian
 - Submit a question
- Mailing Addresses**
 - Tax returns
 - Open records requests
 - Open records fees
- Free Tax Help**
 - Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE)
- Management Contacts**
 - Office of the Secretary
 - Management information
 - Organizational Chart
- Individuals**
 - By topic
 - Office locations
- Businesses**
 - By topic
 - Office locations
- Tax Professionals**
 - By topic
 - Office locations
- Governments**
 - By topic
 - Equalization office locations
 - Districts Map
 - Local Governments Services
 - Manufacturing & Utility office locations
 - Districts Map
 - Office of Technical and Assessment Services

153

Contact Us

- ▷ Practitioner email address and phone number
 - Do not share with your clients
 - DORTaxPractitioners@wisconsin.gov
 - (608) 264-6886

154

Presenter

- ▷ Nate Weber, Director of Technical Services
 - (608) 266-8025
 - nathaniel.weber@wisconsin.gov



Thanks!
Any questions?



11 a.m. – 12 p.m.

International Tax Issues for the General Practitioner

Robert Misey, *Chair, International Department, Reinhart Boerner Van
Deuren s.c*

International Tax Issues For The General Practitioner

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1

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Does the Client Export U.S.-Manufactured Goods?

- If so, the client may be able to take advantage of export benefits—IC-DISCs and the deduction for Foreign-Derived Intangible Income (“FDII”)—to reduce their U.S. taxes

2

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Introduction to IC-DISC

- Formation of the IC-DISC
 - A single class of stock
 - A minimum par value of \$2,500
 - Elect to be an IC-DISC with a Form 4876-A

3

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Introduction to IC-DISC (cont.)

- Taxation of an IC-DISC and its shareholders
 - An IC-DISC is not subject to corporate tax
 - When the IC-DISC pays a dividend, its owners will pay income tax at a 23.8% rate
 - Tax savings to the manufacturing entity's owners vary based on their marginal rate

4

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Qualification as Export Property

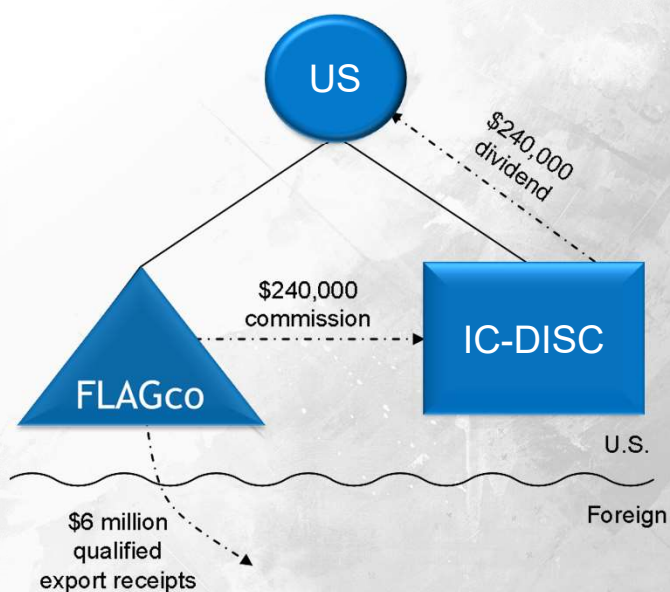
- The property must be manufactured in the U.S. by a person other than the IC-DISC
- The export property must be held primarily for use outside the U.S.
- The property must have a maximum of 50% foreign content

5

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4% of the Qualified Export Receipts

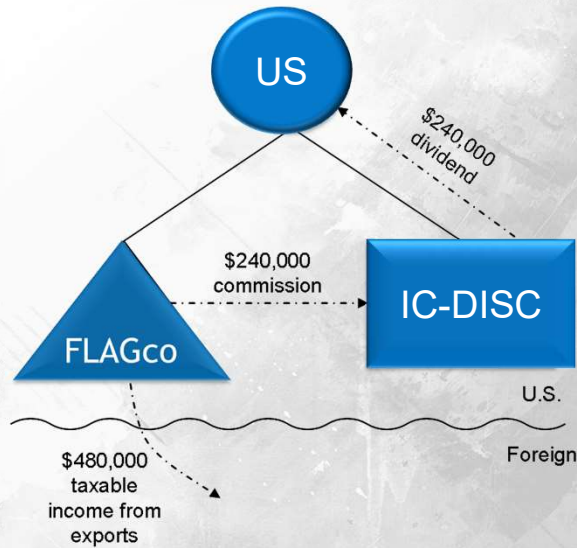


6

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50% of Combined Taxable Income

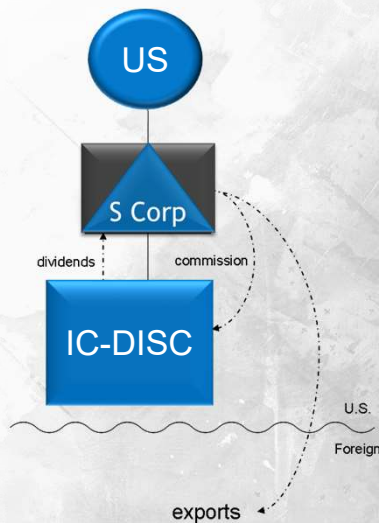


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Structuring the IC-DISC Subsidiary of a Flow-Through

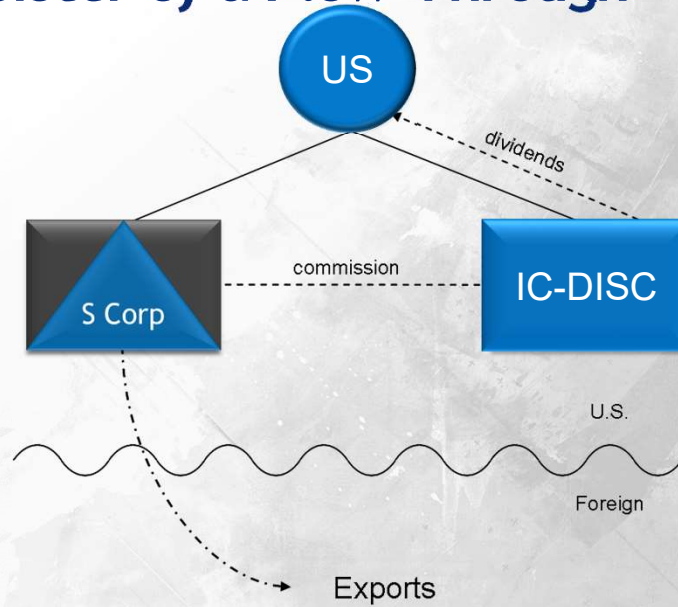


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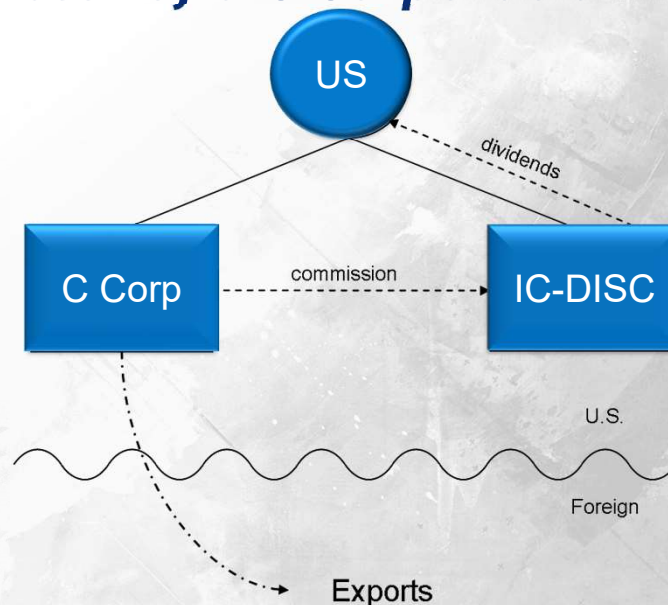
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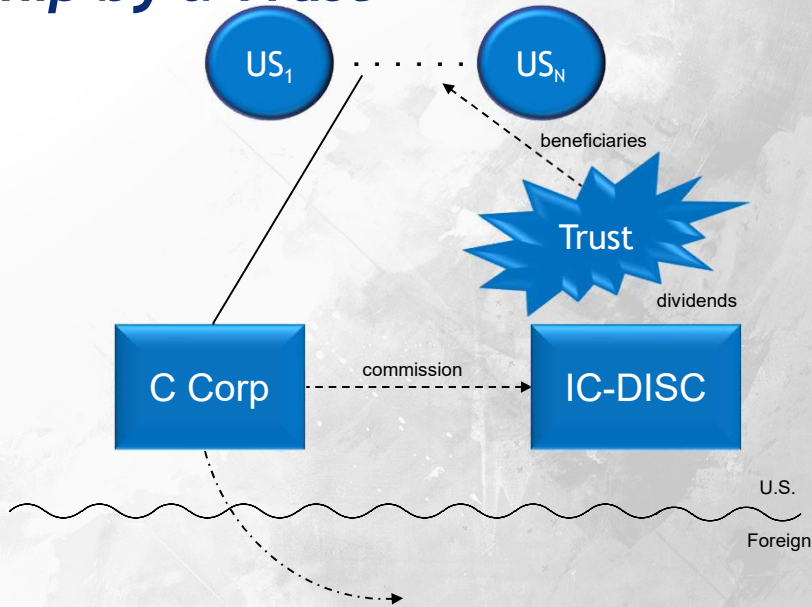
Structuring the IC-DISC Brother-Sister of a Flow-Through



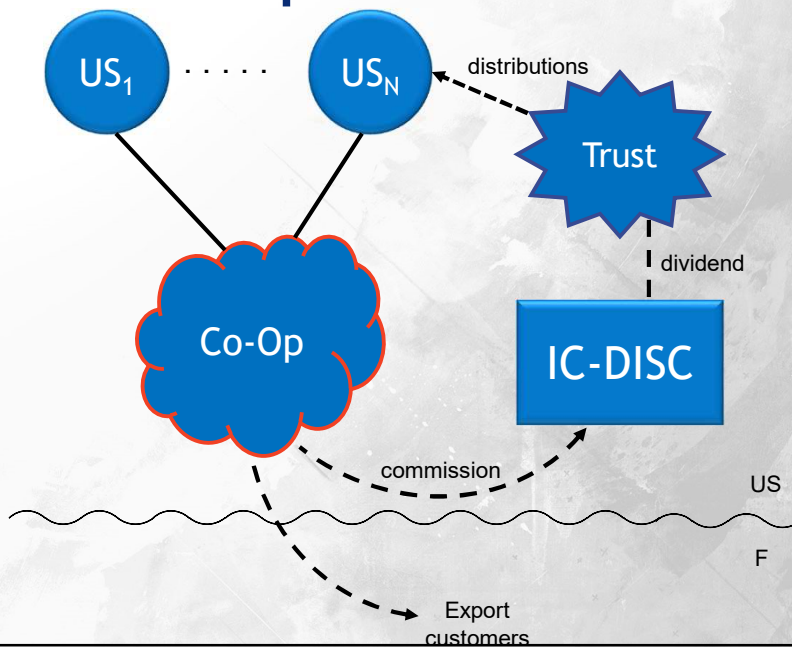
Structuring the IC-DISC Brother-Sister of a C Corporation



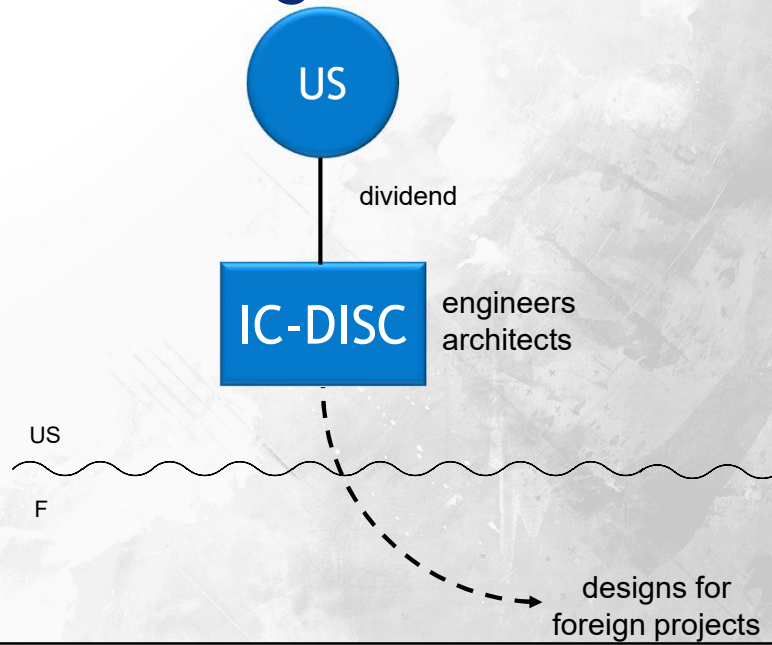
Structuring the IC-DISC Ownership by a Trust



Trust For a Co-Op's Members



Architects and Engineers

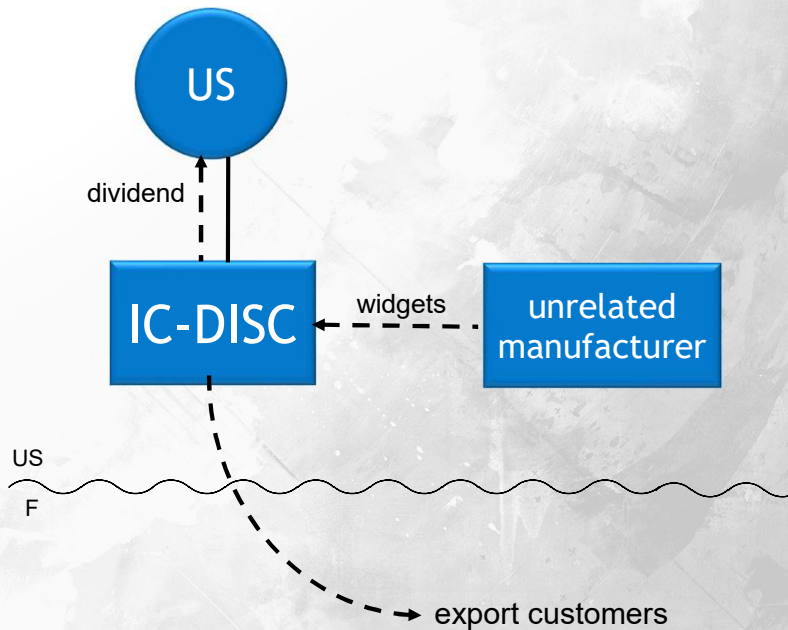


13

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Pure Distributor

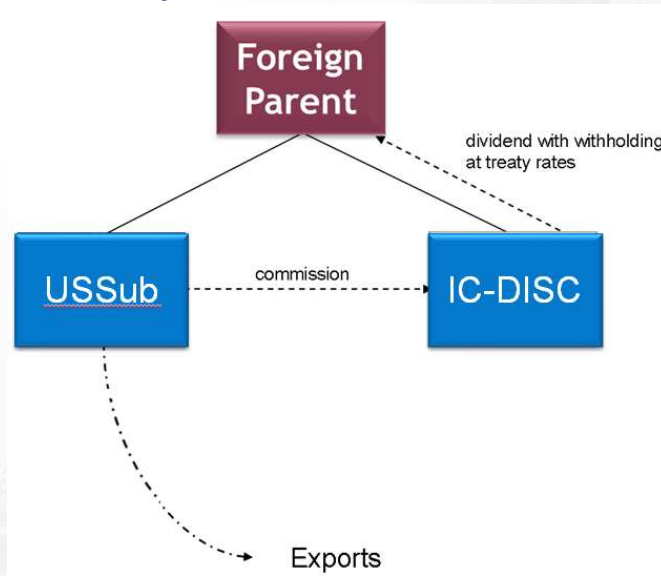


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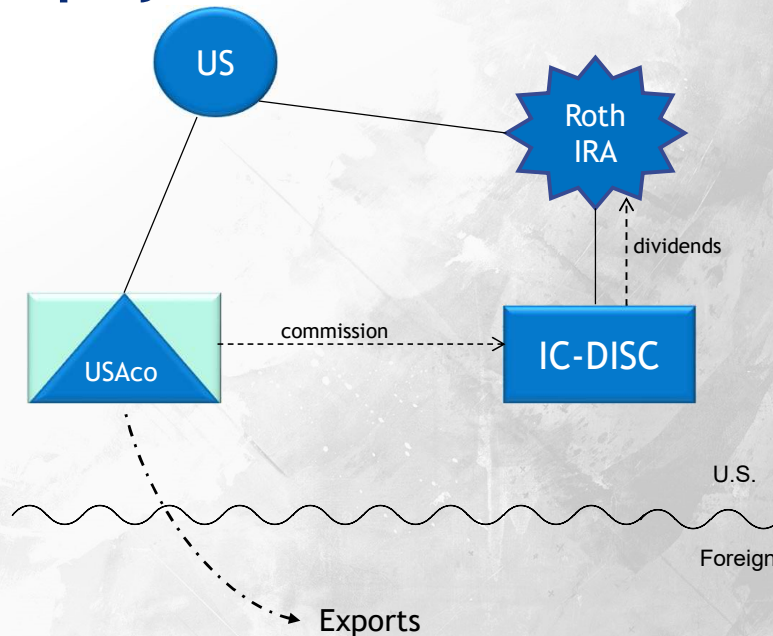
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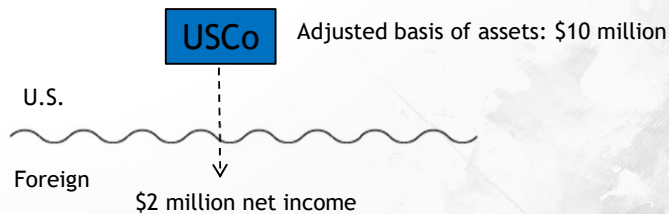
Inbound Treaty Benefits



Ownership by a Roth IRA



37.5% Deduction for FDII of a C Corporation Only (non-routine return taxed at 13.125%)



$37.5\% \text{ of } (2M - 10\% \text{ of } \$10M) \times (\$2M/\$2M)$
\$93,750 deduction

Effective rate of 13.125% on exports or foreign services of a C corporation
beyond a routine 10% return on assets

Does the Client Own a Foreign Subsidiary that Earns Income, but has Few Depreciable Assets?

- If so, the client may have to plan to avoid paying U.S. tax on what is called Global Intangible Low-Taxed Income

Introduction to GILTI

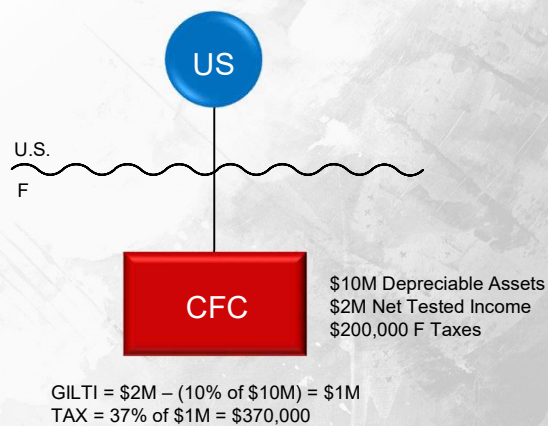
- A U.S. shareholder pays tax on the GILTI of a CFC
- GILTI is the excess of income over 10% of depreciable assets
- Planning Tip #1: Stuff CFC with manufacturing assets that have business purpose to avoid the anti-abuse rules

19

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GILTI Applies To U.S. Individuals and They Don't Receive a Foreign Tax Credit

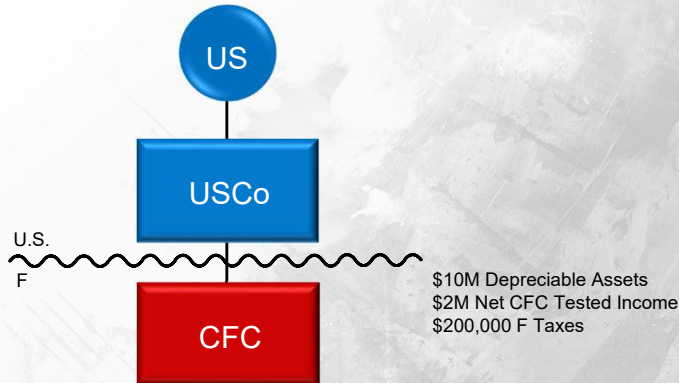


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Planning Tip #2: Contribute CFC To a C Corporation For (a) 50% deduction and (b) Foreign Tax Credit



$$\text{GILTI} = \$2\text{M} - (10\% \text{ of } \$10\text{M}) = \$1\text{M}$$

Tax on GILTI and Dividend will be lower than if the U.S. Individual Directly Owned the CFC

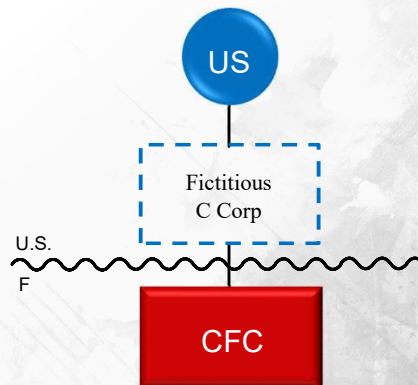
GILTI Tax

$$\begin{aligned} \text{U.S. Tax} &= 21\% \text{ of } [50\% \text{ of } (\$1\text{M} + \$200,000)] - 80\% \text{ of } (\$200,000 \times \$1\text{M}/\$2\text{M}) \\ &= (21\% \text{ of } \$600,000) - (80\% \text{ of } \$100,000) \\ &= \$126,000 - \$80,000 \\ &= \$36,000 \end{aligned}$$

GILTI Tax + Individual Tax

$$\begin{aligned} \$36,000 + (23.8\% \text{ of } \$1\text{M}) &< \$370,000 \\ \$274,000 &< \$370,000 \end{aligned}$$

Planning Tip #3: Section 962 Election



- Same tax impact as if a real C corporation
- Any distributions from CFC are treated as coming from the fictitious C Corp, net of tax previously paid

Does the Client have Significant Intercompany Transactions?

- If so, how is the client protecting itself from an exposure to a transfer pricing adjustment and/or penalty?

Determining the Nature and Amount of Reportable Transactions

- Reportable transactions are intercompany transactions
- A transfer price is the price charged for intercompany transactions
- The principles of I.R.C. Section 482 require that intercompany transactions be priced at arm's length
- Although ostensibly a simple concept, the arm's-length standard has spawned hundreds of pages of regulations and case law

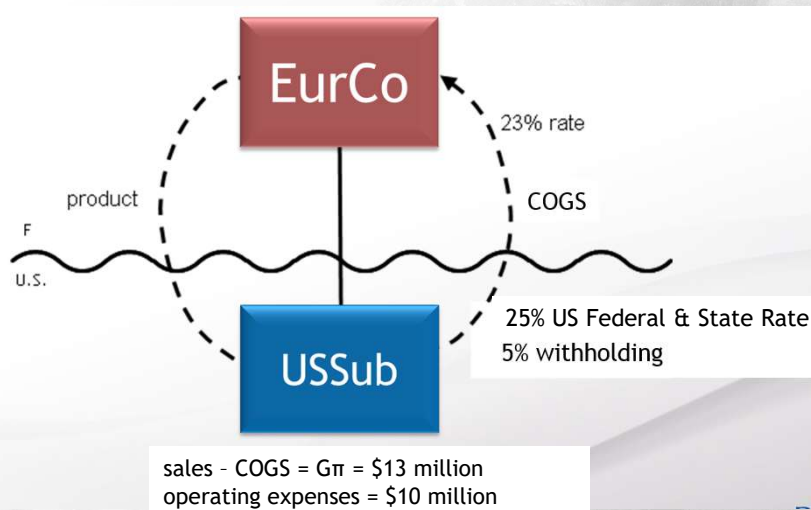
Determining the Nature and Amount of Reportable Transactions (cont.)

- EurCo sells hockey pucks to USSub for resale in the United States
- Although USSub does not have any manufacturing functions, USSub employs its own administrative and sales staff while using EurCo's unique distribution software
- USSub has payment terms to EurCo of six months
- USSub's average collection period is two months
- If USSub's customers do not pay, USSub enjoys the use of EurCo's collection staff
- **A comparable scenario could occur for a US company with a foreign subsidiary**

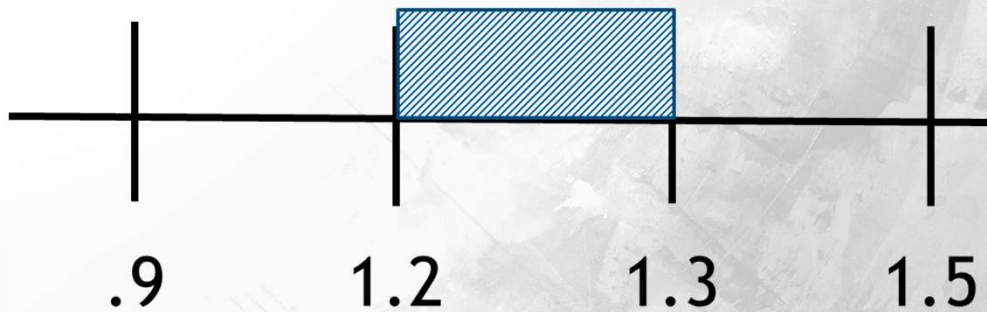
Determining the Nature and Amount of Reportable Transactions

- Methods specified in the Regulations
 - Comparable uncontrolled price method
 - Resale price method
 - Cost plus method
 - Comparable profits method
 - Profit split methods

Comparable Profits Method



The Arm's-Length Range



29

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The Transfer Pricing Penalty

- The Transfer Pricing Penalty
- Transfer Pricing Documentation
- Advance Pricing Agreements



30

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The Transfer Pricing Penalty (cont.)

- The Transfer Pricing Penalty
- If the IRS determines that
 - i. an intercompany transfer price was less than 50 percent or more than 200 percent of arm's-length price or
 - ii. the transfer pricing adjustment increases taxable income by \$5 million or more, USSub must pay a penalty equal to 20% of the additional tax
- The penalty increases to 40% if
 - i. the intercompany transfer price was less than 25 percent or more than 400 percent of an arm's-length price or
 - ii. the transfer pricing adjustment is \$20 million or more

The Transfer Pricing Penalty (cont.)

