2025 Individual Income Tax Workshop

Don Farmer
Tax Education

Nick Preusch, CPA, J.D., LL.M., MSA

INDEXED ITEMS, ETC

Married Filing Jointly & Surviving Spouses (Sec. 1(j)(2)(A))

Rate	Taxable Income
10%	$0 – $23,850
12%	$23,851 – $96,950
22%	$96,951 – $206,700
24%	$206,701 – $394,600
32%	$394,601 – $501,050
35%	$501,051 – $751,600
37%	Over $751,600

Head of Household (Sec. 1(j)(2)(B))

Rate	Taxable Income
10%	$0 – $17,000
12%	$17,001 – $64,850
22%	$64,851 – $103,350
24%	$103,351 – $197,300
32%	$197,301 – $250,500
35%	$250,501 – $626,350
37%	Over $626,350

Single Filers (Sec. 1(j)(2)(C))

Rate	Taxable Income
10%	$0 – $11,925
12%	$11,926 – $48,475
22%	$48,476 – $103,350
24%	$103,351 – $197,300
32%	$197,301 – $250,525
35%	$250,526 – $626,350
37%	Over $626,350

Married Filing Separately & Estates/Trusts

- **MFS:** Half of MFJ thresholds. 37% starts at $375,801.

- **Estates/Trusts:**
- 10%: $0–$3,250
- 24%: $3,251–$11,450
- 35%: $11,451–$15,650
- 37%: Over $15,650

Long-Term Capital Gains & Qualified Dividends

Filing Status	0%	15%	20%
Single	≤$48,350	$48,351–$533,400	$533,401+
MFJ	≤$96,700	$96,701–$600,050	$600,051+
HOH	≤$64,750	$64,751–$566,700	$566,701+
MFS	≤$48,350	$48,351–$300,000	$300,001+

NIIT & Additional Medicare Tax

- **NIIT (3.8%)**
- Applies to lesser of NII or MAGI over threshold:
  - MFJ/QW: $250k | MFS: $125k | Single/HOH: $200k **Additional Medicare (0.9%)**
- Applies to earned income above:
  - MFJ: $250k | MFS: $125k | Single/HOH: $200k

Standard Deduction & Senior Additions

Filing Status	2025 Amount
MFJ/QW	$31,500
HOH	$23,625
Single/MFS	$15,750
Additional (65+)	

- Single/HOH: +$2,000
- MFJ: +$1,600/spouse
- New Senior Bonus (2025–2028): up to $6,000 ($12,000 joint)

AMT Exemptions (2025)

Filing Status	Exemption	Phase-Out Begins
MFJ/QSS	$137,000	$1,252,700
Single/HOH	$88,100	$626,350
MFS	$68,650	$626,350

Rates: 26% up to $220,700; 28% above.

Kiddie Tax & AMT for Children

- First $1,350 tax-free
- Next $1,350 taxed at child’s rate
- Over $2,700 taxed at parent’s rate
- AMT Exemption: Lesser of $88,100 or earned income + $9,550

Deductions & Credits Highlights

- LTC Insurance: Up to $6,020 per person (age-based)
- Education Savings Bond Exclusion: Phase-out $149k–$179k (MFJ)
- Student Loan Interest: Max $2,500; phase-out $85k–$100k single ($170,000 - $200,000 MFJ)
- AOTC: $2,500/student | LLC: $2,000/return
- Educator Deduction: $300

Family Credits

Credit	2025 Amount	Refundable	Phase-Out (MAGI)
CTC	$2,200/child	Up to $1,700	$200k/$400k
ODC	$500	No	Same as CTC
Adoption Credit	$17,280	Up to $5,000 refundable	Phase-out $259,190–$299,190

Estimated Tax & Retirement Contributions

- Safe Harbor: 100% prior year tax or 90% current (110% if AGI > $150k)
- IRA Limits: Under 50: $7,000 | 50+: $8,000
- 401(k)/403(b)/457:Base: $23,500
  - Catch-up (50–59, 64+): +$7,500
  - Ages 60–63: +$11,250
- SIMPLE IRA: up to $21,750 (age 60–63)

Plan Limits & Compensation Caps

- §415(c) DC Plan: $70,000 total contributions
- §415(b) DB Plan: $280,000 annual benefit
- §401(a)(17) Comp Cap: $350,000
- HCE threshold: $160,000

Health Accounts

Account	Self	Family
HSA	$4,300	$8,550
HDHP Min Deductible	$1,650	$3,300
HDHP Max OOP	$8,300	$16,600

FSA: $3,300 (carryover $660)

QSEHRA: $6,350 self / $12,800 family

Estate & Gift Tax (2025)

- Top rate: 40%
- Exclusion: $13.99M per person ($27.98M joint)
- Annual gift exclusion: $19,000 ($38,000/couple)
- Noncitizen spouse exclusion: $190,000
- GST exemption: $13.99M

Payroll & Social Security

- OASDI (6.2% each side): up to $176,100
- Medicare: 1.45% (no cap)
- Max OASDI Tax: $10,918.20
- Combined FICA: 15.3%

Depreciation & Auto Limits

Year	With Bonus	Without Bonus
1st	$20,200	$12,200
2nd	$19,600	$19,600
3rd	$11,800	$11,800
Later	$7,060	$7,060
§179 Limit: $2.5M (phase-out $4M; full at $6.5M)		
Bonus Depreciation: 100% restored for 2025		

Mileage & Penalties

- Standard Mileage (2025):
  - Business: 70¢ | Medical/Moving: 21¢ | Charitable: 14¢
- Late Filing Penalties:1065/1120S: $255/partner per month
- 1099s: up to $660/intentional disregard
- Individual 1040: up to 27.5% combined (file + pay)

Qualified Business Income & Small Business Test

§199A QBI Deduction:

- MFJ: Full ≤$394,600 | Phase-out to $494,600
- Single: Full ≤$197,300 | Phase-out to $247,300

Small Business Gross Receipts Test:

- ≤$31,000,000 average (3-year)
- Exempt from §163(j), UNICAP, can use cash method

SELECTED PROVISIONS SCHEDULED TO EXPIRE OR BE REDUCED

Expiring & Permanent Tax Provisions Overview (Post-2025)

- Source: JCX-1-25 (Jan. 9, 2025)
- Covers provisions expiring after 2025 and 2026
- Indicates whether each is made permanent, modified, or expiring

Overview – Key Legislative Update

- Many provisions from TCJA were set to expire after 2025
- P.L. 119-21 (2025 Act) makes most individual provisions permanent
- Certain credits and deductions still scheduled to expire

Individual Tax Rates & Deductions

- Individual income tax rates (§1(j)) – Made permanent
- Standard deduction increase (§63(c)(7)) – Made permanent
- Miscellaneous itemized deductions suspension (§67(g)) – Permanent
- Pease limitation suspension (§68(f)) – Permanent
- Personal exemption suspension (§151(d)(5)) – Permanent

Credits – Permanent vs. Expiring

- Permanent / Modified by P.L. 119-21:
  - Child Tax Credit (§24(h))
  - Employer Paid Family & Medical Leave (§45S)
  - New Markets Credit (§45D)

- Expiring:
  - Work Opportunity Credit (§51)
  - Premium Assistance Credit (§36B)

AMT & Base Erosion Tax Changes

- AMT exemption increase (§55(d)(4)) – Permanent
- Base Erosion Minimum Tax (§59A) – Modified

Exclusions & Income Adjustments

- Permanent:
  - Student loan discharge (§108(f)(5))
  - Employer-paid student loan assistance (§127(c)(1)(B))
  - Moving expense suspension (§132(g)(2))
  - Deduction for home equity limitation (§163(h)(3)(F))
  - SALT cap limitation (§164(b)(6))

- Expiring:
  - Mortgage debt forgiveness (§108(a)(1)(E))

Charitable & Miscellaneous Deductions

- Cash contribution limit increase (§170(b)(1)(G)) – Permanent
- Wagering losses computation (§165(d)) – Permanent
- Personal casualty losses (disaster-related only) (§165(h)(5)) – Permanent
- Motorsports facility 7-year depreciation (§168(e)(3)(C)) – EXPIRES

Business Deductions & Credits

- Permanent / Modified:
  - QBI deduction (§199A)
  - FDII & GILTI deduction percentages (§250)
  - State/local tax deduction cap (§164)
  - Employer-provided meals (§274(o)) – EXPIRES

Film, TV, and Live Theater Expensing (§181)

- Modified but expires 12/31/2025
- Full expensing remains available through 2025 only

ABLE Accounts (§529A)

- Contributions eligible for Saver's Credit (§25B) – Permanent
- Rollovers from §529 plans – Permanent
- Increased contribution limits – Permanent