- The Transfer Pricing Documentation
- The documentation must state the reasons for believing the prices are at arm's length and must be in place when the return is filed, but does not have to be provided to the IRS until requested on audit
- The Assistant Commissioner LB&I has ordered International Examiners to either request documentation or explain in writing why the documentation was not requested

Transfer Pricing Documentation



- Overview
- Organizational Structure
- Controlled Transactions
- Functional Analysis
- Best-Method Analysis
- Economic Analysis

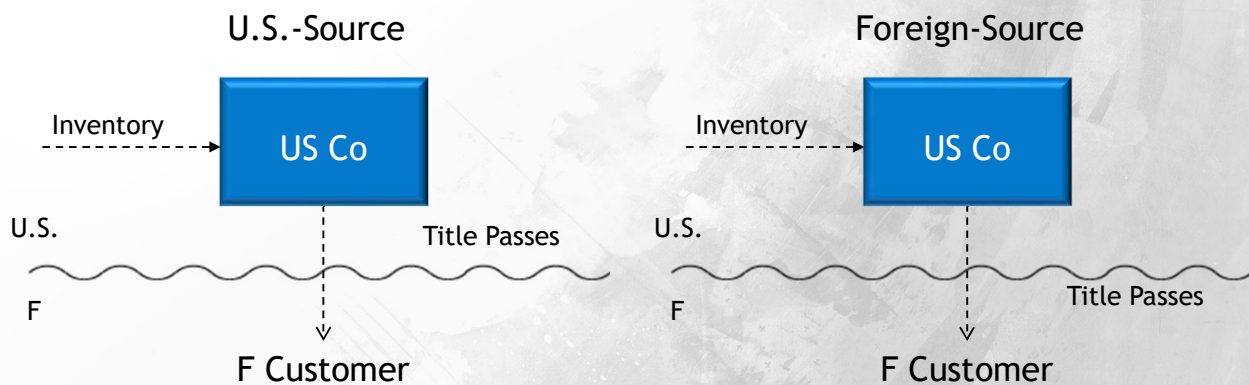
The Advance Pricing Agreement Program (APA)

- An APA is an agreement between the IRS and USSub
- At the request of USSub, the IRS reviews and agrees to USCo's transfer pricing methodology
- The APA describes the factual nature of the related-party transactions, the appropriate pricing methodology and the expected range of results from applying the methodology to the transaction

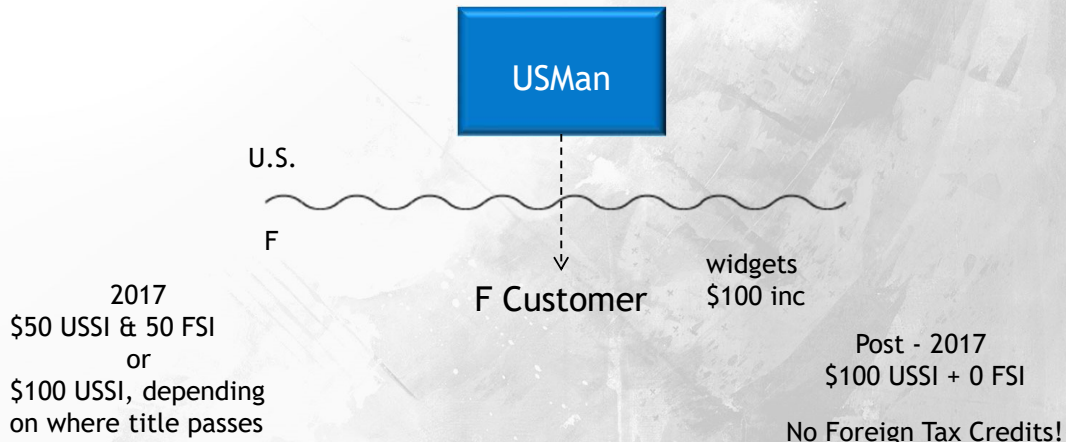
How is the Client Sourcing its Income?

- The sourcing rules, which are not complex, but often misapplied, impact the limit on the foreign tax credit

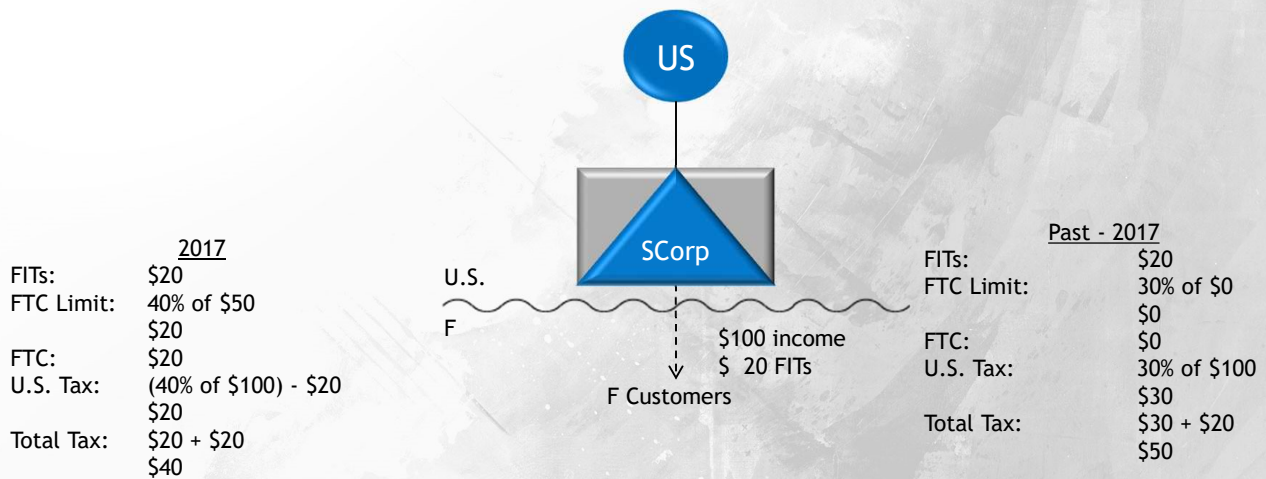
Source Income from Sales of Purchased Inventory By Where Title Passes on Resale



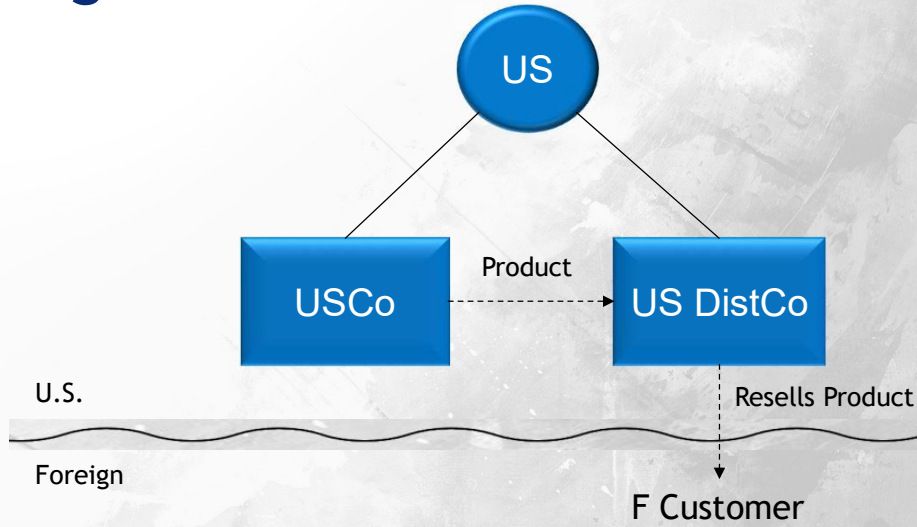
Source Income from Sales of Manufacturing Income Where Manufactured



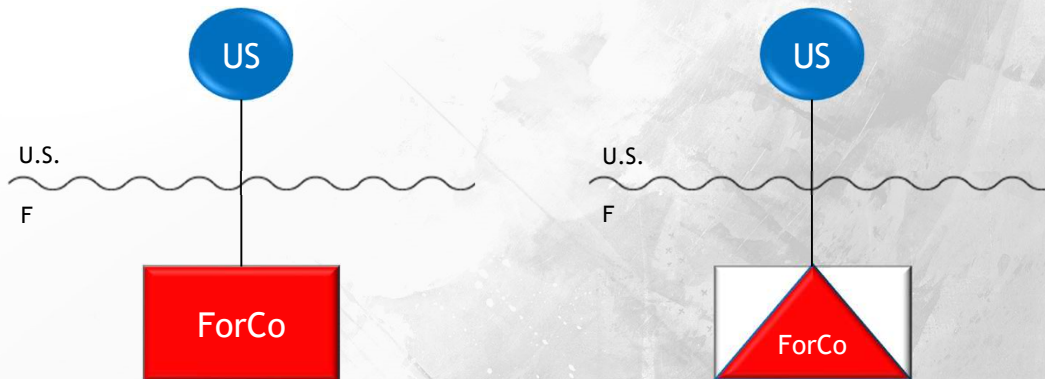
Higher Tax on U.S. Exporters That Pay Foreign Income Taxes



Planning For Foreign-Source Income to take Foreign Tax Credits



Oldie but Goodie: Checking-the-Box



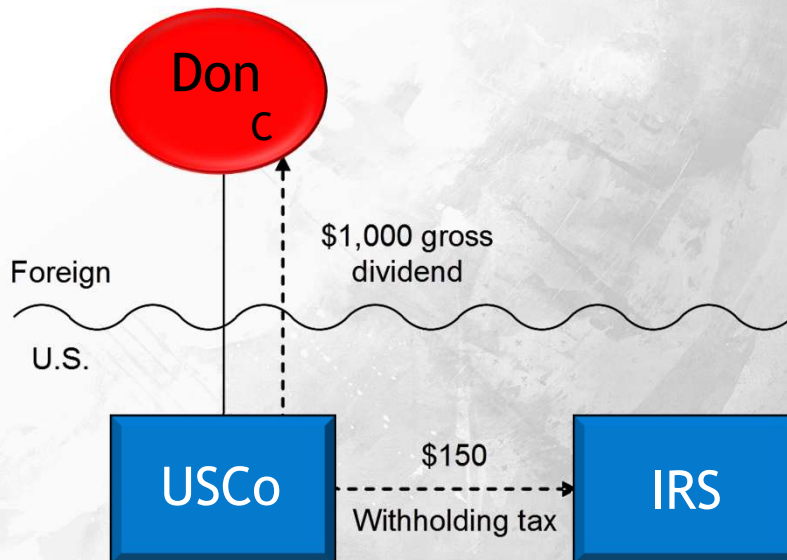
Withholding on FDAP Payments

- To be subject to withholding, the income must generally be of a type that is
- Fixed, determinable, annual, or periodic (FDAP), and
- Derived from sources within the United States

Withholding on FDAP Payments

- There are numerous exemptions and special rules
 - Withholding is not required on any U.S.-source income that is effectively connected with the conduct of a U.S. trade or business
 - The withholding exemption for effectively connected income generally does not apply to the personal services income of a foreign person
 - Bank deposit interest is exempt from withholding
 - Treaties often reduce the withholding rate from 30% to a lower amount (Form W-8BEN-E)

Treaty Reduction



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Foreign Parents Entitled to Treaty Benefits

1. Publicly-Traded Company
2. Subsidiary of Publicly-Traded Company
3. Stock Ownership/Base Erosion Test
4. Active Trade or Business that is substantial
5. Derivative Benefits

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Withholding on FDAP Payments (Services)

- A U.S. payor ordinarily may rely on a type of Form W-8 or Form W-9 to determine the country of the payee's residence
 - Withholding is not required for dividends to a payee that has provided a Form W-9 for U.S. status unless the facts and circumstances indicate that the payee is a foreign national
 - Most other non-compensatory payments of FDAP eligible for treaty-based withholding relief should generally be reported on Forms W-8BEN or W-8BEN-E
 - Nonresident alien recipients of ECI should generally file Form W-8ECI
 - Nonresident alien employees or independent contractors should generally file a Form 8233 for compensatory payments eligible for treaty-based withholding relief

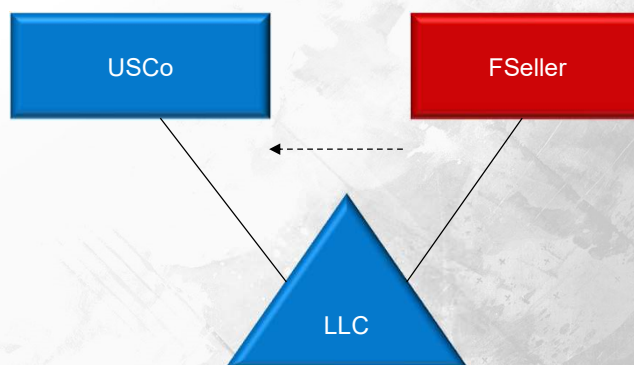
Is a Foreign Business Considering Expansion to the United States?

- If so, what type of entity should they form?

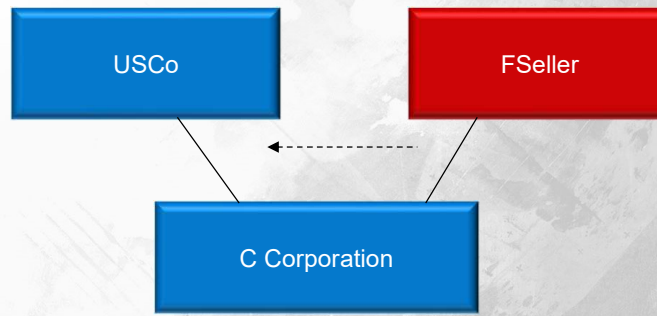
Choice of U.S. Entity

1. An S corporation cannot have foreign owners
2. C corporations and LLCs have similar taxation of continuing operations
 - a. C corporation - U.S. corporate income tax and withholding tax on dividends
 - b. LLC - U.S. corporate income tax and the branch profits tax

The Sale of an LLC will Incur Tax on Exit



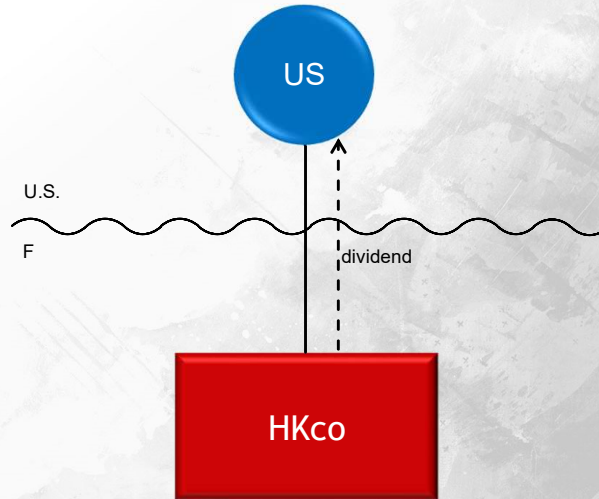
The Sale of a C Corporation's Shares will not Result in Taxable Income



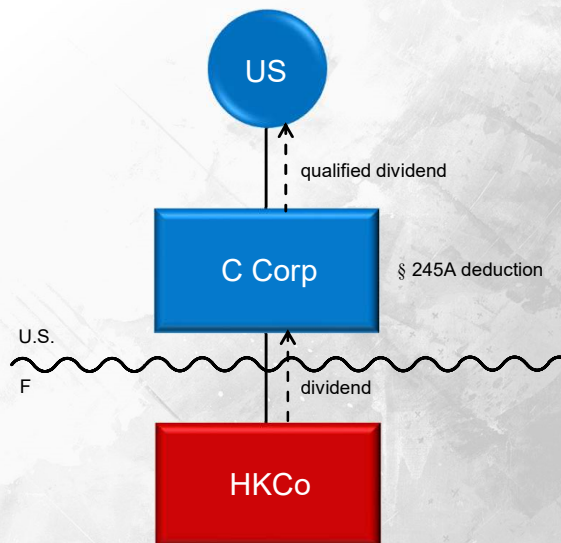
Does the Client Own a Foreign Corporation in a Non-Treaty Country?

- If so, is the client structured to take dividends that are qualified dividends instead of ordinary income?

Dividends From Non-Treaty Countries Are Taxed At 37%



Contribute Non-Treaty Subsidiaries to C Corporations for Qualified Dividend Rates



Has a Client Failed to File a Foreign Information Return?

- If so, there are several options for offshore disclosure

Programs for Failure to File Information Returns

1. Streamlined Filing Compliance Procedures
 - a. U.S. Taxpayers Residing in the U.S.
 - b. U.S. Taxpayers Residing Abroad
2. Delinquent FBAR Submission Procedure
3. Delinquent International Information Return Submission Procedures

About Robert Misey

Robert Misey leads the International Department for the law firm of Reinhart Boerner Van Deuren and is a former trial attorney for the IRS Chief Counsel (International) in Washington, DC. Robert is Chair of the International Tax Committee for the ABA and a member of the bar in California, Wisconsin, and the District of Columbia. He is also the author of the books *A Practical Guide to U.S. Taxation of International Transactions* and *Federal Taxation: Practice and Procedure*.

**Robert can be reached at either 414-298-8135 or
rmisey@reinhartlaw.com**



11 a.m. – 12 p.m.

Remote Sellers Tax Update & Physical Presence: Is It Still Relevant?

Craig Johnson, CPA, *Executive Director, Streamlined Sales Tax Governing Board Inc.*




Remote Sales Tax Collection, The *Wayfair* Decision and Streamlined Sales Tax

Craig Johnson, Executive Director
Streamlined Sales Tax Governing Board



Brief History – Remote Sales Tax Collection Ability

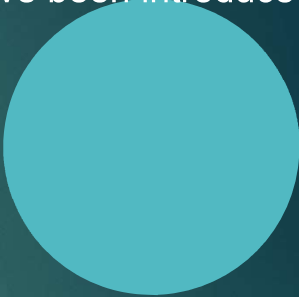
- 
- ▶ *Quill v. North Dakota* (1992)
 - ▶ Compliance with varying state/local sales tax laws by multi-state corporations is too complex
 - ▶ Local merchants suffer from lack of level playing field
 - ▶ Significant losses of tax revenue due to growth in electronic commerce and inability of states/local governments to administer use tax with consumers



Federal Legislation



Federal Legislation – The Proposals



Since 2005, the following types of legislative bills have been introduced:

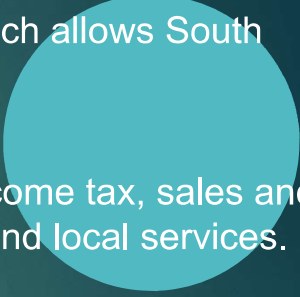
- Main Street Fairness Acts (MSFA)
- Marketplace Equity Act (MEA)
- Marketplace Fairness Acts (MFA)
- Remote Transactions Parity Act (RTPA)
- Online Sales Simplification Act (draft only)
- No Regulation Without Representation Act



The South Dakota Legislation



South Dakota Senate Bill 106

- 
- Inability to collect sales tax from remote sellers threatens South Dakota's efforts to sustain a broad tax system, which allows South Dakota to keep taxes low.
 - Because South Dakota doesn't have a state income tax, sales and use tax revenue are essential in funding state and local services.
 - The growth of online retail ensures further erosion to SD sales tax base.

South Dakota Senate Bill 106 Background

- ▶ Remote Sellers must remit South Dakota sales tax if they meet one of two criteria
 - The seller's gross revenue exceeds \$100,000.
 - The sellers made 200 or more separate transactions into South Dakota.
- Any sales tax obligation required by this act cannot be applied to past sales.

The *Wayfair* Decision

South Dakota v. Wayfair – What the Court Held

- ▶ U.S. Supreme Court (June 21, 2018)
 - ▶ Overturned a physical presence requirement for sales/use tax (Bellas Hess (1967) and Quill (1992))
 - ▶ “Economic and virtual presence” test
 - ▶ Only addressed the first prong of Complete Auto’s (1977) four prong test – requires a taxpayer have “substantial nexus with the taxing state”
 - ▶ South Dakota’s \$100,000 in sales or 200 transactions held by the Court to be sufficient because “the seller availed itself of the substantial privilege of carrying on a business in South Dakota”

South Dakota v. Wayfair - Guidance



- ▶ The Court noted three features about South Dakota’s law that appeared to be **designed to prevent discrimination against or undue burdens upon interstate commerce**:
 - ▶ Transactional Safe Harbor;
 - ▶ No retroactive application; and
 - ▶ **Membership in the Streamlined Sales and Use Tax Agreement (SSUTA)**

South Dakota v. Wayfair - Guidance



- ▶ Specific Items Noted in *Wayfair* Decision Related to Streamlined Sales Tax:
 - ▶ Standardizes taxes to reduce administrative and compliance costs
 - ▶ Single state level administration
 - ▶ Uniform definitions of products and services
 - ▶ Simplified tax rate structures
 - ▶ **Other uniform rules**
 - ▶ Access to sales tax administration software paid for by the state
 - ▶ Sellers who choose to use such software are immune from audit liability

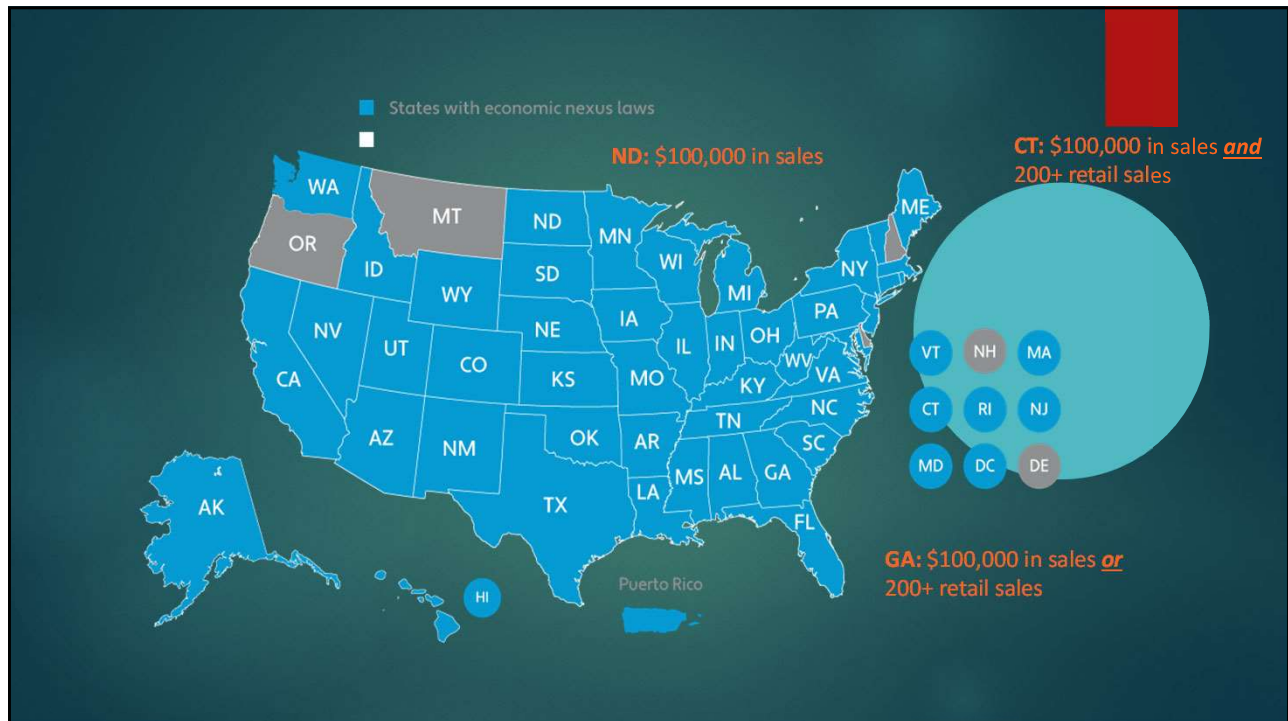
Economic Nexus
and
Remote Sellers



Economic Nexus

It's no longer just location, location, location . . .

- On June 21, 2018, the U.S. Supreme Court ruled in favor of South Dakota, giving states authority to impose sales tax obligations on out-of-state sellers based on their level of economic activity in that state
- All of the 45 states with a state sales tax have now adopted economic nexus
 - ▶ Thresholds vary by state
 - ▶ Calculations vary by state



Remote Sellers – Questions to Ask

- ▶ Do I ship products into states where I am not registered?
- ▶ Have I exceeded the economic nexus laws and thresholds enacted by a state?
 - ▶ How are the thresholds calculated?
- ▶ Do I need to collect sales tax on these transactions?



Streamlined Sales Tax

What is Streamlined Sales Tax?



- ▶ Remove Undue Burdens Referred to in *Quill*
- ▶ Effort by State and Local Governments
 - ▶ Simplification
 - ▶ Uniformity
- ▶ Significant input from business community

Why We Do It – Identifying What Makes the System Burdensome



- Separate state and local tax administration
- Unclear rules on who has the right to tax a transaction
- Too many tax rates within each state and locality
- Different state and local tax bases

Why We Do It – Identifying What Makes the System Burdensome

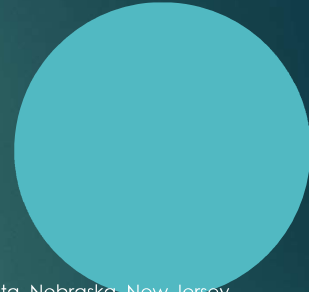
- Separate state definitions – and some locals don't follow their own state definitions
- Retailer held liable for tax when a buyer lies or fails to provide proof of an exempt sale
- Returns different in every state – some locals require separate returns
- Separate registration required in every state – and even some local jurisdictions

Streamlined's Goals

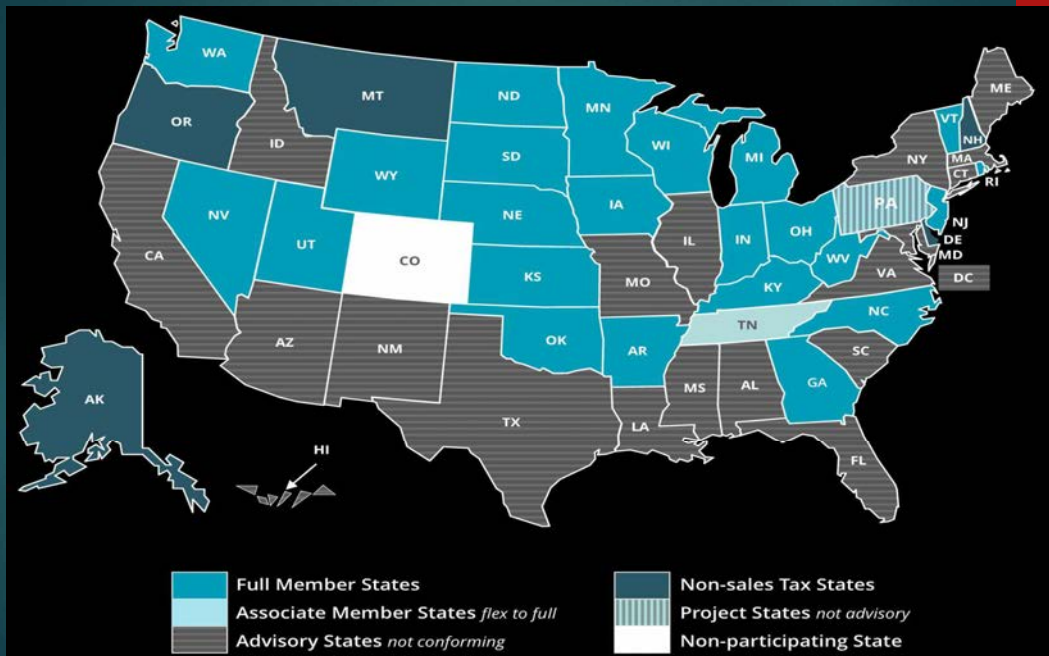
- ▶ Simpler system for administering state and local sales taxes
- ▶ Uniformity
- ▶ Balance state/local sovereignty with simplification and uniformity
- ▶ Use technology to ease the retailer's tax collection and reporting

Results: Streamlined Sales and Use Tax Agreement (SSUTA)

- ▶ SSUTA effective October 1, 2005
- ▶ Current membership (as of 5/1/2022)
 - ▶ 23 Full members
 - ▶ Arkansas, Georgia, Kansas, Kentucky, Indiana, Iowa, Michigan, Minnesota, Nebraska, New Jersey, Nevada, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Utah, Vermont, Washington, West Virginia, Wisconsin, Wyoming
 - ▶ 1 Associate member
 - ▶ Tennessee



STREAMLINED STATE STATUS 10-01-2022



Key Features of SSUTA



- ▶ State level administration of local sales and use taxes
- ▶ Common state and local tax bases within a state
- ▶ Uniform destination-based sourcing rules for goods and services
- ▶ One-stop central registration system
- ▶ Uniform definitions

Key Features of SSUTA



- ▶ Uniform simplified electronic return
- ▶ Rate and boundary databases
- ▶ Taxability matrix
- ▶ Simplified exemption administration
- ▶ Liability relief provisions
- ▶ Certified Service Providers (CSPs)

The “Certified Service Provider” (CSP)



▶ Who or what is a CSP?