International & Foreign Rules

- Look-through payments between related CFCs (§954(c)(6)) – Permanent
- Base erosion and anti-abuse tax (BEAT) rules – Modified

Empowerment Zone Incentives

- All Expire after 2025:
  - Zone designations (§1391)
  - Tax-exempt bonds (§1394)
  - Employment credit (§1396)

Estate & Gift Tax Provisions

- Increased exclusion (§2010(c)(3)(C)) – Permanent
- Unified credit and rates remain unchanged at 40%

Miscellaneous Individual Provisions

- Deduction for moving expenses – Permanent
- Exclusion for employer bicycle reimbursements – Permanent
- Limitation on home mortgage interest – Permanent

Military & Special Cases

- Sinai Peninsula service exclusion (PL 115-97 §11026) – Permanent

Summary of Expiring 2025 Provisions

- Premium Assistance Credit (§36B)
- Work Opportunity Credit (§51)
- Mortgage Debt Forgiveness (§108(a)(1)(E))
- Motorsports Complex Depreciation (§168)
- Employer Meal Deduction (§274(o))
- Empowerment Zone Incentives (§§1391–1396)

Provisions Expiring After 2026

- Saver’s Credit (§25B) – Permanent
- Advanced manufacturing credit (§48D) – Expires after 2026
- Bonus depreciation (§168(k)) – Permanent
- Fruit/Nut plant depreciation (§168(k)(5)) – Permanent
- Opportunity Zone investment (§1400Z-2) – Permanent

Key Takeaways

- Most TCJA provisions made permanent by P.L. 119-21
- Remaining expirations mainly affect energy/manufacturing and niche business areas
- Planning for 2026 transitions remains essential

Practitioner Notes

- Expect further IRS guidance
- Legislative watch: post-2026 updates possible
- Review expiring credits and bonus depreciation elections

Summary

- After 2025: Most provisions remain in effect
- After 2026: Minor phase-outs in manufacturing & energy credits
- Result: 2025 Act stabilizes tax code through 2028

DISASTER RELIEF

2025 Disaster Relief Overview

- IRS Disaster Tax Relief Notices – Summary
  - Covers major disaster areas from Jan–Jul 2025
  - Relief includes filing/payment extensions & penalty abatement
  - Automatic relief for taxpayers in FEMA-declared areas

Key Deadlines & General Rules

- Most disaster extensions through Nov 3, 2025 or Feb 2, 2026
- Covers:
  - Individual, business & tax-exempt returns
  - 2024 IRA/HSA contributions
  - Estimated, payroll & excise taxes
- Penalty relief if paid within deadlines
- Automatic relief; others contact IRS Special Services

California (CA-2025-01 / IR-2025-10)

- Event: Wildfires & winds (began Jan 7, 2025)
- Counties: Los Angeles & others
- New Deadline: Oct 15, 2025
- Includes all individual, business, fiduciary & exempt filings
- Payroll deposit penalties waived if paid by Jan 22

Kentucky (KY-2025-02)

- Event: Storms, winds, flooding, landslides (Feb 14, 2025)
- Scope: Statewide
- Deadline: Nov 3, 2025
- Covers individual, business, fiduciary, exempt returns
- Payroll/excise deposits due Feb 14–Mar 3 waived if paid by Mar 3

West Virginia (WV-2025-02 / IR-2025-34)

- Event: Storms, floods, landslides (Feb 15, 2025)
- Counties: Logan, McDowell, Mercer, Mingo, Wayne, Wyoming
- Deadline: Nov 3, 2025
- Includes IRA/HSA contributions & estimated payments
- Payroll deposit penalties waived if paid by Mar 3

Tennessee (TN-2025-02 / IR-2025-47)

- Event: Storms, winds, tornadoes, flooding (Apr 2, 2025)
- Scope: Entire state (95 counties)
- Deadline: Nov 3, 2025
- Covers all filings including payroll/excise
- Payroll deposits (Apr 2–Apr 17) waived if paid by Apr 17

Arkansas (AR-2025-03 / IR-2025-49)

- Event: Tornadoes, flooding, storms (Apr 2, 2025)
- Scope: All 75 counties
- Deadline: Nov 3, 2025
- Includes individual, business, fiduciary & exempt returns
- Payroll/excise deposits Apr 2–Apr 17 waived if paid by Apr 17

Virginia (VA-2025-03)