A third party that allows sellers to outsource its sales tax compliance responsibilities



The “Certified Service Provider” (CSP)




▶ Uses a Certified Automated System (CAS)

- ▶ Determines:
 - ▶ Taxability of transaction
 - ▶ State and local tax rates
 - ▶ Tax due to each jurisdiction

▶ Generates and files returns

▶ Makes required remittances

▶ Meets other requirements set by SSTGB



The “Certified Service Provider” (CSP)

▶ Benefits To Sellers of Using CSPs

- ▶ Sellers who have to collect tax in a Streamlined state solely because they exceed the state's economic nexus requirements may use CSP's at **no cost** in those states
- ▶ Seller makes a single automated payment for all remittances
- ▶ CSP distributes the money to appropriate jurisdictions
- ▶ CSP assumes responsibility for audit(s)

The “Certified Service Provider” (CSP)

▶ Benefits to States

- ▶ Upfront review of tax rules
- ▶ Confidence that proper rates are being charged
- ▶ Timely and electronic filing of returns
- ▶ Ongoing testing of system for accuracy
- ▶ No cost unless tax is collected and remitted by CSP-compensated Seller

The “Certified Service Provider” (CSP)

▶ Operating in Streamlined and Non-Streamlined States

- ▶ CSP only compensated in SST states where seller qualifies as a “CSP-compensated seller”

▶ Who is a “CSP-compensated seller”

▶ General Requirements:

- ▶ Registered through the SSTRS and
- ▶ The Seller meets all the following criteria during the 12-month period preceding the date of registration with the Streamlined State:
 - ▶ no fixed place of business for more than 30 days in the state
 - ▶ less than \$50,000 of Property in the state
 - ▶ less than \$50,000 of Payroll in the state
 - ▶ less than 25% of its total Property or Payroll in the state
 - ▶ was not required to be registered to qualify as a supplier to the state

Streamlined Website
And
Examples of Resources

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[Governing Board Meetings](#)

States and businesses working together to create simpler, more uniform sales and use tax systems.

Learn more about sales tax registration and reporting requirements for:

[Remote Sellers](#) [Marketplace Sellers](#) [Marketplace Facilitators](#)

Do you qualify for *free* sales tax calculation and reporting services? [Learn more](#)

[Exemption Certificate](#) [Learn more](#) about exemptions

Register to collect and report sales tax in Streamlined States

[Register Now](#) [Log In](#)

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[Home](#) > [For Businesses](#) > [Remote Sellers](#) > Remote Seller State Guidance

Remote Seller State Guidance

Many states have enacted economic nexus laws that require remote sellers to collect and remit sales tax if they exceed certain thresholds. If you have a physical presence in a state, you are not a Remote Seller and are required to register in that state regardless of the amount of sales.

Are you a Remote Seller? A Remote Seller is generally a seller that does not have a physical presence in a state but who sells products or services for delivery into that state.

If you are a remote seller and your sales of products for delivery into a state meet or exceed the threshold for a state, you are required to register to collect and remit sales tax for that state.

Economic nexus laws apply to any business that makes sales into states in which they have no physical presence but meet the state's sales and/or transactions thresholds.

Items to note when reviewing the requirements:

- Many states base their threshold on sales OR transactions, while some states base their threshold on sales AND transactions.
- A state may base its sales threshold on *gross sales, gross revenues, retail sales or taxable sales*. Many states do not distinguish between taxable and non-taxable sales when determining if a threshold is met.

If you know that you will be making sales into a state, you may choose to register to collect and remit that state's sales tax at any time.

IMPORTANT NOTE: This is general guidance and is not legal advice. Nothing in this chart overrides an individual state's laws. For specific state guidance, [contact that state](#).

This chart provides you a summary of the Remote Seller thresholds and compliance dates as of November 19, 2021.

State Registration Guidelines for:

[Remote Sellers](#)

[Marketplace Sellers](#)

[Marketplace Facilitators](#)

Do you qualify for *free* sales tax calculation and reporting services? [Learn more before you register](#)

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Revenue Department Website	Remote Seller Compliance Date	Remote Seller Threshold	State Guidance for Remote Sellers	Notes	Streamlined Member State Information
Alabama	10/1/2018	Sales of TPP of <i>more than</i> \$250,000 in prior calendar year; No transaction threshold Seller must also engage in or conduct certain other activities in Alabama in addition to having more than \$250,000 in sales.	Remote Seller	Press Release (7/3/2018) AL FAQs	
Alaska	4/1/2020	Statewide gross remote sales <i>meets or exceeds</i> \$100,000 or 200 transactions in the current or previous calendar year	Remote Seller	Marketplace Facilitator	
Arizona	10/1/2019	Annual gross retail sales or income from online sales into Arizona is <i>more than</i> \$200,000 in 2019, \$150,000 in 2020 and \$100,000 in 2021 and thereafter.	Remote Seller	Marketplace Facilitator	
Arkansas	7/1/2019	Sales <i>exceed</i> \$100,000 or 200 transactions during the current or preceding year.	Remote Seller	Marketplace Facilitator	AR
California	4/1/2019	The total combined sales <i>exceed</i> \$500,000 during the preceding or current calendar year	Remote Seller	Marketplace Facilitator	
Colorado	12/1/2018	Taxable sales of <i>more than</i> \$100,000 in past calendar year	Remote Seller	Marketplace Facilitator	
Connecticut	12/1/2018	7/1/2019 Threshold change: \$100,000 or more in gross receipts and 200 or more retail transactions 12/1/2018 Threshold: \$250,000 or more in gross receipts and 200 or more retail transactions	Remote Seller		

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Marketplace Seller State Guidance

Many states have enacted Marketplace Facilitator/Provider laws that require the Marketplace Facilitator/Provider to remit tax on sales facilitated on behalf of Marketplace Sellers. The Marketplace Seller may also be required to register and file returns for sales and use tax purposes in that state. Review the chart below to help determine a state's registration and reporting requirements for a Marketplace Seller.

Are you a Marketplace Seller? A Marketplace Seller is generally a seller who sells products through a physical or electronic marketplace operated by a Marketplace Facilitator/Provider.

A Marketplace Seller may also be a "remote seller." A Remote Seller is generally a seller that does not have a physical presence in a state but who sells products or services for delivery into that state.

A remote seller that sells through a Marketplace Facilitator and also sells products direct to its customers, is required to register to collect and remit sales tax in the state if its sales in that state meet that state's Remote Seller Threshold.

If you have a physical presence in a state, you are not a Remote Seller and are generally required to register in that state regardless of the amount of sales.

If you know that you will be making direct sales into a state, you may choose to register to collect and remit that state's sales tax at any time.

IMPORTANT NOTE: This is general guidance and is not legal advice. Nothing in this chart overrides an individual state's laws. For specific state guidance, [contact that state](#).

This chart provides you a summary of Marketplace Seller Registration and Reporting Requirements in the 24 Streamlined Member states and some nonmember states. For specific questions concerning your requirements in a state, [contact that state](#).

State Registration Guidelines for:

[Remote Sellers](#)

[Marketplace Sellers](#)

[Marketplace Facilitators](#)

Do you qualify for *free* sales tax calculation and reporting services? [Learn more before you register](#)

State Marketplace Seller Information	Is the Marketplace Facilitator required to collect and remit sales tax?	Is a seller who only sells through a Marketplace required to register and file returns if the Marketplace is required to collect and remit sales tax?	Does a remote seller include sales through a Marketplace Facilitator in the seller's Remote Seller's Threshold calculation?	If a marketplace seller is required to identify their sales through the marketplace separately from direct sales on a state's sales tax return, how are those sales reported?
Alaska <small>(updated 7/3/2021)</small>	Yes	No	Yes	N/A
Arkansas <small>(updated 6/22/2020)</small>	Yes	No, a seller that has physical presence may want to register in order to purchase merchandise for resale without payment of tax.	No	N/A

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Marketplace Facilitator State Guidance

Many states have enacted Marketplace Facilitator/Provider laws that require the Marketplace Facilitator/Provider to collect and remit sales tax on sales facilitated on behalf of Marketplace Sellers if they exceed certain thresholds. Review the chart below to determine a state's registration and reporting requirements for a Marketplace Facilitator/Provider.

Are you a Marketplace Facilitator/Provider? A Marketplace Facilitator/Provider is generally a business or person who owns, operates or otherwise controls a physical or electronic marketplace and facilitates the sale of a third-party Seller's products. The Marketplace Facilitator/Provider either directly or indirectly through contracts, agreements, or other arrangements with third parties, collects the payment from the purchaser and transmits all or part of the payment to the Seller.

States may define a Marketplace Facilitator/Provider more narrowly or more broadly than the general definition above. It is important to review a state's laws and other published guidance for specific state requirements.

A Marketplace Facilitator/Provider may also be a "remote seller." A Remote Seller is generally a seller that does not have a physical presence in a state but who sells products or services for delivery into that state.

If the Marketplace Facilitator/Provider has a physical presence in a state, it is not a Remote Seller and is generally required to register in that state regardless of the amount of sales.

If you are a **Marketplace Seller** making sales through a Marketplace Facilitator/Provider, you may also be required to register and file returns for sales and use tax purposes in that state. See the Marketplace Seller state Guidance for more information.

IMPORTANT NOTE: This is general guidance and is not legal advice. Nothing in this chart overrides an individual state's laws. For specific state guidance, [contact that state](#). If you have questions related to this chart, please [contact us](#).

This chart provides you a summary of Marketplace Facilitator/Provider Registration and Reporting Requirements in the 24 Streamlined member states and some nonmember states. For specific questions concerning your requirements in a state, contact that state.

State Registration Guidelines for:

[Remote Sellers](#)

[Marketplace Sellers](#)

[Marketplace Facilitators](#)

Do you qualify for **free sales tax calculation and reporting services?** [Learn more before you register](#)

State Marketplace Facilitator Information	Marketplace Facilitator Compliance Date	Is the Marketplace Facilitator required to collect and remit sales tax?	Marketplace Facilitator Threshold	Is a Marketplace Facilitator required to identify sales made on behalf of marketplace sellers separately from its own direct sales on its return?	Does your state allow or require the Marketplace Facilitator file a separate return for any third-party sales it facilitates?	Is the Marketplace Facilitator required to provide certification that it will collect and remit tax on behalf of the marketplace seller?
Alaska <small>(updated 7/13/2021)</small>	4/1/2020	yes	Statewide gross remote sales meets or exceeds \$100,000 or 200 transactions in the current or previous	No	Allow	No

Taxability Matrix

Reference Number	Food and food products	Taxable	Exempt	Statute/Rule Cite	Comment
40010	Candy	X		77.51(16m), 77.54(20n), 77.54(20v)	
40015	Dried or partially dried fruit that contains one or more sweeteners and may also contain other additives		X	77.51(16n)(b), 77.54(20n), 77.54(20v)	Effective October 1, 2021 (2021 Vils. Act 58), dried or partially dried fruit that contains one or more sweeteners and may also contain other additives is excluded from the definition of candy and exempt.
40020	Dietary Supplements	X		77.51(3n), 77.54(20n), 77.54(20v)	
40030	Food and food ingredients excluding alcoholic beverages and tobacco		X	77.51(3l), 77.54(20n)(a), 77.54(20n)(b), 77.54(20n)(c)	*Exempts all food and food ingredients except candy, dietary supplements, soft drinks, and prepared foods.
40040	Food sold through vending machines				Taxability based on specific food product being sold. Example: Candy would be taxable, but unsweetened bottled water would not be taxable.
40050	Soft Drinks	X		77.51(17w), 77.54(20n), 77.54(20v)	
40060	Bottled Water		X	77.54(20n)	Also assumes not a soft drink.
41000	Prepared Food	X		77.51(10m), 77.54(20n), 77.54(20v)	

Streamlined Certificate of Exemption

Streamlined Sales Tax Certificate of Exemption

Do not send this form to the Streamlined Sales Tax Governing Board. Send the completed form to the seller and keep a copy for your records.

This is a multi-state form for use in the states listed. Not all states allow all exemptions listed on this form. The purchaser is responsible for ensuring it is eligible for the exemption in the state it is claiming the tax exemption from. Check with the state for exemption information and requirements. The purchaser is liable for any tax and interest, and possible civil and criminal penalties imposed by the state, if the purchaser is not eligible to claim this exemption.

1. Check if this certificate is for a single purchase. Enter the related invoice/purchase order # _____

2. A. Purchaser's name _____
 B. Business address _____ City _____ State _____ Country _____ Zip code _____
 C. Name of seller from whom you are purchasing, leasing or renting _____
 D. Seller's address _____ City _____ State _____ Country _____ Zip code _____

3. Purchaser's type of business. Check the number that best describes your business.

<input type="checkbox"/> 01 Accommodation and food services	<input type="checkbox"/> 08 Real estate	<input type="checkbox"/> 15 Professional services
<input type="checkbox"/> 02 Agriculture, forestry, fishing, hunting	<input type="checkbox"/> 09 Rental and leasing	<input type="checkbox"/> 16 Education and health-care services
<input type="checkbox"/> 03 Construction	<input type="checkbox"/> 10 Retail trade	<input type="checkbox"/> 17 Nonprofit organization
<input type="checkbox"/> 04 Finance and insurance	<input type="checkbox"/> 11 Transportation and warehousing	<input type="checkbox"/> 18 Government
<input type="checkbox"/> 05 Information, publishing and communications	<input type="checkbox"/> 12 Utilities	<input type="checkbox"/> 19 Not a business
<input type="checkbox"/> 06 Manufacturing	<input type="checkbox"/> 13 Wholesale trade	<input type="checkbox"/> 20 Other (explain)
<input type="checkbox"/> 07 Mining	<input type="checkbox"/> 14 Business services	

4. Reason for exemption. Check the letter that identifies the reason for the exemption.

<input type="checkbox"/> A Federal government (Department) *	<input type="checkbox"/> H Agricultural Production *
<input type="checkbox"/> B State or local government (Name) *	<input type="checkbox"/> I Industrial production/manufacturing *
<input type="checkbox"/> C Tribal government (Name) *	<input type="checkbox"/> J Direct pay permit *
<input type="checkbox"/> D Foreign diplomat #	<input type="checkbox"/> K Direct Mail *
<input type="checkbox"/> E Charitable organization *	<input type="checkbox"/> L Other (Explain)
<input type="checkbox"/> F Religious organization *	<input type="checkbox"/> M Educational Organization *
<input type="checkbox"/> G Resale *	

* see Instructions on back (page 2)

5. Identification (ID) number: Enter the ID number as required in the instructions for each state in which you are claiming an exemption. If claiming multiple exemption reasons, enter the letters identifying each reason as listed in Section 4 for each state.

ID number	State/Country	Reason	ID number	State/Country	Reason
AR			NV		
GA			OH		
IA			OK		
IN			RI		
KS			SD		
KY			TN		
MI			UT		
MN			VT		
NC			WA		
ND			WI		
NE			WV		
NJ			WY		

6. I declare that the information on this certificate is correct and complete to the best of my knowledge and belief.

Signature of authorized purchaser _____ Print name _____ Title _____ Date _____

SS1GB Form F0003 Exemption Certificate (Revised 12/21/2021)

Streamlined Sales and Use Tax Exemption Certificate Instructions

Sections 1-4 are required information. A signature is not required if in electronic form.

Section 1: Check the box for a single purchase and enter the invoice number. If the box is not checked, this certificate is considered a blanket certificate and remains effective until cancelled by the purchaser if purchases are no more than 12 months apart, unless a longer period is allowed by a state.

Section 2: Enter the purchaser's and seller's name, street address, city, state, country and zip code.

Section 3 Type of Business: Check the number that best describes the purchaser's business or organization. If none of the categories apply, check 20 and provide a brief description.

Section 4 Reason for Exemption: Check the letter that identifies the reason for the exemption. If the exemption you are claiming is not listed, check "L Other" and provide a clear and concise explanation of the exemption claimed. Not all states allow all exemptions listed on this form. The purchaser must check with that state for exemption information and requirements.

Section 5 Identification ID Number:

Purchaser's Instructions:
 Enter the ID number as required in the instructions below for each state in which you are claiming an exemption. Identify the state or if a foreign ID, the country the ID number is from. If multiple exemption reasons are being claimed enter the letters identifying the reasons for exemption as listed in Section 4 for each state.

ID Numbers for Exemptions other than resale: You are responsible for ensuring that you are eligible for the exemption in the state you are claiming the tax exemption. Provide the ID number to claim exemption from sales tax that is required by the taxing state. Check with that state to determine your exemption requirements and status.

Foreign diplomats and consular personnel must enter their individual tax identification number shown on their sales tax exemption card issued by the United States Department of State's Office of Foreign Missions.

ID Numbers for Resale Purchases (Including Drop Shipments): If you are claiming a purchase is not subject to tax because it is for resale (Exemption Reason G.) and you are:

- Required to be registered in the state you are claiming the tax exemption:** Provide your sales tax ID number issued by that state. If claiming exemption in OH and registration is not required in the state, enter any tax ID number issued by OH. If claiming exemption in MI and registration is not required in the state, enter "Not Required".
- Not registered in the state you are claiming the tax exemption:** Provide your sales tax ID number issued by any state.
- Not required to register for sales tax and you do not have a sales tax identification number from any state:** Enter -Your FEIN.
 -If you do not have a FEIN, enter a different state-issued business ID number.
 -If you do not have any state-issued business ID number or FEIN, enter your state driver's license number.
- A foreign purchaser and you do not have an ID number described in 1, 2 or 3:** The following states will accept the tax ID number (e.g., VAT number) issued by your country: AR, IN, KS, KY, ND, NJ, OK, RI, SD, TN, UT, WA, WY. All other states require an ID number as listed in 1, 2 or 3.

If you do not have any of the ID numbers listed in 1 thru 4: You are not required to list an ID number for the following states: NE, OH, SD, WI. Enter "Not Required" and the reason for exemption for that state. All other states require an ID number.

Seller's Instructions
 The seller is not required to verify the purchaser's ID number or determine the purchaser's registration requirements. (GA requires the seller verify the purchaser's ID number.) The seller is required to maintain proper records of exempt transactions and provide those records to the state when requested in the form in which it is maintained. These certificates may be provided in paper or electronic format.

The seller is not liable for any tax, interest, or penalty if the purchaser improperly claims an exemption or provides incorrect information on the certificate, provided all the following conditions are met:
 1. The fully completed exemption certificate is provided to the seller at the time of sale or within 90 days subsequent to the date of sale;
 2. The seller did not fraudulently fail to collect the tax due; and
 3. The seller did not solicit customers to unlawfully claim an exemption.

Note: A seller may not accept a certificate of exemption for an entity-based exemption on a sale made at a location operated by the seller within the designated state if the state does not allow such an entity-based exemption.

Drop Shipper Instructions: The drop shipper may accept an ID number to claim the resale exemption as provided above in the Purchaser's Instructions. The ID number may include an ID number issued by another state. This may result in the same ID number being used for multiple states to claim the resale exemption (e.g., a retailer or marketplace seller may only be required to register for sales tax in one state).

SS1GB Form F0003 Exemption Certificate Page 2 (Revised 12/21/2021)

Streamlined's Success to Date


- ▶ Over 20,000 active sellers registered through SSTRS (9/30/22)
- ▶ Over 500% Increase in registrations since Wayfair
- ▶ Billions collected by member states



Streamlined's Goals for 2022 and Beyond



Streamlined's Goals

- 
- ▶ Educate remote sellers on collection requirements post-*Wayfair*
 - ▶ Assist member states in enacting legislation that complies with Streamlined and accomplishes their goals
 - ▶ Encourage nonmember state participation
 - ▶ Identify additional simplifications/uniformity that may be needed
 - ▶ Develop additional disclosed practices

Streamlined's Goals

- ▶ Offer education/training to state members related to Streamlined activities/requirements
- ▶ Continue to work with business community in identifying pain points and work to resolve them
- ▶ Develop single filing portal for all member states
- ▶ Develop single rate look-up application for all member states

Questions

Craig Johnson, Executive Director, Streamlined Sales Tax Governing Board, Inc.
craig.johnson@sstgb.org
608-634-6160

11 a.m. – 12 p.m.

Medicare Planning

Brian Ellenbecker, CFP, EA, CPWA, CIMA, CLTC, *Financial Advisor,*
Shakespeare Wealth Management



Understanding Medicare

Brian Ellenbecker, CFP®, EA, CIMA®, CPWA®, CLTC®
Financial Planner
Shakespeare Wealth Management



Your mailbox when you turn 64



Agenda

- Medicare Plan Details
 - Parts
 - Enrollment
 - Costs
 - Supplement Plans
 - Advantage Plans
- Planning Opportunities and Considerations

3

Parts of Medicare

Provided by Medicare and is the same for everyone:

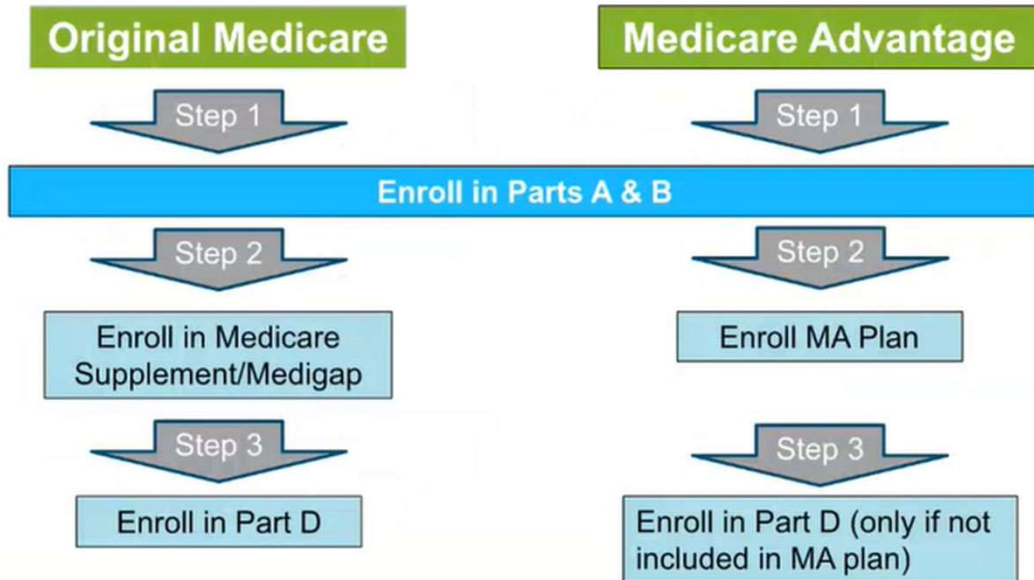
- Part A – Hospital coverage
- Part B – Medical insurance

Administered by private insurer where each person selects a different plan based on their needs

- Part D – Prescription Drug Coverage
- Part C – Medicare Advantage
 - Combines Parts A, B and usually D

4

Two Options to Receive Medicare



5

ENROLLMENT

6

Enrolling in Medicare

- Why is this important?
 - Avoid costly mistakes
 - If you don't enroll in a timely manner, you **WILL** pay a premium **penalty for the rest of your life**
 - Avoid **gaps in coverage**.

7

Key Factors in Determining Enrollment Period

- Age
 - Must be 65 or older in most cases
 - If you collected SS Disability for 2 years, you become eligible at any age
- Social Security Status
 - Have you filed for benefits yet?
- Employment Status
 - Are you covered by employer plan as employee or non-employee spouse?
 - Size of employer
 - Small employer = 19 or less employees
 - Large employer = 20 or more employees

8

Enrollment based on SS Claiming Status

- **If you **ARE** receiving Social Security when you turn 65:**
 - Medicare Parts A & B are automatic
 - Can decline Part B if you don't want it
 - Cannot decline Part A
 - Coverage starts 1st of month you turn 65
 - Part D, Supplement, and/or Advantage are not automatic
 - Must choose private insurer and proactively enroll

9

Enrollment based on SS Claiming Status

- **If you **ARE NOT** receiving Social Security when you turn 65:**
 - Must sign up through Social Security Administration (SSA) during Medicare enrollment period
 - Initial enrollment period: You **are not covered by a group plan** at 65
 - Special enrollment period: You **are covered by a group plan** at 65
 - General enrollment period: You **missed your initial or special enrollment** period

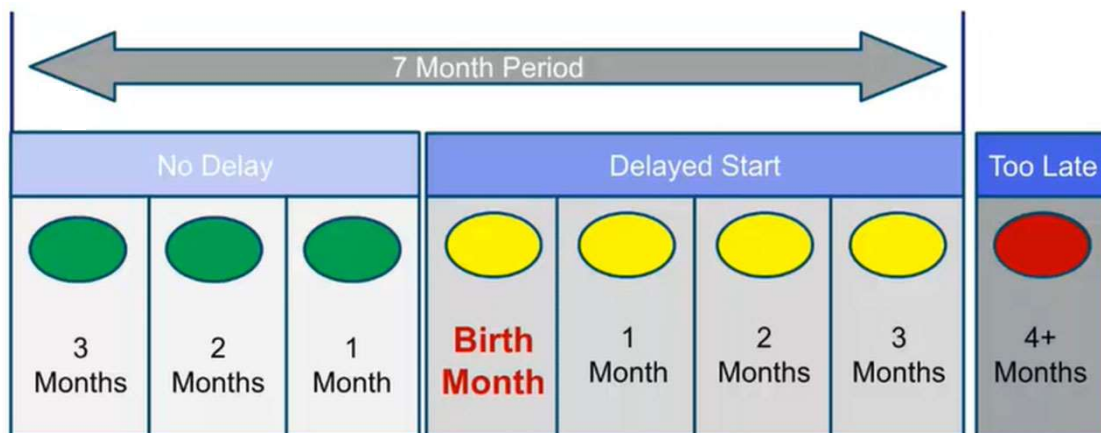
10

Initial Enrollment Period

- First chance to enroll in Medicare
 - Birth month and 3 months before & after
 - 7 months total
 - You should enroll if you are not covered by an employer plan
 - Parts A & B
 - Choose a Medicare Supplement plan or Medicare Advantage Plan
 - Part D or other prescription drug plan

11

Initial Enrollment Period Timeline



12

Initial Enrollment Period

- Part A
 - Many who turn 65
 - Enroll to avoid penalty if you:
 - Don't have other coverage
 - Have other non-employer coverage (individual policy, COBRA, retiree coverage, etc.)
 - Still working and covered by employer plan:
 - Small employer
 - Must enroll
 - **Medicare is primary** over employer plan
 - Large employer
 - **Medicare is secondary** to employer plan
 - Enroll in A to supplement employer's hospital coverage
 - **Do not enroll** if you have a Health Saving Account (HSA) and want to continue making contributions

13

Initial Enrollment Period

- Part B
 - Enroll to avoid penalty if you:
 - Don't have other coverage
 - Have other non-employer coverage (individual policy, COBRA, retiree coverage, etc.)
 - If you have employer coverage:
 - Small employer
 - Must enroll
 - **Medicare is primary** over employer plan
 - Large employer
 - **Medicare is secondary** to employer plan
 - May enroll in B to supplement employer's hospital coverage

14

Initial Enrollment Period

- Drug coverage options:
 - Part D
 - Signed up for A or B
 - Want drug coverage either now or in the future
 - Can delay coverage without penalty if you have other “**creditable**” drug coverage (employer or private policy)
 - Enroll in Medicare Advantage Plan with drug coverage included
 - Only if going Medicare Advantage route

15

Special Enrollment Period

- **Covered** as a worker or spouse of a current worker by a **large group plan** AND
- Did not previously sign up for Parts B and/or D

16

Special Enrollment Period

- Part B
 - 8-month period starting the month group coverage ends **or**
 - Before coverage ends
- Part D
 - Within 63 days after coverage ends **or**
 - Before coverage ends

Enrolling in the time window avoids a late-enrollment penalty, BUT...

Enrolling before current coverage ends avoids gaps in coverage.

17

General Enrollment Period

- Missed initial and special enrollment periods
- January 1 to March 31
 - Coverage starts July 1
- Will likely pay a premium penalty
- Will likely have coverage gaps

18

Signing Up for Parts A & B

- Go to www.medicare.gov and click on Sign Up / Change Plans

Apply for Medicare Only

- Can apply for Social Security and Medicare together
- Call Social Security Administration at 800-772-1213
 - Enroll over the phone
 - Schedule appointment at local office

19

Sign Up for Supplement, Advantage, and/or Part D

- Work with health insurance agent
- Directly through insurance company
- Through Medicare
 - www.medicare.gov
 - 1-800-MEDICARE

20

OPEN ENROLLMENT

21

Two “Open Enrollment” Periods

- Medi**care** Open Enrollment
- Medi**gap** Open Enrollment

22

When is Medicare Open Enrollment

- October 15 – December 7 of each year
- Changes to coverage are effective January 1 of the following year
 - e.g., Changes made to plans in fall of 2021 take effect on Jan 1, 2022



23

What Changes Can Be Made During Medicare Open Enrollment

- Make changes to your Medicare Part D prescription drug plan on Medicare Advantage Plan:
 - Join a plan
 - Switch from one plan to another
 - Drop your plan
- Switch from Original Medicare to a Medicare Advantage plan
- Switch from Medicare Advantage plan back to Original Medicare
 - Guaranteed issue on Medicare Supplement plan is usually NOT available
 - See Guaranteed Issue section of the *Wisconsin Guide to Health Insurance for People with Medicare* for reasons you may qualify to change your Supplement plan

24

Medigap Open Enrollment

- Guaranteed issue period
 - Have to sell you a policy regardless of health
 - Cannot adjust premiums
 - Cannot exclude pre-existing conditions
- 6-month period beginning with the month you are both:
 - Age 65 **and**
 - Enrolled in Part B

Medical Questions

5. HEALTH QUESTIONS

- A. Do any of the following apply to you within the past **two years**? Yes No
- Have you been hospitalized (more than 24 hours) three times or more, or been recommended to have inpatient surgery that hasn't yet been performed?
 - Have you been hospitalized for the treatment of mental or nervous disorders, including alcohol or drug abuse?
 - Have you had or been told by your physician you had a heart attack, congestive heart failure, heart valve disorder, heart rhythm disorder, enlarged heart, coronary artery disease (hardening or narrowing of the artery or arterial blockage), carotid artery disease, stroke, aneurysm, or peripheral vascular disease?
 - Have you had or been told by your physician you had diabetes that requires insulin; liver disease; or broken bones due to osteoporosis?
 - Have you had or received treatment for end-stage renal disease (ESRD), kidney disease, or have you received kidney dialysis?
- B. Do any of the following apply to you within the past **five years**? Yes No
- Have you had or received treatment or surgery for cancer (except for non-melanoma skin cancer), Hodgkin's disease, melanoma, or leukemia?
 - Have you had, or been recommended to have, any organ transplant other than of the cornea?
- C. Have you been diagnosed with one or more of the following **at any time**? Yes No
- | | | |
|---|----------------------|------------------------|
| • Alzheimer's disease | • Emphysema | • Myasthenia gravis |
| • Amyotrophic lateral sclerosis (ALS or Lou Gehrig's disease) | • Hemophilia | • Parkinson's disease |
| • Cerebral palsy | • Multiple sclerosis | • Rheumatoid arthritis |
| • Cystic fibrosis | • Muscular dystrophy | • Sickle cell anemia |
| | | • Systemic lupus |
- D. Do any of the following statements **currently** describe you? Yes No
- I am confined to a nursing facility
 - I am hospitalized
 - I am enrolled in a hospice program

STOP: If you answered yes to questions A, B, C, or D in this section, you are not eligible for this Medicare supplement plan at this time. If you need assistance answering these health questions, please contact us or speak with your agent.

If you answer YES to any of the questions asked, you are NOT eligible for a Supplement Plan.

The questions asked and conditions asked about can vary from plan to plan.

MEDICARE COSTS

27

Definitions

- Premium
 - Paid monthly, regardless of use
- Deductible
 - Paid by patient, based on cost of services
- Co-insurance
 - Cost is split between patient and insurance company/Medicare
 - Co-pays, percentage split (e.g. 80/20), etc.

28

Costs of Medicare – Part A

- No monthly premium if an individual or their spouse worked for 40 quarters (10 years)
- No cost to non-working spouse if:
 - **Currently married** to a **spouse who is eligible for Social Security** (age 62) and married for at least one year before applying, or
 - **Divorced** and the **former spouse is eligible for Social Security** (must have been married to ex-spouse for 10 years and not currently married), or
 - **Widowed** (and did not remarry) and they were married for at least nine months before their spouse died.

29

Costs of Medicare – Part A

Insurance Premiums		Benefit Period Deductible	Hospital Co-Insurance Charges		Skilled Nursing Care Co-Insurance Charges	
Work History of you or your spouse	Monthly Premium		Benefit Period	Daily Charge	Benefit Period	Daily Charge
<30 Quarters	\$506 per person	\$1,600 per person	1-60 Days	\$0	0-20 Days	\$0
30-39 Quarters	\$278 per person		61-90 Days	\$400	21-100 Days	\$200
40+ Quarters	\$0 per person		91-150 days (60 lifetime reserve days*)	\$800	101+ Days	100% of cost
			151+ Days	100% of cost		

*The insured may decide to forgo using their lifetime reserve days during that benefit period, in which case they will be responsible for 100% of the cost.

30

Costs of Medicare – Part B

Modified Adjusted Gross Income* (2022 MAGI determines 2024 premium)		2023 Medicare Part B Premium for New Enrollees
Single	Married Filing Joint	Monthly Premium
\$97,000 or less	\$194,000 or less	\$164.90
\$97,001 - \$123,000	\$194,001 - \$246,000	\$230.80
\$123,001 - \$153,000	\$246,001 - \$306,000	\$329.70
\$153,001 - \$183,000	\$306,001 - \$366,000	\$428.60
\$183,001 - \$500,000	\$366,001 - \$750,000	\$527.50
\$500,001+	\$750,000+	\$560.50

*MAGI = Adjusted gross income plus tax-exempt interest.

31

Life-Changing Events

- You can appeal IRMAA premium increase if you experience a “life-changing” event
- File form SSA-44 with Social Security Administration
 - Optional but recommended: attach a letter of explanation
- Life changing Events:
 - Marriage
 - Divorce/Annulment
 - Death of Spouse
 - **Work Stoppage**
 - Work Reduction
 - Loss of Income-Producing Property
 - Loss of Pension Income
 - Employer Settlement Payment

32

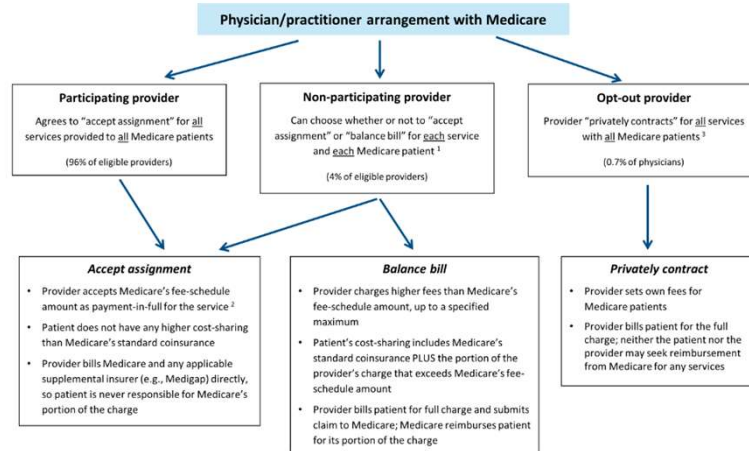
Costs of Medicare – Part B

Annual Deductible	Medical Co-Insurance Charges	
\$226	Type of Care	Patient Responsibility
	Medical Services	Assigned – 20% Unassigned – 20% + 15% over approved amount
	Out-patient Hospital Care	Co-pay can't exceed Part A deductible
	Out-patient Mental Health	20%
	Annual Wellness	\$0
	Service providers may or may not accept Medicare.	
Service providers that accept Medicare may not accept the Medicare pre-approved cost for service. Under these circumstances, the service provider may charge up to an additional 15% out-of-pocket fee to the insured.		

Note: There is no Part B out-of-pocket maximum!

Assigned vs. Unassigned Providers

Physician/Practitioner Billing Options in Traditional Medicare



NOTES: ¹Balance billing is prohibited for some fee-schedule services, such as diagnostic lab services, and those billed by certain practitioners, such as physician assistants. Balance billing is also prohibited for Medicare beneficiaries who have Medicaid coverage. ²Medicare's fee-schedule rates for non-participating providers are reduced by 5 percent compared to the fee-schedule rates for participating providers. ³Providers are prohibited from entering into a private contract with a beneficiary who also has Medicaid or who is experiencing an urgent or emergent health care event.



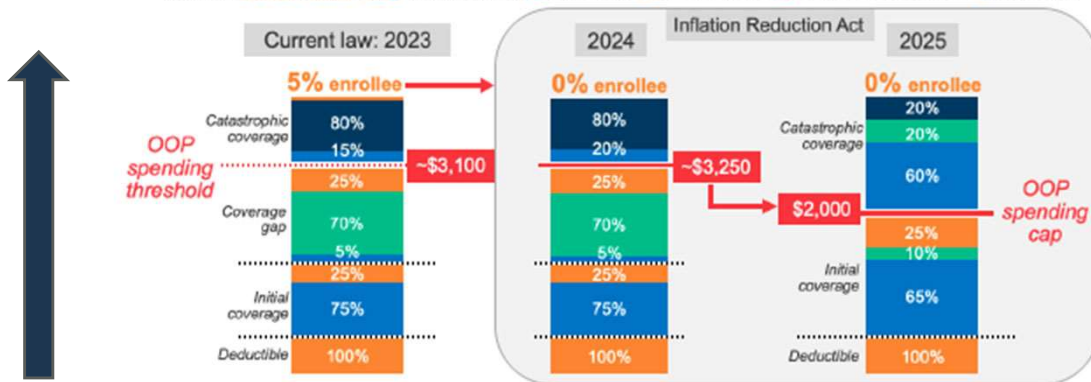
Part B Premium Penalty

- Penalty
 - 10% for every year that you fail to enroll
 - Penalty is charged to base premium amount (\$164.90 in 2023)
 - If base premium increases, penalty increases
 - Penalty accessed every year going forward

Changes to Part D – Inflation Reduction Act

Changes to Medicare Part D for Brand-Name Drug Costs

Share of brand-name drug costs paid by: ● Enrollees ● Part D Plans ● Drug manufacturers ● Medicare



NOTE: OOP is out-of-pocket. The out-of-pocket spending threshold will be \$7,400 in 2023 and is projected to be \$7,750 in 2024 and \$8,100 in 2025, including what beneficiaries pay directly out of pocket and the value of the manufacturer discount on brand-name drugs in the coverage gap phase. These amounts translate to out-of-pocket spending of approximately \$3,100, \$3,250, and \$3,400 (based on brand-name drug use only).



Drug Price Negotiation

Medicare Drug Price Negotiation Timeline for 2026 & 2027



SOURCE: KFF analysis of section 11001 of the Inflation Reduction Act of 2022.

KFF

37

Costs of Medicare – Part D

- National Base Beneficiary Premium = \$32.74 (only used to calculate IRMAA and penalty)
- Your premium will be higher or lower, depending on coverage purchased
 - 2023 US national average premium*
 - US weighted average premium = \$43
 - WI weighted average premium = \$47
 - 3% increase vs. 2022
 - IRMAA applies to higher incomes
 - MAGI above \$194,000 married filing jointly or \$97,000 single
 - Income brackets are inflation adjusted

*Source: The Kaiser Foundation's Medicare Part D: A First Look at Medicare Prescription Drug Plans in 2022

38

Part D Premium

Modified Adjusted Gross Income (2022 MAGI determines 2024 premium)		2023 Medicare Part D Premium
Single	Married Filing Joint	
\$97,000 or less	\$194,000 or less	Your plan premium
\$88,001 - \$123,000	\$194,001 - \$246,000	\$12.20 + your plan premium
\$123,001 - \$153,000	\$246,001 - \$306,000	\$31.50 + your plan premium
\$153,001 - \$183,000	\$306,001 - \$366,000	\$50.70 + your plan premium
\$183,001 - \$500,000	\$366,001 - \$750,000	\$70.00 + your plan premium
\$500,001+	\$750,001+	\$76.40 + your plan premium

39

Part D Deductible & Coinsurance

	Paid by Insured	Threshold
Annual Deductible	\$505	n/a
Initial Coverage Period	25% of drug costs (\$4,660 * .25 = \$1,165)	On the first \$4,660 of drug expenses (not out-of-pocket costs) after deductible
Coverage Gap (aka Donut Hole)	25% of cost of Brand Name or Generic Drugs	Lasts until TrOOP* reaches \$7,400
Catastrophic Coverage – Starts when total true out-of-pocket (TrOOP*) costs reach \$7,400 (\$505 deductible + \$1,165 initial coverage + \$5,730 donut hole)	Greater of: <ul style="list-style-type: none"> • 5% of drug costs OR • \$10.35 for brand name or \$4.15 for generic 	On all out-of-pocket costs in excess of \$7,400

*What the drug plan pays towards drug cost (5%) and dispensing fee (75%) do not count towards TrOOP.

40

Part D Premium Penalty

- 1% penalty for every month you are not enrolled
- Carries over every year
- Increases if base premium increases

41

MEDICARE SUPPLEMENT (MEDIGAP) PLANS

42

Medicare Supplement Plans

- Sold by private insurance companies
- Supplemental coverage for Medicare Parts A & B
- Plans followed federal & state laws to protect you

Medicare Supplement Plans

Medigap Benefits	A	B	C	D	F*	G*	K	L	M	N
Part A coinsurance and hospital costs up to an additional 365 days after Medicare benefits are used up.	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Part B coinsurance or copayment	✓	✓	✓	✓	✓	✓	50%	75%	✓	✓ [^]
Blood (first 3 pints)	✓	✓	✓	✓	✓	✓	50%	75%	✓	✓
Part A hospice care coinsurance or copay	✓	✓	✓	✓	✓	✓	50%	75%	✓	✓
Skilled nursing facility care coinsurance			✓	✓	✓	✓	50%	75%	✓	✓
Part A deductible		✓	✓	✓	✓	✓	50%	75%	50%	✓
Part B deductible**			✓		✓					
Part B excess charges					✓	✓				
Foreign travel emergency (up to plan limits)			80%	80%	80%	80%			80%	80%
Out of Pocket Limit***	N/A	N/A	N/A	N/A	N/A	N/A	\$6,220	\$3,110	N/A	N/A

* Plans F & G offer high deductible options in some states.

** Plans C & F aren't available to new participants as of January 1, 2020.

*** For Plans K & L, after you meet your OOP limit and Part B deductible, the plan pays 100%.

[^] Plan N pays 100% of the part B coinsurance, except for \$20 copay for some office visits and \$50 copay for ER visits.

WPS Medicare Complete – Wisconsin

Design your plan

1. Determine your rate area (see previous page)

- Area 1**
See rates on page 7
 Area 2
See rates on page 8
 Area 3
See rates on page 9

2. Select your plan (choose one)

<input type="checkbox"/> Base plan—highest coverage option	OR	<input type="checkbox"/> Base plan with Medicare Part B copayment or coinsurance rider
Covers your Medicare Part A and Part B copayments and coinsurance—costs you would otherwise pay out of pocket. This plan also offers unlimited preventive benefits.*		After you pay the Medicare Part B deductible, you pay a \$20 copayment for office visits and either up to a \$50 copayment for emergency room visits or the Medicare Part B coinsurance, whichever is less. This plan also offers unlimited preventive benefits.*

*Base plans include Medicare Part B preventive services with no maximum benefit amounts.

3. Choose optional base plan riders

Enhance your plan with optional benefit riders, each at an additional cost.

- Rider 1—Medicare Part A Deductible**—WPS will pay either 100% or 50% of your Medicare Part A deductible of \$1,484 during the first 60 days of hospitalization.
- 100% Medicare Part A Deductible
 OR
 50% Medicare Part A Deductible
- Rider 2—Medicare Part B Deductible** (available for highest base plan option only)—WPS will pay your Medicare Part B deductible of \$203 each calendar year. This rider is only available to applicants who were first eligible for Medicare prior to Jan. 1, 2020.

- Rider 3—Medicare Part B Excess Charges**—If your health care provider does not accept Medicare assignment, WPS will pay the difference between what Medicare approves for payment and the amount charged by the provider. The difference shall be no more than the actual charge or the limiting charge allowed by Medicare, whichever is less.

- Rider 4—Additional Home Health Care**—WPS will pay benefits for an additional 325 home health care visits each calendar year up to a total of 365 visits per year, including those covered by Medicare.

- Rider 5—Foreign Travel Emergency**—WPS will pay 80% of the billed charges for expenses associated with medically necessary emergency medical care you receive outside the U.S. that begins in the first 60 days of a trip after you satisfy a deductible of \$250; lifetime maximum benefit of \$100,000.

4. Apply discounts for which you qualify

- 2% Automatic Bank Withdrawal Discount**—Receive a 2% discount when you pay your premium by automatic bank withdrawal each month.
- 7% Household Discount**—Receive a 7% discount when you and another member of your household enroll in a WPS Medicare supplement insurance plan. Household is defined as two or more individuals who reside together in the same dwelling. Dwelling is defined as a single home, condominium unit, or apartment unit within an apartment complex.

Total Medicare Costs Per Person at Age 65

MAGI Tier	Part B Premium (Base Premium)	Part D Premium ¹	IRMAA	Medigap ²	Total Annual Cost
1 (Base)	\$1,979	\$564	\$0	\$2,251	\$4,794
2	\$1,979	\$564	\$791	\$2,251	\$5,585
3	\$1,979	\$564	\$1,978	\$2,251	\$6,772
4	\$1,979	\$564	\$3,164	\$2,251	\$7,958
5	\$1,979	\$564	\$4,351	\$2,251	\$9,145
6	\$1,979	\$564	\$4,747	\$2,251	\$9,541

¹ Weighted WI average premium from slide 38.

² Plan G equivalent from WPS for 65-year-old WI resident living in Southeastern WI premium area (Area 1).

Total Medicare Costs Per Person at Age 80

MAGI Tier	Part B Premium (Base Premium)	Part D Premium ¹	IRMAA	Medigap ²	Total Annual Cost
1 (Base)	\$1,979	\$564	\$0	\$3,911	\$6,454
2	\$1,979	\$564	\$791	\$3,911	\$7,245
3	\$1,979	\$564	\$1,978	\$3,911	\$8,432
4	\$1,979	\$564	\$3,164	\$3,911	\$9,618
5	\$1,979	\$564	\$4,351	\$3,911	\$10,805
6	\$1,979	\$564	\$4,747	\$3,911	\$11,201

¹ Weighted WI average premium from slide 38.

² Plan G equivalent from WPS for 80-year-old WI resident living in Southeastern WI premium area (Area 1).

47

MEDICARE ADVANTAGE

48

Medicare Advantage Plans

- All-inclusive plans
- Combine Parts A, B, and usually D
- May cover services not covered by Original Medicare (for an extra cost)
 - Vision
 - Dental
 - Alternative care
 - Gym memberships
- Emphasis on wellness and preventative care

49

Enrolling in an Advantage Plan

- Enroll in Parts A & B first
 - Pay Part B premium
- Enroll in MA plan with private insurance company
- MA plan may charge its own premium
- Most include prescription drug coverage
- May not deny enrollment based on health status

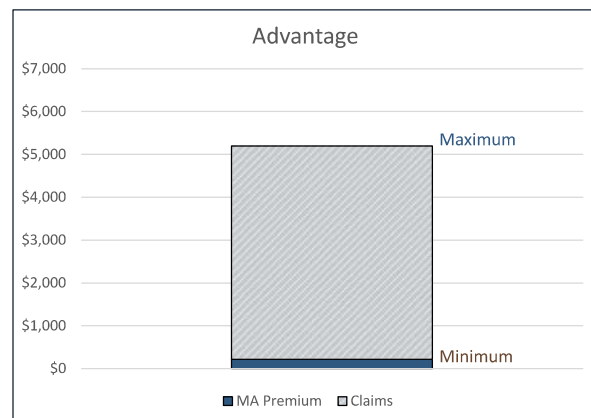
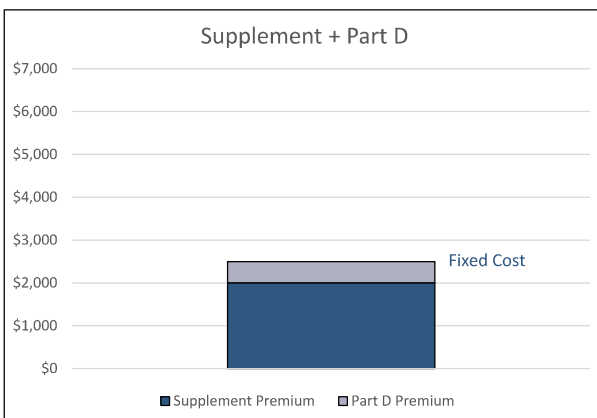
50

Original Medicare vs. Medicare Advantage

Benefit	Original Medicare	Medicare Advantage
Monthly Premium (in addition to Part B)	Yes, for Part D and Medigap	Sometimes
Copays	Rarely	Yes
Annual policy changes	No	Yes
Premium changes annually	Yes	Yes
Prescription Drug Coverage	Must purchase separate plan	Usually included, but plans are available without it
Extra Benefits (dental, vision, etc.)	Varies by plan	Varies by plan, but usually multiple options
Network	Yes	Yes
Guaranteed Issue	Only during first 6 months after Part B enrollment	Yes

51

Example of Annual Costs at Age 65



Medicare Advantage premiums and out of pocket max are based on national averages: <https://www.kff.org/medicare/issue-brief/medicare-advantage-in-2022-premiums-out-of-pocket-limits-cost-sharing-supplemental-benefits-prior-authorization-and-star-ratings/>

52

Helpful Resources

- Plan Finders
 - Medicare Supplement, Advantage, and Part D Plan Finder
 - <https://www.medicare.gov/plan-compare/#/?year=2023&lang=en>
- Resources offered by your state insurance department
 - Check with your state's insurance commissioner (website) for additional information
 - <https://www.medicare.gov/talk-to-someone#resources/sids>
 - 2022 Guide to Health Insurance for People with Medicare in Wisconsin
 - <https://oci.wi.gov/Documents/Consumers/PI-002.pdf>

53

QUESTIONS?

54

1 p.m. – 2 p.m.

M&A Teamwork: The CPA, Investment Banker & Attorney

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Maggie Bafia is a Senior Manager specializing in mergers and acquisitions tax consulting. She has worked closely on numerous transactions with complex tax issues arising from transactions and other M&A activities including a variety of transactions to assist clients with buy- and sell-side due diligence, tax structuring and modeling, merger integration and tax attributes analysis. Maggie has been involved in a variety of transactions across numerous industries. She has extensive experience with cross-border due diligence and structuring engagements, working directly with Grant Thornton International Ltd member firms in various countries, helping clients efficiently and effectively execute on multi-national transactions. Maggie is a Certified Public Accountant, and has a Bachelor of Business Administration in Accounting and Finance from Loyola University Chicago and a Masters of Science in Taxation from DePaul University.



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Tim Oleszczuk is a Managing Director and Co-Founder of TKO Miller, LLC. Tim specializes in middle-market mergers and acquisitions with an emphasis on advising family-and founder-held companies during the business sale process. Prior to co-founding TKO Miller, Tim was a Managing Director and General Counsel at Grace Matthews, a leading Milwaukee-based boutique investment bank. During this time, he focused primarily on the manufacturing and industrial service sectors. While there, he completed nearly 20 deals for one of the largest scaffolding companies in the U.S., and established himself as one of the premier dealmakers within those sectors. Tim has advised on transactions totaling approximately \$3 billion in aggregate value. Prior to Grace Matthews, Tim was a shareholder at Godfrey & Kahn, S.C., where he and his team focused on mergers and acquisitions, corporate finance, and insurance law.

3



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John Sikora is a Shareholder in the Tax, Real Estate and M&A sections at von Briesen & Roper, s.c. He represents clients in tax planning and the buying and selling of businesses and real estate. John has taught the tax practice and procedure course and the corporate income tax course at Marquette University Law School and the taxation of partnerships and S corporations course at the University of Wisconsin-Milwaukee masters program. He has been a frequent presenter to the State Bar of Wisconsin and the WICPA, has presented to the ABA Tax Section, has authored articles for the Journal of Taxation, Journal of Real Estate Taxation, TAXES – The Tax Magazine and other tax publications. He is a former chair of the Board of Directors of the State Bar of Wisconsin Taxation Section, a former editor of the *Wisconsin State Bar Tax News*, has been included in *The Best Lawyers in America*®, Tax (2003-2023), and was named Best Lawyers® Tax "Lawyer of the Year", Milwaukee for 2013.

4

Approach/Objectives

- Timeline of a deal
- Tax considerations along the way for taxable deals
- The team - CPA, investment banker, attorney
- Working together to further client tax-related objectives – seller side, buyer side
- Observations, recommendations regarding critical role of CPA throughout timeline

5

Timeline

- Preparing to market
- NDA
- Letter of intent
- Due diligence
- Definitive agreement
- Closing (and potential pre-closing restructuring)
- Post closing matters/reconciliations/liquidation

6

Preparing to Market - 1

- Value generally – ongoing during life of business, not just when deciding to sell
- Value as to tax matters
- Seller side - calculating correct outside basis of each owner in each entity – seemingly straightforward, but in some situations may require more analysis
- Review of typical tax representations and warranties (see later slides) can aid CPA in identifying tax items to address before buyers are sought. Some examples:
 - If S corporation, review of records for potential prior termination issues - e.g.:
 - Failures to sign S election – e.g., spouses in community property states
 - Ineligible shareholders over time
 - Inappropriate governing documents – e.g., providing for distributions other than based on share ownership
 - Improper/disproportionate distributions
 - Section 1362(d)(3)

7

Preparing to Market - 2

- Review of typical tax representations and warranties (see later slides) can aid CPA in identifying tax items to address before buyers are sought. Some examples - continued:
 - Nexus/state filing issues
 - Notices from tax authorities
 - Potential or past S corp tax liabilities - Sections 1374, 1375
 - Past audits; closing agreement requirements
 - Potential audit issues
 - Independent contractor/ee issues
 - Prior acquisitions/purchases of 197 assets

8

If C Corp, Potential 1202 Benefit?

- Can help to assess early, particularly if many seller shareholders
- CPA/others work together to evaluate potential applicability and degree
- Section 1202
 - Allows for exclusion of gain from sale of certain stock held more than 5 years; portion of gain excluded depends on when acquired
 - General requirements
 - C corporation stock
 - Type of shareholder
 - Original issuance
 - Exchange for money, property or as compensation
 - Active business requirement
 - \$50M gross asset limitation
 - Certain types of businesses excluded
 - \$10M/10 times adjusted basis limitation per shareholder
 - Other

9

EOI/LOI – Some Initial Big Picture Inquiries

- What is essential nature of potential deal?; price?; what is being purchased? is there any real estate that is part of deal?
- The whole or part of a business?; will there be excluded assets?
- What are the seller entities?
- What are tax natures of seller(s), buyer?
- Might sellers retain interest in business after acquisition?; if so, do sellers expect to do so on tax deferred basis?
- Expected to be entity acquisition or asset acquisition from legal perspective?; what is prompting that expectation?
- Is there any reason parties will not be able to agree on purchase price allocation at LOI stage?

10

Early Tax Related Calculations – Seller Side - 1

- Important early step seller side – CPA lead – “walk away money” calculation
- Aids seller side in evaluating alternative buyer proposals, structuring, planning and evaluation in negotiations, and as negotiations progress, things change, detail determined; should be tailored to the situation; see allocation discussion in later slides
- Entity sale deal template - if C corp or S corp stock
 - Start with gross purchase price; allocate it among sell side entities
 - Adjust for estimated closing funds flow items – e.g.:
 - Transaction expenses
 - Funded debt
 - Working capital excess or deficit
 - Equals net purchase price to be paid to shareholders for stock of various entities
 - Allocate such amount among shareholders; subtract outside basis of each shldr
 - Apply applicable tax rates – capital gain federal and state; NIIT; potential 1202 benefit – to calculate tax on gain for each shareholder
 - Summary page – net cash at closing to each shareholder, tax to each shareholder, net after tax cash to each shareholder

11

Early Tax Related Calculations – Seller Side - 2

- Entity sale deal template - if disregarded entity or tax partnership
 - If disregarded entity – sell side and buy side - treated as asset sale, but without need to calculate liquidation step for sell side (see later slide)
 - If tax partnership (all interests acquired) – Rev. Rul. 99-6, Situation 2
 - Buy side – purchase of assets following deemed liquidating distribution of assets to existing tax partners
 - Sell side - sale of interests; Sections 741 and 751 applicable
 - Start with gross purchase price, with adjustment for potential working capital excess/deficit; allocate it among sell side entities
 - Allocate result among assets of the entities
 - Apply Section 751 principles to determine ordinary income item/amounts
 - Adjust for each owner’s share of expected closing funds flow items (see exps. prior slide)
 - Apply applicable tax rates – capital gain to 741 portion and ordinary to 751 items
 - Summary page - net cash at closing to each owner, tax to each owner, net after tax cash to each owner

12

Early Tax Related Calculations – Seller Side - 3

- Asset sale deal template – usually involves determining tax consequence of asset sale and then of liquidation (or deemed liquidation) of each entity
 - Start with gross purchase price, and provide for potential working capital excess/deficit modification; for tax calculations, add estimated debt to be assumed by buyer, including current liabilities assumed in connection with working capital aspect of deal
 - Allocate result among sell side entities
 - Allocate amounts allocated to each entity among assets of the entity, and determine adjusted basis of the various assets to which purchase price has been allocated
 - Calculate gains or losses of sales on various assets (taking into account also expenses of sale of each entity)
 - Determine character (if entity is pass through entity) of gains and losses
 - For other than pass through entities, apply applicable federal and state tax rates to determine tax amounts, if any, due from entity (and, if S corp and applicable, 1374 tax)

13

Early Tax Related Calculations – Seller Side - 4

- Asset sale deal template - continued
 - Allocate (for each pass through entity) total gains and losses, by category (capital/1231, ordinary, unrecaptured 1250 gain) among the owners of the entity
 - Calculate the resulting outside basis of each owner for the entities that are pass through entities after such allocation of total asset sale gain/loss to each owner
 - Next (moving to liquidation step)
 - Calculate distribution to be made to each owner of each entity after payment of all entity obligations not assumed by buyer and any entity level taxes
 - Determine capital gain or loss on liquidation to each owner on liquidation of each entity (liquidating distribution minus outside basis in interest)
 - If entity is pass through entity, net the capital gain or loss upon liquidation and the capital/1231 gains from asset sale flow throughs

14

Early Tax Related Calculations – Seller Side - 5

- Asset sale deal template - continued
 - Next (moving to shareholder tax calculation step)
 - For other than pass through entities, apply applicable state and federal capital gain tax rates to liquidation gain, if any, to determine tax for each owner of each such entity
 - For pass through entities, apply applicable federal and state capital gain, ordinary, and unrecaptured 1250 gain tax rates to overall income and gain amounts of each owner from combination of items passed through and resulting from liquidation, to determine tax for each owner of each such entity
 - Next (moving to summary step), summarize amount available for distribution to shareholders, shareholder tax and net cash to shareholders

15

Early Tax Related Calculations – Buyer Side - 1

- Buyer side template is tool to evaluate: effect of purchase price allocations; effect of purchasing interests in a corporate tax entity without deemed asset sale treatment (discussion in later slides); potential gross up (see later slides)
- Aids buyer side in evaluating alternative seller proposals, structuring, planning and evaluation in negotiations, and as negotiations progress, things change, detail determined; should be tailored to the situation; see allocation discussion in later slides
- Buyer deal template
 - Start with gross purchase price, including assumed liabilities; allocate it among sell side entities
 - Identify assets held by each
 - Allocate purchase price allocated to the entity among those assets
 - Using such allocations, determine depreciable/amortizable lives of the various assets, and calculate expected depreciation deduction for assets in each year

16

Early Tax Related Calculations – Buyer Side - 2

- Buyer deal template - continued
 - Determine assumed tax rate that will apply given buyer tax entity status for each such year, and apply that tax rate to the expected depreciation/amortization deduction in each year to determine expected tax benefit of depreciation/amortization for each year
 - Calculate present value of those tax benefits
 - Result will be referred to below as “PV Depr at FMV”
 - Then, identify seller entities that are taxed as corporations
 - Identify assets held by each
 - Using adjusted basis of seller corporation in those assets, calculate expected depreciation/amortization deduction for those assets in each year

17

Early Tax Related Calculations – Buyer Side - 3

- Buyer deal template - continued
 - Determine assumed tax rate that will apply given buyer tax entity status for each such year, and apply that tax rate to such expected depreciation/amortization deductions in each year to determine expected tax benefit of depreciation/amortization for each year
 - Calculate present value of those tax benefits
 - Add present value of tax benefits from PV Depr at FMV for entities other than those corporations
 - Result will be referred to below as “PV Depr Without Asset Sale Election”
 - Subtract PV Depr Without Asset Sale Election from PV Depr at FMV
 - Result is difference in value to buyer between entity purchase (without any deemed asset sale elections discussed in later slides) and asset purchase transaction

18

Will/should Asset Sale Deal Include a Gross Up - 1

- The results of this early work commonly shows that the net amount to the seller side owners from a sale of stock will exceed net amount to them from an asset sale or deemed asset sale (see later slides); the seller calculations will show the magnitude of the difference, and sellers will normally want stock sale and not asset sale transaction; buyers will typically not want to forego the value of a deal structured entirely as asset deal, the magnitude of which will be disclosed by its calculations
- Conflicting desires often resolved by buyer agreeing to make an additional payment to the sellers so that seller owners are in the same net cash position from the deal as if there had been a stock sale or transaction in which only capital gain had been recognized (such additional payment, a “gross up”)

19

Will/should Asset Sale Deal Include a Gross Up - 2

- Because the gross up will be additional purchase price, it will be also be taxable; accordingly, if there is to be a gross up, it is common for the amount of the additional payment from buyer to include the additional tax on the gross up (that portion, sometimes referred to as a “gross up on the gross up”)
- Issue should be discussed in connection with evaluation of proposals from buyers; may be differentiating factor as between potential buyers; reply from some prospective buyers to seller request for gross up is that deal was priced on assumption it would result in full basis step up for buyer
- Complicating factors/items to be addressed:
 - Text of definitive agreement will typically refer to difference in tax or difference in net cash to seller owners determined by comparing a stock sale and an asset sale; without more, such text may produce uncertainty regarding how calculation to be done and when

20

Will/should Asset Sale Deal Include a Gross Up - 3

- Complicating factors/items to be addressed - continued
 - Other uncertainty sometimes existing regarding intent of parties as to gross up calculation – e.g., whether other seller tax attributes should affect calculation; whether seller side benefit from state SALT deduction limitation workarounds should be considered; whether and how Section 199A should apply; whether and how net investment income tax should apply; what if the seller is on the cash method of accounting and has significant receivables – should the buyer in effect bear burden of same in the gross up calculation?
 - Solution – CPA should prepare spreadsheet that is incorporated in definitive agreement showing detailed methodology for calculation of gross up
 - Alternative – address some of the uncertainties in definitive agreement text
 - Alternative – agree on specific gross up amount at time of definitive agreement, with no later adjustment; parties will then each assume some risk the amount will differ from actual that would have been calculated

21

Deemed Asset Sale – 338(h)(10) or 336(e) - I

- If the deal involves a purchase of at least 80% of the stock of a C corp subsidiary or the stock of an S corp, another EOI/LOI stage consideration will be whether buyer seeks deemed asset sale treatment under Section 338(h)(10)
- Results for income tax purposes in treatment of stock deal as deemed sale of assets of target to a new tax entity deemed to have been formed, followed by deemed liquidation of old target corp (so, stock sale is ignored for tax purposes, and asset sale issues such as gain/loss character, potential 1374 tax, etc. will apply)
- So, buyer will obtain benefit of purchase price basis in assets, as opposed to existing inside basis if no (h)(10) election made
- Requirements
 - Purchaser is corporation
 - Election made by shareholders of seller corporation and buyer

22

Deemed Asset Sale – 338(h)(10) or 336(e) - 2

- Section 336(e) election similar; unlike (h)(10), it may also be used in case of noncorporate purchaser
- Advantages of each over actual asset purchase are principally non-tax (e.g., avoiding of potential issues obtaining third party approvals regarding transfer of contracts, fewer conveyancing issues, etc.)
- However, non-tax and tax issues relating to purchase of stock remain for buyer (e.g., risk of undisclosed liabilities in corporation, including all tax obligations of entity)

23

F Reorganization - I

- Now common approach (as opposed to 338(h)(10)) to achieve asset sale treatment for income tax purposes involving transfer of equity interests in sale of S corp business
- Term refers to initial steps in a pre closing restructuring intended to result in single member disregarded entity then purchased by buyer; See Rev. Rul. 2008-18
- Typical steps (first 3 are “F reorg steps”)
 - Formation of new corporation (“Holdco”)
 - Contribution by S shareholders of stock in existing S corp (“Oldco”) to Holdco solely in exchange for stock in Holdco
 - Making of Qsub election for Oldco by Holdco, to be effective immediately after the contribution
 - State law conversion of Oldco to single member LLC; or formation by Holdco of new SMLLC and merger of Oldco into that new LLC
 - Buyer then purchases interests in disregarded LLC; asset purchase for income tax purposes if all interests acquired by buyer and Rev. Rul. 99-5, Situation 1 treatment if less than all interests acquired by buyer

24

F Reorganization - 2

- CPA involvement important in planning for and carrying out these steps in timely and correct manner over period of time before closing date; items (see Rev. Rul. 2008-18):
 - Obtaining of new EIN for Holdco (Oldco retains its EIN)
 - Filing of S election for Holdco; though the revenue ruling indicates that where, in connection with such F reorg, Holdco meets the requirements to be an S corporation, the reorg does not terminate the S election of Oldco and the S election remains in effect for Holdco, it is common practice to file a protective S election for Holdco
 - Making of Qsub election for Oldco by Holdco, to be effective immediately after the contribution; election must be made prior to Oldco converting to an LLC or merging into a new LLC, so election is done some number of day(s) before that step
 - If Oldco has made tax payments (such as under Section 7519 or to state), sell side CPA will want to work with counsel to include text in definitive agreement confirming seller ownership of such payments and work with taxing authority to get same moved to account of Holdco

25

Due Diligence – Tax Matters - I

- Buy side CPA involvement in/leadership of tax due diligence
- CPA should seek prompt access to deal data room
- Typical representations and warranties tend to identify tax matters the CPA may be asked to review/address/understand
- Will vary depending on nature of deal/structure
- Examples of items/issues (and see seller list above):
 - Seller entities tax status
 - Seller S corporation election and confirming IRS documentation
 - Seller S corporation termination issues – see prior slides for types of issues
 - Seller entities tax accounting methods
 - Seller entities tax returns for obvious errors or omissions/disclosures
 - Target NOLs/other tax attributes
 - Potential for 1374 tax
 - Potential for 1375 tax
 - Prior acquisitions

26

Due Diligence – Tax Matters - 2

- Examples of items/issues - continued
 - Sufficiency of tax reserves, deposits
 - Sufficiency of information reporting
 - Property tax reassessment notices
 - Sales tax exemptions and exemption certificates
 - Potential international presence
 - Related party payments
 - Identity of affiliates
 - Tax sharing agreements
 - Tax obligations under third party agreements
 - Investments in pass through entities
 - If tax partnership, identity of partnership representative, and potential liability at entity level under partnership audit regime
 - Prior audits/settlement documents/closing agreements
 - Extensions of statutes of limitation
 - Prior federal, state, local tax notices

27

Due Diligence – Tax Matters - 3

- Common significant issue – nexus/state tax filings/voluntary disclosure
 - Buyer due diligence will include review target's business activity, including where sales occurring, employees located, property located, affiliates located, trade shows and other business generation activities occurring, etc.
 - Buyer may want some level of nexus study, comparing that activity to state sales and income tax reporting history; review should include how long target has filed in states; reference will be to physical presence or economic nexus
 - If potential filing requirements have not been met, buyer may ask for number of protections, including cooperation regarding filing of voluntary disclosure agreement applications and specific tax indemnity on subject and specific tax escrow, which will likely include seller obligation to pay fees for VDA work
 - If VDA is to be pursued, negotiation will follow regarding who is to do (usually buyer CPA firm), applicable states, deadlines for completion, seller VDA review rights, seller objection rights and dispute resolution

28

Definitive Agreement – Generally

- CPA should be asked to review tax provisions from earliest draft forward
- Typical sections for review:
 - Tax related definitions
 - Purchase price and purchase price adjustment
 - Gross up provisions
 - Purchase price allocation
 - Tax representations and warranties
 - Survival period
 - Tax covenants
 - Tax indemnity
 - Transfer tax
 - Tax escrow, if any
 - Tax controversy

29

Definitive Agreement – Tax Definitions

- Among potentially important tax related definitions typically in purchase agreement that CPA should review:
 - Tax – the text tends to be quite similar in all purchase documents; but, CPA should review closely, as used throughout document, often relating to seller responsibility for tax; so, buyer side will generally want to be sure definition is broad and includes, for example, all types of taxes, including foreign, federal and local, and that it includes penalties, additions to tax and interest
 - Pre-Closing Tax and Pre-Closing Tax Period or similar defined terms – the terms will be used in various provisions, significantly in the tax indemnity or other provision governing seller responsibility for tax; both sides should consider effect of authority regarding when tax years are deemed to end in reviewing these definitions
 - Tax Return
 - Transfer Tax

30

Definitive Agreement - Escrows

- Escrows are common in any type of transaction, most often used to secure for some period of time the accuracy of seller representations, warranties and covenants in favor of buyer; a tax question is whether the amount of the escrow is considered received by seller at time of closing; IRS view is that escrowed funds are deemed received by seller unless seller rights in escrow funds are subject to substantial restrictions and seller does not have economic benefits in funds until they are released; in most transaction cases, escrowed amounts will not be considered received by seller until circumstances occur requiring release from escrow; CPA may be asked to advise regarding whether seller rights under agreement are appropriately limited at closing; CPA, unless facts suggest otherwise, usually assumes all escrow funds will be received in doing tax calculations in “walk away money” spreadsheet

31

Definitive Agreement - Contingent Payment Arrangements

- Earn outs are part of a minority of deals; when present, they take a variety of forms, most of which are measured with respect to revenue or earnings metrics, but there are occasionally other types of contingent payment arrangement benchmarks; as to former, sellers generally like measurement metric to be as far up the income statement as possible, and buyers may generally like the metric farther down, such as measured after certain expenses or costs; sellers will prefer progressive type arrangements, buyer often cliff type arrangements
- CPA should be prepared to advise regarding rules governing taxation of deals with contingent payment arrangements; see, e.g., Regulation 15a.453-1(c); installment sale rules for determining amount of gain to recognize each year distinguish contingent payment sales for which a maximum selling price is determinable, sales for which a maximum selling price is not determinable but the time over which payments will be received is determinable, and sales for which neither a maximum selling price nor a definite payment term is determinable
- If the entity is a corporation, is to be liquidated after closing and will be distributing an installment obligation received in the deal, will likely be important to adopt a plan of liquidation (12 month) on or before the day of closing; see Sections 453(h) and 453B(h)

32

Definitive Agreement – Gross Up - 1

- If asset sale for tax purposes and there is to be gross up:
 - Review gross up text; “with and without” asset sale text is typical; but other text sometimes used; text should effectively compare net cash owners would have received if transaction treated as a stock deal to net cash owners would receive from treatment as asset deal; calculation should take effect of liquidation or deemed liquidation of seller entities into account, but sometimes parties will agree to a less precise approach
 - Gross up provision may not be well understood by nontax drafter and parties, and general text may produce ambiguity (see discussion earlier slide); so, recommend including exhibit illustrating calculation in definitive agreement; this benefits both seller and buyer as if detailed will show expectations of parties regarding text used in document; CPA should prepare it
 - Seller side – important - seek payment of estimated gross up amount at closing; this is very often overlooked, but can have beneficial effect of not only getting cash to seller earlier, but also for both sides as shows expectations of the parties regarding text in the document

33

Definitive Agreement – Gross Up - 2

- If asset sale for tax purposes and there is to be gross up – continued
 - Parties occasionally agree to a set dollar modification to purchase price intended to approximate gross up, with then no later text about it or later true up
 - More common approach is not to so agree on a set dollar amount, and to finalize determination within some period after closing, often the same or similar to period for finalizing working capital adjustment
 - Party who is to do first post closing calculation of gross up is negotiable, but most often will be buyer; dispute resolution text should included/reviewed, both as to who is to resolve seller-buyer differences in calculation and scope of that person’s authority; again, recommended that calculation exhibit be included in agreement
 - Additional negotiated item – whether gross up is to be redetermined in event of examination adjustment to purchase price allocation; seller side typically wants, buyer side often not

34

Definitive Agreement – Allocation - 1

- Allocation provisions should be negotiated as early as possible in any straight asset sale deal or any deal involving sale of disregarded or pass through entity interests or any deal involving deemed asset sale treatment, particularly, as to seller side, if no complete gross up is to be part of deal; the more uncertain the ultimate allocation, the greater the potential seller side desire for gross up; some deal participants may require post closing allocation based on valuation occurring then, but even if so, stating of allocation principles early preferred; best not to defer to near closing
- Obvious influence in many transactions on amount sellers will ultimately receive from deal
- If allocation is to be done post-closing, allocation principles should be included in definitive agreement that are as detailed as possible

35

Definitive Agreement – Allocation - 2

- Allocation at entity level and asset level should be done if more than one seller entity; buyer side may sometimes be indifferent regarding entity level allocations
- Definitive agreement should require all parties to report the transaction in a manner consistent with the final allocation, and prohibit parties from advancing positions inconsistent with allocation on audit
- Agreement may provide that parties will exchange copies of applicable asset acquisition forms at the time of the filing of their respective tax returns

36

Definitive Agreement - Tax Representations and Warranties - 1

- Certain are typical – nonexclusive list of examples below
- Will differ some depending on whether entity purchase or asset purchase deal
- Nature of seller entity – C corp, S corp or tax partnership
- If an S corp:
 - Proper election made
 - Date
 - Federal and state
 - No circumstances at any time resulting in termination of S status
 - Each shareholder and former shareholder was eligible S shareholder
 - No challenge at any time received to S status
 - No liabilities under Section 1374 or 1375

37

Tax Representations and Warranties - 2

- Tax returns and payments
 - All filed; all timely filed
 - Including affiliated groups of which target is or was member
 - No inclusion in such groups currently or previously
 - All are true, accurate and complete
 - No extensions
 - Copies have been provided to buyer
 - All taxes (whether required to be shown on returns or not) have been fully and timely paid
 - No notice from any jurisdiction in which entity does not file that tax return or tax payment may be required

38

Tax Representations and Warranties - 3

- No tax liens on equity interests or assets
- Tax audits/proceedings
 - None pending
 - None threatened
 - No waivers of statutes of limitation or extensions regarding assessment or deficiency
 - Copies of all examination notices, notices of deficiency, etc. have been provided to buyer
- All required withholding done and timely paid – ees, independent contractors, third parties, etc.
- Seller is not a beneficiary of any tax rebate, tax holiday or similar benefit from any government authority

39

Tax Representations and Warranties - 4

- No responsibility for tax liabilities of another
 - Under Section 1502 regulations
 - By reason of tax sharing agreements
 - Under contract
 - As transferee or successor
 - Any other reason
- No closing agreements, offers in compromise existing

40

Tax Representations and Warranties - 5

- No potential for post-closing inclusion of income or prohibition on deduction due to pre-closing matters; e.g.:
 - Use of installment method
 - Accounting method changes
 - Use of improper accounting methods
 - Prepaid amounts received
 - Section 108(i)
 - Related party or intercompany transactions
 - Other
- If corp, it has not distributed stock or had its stock distributed in 355 type transaction

41

Tax Representations and Warranties - 6

- Seller has not be party to any “reportable transaction”
- All transactions that could give rise to an underpayment of tax were reported in a manner that will not give rise to penalties
- Seller has not deferred any taxes or taken a credit for any taxes pursuant to any government program (e.g., COVID-19 related program)
- Seller does not have and has not previously had any foreign establishment and is not liable for any foreign tax or filing obligations
- If an F reorg deal, that all restructuring steps have been completed prior to closing; buyer may want assurance restructuring steps have certain effect; seller side will typically want buyer side to review documents to be filed and make its own assessment regarding same

42

Definitive Agreement - Tax Covenants - 1

- CPA should review all these provisions (sometimes request overlooked)
- Preparation and filing of tax returns
 - In “straight” asset deal, less text
 - In equity purchase, including equity purchases that are deemed asset sale deals, text regarding authority/responsibility to prepare returns needed
 - Seller will typically be responsible for all seller entity returns due prior to closing date; buyer may seek text allowing it to prepare all purchased entity returns due after closing; while may be acceptable, seller usually seeks to carve out from that provision authority to prepare income tax returns for tax periods ending on or before closing date, and in particular income tax return for the “S short year” resulting from termination of S status, which commonly results from such transactions

43

Definitive Agreement - Tax Covenants - 2

- Preparation and filing of tax returns - continued
 - Straddle periods are those that begin before closing and end after; buyer typically prepares; both parties typically desire “closing of the books” text to govern allocation of items to pre- and post-closing times for purposes of allocating responsibility for tax for straddle period income tax returns; similarly, parties typically prefer such text for purposes of allocating items to short S year and short C year returns in cases in which transaction terminates S status; for other than income tax straddle returns (e.g., ad valorem taxes), responsibility for tax is typically allocated between buyer and seller based on daily proration
 - Parties should both have reasonable review and comment rights regarding returns prepared by the other, and dispute resolution provisions are often included
 - Seller will want text stating returns for which seller may have liability for all or portion of tax are to be prepared consistent with prior practices, consistently applied, and that deductions for transaction expenses and change of control and similar payments for which it bears burden are to be for its benefit

44

Definitive Agreement - Tax Covenants - 3

- Seller should seek text prohibiting buyer from amending prior year returns without seller consent, or, if that not acceptable to buyer, then consent required if the amendment would have the effect of increasing seller responsibility for taxes
- Both parties will typically want tax cooperation text relating to such matters as providing access to records and documents in connection with preparation of tax returns and audit proceedings for which it is responsible; seller will usually no longer possess business records after closing and so should seek text requiring buyer to retain them until expiration of statute of limitations period
- Regarding audits, seller should seek text requiring notice of commencement affecting pre-closing periods, and right to control such audits; buyer will want right to participate at its cost; regardless of which party will control, both parties will want right to reasonably approve settlements to be made by the controlling party and right to be kept reasonably informed of progress of audit
- Parties sometimes seek confirming text that no 336 or 338 elections will be made, if that is the case

45

Definitive Agreement - Tax Indemnity

- Typical indemnification in favor of buyer: taxes for tax periods ending on or before closing date; taxes for portion of straddle periods through closing date (seller preference, though, is sometimes to measure with respect to an effective time on closing date); taxes for any group of which any seller entity was a member; and taxes for which any seller entity is liable under contract or as transferee or successor or under law
- CPA should review text, with particular attention to effect of tax provisions governing when tax years end
- Text often states seller indemnification obligation will not expire until some number of days after all applicable statutes of limitation expire

46

Transfer Tax

- Transfer tax on transaction events most often a seller responsibility, sometimes split between parties, rarely buyer complete responsibility – but, is negotiated item, and agreement may depend on magnitude/applicable state/item giving rise to potential transfer tax
- CPA should review definition in definitive agreement
- CPA should assist in evaluating potential amount due and potential exemptions, such as occasional sales exemption
- Obtaining of applicable sales tax exemption certificates from buyer may be helpful for seller in some situations; for example, seller will sometimes seek resale exemption certificate
- If large real estate value, parties sometimes discuss structuring that appropriately eliminates real estate transfer tax

47

Rollovers

- Seller owners sometimes acquire some equity in buyer or buyer affiliate in connection with the business sale; sellers typically want to do so on a tax deferred basis, and buyers are usually eager to cooperate as it is an inducement to seller making investment
- In such cases, CPA should assist in evaluating recommended structure for accomplishing nonrecognition treatment, which will often involve application of Section 721 and sometimes Section 351, and consult with counsel regarding satisfying of requirements of those sections
- Seller side CPA should also be asked to review tax provisions of governing instruments of buyer entity in which seller owners will hold interests, such as operating agreement of buyer LLC if to be taxed as partnership, regarding which CPA will want to advise regarding allocation, distribution, capital account and, importantly, Section 704(c) matters

48

Post Closing Matters - 1

- CPA will naturally (should) participate in post-closing tax-related matters
- Including:
 - Review of any post-closing purchase price allocation proposal; seller side - updating of “walk away money” projection in light of allocation and finalizing of closing statement and working capital
 - Preparation or review of proposed/final gross up calculation
 - Review and comment regarding all pre- and post-closing returns, particularly straddle period returns
 - Preparation or review and exchange of Forms 8594 with other side

49

Post Closing Matters - 2

- It may be advantageous to be sure seller entities engaged in asset sale type transactions are liquidated before the end of the tax year of the owners with or within which the year of the applicable entity ends; this will be particularly important if a liquidation will result in a capital loss to the owner and capital gain/1231 income is being recognized and passed through in the sale transaction; examples of situations in which need to timely liquidate likely are S corporation asset sales where there have been prior outside basis step ups due to prior purchases of stock by current shareholder(s) or receipt of stock by current shareholder(s) upon death
- Can result in need for prompt post-closing work in connection with transactions closing near year end

50

Post Closing Matters - 3

- “Walk away money” seller side spreadsheet should disclose whether prompt liquidation desirable
- Liquidation is automatically deemed to occur in the case of a Section 338(h)(10) election, but that is not be the case (for Holdco) in the case of an F reorganization type transaction

51

Questions/Comments

Thank you for your attention

52

1 p.m. – 2 p.m.

Family Offices Large, Medium & Small

Lucien Beaudry, J.D., *Shareholder, Reinhart Boerner Van Deuren s.c.*

Gregory Monday, J.D., *Shareholder, Reinhart Boerner Van Deuren s.c.*

WISCONSIN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

TAX CONFERENCE 2022

FAMILY OFFICES: LARGE, MEDIUM & SMALL

Presented by:
Lucien Beaudry
Gregory Monday
Kristi Allen

1

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Introduction

Objective

Help families use a Single Family Office or similar alternative to collectively manage their wealth and financial affairs in a way that is likely to produce better results than if family members are left to find their own ad hoc and separate approaches to investing, financial planning, accounting, and wealth succession.

2

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Introduction

- PART I

What does a Single Family Office do and how does it benefit the family members it serves?

- PART II

How can a classic Single Family Office be organized and operated to utilize tax efficiencies that are not available without the Family Office structure?

- PART III

What are the alternatives for a collective approach to managing the wealth and financial affairs of a family whose net worth cannot support a classic Single Family Office?

3

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What is a “Single Family Office”?

- "Family Office" is a loosely-defined term to refer to any formal structure under which the delivery of a range of financial services is coordinated for all or some of the members of a family and the trusts that have been established for them.
- A Single Family Office entity is established as an LLC or a corporation to provide financial services to family members and their trusts more effectively than an approach under which family members and their trustees obtain financial services from disparate providers on an *ad hoc* basis.

4

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Why a Family Office?

- For family members and their trusts, a collective approach to financial services lowers costs and improves quality of services (through improving quality of service provider and better coordination of services).
- If the family owns an operating business, a formal separation of personal and trust financial management into a segregated, independent entity, lowers the risk that the family business personnel will make mistakes involving personal family and trust affairs due to an uncoordinated, *ad hoc* approach, and reduces the distraction that can be created when family and trust affairs are run through the Business systems.

5

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What Services can a Family Office provide?

- Financial record keeping (electronic and/or hard copies), including:
 - All business entities' governing documents and owner agreements (e.g., shareholders' agreements, operating agreements, voting trusts);
 - Historical business financial reports and account investment statements;
 - Copies of business entity tax returns, trust tax returns, personal income tax returns, gift tax and estate tax returns;
 - Trust instruments, trust amendments, copies of annual accountings, copies of historical investments statements, copies of appointment and resignation of trustees;

6

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What Services can a Family Office provide?

- Financial record keeping (continued):
 - Personal estate planning documents, including prenuptial agreements and powers of attorney;
 - Family member names and contact information, social security numbers, family tree, birthdates and death dates;
 - Copies of documents for substantial personal or trust transactions (e.g., acquisition of a residence, loans among family members or from commercial lenders, purchase or sale of business entity interests, divorce docs, adoption docs);

7

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What Services can a Family Office provide?

- Tax support and compliance, through one third party provider (i.e., YOU!);
- Trust accounting and administration, including payment of life insurance premiums, payment on installment notes, delivery of annual "Crummey" notices, payment of annual amounts under grantor retained annuity trusts, charitable remainder trusts, charitable lead trusts;
- Record keeping and support for 529 Plans;

8

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What Services can a Family Office provide?

- Cash management and bill pay for individuals and trusts;
- Facilitation of individual estate planning through preferred providers, or support provided to personal estate planning professionals, including prenuptial agreements, generation-skipping trusts, and valuation of business entity interests for estate planning transactions;
- Assistance with life insurance, disability insurance, and long-term care insurance underwriting and policy maintenance;

9

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What Services can a Family Office provide?

- Administrative support and record keeping for family foundations and other charitable entities, including coordination of asset custody and management;
- Collaborative or pooled investment in marketable securities for family members and trusts, including negotiated custodial arrangements, with preferred providers;
- Collaborative or pooled investment in alternative investments, including legal review of investment documents, for family members and trusts;

10

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What Services can a Family Office provide?

- Creation and management of family investment vehicles, including LLCs or limited partnerships to make direct investments in promising businesses started by individual family members or third parties;
- Creation and management of a "family bank" to make low interest loans to family members for home acquisitions, education, or new business opportunities.

11

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Summary of Lender Management Case and Sample Family Office Structure

12

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Background

- Goal: operate a family office tax efficiently:
 - Deduct applicable expenses of employees
 - Avoid personal expense characterization
 - Avoid related income and expenses that do not offset
- Challenges:
 - 2017 TCJA - eliminates section 212 deductions, including “investment advisory” deductions
 - “Trade or business” expenses under section 162 are deductible
 - Can a family office be a trade or business? Facts and circumstances test = risk
- 2017 case (Lender Management) provides potential pathway to creating a family office that constitutes a trade or business

Lender Management, LLC v. Commissioner, TC Memo 2017-246

Facts:

- Family office LLC is managed and owned almost entirely by a grandson of a founder of Lender Bagels provided financial advisory and management services to investment LLCs
- Investment LLCs primarily benefited of related younger generation
- Grandson: qualified financial background and served as chief investment advisor
- Family office LLC held a “profits interest” in investment LLCs
- In profitable years, the family office received a distribution and in unprofitable years it did not

Lender Management, LLC v. Commissioner, TC Memo 2017-246

- Key Issue: Did the Family office LLC constitute a “trade or business” for purposes of section 162.
- Key facts in court’s finding of a trade or business:
 - Extensive activities of full-time employees
 - Grandson’s extensive activities in researching investment opportunities, negotiating and executing new investments, monitoring existing positions, and working with individual clients to understand their investment needs
 - Although heightened scrutiny due to related party status of “clients,” taxpayer overcame this scrutiny because of the professional manner of doing business and the family office’s observance of formalities
 - Each family member was provided with individually tailored advice based on such family member’s situation

15

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Key Considerations For Deductible Expenses

- Actual business activity, conducted on a regular and arms-length basis consistent with a profit motive, and not primarily for the management of one’s own capital
- Diverse investment activities (*i.e.*, real estate, private equity, venture capital) could enhance trade or business facts
- Avoid/minimize “personal expenses” at family office
- “Profits interest” is key, although it comes with cash flow risk. Fee from related investment partnership will be non-deductible to the investment partnership.
- Outside clients could be very helpful (especially if services provided on the same terms as related clients). However, this could create a risk of SEC “investment advisor” compliance and registration.

16

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Sample Structure

- Multiple Activities
 - Liquid investments
 - Private Equity/Venture Capital Investments
 - Real Estate
 - Business Consulting
- S corp structure for service entity
- All entities operated in a flow-through structure

17

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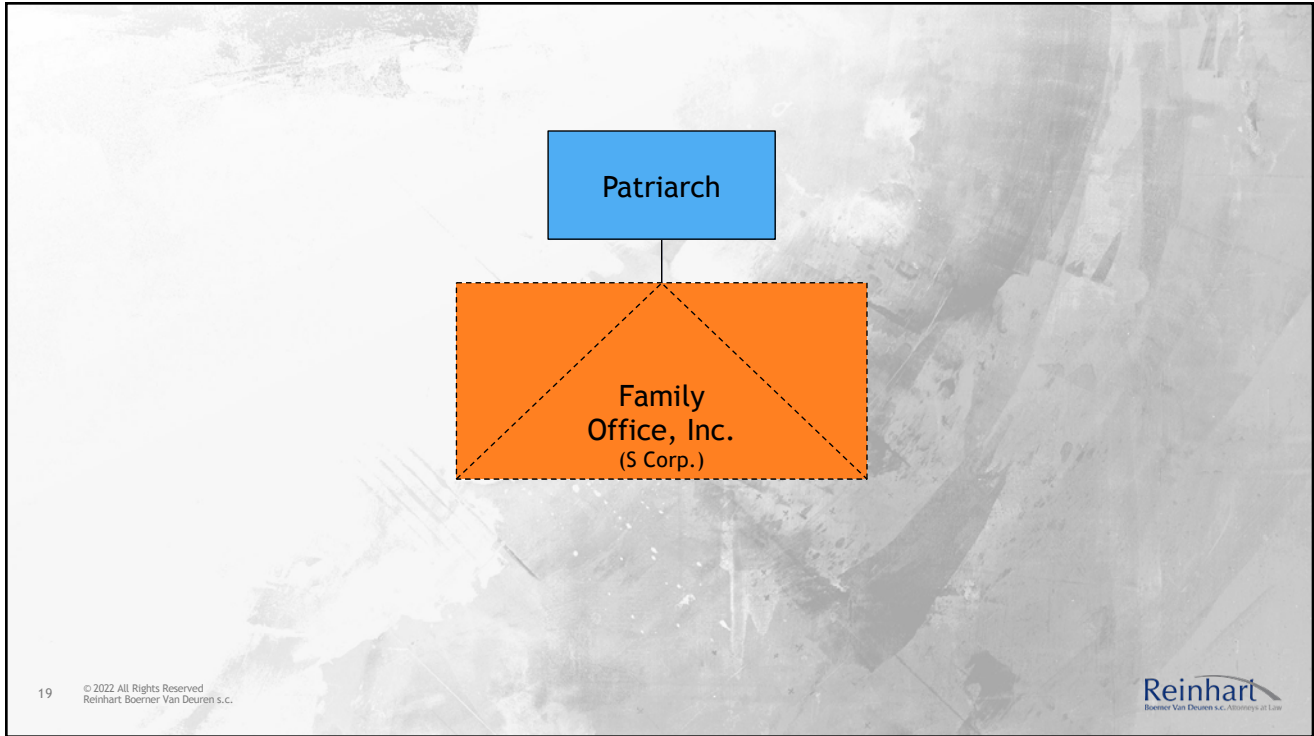
Family Office, Inc.

- Taxed as an “S” corporation
- Purpose
 - Investment Management Company
 - Business consulting
- Ownership Structure
 - Owned 100% by Patriarch
- Other
 - Cash flow derived from:
 - Profits interests in managed entities
 - Revenue from consulting and management services
 - Revenue from back office services (e.g., accounting and bill pay)
 - Patriarch may be required to make a capital contribution to fund operations if insufficient cash flow is derived from the profits interests and activities described above

18

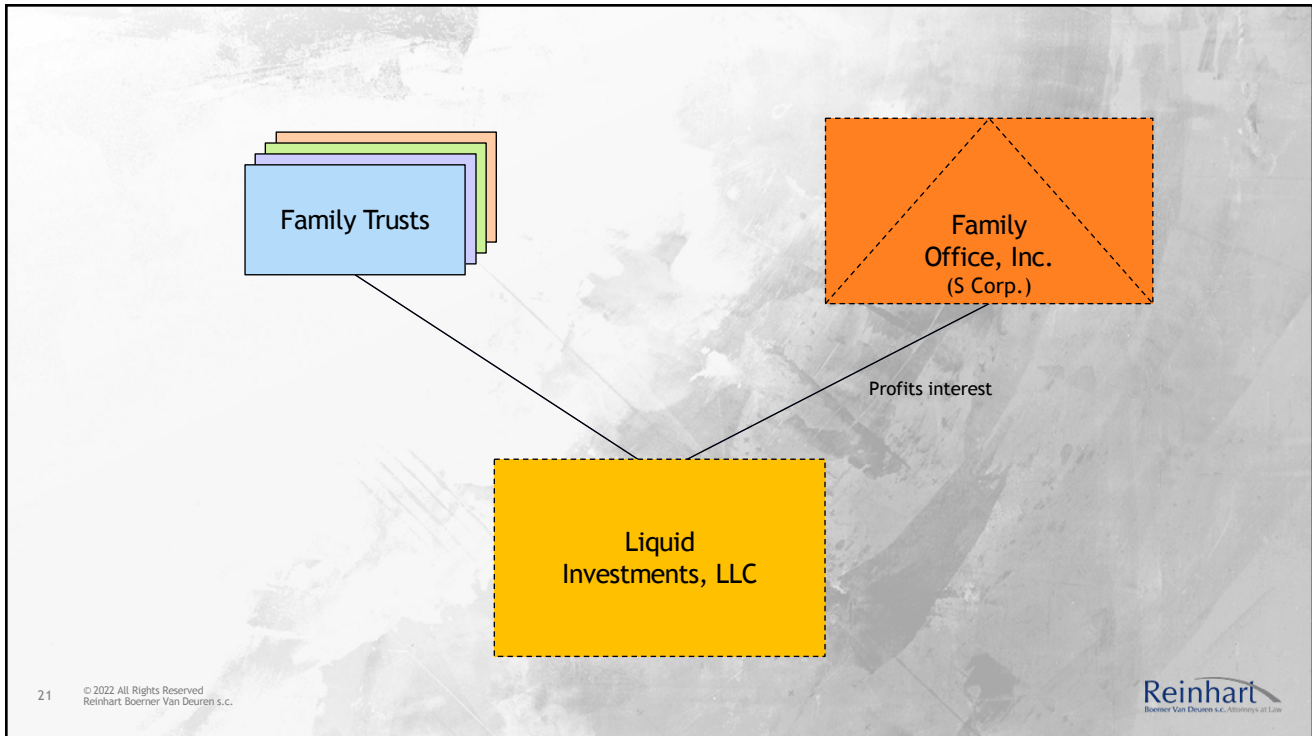
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Liquid Investments, LLC

- Purpose
 - Hold liquid investment assets that are capable of being “marked to market” on a monthly basis
 - Intended to qualify as a “securities partnership” for tax purposes
- Ownership Structure
 - Partnership for tax purposes
 - Owned by Patriarch individually, Family Trusts and Family Office, Inc.
 - Patriarch and trusts own “common units”
 - Family Office, Inc. owns “incentive units”
 - Family Office, Inc. is the manager of the LLC
- Other
 - Permits the creation of different investment pools whereby the owners may have a different percentage in the various pools. May also operate using just one pool to ease the accounting burden.
 - Incentive Units entitle Family Office, Inc. to a portion of the profits of Liquid Investments, LLC, determined separately for each pool. Each owner (including Family Office, Inc.) controls the timing of distributions of its share of capital contributions and profits, and may cause distributions to be made on a periodic basis to the extent such owner has a positive capital account
 - Accrued allocations to Family Office, Inc. carryover and are paid when the company has sufficient cash flow



Private Equity Investments

➤ Purpose

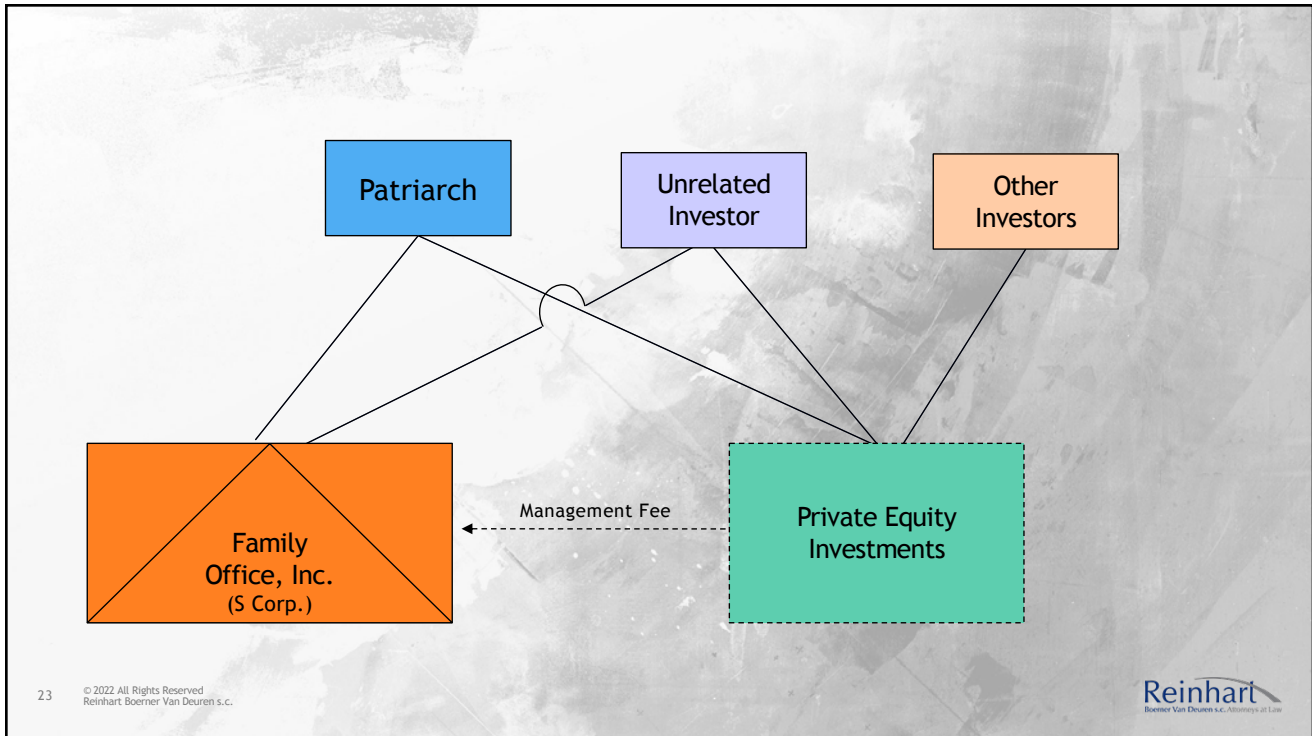
- Invest in the equity of closely held businesses (the “Private Equity Investments”)
- Provide management services to the Private Equity Investments through Family Office, Inc.

➤ Ownership Structure

- The Private Equity Investments are owned by Patriarch, Unrelated Investor and certain other investors and key employees

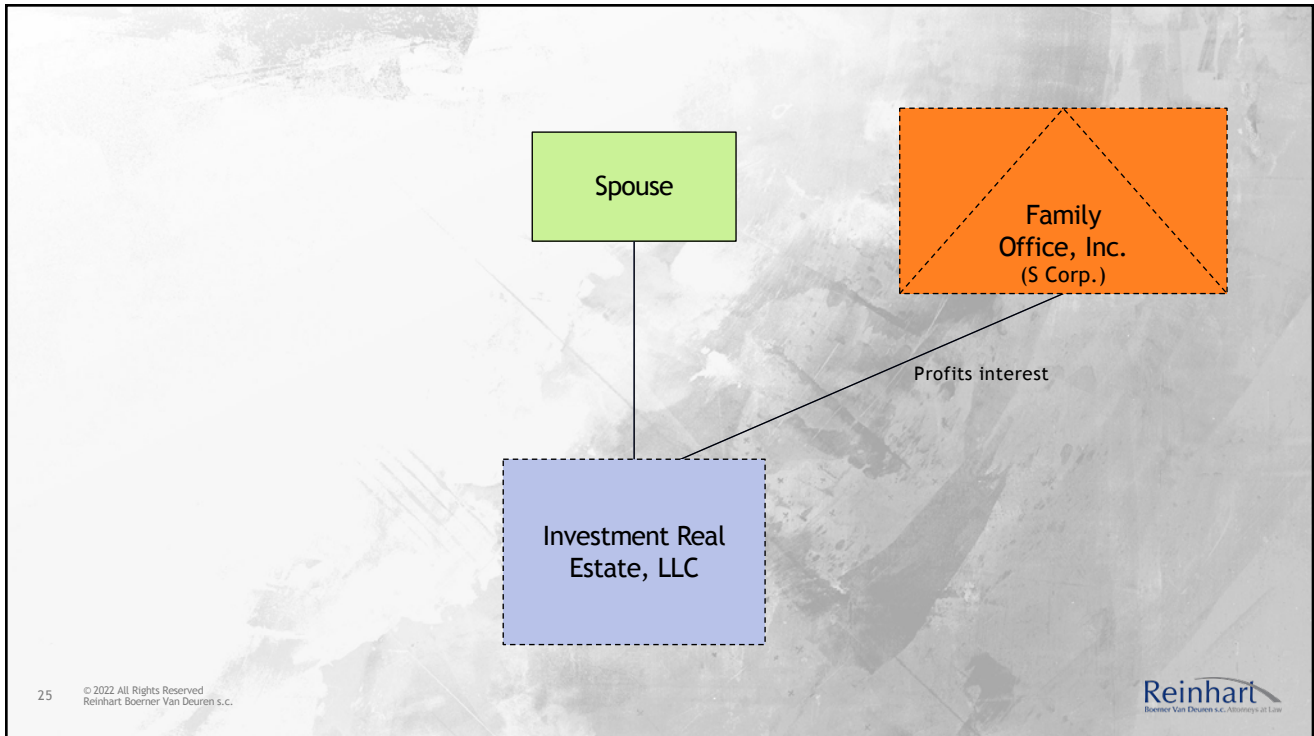
➤ Other

- Family Office, Inc. receives a management fee from each of the Private Equity Investments



Investment Real Estate, LLC

- Purpose
 - Invest in long-term hold real estate
- Ownership Structure
 - Partnership for tax purposes
 - Spouse owns 100% of common units, and Family Office, Inc. owns “Incentive Units”
 - Family Office, Inc. and Spouse are the managers of the LLC, and Spouse’s decision would control in the event of a disagreement between Family Office, Inc. and Spouse
- Other
 - Incentive Units entitle Family Office, Inc. to a portion of the profits of Investment Real Estate, LLC.
 - The manager controls the timing of distributions of the profits, and may cause distributions to be made on a periodic basis
 - Accrued allocations to Family Office, Inc. carryover and are paid when the company has sufficient cash flow
 - All other profits are allocable to Spouse, and other cash flow is distributable to Spouse

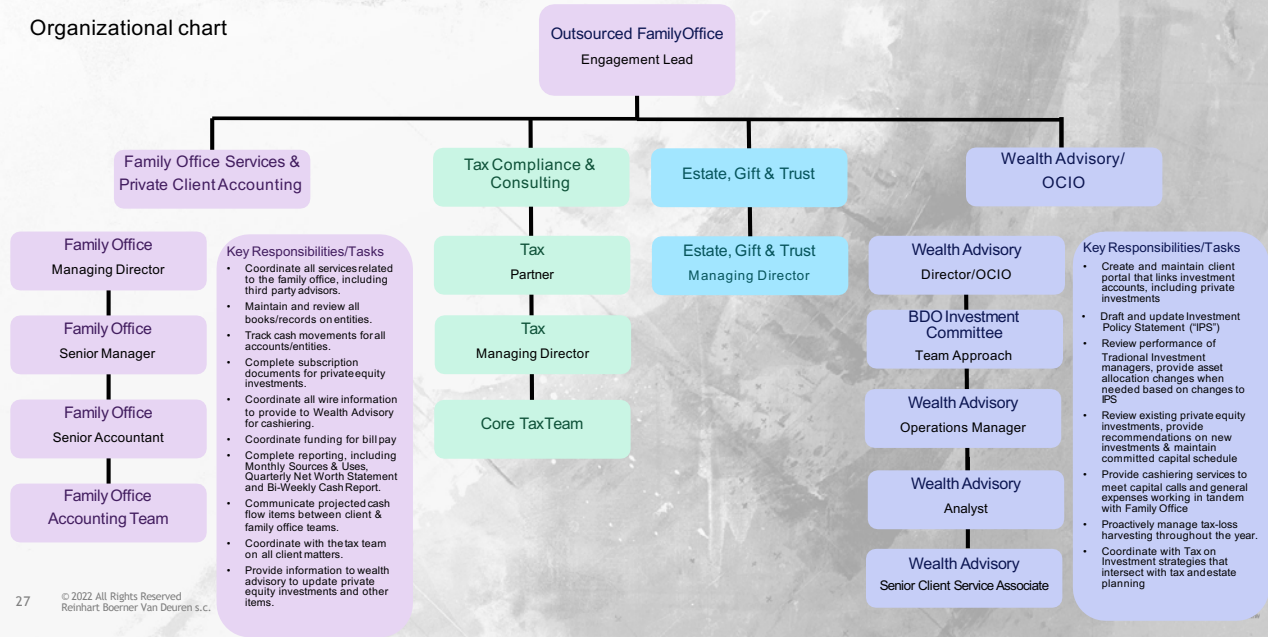


Alternatives to “Lender”-style Single Family Office

- Fee-Based Single Family Office (i.e., break-even model; no carried interest).
- Multi-Family Office: a third party financial services firm provides all the infrastructure and back office functions.
- Virtual Family Office or Out-Sourced Family Office: a team of third party service providers, coordinated by one or more designated family members.
- Collective investing: Example, Family Limited Partnership.

Outsourced Family Office Services

Organizational chart



Thank you for attending!
Questions?

1 p.m. – 2 p.m.

Schedules K-2 & K-3: What Taxpayers Need to Know

Heidi Konkel, CPA, Senior Manager, Wipfli LLP

Schedule K-2 & K-3 – What Taxpayers Need to Know

PERSPECTIVE

CHANGES EVERYTHING.

Heidi Konkel
- Director of International Tax

WIPFLI

AGENDA

- 01 BACKGROUND
- 02 WHO NEEDS TO FILE SCHEDULES K-2 & K-3?
- 03 PARTS TO SCHEDULES K-2 & K-3
- 04 FILING PENALTIES
- 05 FREQUENTLY ASKED QUESTIONS
- 06 OPEN ITEMS/ISSUES
- 07 KEYS AREAS TO NOTE 2022
- 08 CONCLUSION



<p>BACKGROUND</p>	<p>Background</p> <ul style="list-style-type: none">• Intended to assist partners and shareholders in preparing their own tax filings regarding foreign matters.• Create consistency amongst tax practitioners• Schedule K-2 is an extension of Schedule K• Schedule K-3 is an extension of Schedule K-1• IRS Notice 2021-39 provided relief• January 18, 2022, revised instructions• Required for all passthrough entities 2021 tax year• February 16, 2022, IRS provided relief for 2021 filings
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**WHO NEEDS TO
FILE SCHEDULES
K-2 & K-3**

Taxpayers with a tax year beginning on or after January 1, 2021.

- Domestic partnerships
- S Corporations
- Foreign partnerships
 - Category 1 – Persons that control 50% or more of the foreign partnership
 - Category 2 – Taxpayers that own 10% or more if there is no Category 1 filer.

Exception for Short Period Returns - 2021 Tax Year

Exceptions added February 16, 2022 – 2021 Tax Year if taxpayer meets all the following:

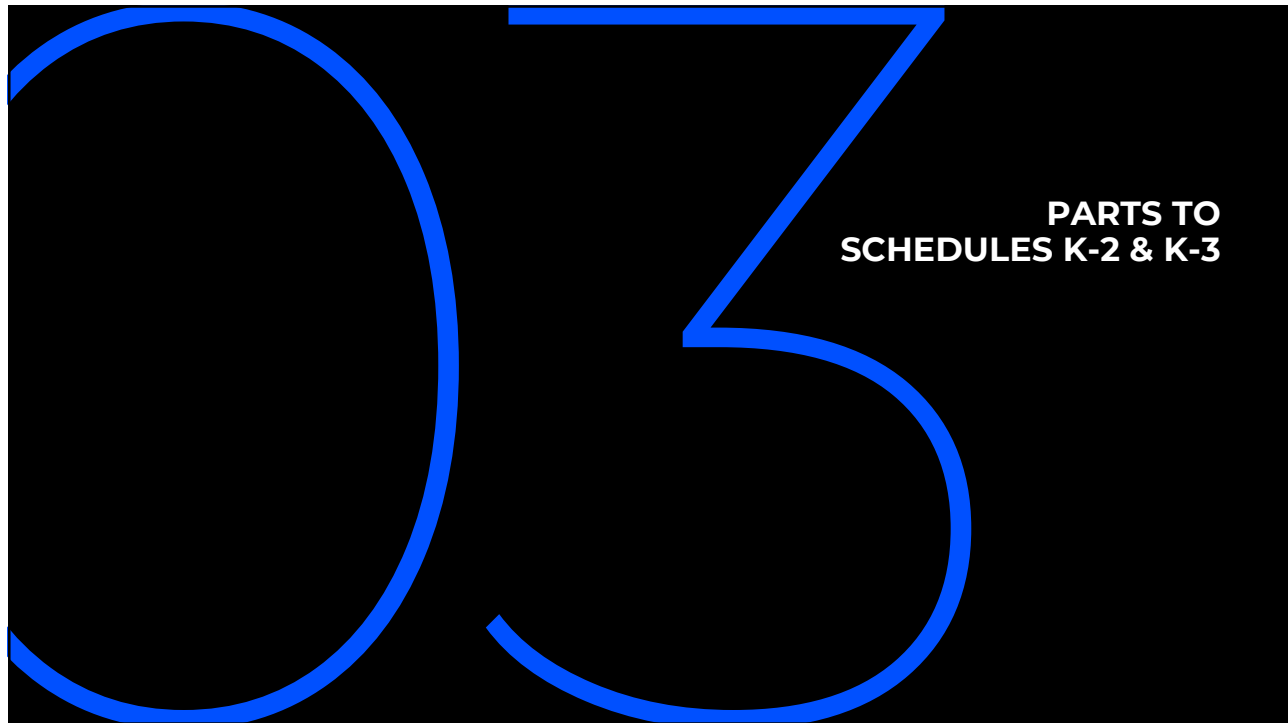
- No foreign partners
- No foreign activity
- 2020 filing did not include information on Schedule K line 16 and 20c for 1065 and lines 14 and 17d for S Corporations **AND**
- Entity has no knowledge that the owners are requesting such information for tax year 2021.

<https://www.irs.gov/businesses/partnerships/frequently-asked-questions-Frequently-ASKED-QUESTIONS-for-2021-short-tax-year-pass-through-entity-returns-and-schedules-k-2-and-k-3>

**WHO NEEDS TO
FILE SCHEDULES
K-2 & K-3**

- 2022 Tax Year – Required for All?
- August 31, 2022, AICPA letter to Office of Associate Chief Counsel
 - Provide broader exceptions
 - Provide permanent exceptions from filing as already provided in IRS Frequently Asked Questions for 2021 filing season
 - Consolidated Form 8082 filings
 - Simplification of Foreign Tax Credit Reporting

<https://www.taxnotes.com/research/federal/other-documents/irs-tax-correspondence/aicpa-maintains-focus-on-schedules-k-2-k-3-compliance/7f1td>



**PARTS TO
SCHEDULES K-2
& K-3**

Form - 1065

- Part I – Attachments
- Part II - Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116 or 1118
 - Gross Receipts by SIC code
 - Interest Expense Apportionment Factors
 - Foreign Derived Intangible Income (FDII) Deduction Apportionment Factors
 - Foreign Taxes
 - Other tax information - §743(b) adjustments
- Part IV- IRC Section 250 Deduction related to FDII
- Part V – Distributions from Foreign Corporations to Partnership
- Part VI – Partners’ IRC Section 951(a) and IRC Section 951A Inclusions
- Part VII – Information to Complete Form 8621
- Part VIII – Partnership Interest in Foreign Corporation Income (IRC Section 960)
- Part IX – Base Erosion and Anti-Abuse Tax (BEAT) IRC Section 59A
- Part X – Foreign Partner Character and Source of Income
- Part XI – IRC Section 871(m) Covered Partnerships
- Part XII – Reserved for Future Use
- Part XIII – Foreign Partner’s Distributive Share of Deemed Sale Items or Transfer of Partnership Interest*

**PARTS TO
SCHEDULES K-2
& K-3**

Form – 1120S

- Part I – Attachments
- Part II - Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116
 - Gross Receipts by SIC code
 - Interest Expense Apportionment Factors
 - Foreign Taxes
- Part IV – Distributions from Foreign Corporations to Corporation
- Part V – Shareholders’ IRC Section 951(a) and IRC Section 951A Inclusions
- Part VI – Information to Complete Form 8621
- Part VII – Corporation’s Interest in Foreign Corporation Income (IRC Section 960)

**PARTS TO
SCHEDULES K-2
& K-3**

Form- 8865

- Part I – Attachments
- Part II – Foreign Tax Credit Limitation
- Part III – Information to prepare Form 1116 or 1118
 - Gross Receipts by SIC code
 - Interest Expense Apportionment Factors
 - Foreign Derived Intangible Income (FDII) Deduction Apportionment Factors
 - Foreign Taxes
 - Other tax information - §743(b) adjustments
- Part IV – IRC Section 250 Deduction related to FDII
- Part V – Distributions from Foreign Corporations to Partnership
- Part VI – Partners' IRC Section 951(a) and IRC Section 951A Inclusions
- Part VII – Information to Complete Form 8621
- Part VIII – Base Erosion and Anti-Abuse Tax (BEAT) IRC Section 59A

FILING PENALTIES

**FILING
PENALTIES**

When Penalties Apply

- Failure to file or show all the information required on schedules IRC Section 6698 & IRC Section 6699
- Failure to file correct information return IRC Section 6721
- Failure to furnish correct payee statements IRC Section 6722
- Failure to file information required by IRC Section 6038

**FILING
PENALTIES**

2021 Filing Instructions

- \$280 per owner for incorrect information
 - maximum of \$3,426,000 for partnerships
- If intentionally disregarded, penalty is increased to \$570, or if greater 10% of the aggregate amount of items to be reported.

**FILING
PENALTIES**

2021 Relief – Notice 2021-39

- Only applies to tax years beginning in 2021
- File 1065, 1120S or 8865 timely
- Good faith effort to comply



FREQUENTLY ASKED QUESTIONS - IRS

- [FAQ #5 - New Information Required](#)
 - No, all the information requested on Schedule K-2 and K-3 was required in the past.
- [FAQ #15 - Exceptions](#)
 - Provided the exception list for the 2021 filing season based on 2021 data and the 2020 filing.
- [FAQ #18 - Additional Questions or Comments to IRS](#)
 - Additional inquires to the IRS can be made at lbi.passthrough.international.form.changes@irs.gov.
- [FAQ #19 - Passthrough doesn't qualify under FAQ#15](#)
 - Only applicable portions of the schedules are required to be filled out
- [FAQ #20 - Multiple Filers of Form 5471, 8865 and/or 8858](#)
 - If appropriate disclosures in taxpayer's filing the forms are not required, however, applicable portions of the Schedules K-2 and K-3 are to be filled out.

FREQUENTLY ASKED QUESTIONS - IRS

- [FAQ #22 – Reporting for Section 1 of Part III](#)
 - If a taxpayer does not have research and experimental expenses and it is not expected that the owner of the passthrough to license, sell or transfer intangible property to the passthrough.
- [FAQ #23 - Mark to Market Election Made on PFIC](#)
 - The filer does not need to report information in Part VII. However additional information may be needed by the ultimate filer if the mark-to-market election was not made in the first year of the holding period.
- [FAQ #24 – Reporting Dormant Foreign Corporations](#)
 - Part corresponding with Corporation's Interest in Foreign Corporation Income (IRC Section 960) does not need to be filled out.
- [FAQ #26 – Part X, Section 3 Assets & Liabilities](#)
 - Clarification will be added to 2022 filing instructions. For 2021 taxpayers can Treasury Regulation Section 1.882-5 to allocate assets, liabilities and directly allocated partnership indebtedness.

<https://www.irs.gov/businesses/schedules-k-2-and-k-3-frequently-asked-questions-forms-1065-1120s-and-8865>

FREQUENTLY ASKED QUESTIONS

- **When would an individual not be required to file Form 1116 to take a foreign tax credit?**
 - When all foreign sourced income is passive and the total amount of creditable foreign taxes are not more than \$300 (\$600 if married filing joint).
- **Why are gross receipts required to be reported?**
 - Treasury Regulation Section 1.861-17 requires that research and experimental (R&E) expenses are allocated based on gross receipts. If a taxpayer has R&E the deduction allocable to foreign sources could impact foreign tax credits coming from other sources.
- **What are average assets required to be reported?**
 - Interest expense is allocated to foreign sources using the greater percentage of foreign gross sales over total gross sales or foreign average assets over total average assets. By not incorporating interest expense in the foreign tax credit calculation, it is possible to overstate foreign sourced income which could lead to an invalid foreign tax credit calculation.

FREQUENTLY ASKED QUESTIONS

- **Partnership has sales to foreign countries. What is reported?**
 - If not a tiered partnership structure and no C Corporation as a partner no information would need to be reported
 - If tiered structure or a Corporation as a partner information would be included to calculate the foreign derived intangible income (FDII) deduction.
- **What if Schedule K-3 was not received with Schedule K-1?**
 - Go back to the tax preparer of the passthrough entity and ask for them to provide the Schedule K-3 data, or
 - File Form 8082 and report each instance to indicate the passthrough that didn't provide Schedule K-3
- **Passthrough entity receives a K-3 from a partnership. How does this information get incorporated into the taxpayers' Schedule K-2 and Schedule K-3?**
 - First the taxpayer would calculate their Schedule K-2 without regard to any factors from the passthrough entity. Then the Schedule K-3 received is layered on top of the taxpayer's information to arrive at the totals to be reported on the taxpayer's Schedule K-2.

FREQUENTLY ASKED QUESTIONS

- What should be filled out for a partnership that has no foreign owners but has a C Corporation partner?
 - If no foreign sales Schedule K-2 Part I, Part II, Part III, Part IV Line 1, Part V, Part VI, Part VII, Part VIII and Part IX.
 - If parts Part V, Part VI, Part VII and Part VIII are not applicable to taxpayer those parts do not need to be filled out.
 - If foreign sales, same as above except Part IV should be filled out in its entirety
- What should be filled out for a partnership that is 100% domestic with no direct foreign owners, but the full ownership structure is not known?
 - If the full ownership structure is not known, Part I, Part II, Part III, Part IV and Part IX

OPEN ITEMS/ISSUES

**OPEN
ITEMS/ISSUES**

- Tiered Partnerships and timing
- Schedule K-3 for 1065 has a part XIII, but no Schedule K-2 equivalent
- Received K-1 but not K-3
- Form 926 information still requires a footnote disclosure
- IRC Section 951(a) and IRC Section 951A does not include foreign taxes allocable to that income
- Inconsistent information in footnotes
- 2022 passthrough entity would need to document why they are not required to file Schedules.



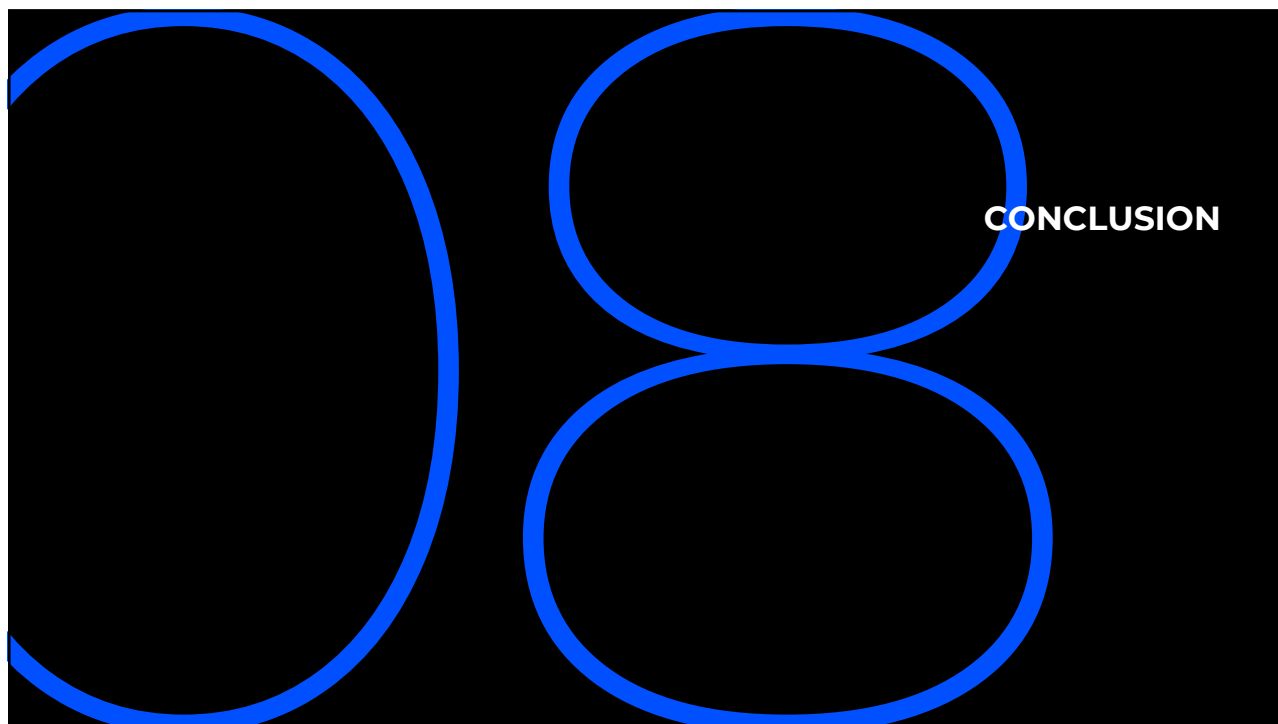
**KEYS AREAS TO
NOTE FOR 2022**

**KEYS AREAS TO
NOTE FOR 2022**

- Review of owners' citizenship
- Type of domestic owners
- Determination of applicable part of Schedules to be filled out
- Review of foreign ownership, foreign subsidiaries, foreign related party transaction for additional reporting requirements

**KEYS AREAS TO
NOTE FOR 2022**

- No penalty relief for tax years beginning on or after January 1, 2022
- Limited exceptions to filing
- Documentation of non-filing
- IRS will be updating instructions and schedules



<p>CONCLUSION</p>	<ul style="list-style-type: none">• Not all information is included in Schedule K-3• Review IRS Frequently ASKED QUESTIONS• Review updated filing instructions and forms for 2022 when released
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Questions?

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2:15 – 3:45 p.m.

The SECURE Act Regulations: IRAs After Death

Robert Keebler, CPA/PFS, MST, AEP, *Partner, Keebler & Associates LLP*

The SECURE Act Proposed Regulations

Post-mortem IRA Distributions

Robert S. Keebler, CPA/PFS, MST, AEP (Distinguished)
February 28, 2022

Effective Date

- The new proposed regulations apply to distributions on or after January 1, 2022.
- *Recall*, taxpayers were to calculate 2021 distributions by applying the existing regulations and a reasonable, good faith interpretation of the Secure Act

Regulations Table of Contents

§1.401(a)(9)-0

- §1.401(a)(9)-1 *Minimum distribution requirement in general*
- §1.401(a)(9)-2 *Distributions commencing during an employee's lifetime*
- §1.401(a)(9)-3 *Death before required beginning date*
- §1.401(a)(9)-4 *Determination of the designated beneficiary*
- §1.401(a)(9)-5 *Required minimum distributions from defined contribution plans*
- §1.401(a)(9)-6 *Required minimum distributions for defined benefit plans and annuity contracts*
- §1.401(a)(9)-7 *Rollovers and transfers*
- §1.401(a)(9)-8 *Special rules*
- §1.401(a)(9)-9 *Life expectancy and distribution period tables*

Death Before Required Beginning Date

§1.401(a)(9)-3

- Key Point
 - Based on the existing regulations

Determination of The Designated Beneficiary §1.401(a)(9)-4

- Key Points
 - Substantially similar to existing regulations
 - Simplifies identifying the beneficiary for §401(a)(9) when the retirement account is payable to a trust
 - Adds examples to clarify common questions involving IRA trusts
 - Expounds on the definition of an eligible designated beneficiary
 - Defines age of majority as the child's 21st birthday to avoid conflict of law complexities
 - Expounds on the definition of disabled
 - Expounds on the definition of chronically ill

Required Minimum Distributions From Defined Contribution Plans §1.401(a)(9)-5

- Key Points
 - Largely retains the pre-existing structure
 - Retains life expectancy distributions for pre-2020 deaths
 - Retains the “ghost life expectancy rule” which applies when there is not a qualified designated beneficiary
 - Modifies the post-mortem distribution calculations to include the new 10-year rule
 - Modifies the multiple beneficiary rules to account for the new 10-year rule

Rollovers and Transfers §1.401(a)(9)-7

- Key Point – Retains the pre-existing rules
- However, the § 402(c) regulations will be updated
 - Rollovers
 - Distributions

Special Rules §1.401(a)(9)-8

- Key Points
 - Separate account treatment
 - Updated definition of spouse
 - Qualified domestic relation order rules
 - Elections

Life Expectancy and Distribution Period Tables §1.401(a)(9)-9

- Key Point: Only includes minor changes to terminology

Other Sections Modified

Distribution Requirements for IRAs §1.408-8

- The IRA distributions regulations will also be updated for the SECURE Act
- A nominal change is made to account for the RBD age increase from 70½ to 72
- However, there are also several other changes to incorporate the Secure Act, including rules regarding surviving spouses

Other Sections Modified

- The proposed regulations also include other small modifications
 - § 1.457-6(d) is modified to strike a reference to age 70½
 - § 54.4974-1 involves the accumulation excise tax and also will be modified to implement the Secure Act; specifically to account for the new 10-year rule

Death Before Required Beginning Date §1.401(a)(9)-3

Death Before RBD

- 5-year Rule – Proposed Regulations
 - Full distribution by the end of the calendar year that includes the fifth anniversary of death (e.g. 2022 deaths = 12/31/27 liquidation)
 - Pre-2020 deaths can disregard the 2020 calendar year when determining the fifth anniversary (due to corona-virus related relief)
 - This rule applies if there's no qualified Designated Beneficiary

Treas. Reg. §§ 1.401(a)(9)-3(c)(2),(5)

Death Before RBD

- **10-year Rule– Proposed Regulations:**
 - Full distribution by the end of the calendar year that includes the tenth anniversary of death (e.g. 2021 deaths = 12/31/31 liquidation)
 - This rule applies if there is a qualified Designated Beneficiary who is not an Eligible Designated Beneficiary

Treas. Reg. §§ 1.401(a)(9)-3(c)(3),(5)

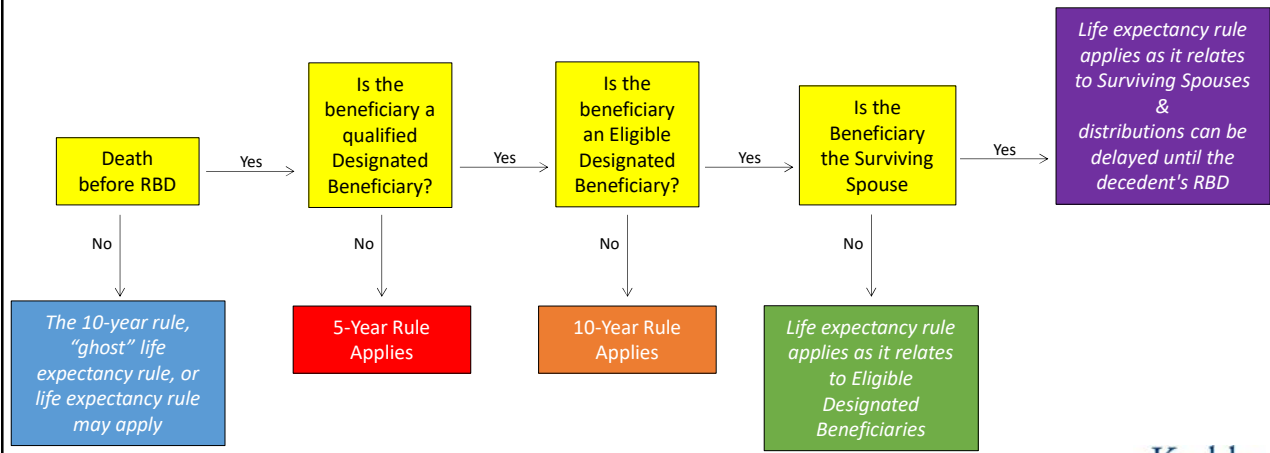
Death Before RBD

- **Surviving Spouse as Beneficiary – Proposed Regulations:**
 - Commencement of distributions can be delayed under the end of the calendar year in which the decedent would have reached age 72 (Age 70½ applies if the decedent was born before July 1, 1949)
 - If the surviving spouse is the employee's sole beneficiary and dies after the employee, but before distributions commence or should have (due to the above) then the 5-year or 10-year rule applies, as the case may be, and date of death of the surviving spouse is used to determine when the IRA must be fully distributed
 - If the surviving spouse remarries and then dies before receiving distributions, distributions cannot be further delayed

Treas. Reg. §§ 1.401(a)(9)-3(d), (e)

Death Before RBD

§1.401(a)(9)-3 Summary



Determination of The Designated Beneficiary

§1.401(a)(9)-4

Determination of The Designated Beneficiary

- **General Rules in the Proposed Regulations:**
 - A beneficiary need not be specified by name, provided the beneficiary is identifiable – for example: “children in equal shares” is OK
 - A beneficiary can be designated by default election provided by the custodian (plan) agreement or by affirmative election
 - A qualified Designated Beneficiary must be an individual or an individual who is an identifiable beneficiary of a see-through trust; it cannot be an estate for example
 - A named beneficiary can or must be disregarded in certain circumstances

Treas. Reg. §§ 1.401(a)(9)-4(a),(b)

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19



Determination of The Designated Beneficiary

- **When can a designated beneficiary be disregarded:**
 - A designated beneficiary who executes a qualified disclaimer within 9-months of death can be disregarded
 - A beneficiary who disclaims before Sept 30 of the calendar year following the calendar year of death, but not within 9-months of death, remains a designated beneficiary
 - A beneficiary who receives consideration in exchange for their disclaimer, remains a designated beneficiary
 - A charity named as beneficiary can be disregarded if their interest is satisfied by Sept 30 of the calendar year following the calendar year of death
 - A surviving spouse treated as predeceasing under a simultaneous death provision, can be disregarded as a beneficiary
 - A beneficiary who dies before Sept 30 of the calendar following the calendar year of death, remains a beneficiary absent specific events

Treas. Reg. § 1.401(a)(9)-4(c)

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20



Determination of The Designated Beneficiary

- Application to the Surviving Spouse
 - If the surviving spouse is the employee's sole beneficiary and dies after the employee, but before distributions commence – the successor beneficiary is the person designated as beneficiary as of the date of the surviving spouse's death and remains a beneficiary as of Sept 30 of the calendar year following the calendar year of the surviving spouse's death

Treas. Reg. § 1.401(a)(9)-4(d)

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Eligible Designated Beneficiary Defined

- Added by the SECURE Act, IRC § 401(a)(9)(E)(ii) creates a new concept and exception to the 10-year rule, the Eligible designated beneficiary
- This class of beneficiaries includes designated beneficiaries which are:
 - The surviving spouse of the employee
 - A child of the employee who has not yet reached the age of majority
 - Disabled
 - Chronically ill, or
 - not more than 10 years younger than the employee

IRC § 401(a)(9)(E)(ii); Treas. Reg. § 1.401(a)(9)-4(e)(1)

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Eligible Designated Beneficiary Defined

- **Multiple Designated Beneficiaries**

- Generally, if least one of multiple DBs is not an EDB, favorable treatment under the EDB rules is not available
- However, there are exceptions:
 - For minor children EDBs
 - Applicable multi-beneficiary trusts
 - When separate account treatment is available

Treas. Reg. § 1.401(a)(9)-4(e)(2)

Eligible Designated Beneficiary Defined

- **Special Rule for Children & Multiple Beneficiaries**

- If any DB is an EDB as a minor child, EDB treatment is available even if other DBs are not EDBs

Treas. Reg. § 1.401(a)(9)-4(e)(2)(iii)

Eligible Designated Beneficiary Defined

- **A child of the employee who has not yet reached the age of majority:**
 - The proposed regulations refine the definition of age of majority; the statute does not provide an age.
 - Specifically, the proposed regulations provide a child meets the age of majority on their 21st birthday. Treasury reasoned setting the age higher, to accommodate the definition in all 50 states would avoid conflict of law issues and simplify custodian agreements.
 - The preamble also restates the statutory allowance that a child may be treated as having not reached the age of majority if the child has not completed a specified course of education and is under the age of 26.

Treas. Reg. § 1.401(a)(9)-4(e)(3)

Eligible Designated Beneficiary Defined

- **A child of the employee who has not yet reached the age of majority:**

Recall, the 10-year rule applies once this exception no longer applies.

Special consideration is warranted regarding disposition of assets when the IRA is forced to liquidate between age 31 and 36.

Eligible Designated Beneficiary Defined

- **Disabled:**

- IRC § 401(a)(9)(E)(ii)(III), as added by the secure act, provides that the definition of disability under IRC § 72(m)(7) applies.
- IRC § 72(m)(7) determines disability based on whether an individual is unable to engage in substantial gainful activity.
- The proposed regulations expand this definition to make it easier to apply to those under age 18.

Treas. Reg. § 1.401(a)(9)-4(e)(4)

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27



Eligible Designated Beneficiary Defined

- **Disability Definition – Over 18:**

“Unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration”

- **Disability Definition – Under 18:**

“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”

Treas. Reg. §§ 1.401(a)(9)-4(e)(4)(ii),(iii)

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Eligible Designated Beneficiary Defined

- **Social Security Disability Determination:**

If an individual is determined to be disabled for Social Security with the meaning of 42 U.S.C. 1382c(a)(3) they will be treated as disabled for these rules

- **Disability Documentation Requirements:**

Documentation must be provided to the plan administrator no later the October 31 of the calendar year following the calendar year of the employee's death.

Treas. Reg. § 1.401(a)(9)-4(e)(4)(iv),(7)

Eligible Designated Beneficiary Defined

- **Chronically Ill:**

- IRC § 7702B(c)(2) provides the definition of Chronically Ill
- Documentation requirements in the proposed regulations:
 - A licensed healthcare practitioner's certification is required
 - The certification must include the individual is unable to perform at least two activities of daily living (ADLs) for an indefinite period that is reasonably expected to be lengthy in nature
 - Documentation must be provided to the plan administrator no later the October 31 of the calendar year following the calendar year of the employee's death.

*Recall, ADLs include: Mobility, Dressing, Eating,
Personal Hygiene, and Toileting*

Treas. Reg. §§ 1.401(a)(9)-4(e)(5),(7)

Eligible Designated Beneficiary Defined

- **Beneficiaries who qualify as an Eligible Designated Beneficiary (EBD) as a minor child and as disabled or chronically ill:**
 - Minor children will continue to be treated as an EBD after reaching the age of majority
 - However, the documentation requirements outlined in the previous slides *must be timely met*

Treas. Reg. § 1.401(a)(9)-4(e)(8)

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31



Eligible Designated Beneficiary Defined

- **Disabled:**

This modification is important as it allows a minor who is also disabled to take life expectancy-based distributions over their entire life span rather than merely while under 21 as a person who has not yet reached the age of majority.

Treas. Reg. § 1.401(a)(9)(E)(ii)(III)

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Eligible Designated Beneficiary Defined

- **Disabled:**

The regulations fail to provide relief for a minor beneficiary who becomes disabled before reaching the age of majority.

IRC § 401(a)(9)(E)(ii) requires the disability determination made at the employee's death.

Treas. Reg. § 1.401(a)(9)(E)(ii)(III)

Eligible Designated Beneficiary Defined

- **Examples involving EBDs as both a minor child and as disabled or chronically ill:**

1. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and qualifies as disabled. If the documentation requirements are satisfied, life expectancy payments can continue after 2024 rather than the 10-year rule forcing complete distribution by 2034.
2. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and qualifies as disabled. However, the documentation requirement to qualify as disabled is not timely satisfied. Total distribution must occur by 2034.
3. Parent dies in 2022 with their child as beneficiary. The child won't reach the age of majority until 2024 and becomes disabled in 2023. Because the child was not disabled at the parent's death, they cannot qualify as disabled and therefore total distribution must occur by 2034.

Treas. Reg. §§ 1.401(a)(9)-4(e)(9)

Eligible Designated Beneficiary Defined

- **Individual not more than 10 years younger than the employee.**
 - The proposed regulations clarify how this is measured
 - Specifically, they provide its based on dates of birth
 - The example used is as follows:
 - If the decedent's date of birth is 10/1/1953
 - The youngest possible beneficiary's date of birth is 10/1/1963

Treas. Reg. § 1.401(a)(9)-4(e)(6)

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35



Eligible Designated Beneficiary Defined

- **EDBs as DBs of the Surviving Spouse**

- If the DB of a Surviving Spouse qualifies as an EDB at the time of the Surviving Spouse's death, EDB treatment is available

Treas. Reg. § 1.401(a)(9)-4(e)(8)

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36



Trusts as Beneficiaries

- The proposed regulations retain:
 - The see-through concept to identify beneficiaries
 - The conduit and accumulation trust concept
 - The four requirements for a trust to be a qualified designated beneficiary
- The proposed regulations also provide additional guidance regarding identifying beneficiaries with new fact pattern examples.

Treas. Reg. § 1.401(a)(9)-4(f)

Trusts as Beneficiaries

- Certain beneficiaries can be disregarded – #1: conditioned on the death of secondary beneficiary
 - A beneficiary that could receive retirement assets solely because of the death of another beneficiary can be disregarded
 - Applies to accumulation trusts
 - The current beneficiary cannot pre-decease the IRA owner (plan beneficiary/employee) for the residuary beneficiary to be disregarded
 - Meant to exclude minimal interests

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)

Trusts as Beneficiaries

- See-through trust beneficiaries disregarded – an example:

IRA trust provides: (1) first to surviving spouse, (2) then to brother, if he's alive, at the spouses death, and (3) then to charity.

In this case, the brother is only entitled to a residual interest and the charity is entitled to only what remains thereafter – so the charity can be disregarded.

Pg. 32

The charity would be counted if the brother's interest was not subject to any contingences or contingent on an event other than the surviving spouse's death.

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(A)

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Trusts as Beneficiaries

- Certain see-through trust beneficiaries disregarded - #2: entitlement conditioned on death of young individual
 - If a trust provides for full distribution by the calendar year following the death, any beneficiary whose sole entitlement is contingent on the primary beneficiary's death can be disregarded.
 - If a trust provides for a minor beneficiary, any beneficiary whose sole entitlement is contingent on the primary beneficiary's death within 10-years of reaching the age of majority can also be disregarded
 - Meant to exclude remote interests

Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B)

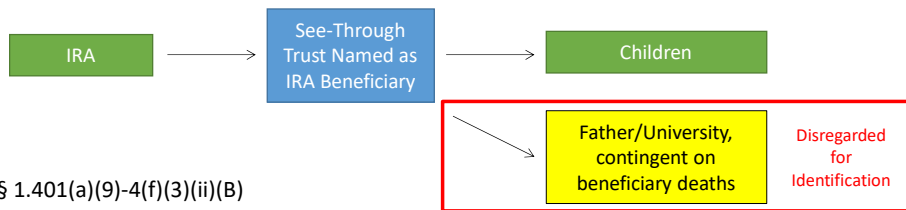
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Trusts as Beneficiaries

- See-through trust beneficiaries disregarded – an example:
 - You have a 45 year old physician client, recently divorced, who dies in a car accident
 - He had accumulated about \$500,000 in his qualified plan (diligent contributions since residency) so you advised a testamentary stand-alone IRA trust in his estate plan.
 - He leaves behind a 15 and 13 year old who are beneficiaries of trust
 - Since he had no one else, his 72 year-old father is the contingent beneficiary, in case both children are unavailable, and thereafter the trust is payable to his alma mater



Treas. Reg. § 1.401(a)(9)-4(f)(3)(ii)(B)

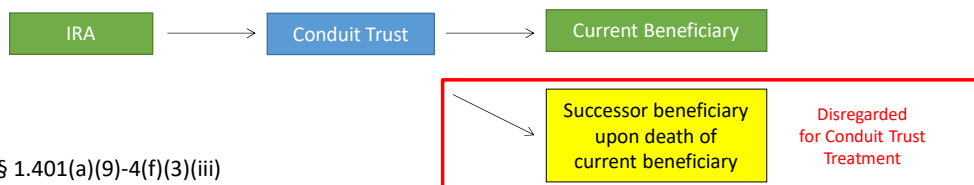
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41

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Trusts as Beneficiaries

- Conduit trusts allowed terms for certain accumulations
 - A trust will not fail to be treated as a conduit trust merely because the trust terms requiring the direct payment of amounts received from the plan do not apply after the death of all of the current beneficiaries



Treas. Reg. § 1.401(a)(9)-4(f)(3)(iii)

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Trusts as Beneficiaries

- Multiple Trust Arrangements

- If a beneficiary of a see-through trust is another trust, the beneficiaries of the second trust will be treated as beneficiaries of the first trust, provided the second trust is a Qualified Designated Beneficiary



Treas. Reg. § 1.401(a)(9)-4(f)(4)

Trusts as Beneficiaries

- Identifiability of trust beneficiaries

- Generally, it must be possible to identify each person designated by the employee to receive retirement plan assets
- However, the proposed regulations provide some relief:
 - An employee can name a class of individuals as the beneficiary
 - And now the addition of another member of that class will not fail the identifiability requirements
 - For example, grandchildren can be named as a class and the birth of another grandchild will not pose a problem

Treas. Reg. § 1.401(a)(9)-4(f)(5)

Trusts as Beneficiaries

- Powers of Appointment

- Generally, if an individual holds a power of appointment over the retirement assets it creates an identifiability problem.
- However, the proposed regulations provide relief:
 - Power to name a non-identifiable beneficiary doesn't cause the trust to fail the Qualified Designated Beneficiary (QDB) requirements
 - If the power is exercised by Sept. 30 in the calendar year following the calendar year of death the appointed beneficiaries are DBs
 - The power can also be restricted by Sept. 30 to a group of beneficiaries which will then be treated as DBs.
 - If the power is not exercised (or restricted) by that Sept, 30 then the taker in default is treated as the DB.

Treas. Reg. § 1.401(a)(9)-4(f)(5)(ii)(A)

Trusts as Beneficiaries

- Powers of Appointment

- If a POA adds a new beneficiary after Sept. 30 of the calendar year following the calendar year of death that the added beneficiary is considered a DB
- If the added beneficiary requires a full distribution, the distribution must occur by the end of the calendar year following the calendar year in which the beneficiary was added

Treas. Reg. § 1.401(a)(9)-4(f)(5)(ii)(B)

Trusts as Beneficiaries

- Reformation & Decanting

- The proposed regulations provide that a see-through trust will not fail to satisfy the identifiability requirements if state law permits the trust to be modified after death (and the terms are modified after the death to a change beneficiaries).
- If a beneficiary is removed by Sept 30 of the calendar year following the calendar year of the employee's death, the beneficiary is simply disregarded.
- A beneficiary added by that Sept 30 will also be considered a beneficiary for the see-through rules.

Treas. Reg. § 1.401(a)(9)-4(f)(5)(iii)(A)

Trusts as Beneficiaries

- Reformation & Decanting

- The proposed regulations provide that a see-through trust will not fail to satisfy the identifiability requirements if state law permits the trust to be modified after death and terms are modified after the death

Treas. Reg. § 1.401(a)(9)-4(f)(5)(iii)(A)

Trusts as Beneficiaries

- Reformation & Decanting

- **Remove Beneficiary:** A beneficiary cannot be removed the after Sept 30 of the calendar year of the calendar year following death

- **Add Beneficiary:**

- A beneficiary added before Sept 30 of the calendar year of the calendar year following death is considered a DB

- A beneficiary is added after the Sept 30 deadline is analyzed under the new POA rules

- ✓ Will not cause the trust to fail the identifiability rules

- ✓ The added beneficiary will be considered in determining the proper distribution in the calendar year after the calendar year of addition (including an addition which requires full distribution)

Treas. Reg. §§ 1.401(a)(9)-4(f)(5)(iii)(B),(iii)(C),(iv)

Trusts as Beneficiaries

- Applicable Multiple Beneficiary Trusts

- A see through trust with multiple QDBs and at least one EDB

- The proposed regulations defined two types:

- Type I – Divided immediately upon death into separate trusts

- Type II – Provides **solely** for a disabled or chronically ill EDB, until death of that person

- A Type II trust is treated as an EDB regardless of the other beneficiaries

- A Type II trust can be also be created when a Type I trust is split

Treas. Reg. §§ 1.401(a)(9)-4(g)

Trusts as Beneficiaries

- Special rules for multiple designated beneficiaries
 - The general rule in the proposed regulations is that if a trust as multiple beneficiaries and at least one is not an EDB, the 10-year rule applies
 - Exceptions
 - 1. If any designated beneficiary is a minor child of the employee, the life expectancy distribution rules apply until the age of majority and the 10-year rule applies thereafter.
 - 2. A Type II Applicable Multiple Beneficiary Trust

Treas. Reg. §§ 1.401(a)(9)-4

Trusts as Beneficiaries

- Applicable Multiple Beneficiary Trusts
 - SNT & Type II trusts:
 - A SNT usually includes provisions providing the disabled individual loses their interest in the trust in the event the interest causes losses of mean-tested benefits
 - Treasury is seeking comments regarding how a trust can include this provision while not providing for trust payments to any other individual until the death of the disabled individual

Treas. Reg. §§ 1.401(a)(9)

Trusts as Beneficiaries

- Documentation Requirements – Post-mortem Minimum Distributions
 - Trustee must provide the custodian a list of beneficiaries or a copy of the trust instrument
 - If a beneficiary list is provided the trustee must:
 - Include a description of the conditions on their entitlement sufficient to establish who are the beneficiaries
 - Certifies that, to the best of the trustee's knowledge, this list is correct and complete and the trust is a QDB
 - Submission Deadline: October 31 of the calendar year following the calendar year of death

Treas. Reg. §§ 1.401(a)(9)-4(h)

Required Minimum Distributions from Defined Contribution Plans §1.401(a)(9)-5

RMDs from DC Plans

- The existing general rules are maintained
- The “applicable divisor” is renamed the “applicable denominator”
- The proposed regulations also outline events which require full distribution

Treas. Reg. §§ 1.401(a)(9)-5

Post-mortem Distributions

- Death on or After the RBD:
 - Designated Beneficiary – the applicable dominator is the greater of:
 - The DB’s remaining life expectancy
 - The decedent’s remaining life expectancy (“Ghost” life expectancy rule)
 - No Designated Beneficiary – the applicable dominator is the decedent’s remaining life expectancy
 - All life expectancies are determined using the single life table for this purpose
 - The decedent’s remaining life expectancy is determined in the calendar year of death and reduced by one in each subsequent year (subtract one method)
 - A non-Spouse DB’s life expectancy is also determined in the calendar year of death and reduced by one in each subsequent year(subtract one method)

Treas. Reg. § 1.401(a)(9)-5(d)

Post-mortem Distributions

- Life expectancy to compute the applicable denominator:
 - Determined using the single life table
 - The decedent's remaining life expectancy is determined in the calendar year of death and reduced by one in each subsequent year
 - A non-Spouse DB's life expectancy is also determined in the calendar year of death and reduced by one in each subsequent year
 - A surviving spouse's life expectancy is redetermined annually

Treas. Reg. §§ 1.401(a)(9)-5(d)(3)

Post-mortem Distributions

- Distribution of Entire Interest Required on the earliest of the Following:
 - (1) End of the 10th year following the calendar year in which the employee died if the DB is not an EDB
 - (2) End of the 10th year following the calendar year in which the DB died, if the DB was an EDB
 - (3) End of the 10th year following the calendar year the beneficiary reaches the age of majority if the DB was a minor child EDB
 - (4) End of the calendar year in which the applicable denominator is less than or equal to 1, if life expectancy distributions apply.

Treas. Reg. §§ 1.401(a)(9)-5(e)

Post-mortem Distributions

The general rules are maintained:

	Eligible DB	Qualified DB	No Qualified DB
Death Before RBD	EBD's Life Expectancy Annual RMDs	10-Year Rule (No Annual RMDs)	5-Year Rule (No Annual RMDs)
Death After RBD	EBD's Life Expectancy Annual RMDs	Life Expectancy Annual RMDs & the 10-Year Rule*	Ghost Life Expectancy Annual RMDs

*Annual RMDs may not be required for Roth IRAs & the greater of decedent's or DB's life expectancy is used

Treas. Reg. § 1.401(a)(9)(E)(ii)(IV)

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59

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Post-mortem Distributions

- Multiple Designated Beneficiaries
 - The proposed regulations require the applicable denominator is determined using the life expectancy of the oldest DB – rather than the beneficiary with the shortest life expectancy
 - The proposed regulations also require the life expectancy of the oldest DB will generally be used to determine whether a full distribution is required

Treas. Reg. § 1.401(a)(9)-5(f)

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60

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Post-mortem Distributions

- Multiple Designated Beneficiaries

- **First Exception:** For a Type II Applicable Multi-Beneficiary Trust, then only the disabled and chronically ill beneficiaries of the trust are taken into account in determining the oldest beneficiary

- All ages are disregarded, except the age of the disabled or chronically ill beneficiary
 - The death of the (last) disabled or chronically ill beneficiary triggers the 10-year rule

- **Second Exception:** If any of the beneficiaries qualifies as a minor child EDB, only the age any minor child EDB is taken into account

- Death of an older DB, who is not an EDB, will trigger the 10-year rule and require a full distribution before the oldest child reaches the age of majority plus 10-years.

Treas. Reg. § 1.401(a)(9)-5(f)

Special Rules §1.401(a)(9)-8

Special Rules

- **Separate account treatment for beneficiaries**
 - Continues the existing regulation rules to prohibit applying the 401(a)(9) rules to separate shares in a trust
 - However, an exception is added to accommodate the new multi-beneficiary trust rules – specifically the separate application of the rules to Type I subtrusts
- **Definition of a spouse (updated to include the post-Obergefell regulations under §301.7701-18)**
- **Application of the qualified domestic relations order (QDRO) rules**

§1.402(c)-2 Eligible Rollover Distributions

Rollovers

- The general rule that a 60-day rollover is income tax-free is preserved
- No limit on the number of rollovers from a qualified plan, but the 60-day deadline applies separately to each distribution

Treas. Reg. § 1.402(c)-2(a)

Roth Rollovers

- However, if any portion of the rollover distribution is to a Roth IRA and the distribution is not from a designated Roth account, that portion is includible in the taxpayer's gross income but generally not subject to the 10-percent additional tax

Treas. Reg. § 1.402(c)-2(b)(1)(i)

Extensions & Exceptions

- Extensions of and Exceptions to the 60-day Rollover Deadline
 - The existing rules allowing waivers are retained
 - In addition, the proposed regulations provide that the 60-day period does not include any period during which the amount transferred to the employee is a frozen deposit described in section 402(c)(7)(B), and does not end earlier than 10 days after that amount ceases to be a frozen deposit
 - The proposed regulations also clarify that in the case of a repayment of a distribution treated as a rollover (such as a qualified disaster distribution), the repayment timing requirements in the statutory provision giving rise to that treatment take precedence over the otherwise applicable 60-day period

Treas. Reg. § 1.402(c)-2(b)(2)

Rollovers & Basis

- Basis can only be rolled over via a trustee-to-trustee transfer
- The proposed regulations require any rollover which includes basis, when only a portion of the distribution is rolled over, the portion rolled over first consists of the portion which is not basis
- There is also a provision that allows property to be distributed, sold and the sale proceeds then recontributed as a rollover

Treas. Reg. §§ 1.402(c)-2(b)(3), (4)

Distribution Requirements for IRAs §1.408-8

Distribution Requirements for IRAs

- The proposed regulations change the spousal rollover rules to accommodate SECURE Act changes:
 - If the employee dies before the RBD and designates the surviving spouse as beneficiary, and surviving spouse conducts a rollover from a qualified plan or IRA to an IRA in the name of decedent, any distribution method elected under the distributing IRA or qualified plan continues to apply
 - A surviving spouse to whom the 5 or 10-year rules applies can rollover a distribution to an IRA in the decedent's name and elect the life expectancy rule

Distribution Requirements for IRAs

- The proposed regulations change the spousal rollover rules to accommodate SECURE Act changes:
 - These rules do not apply to a surviving spouse who makes a rollover distribution to their own IRA – the spousal rollover election must be made by the later of: (1) the calendar year in which the surviving spouse reaches age 72, or (2) the end of the calendar year following the calendar of the IRA owner's death; late rollovers are subject to catch-up RMDs

Distribution Requirements for IRAs

- The proposed regulations change the RBD to 72 and reaffirm Roth RMDs are not required.
- Similar rules are also created for EBDs
 - If an EBD elects the 10-year rule, any rollover from a plan to an IRA in the name of the decedent remains subject to the 10-year rule
 - However, if the distribution is made by the end of the calendar year following the year the employee dies, then the beneficiary would be permitted to make an election to have the life expectancy rule apply under the IRA

Excise Tax on Accumulations in Qualified Retirement Plans § 54.4974-1

Excise Tax on Accumulations

- The proposed regulations modify the rules to accommodate the new 10-year rule.
- The proposed regulations also provide two situations in which an automatic waiver of the excise tax applies:
 - First Situation: (1) The employee died before the RBD, (2) The payee is an EDB who failed to make an affirmative election to use the life expectancy rule, (3) payee failed to make RMDs, and (4) the payee elects the 10-year rule applies
 - Second Situation: (1) Individual dies before making their RMD (2) beneficiary fails to make the RMD before the end of the calendar year, (3) The beneficiary makes the RMD before the beneficiary's tax filing deadline, including extensions

PRACTICAL EXAMPLES

IRAs at Death & Beyond

Example 1: Husband to Wife



- **Spousal rollover available.** The Uniform Lifetime Table is used to compute RMDs. No RMDs required for Roth IRAs.
- **Inherited IRA available.** EDB rules apply for wife's distributions. RMDs based on the wife's life expectancy and the Single Life Table. The Wife's life expectancy is redetermined annually (The Subtract-One Method does not apply). Also, distributions can be delayed until the Wife's RBD.

IRAs at Death & Beyond

Example 2: Husband to Wife to Child



- **Spousal rollover available.** The Uniform Lifetime Table is used to compute RMDs. No RMDs required for Roth IRAs during wife's life. At wife's death, the 10-year rule applies with RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method. At Wife's death, the 10-year rule applies with RMDs.
- **Inherited IRA available.** EDB rules apply for wife's distributions. RMDs based on the wife's life expectancy and the Single Life Table. The Wife's life expectancy is redetermined annually (The Subtract-One Method does not apply). Also, distributions can be delayed until the Wife's RBD, despite it being an "inherited" IRA. At Wife's death, the 10-year rule applies without RMDs.

IRAs at Death & Beyond

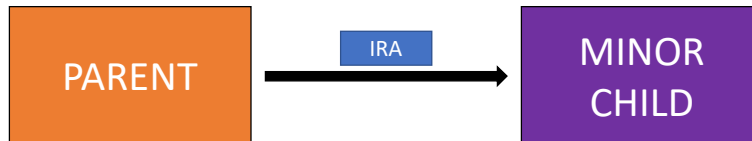
Example 3: Parent to Adult Child



- The 10-year rule applies with RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- No 10-year rule RMDs required if Parent dies before their RBD
- No 10-year rule RMDs required for Roth IRAs.

IRAs at Death & Beyond

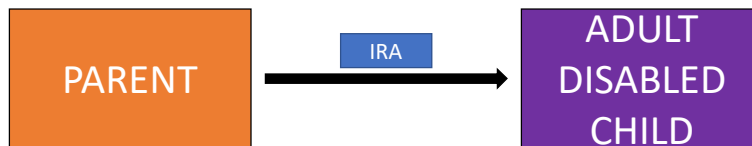
Example 4: Parent to Minor Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- When the child reaches the age of majority, the 10-year rule without RMDs applies.

IRAs at Death & Beyond

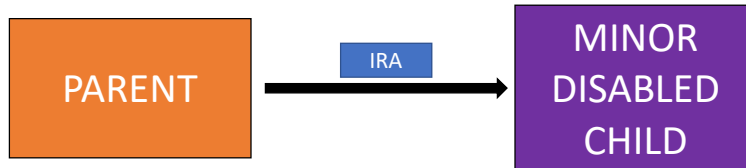
Example 5: Parent to Adult Disabled Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- Documentation of disability must be provided to the custodian at the parent's death.
- At the Disabled Child's death, the 10-year rule without RMDs applies

IRAs at Death & Beyond

Example 6: Parent to Minor Disabled Child



- EDB rules apply. RMDs based on the child's life expectancy, the Single Life Table, and the Subtract-One Method.
- Documentation of disability must be provided to the custodian at the parent's death.
- If documentation is not provided timely, the 10-year rule applies when the child reaches the age of majority. The child cannot become disabled after the parent dies and qualify as disabled EDB.

IRAs at Death & Beyond

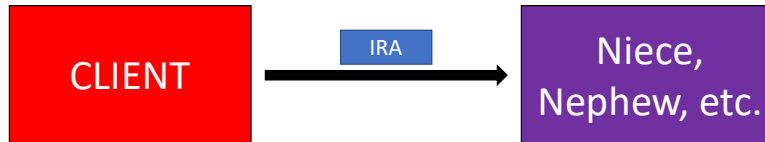
Example 7: Client to Sibling, Cousin, Friend, etc. (beneficiary of similar age)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled, chronically ill, or not more than 10-years younger than the client. In that case, RMDs based on beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.
- If the EDB rule applies, at the beneficiary's death the 10-year rule will apply without RMDs.

IRAs at Death & Beyond

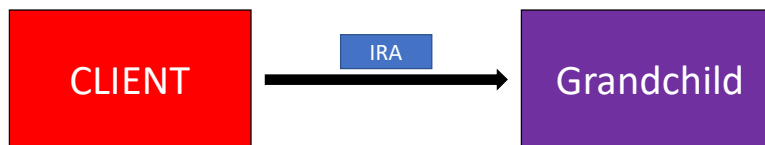
Example 8: Client to Niece, Nephew, etc. (younger beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.
- If the EDB rule applies, at the beneficiary's death the 10-year rule will apply without RMDs.

IRAs at Death & Beyond

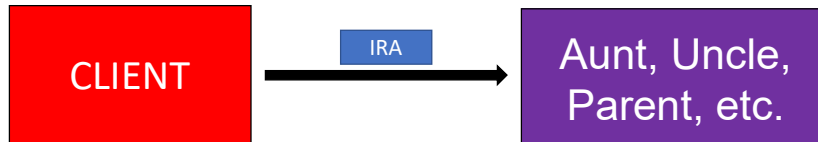
Example 9: Client to Niece, Nephew, etc. (much younger beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.

IRAs at Death & Beyond

Example 10: Client to Aunt, Uncle, Parent, etc. (older beneficiary)



- Generally, the 10-year rule applies with RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method. No 10-year rule RMDs required for Roth IRAs or if Client died before their RBD.
- However, the EDB rules might apply if the beneficiary is disabled or chronically ill. RMDs based on the beneficiary's life expectancy, the Single Life Table, and the Subtract-One Method.

IRAs at Death & Beyond

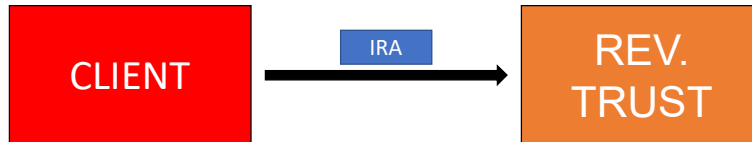
Example 11: Client to their Estate



- An estate is not a Qualified Designated Beneficiary
- If the client dies their Require Beginning Date (RBD), a the 5-year rule applies. No RMDs, but full distribution must occur within 5-years.
- If the client dies after the RBD, the "Ghost" Life Expectancy rule applies. The RMD denominator is computed using decedents remaining life expectancy according to the Single Life Table using the subtract-one method.

IRAs at Death & Beyond

Example 12: Client to their Rev. Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.
- The 5-year rule, ghost life expectancy rule or EDB rules could apply but it would be dependent on the circumstances surrounding death & how the trust is drafted.

IRAs at Death & Beyond

Example 13: Client to their Bypass Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.
- The 5-year rule, ghost life expectancy rule or EDB rules could apply but it would be dependent on the circumstances surrounding death & how the trust is drafted.

IRAs at Death & Beyond

Example 14: Husband to Bypass Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. The 10-year rule applies, but no RMDs for Roths.

IRAs at Death & Beyond

Example 15: Husband to Bypass Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. If 10-year rule applies, to a Roth IRA there will be no RMDs.
- However, if the Surviving Spouse is chronically ill or disabled and the children's interest is contingent on her death, EBD treatment based on the wife's life may be possible.

IRAs at Death & Beyond

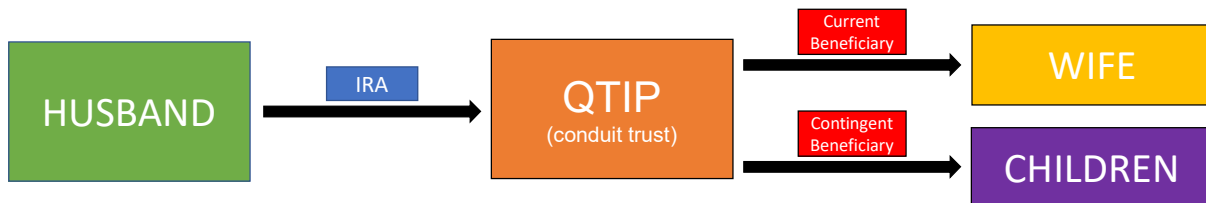
Example 16: Husband to QTIP Trust



- Generally, the 10-year rule will apply with RMDs based on the oldest beneficiary. If 10-year rule applies, to a Roth IRA there will be no RMDs.
- However, if the Surviving Spouse is chronically ill or disabled and the children's interest is contingent on her death, EDB treatment based on the wife's life may be possible.

IRAs at Death & Beyond

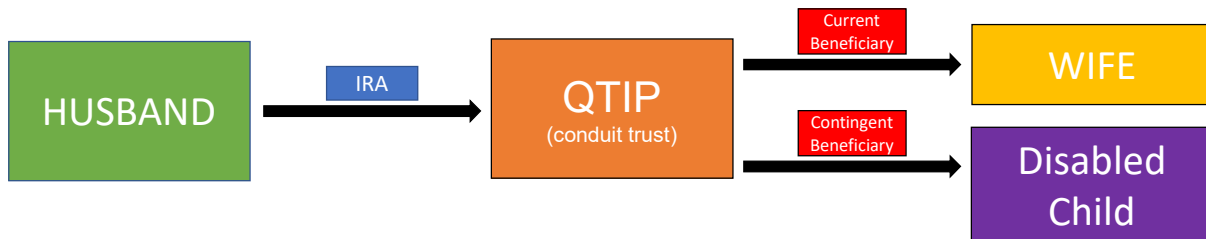
Example 17: Husband to QTIP Trust



- If the QTIP is a conduit trust, EDB treatment based on the wife's life expectancy is available. The single life table and subtract-one method is used. Moreover, the wife can wait until the earlier of when she reaches her RBD or when her deceased husband (would have) reached his RBD to begin distributions.
- When the wife dies, the 10-year rule with no RMDs applies.

IRAs at Death & Beyond

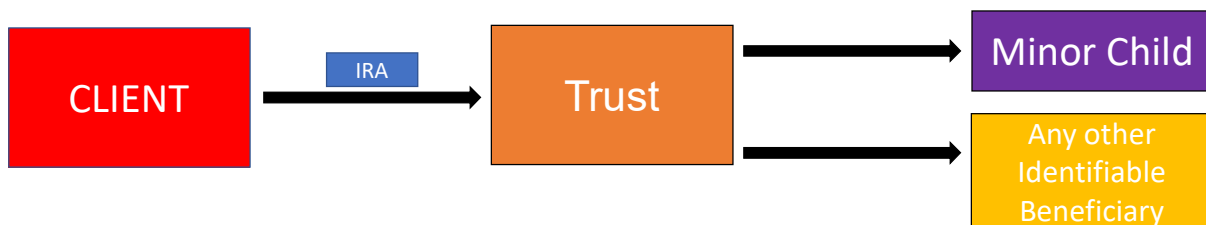
Example 18: Husband to QTIP Trust



- If the contingent beneficiary is a disabled child, EDB life expectancy distributions may be able to continue based on the child's life expectancy.

IRAs at Death & Beyond

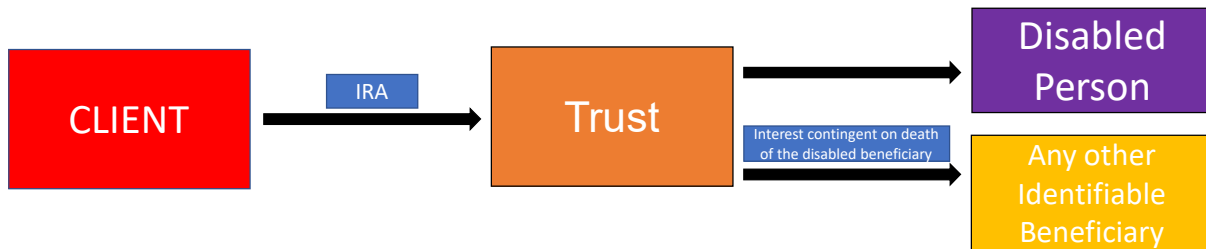
Example 19: Trust for a Minor Child



- If a current trust beneficiary is the deceased client's minor child, EDB treatment is available and is generally not limited by other beneficiaries. The single life table and subtract-one method is used. When the child reaches the age of majority, the 10-year rule without RMDs applies.

IRAs at Death & Beyond

Example 20: Trust for a Disabled Person



- If a current trust beneficiary is disabled and the only interest(s) are contingent on the death of the disabled beneficiary, EDB treatment is available. The single life table and subtract-one method is used. When the disabled person dies, the 10-year rule without RMDs applies.

IRAs at Death & Beyond

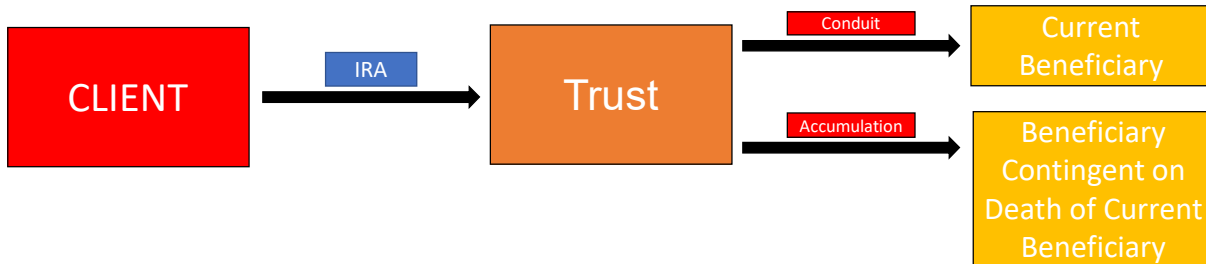
Example 21: Charity as a Remote Contingent Beneficiary



- If a charity's potential interest in an IRA is contingent on the death of a beneficiary with merely a residual interest in the IRA, the charity can be disregarded.
- The trust can be treated as a qualified designated beneficiary and the Section 409(a) rules are applied ignoring the charity's interest.

IRAs at Death & Beyond

Example 22: Conduit to Accumulation Trust



- If a conduit trust will switch to an accumulation trust at the death of the current beneficiary to an accumulation trust, the trust will be treated as a conduit currently

Conclusion