- Event: Winter storms & flooding (Feb 10, 2025)
- Counties: Amelia, Bedford, Bristol, Botetourt, others
- Deadline: Nov 3, 2025
- Includes individual, business, fiduciary, exempt returns
- Payroll/excise deposits Feb 10–Feb 25 waived if paid by Feb 25

Missouri (MO-2025-01 / MO-2025-02)

- Events:
- MO-2025-01: May 16 (St. Louis area storms)
- MO-2025-02: Mar 14 (statewide storms, winds, wildfires)
- Deadline: Nov 3, 2025
- Payroll penalties waived for deposits made by Mar 31

Mississippi (MS-2025-01)

- Event: Storms, tornadoes, flooding (Mar 14, 2025)
- Counties: Calhoun, Grenada, Issaquena, Lee, Pike, etc.
- Deadline: Nov 3, 2025
- Includes IRA/HSA & estimated taxes
- Payroll/excise penalties waived if paid by Apr 10

Oklahoma (OK-2025-02)

- Event: Wildfires & winds (Mar 14, 2025)
- Counties: Cleveland, Creek, Lincoln, Oklahoma, Pawnee, Payne
- Deadline: Nov 3, 2025
- Includes IRA/HSA contributions, estimated taxes
- Payroll penalties waived if deposits made by Mar 31

Texas (TX-2025-03 / TX-2025-04)

- Events:
- TX-2025-03: Storms/flooding (Mar 26, 2025)
- TX-2025-04: Storms/winds/flooding (Jul 2, 2025)
- Counties: Cameron, Hidalgo, Starr, Willacy, etc.
- Deadlines: Nov 3, 2025 & Feb 2, 2026
- Payroll penalty relief for timely deposits

North Carolina (NC-2025-01)

- Event: Hurricane Helene (Sept 25, 2024)
- Scope: Entire state
- Deadline: Sept 25, 2025
- Covers 2023 extended & 2024 filings
- Automatic relief; contact IRS if outside state

New Mexico (NM-2025-03)

- Event: Storms, flooding, landslides (Jun 23, 2025)
- Counties: Chaves, Lincoln, Otero, Valencia
- Deadline: Feb 2, 2026
- Covers all filing types & estimated payments
- Automatic relief; penalty abatement available

West Virginia (WV-2025-04)

- Event: Storms, flooding, landslides (Jun 14, 2025)
- Counties: Marion, Ohio
- Deadline: Feb 2, 2026
- Includes all return types
- Claim casualty losses on 2024 or 2025 returns

Claiming Casualty Losses

- Losses may be claimed on 2024 or 2025 returns
- Election available 6 months post due date
- Use Form 4684 to claim
- Include FEMA disaster declaration number

Practice Alert

- See IRS Disaster Relief Portal:
  - https://www.irs.gov/newsroom/tax-relief-in-disaster-situations
- Monitor FEMA/IRS updates
- Review taxpayer addresses for qualification

Summary

- Relief extends key deadlines to late 2025 / early 2026
- Automatic penalty relief for designated counties
- Taxpayers outside may qualify if records affected
- Action: Review clients & filing schedules

ONE BIG BEAUTIFUL BILL – TCJA EXTENSIONS

Extension & Enhancement of Reduced Rates

- TCJA reduced rates (10%-37%) are made permanent.
- Inflation adjustments continue annually; 10% and 12% brackets use 2016 as new base year after 2025.
- Trust and estate 10% bracket also uses 2016 base year.
- Prevents automatic reversion to pre-TCJA higher rates.
- Promotes long-term certainty for taxpayers.

Extension & Enhancement of the Standard Deduction

- TCJA doubled standard deduction—now made permanent.
- 2025 enhanced amounts:
- – Single: $15,750 (was $15,000)
- – MFJ: $31,500 (was $30,000)
- – HOH: $23,625 (was $22,500)
- Indexed for inflation using 2024 as base year.
- Simplifies filing for majority of taxpayers; fewer itemize deductions.

Permanent Repeal of Personal Exemptions & Senior Deduction

- Personal exemptions repealed permanently beyond 2025.
- New Temporary Senior Deduction (2025–2028):
- – $6,000 per senior 65+, $12,000 for joint filers if both qualify.
- – Phases out: 6% of MAGI above $75k single / $150k joint.
- – Must include SSNs for all qualifying seniors.
- Ensures fairness while compensating seniors for lost exemptions.

Extension & Enhancement of Child Tax Credit (CTC)

- CTC expansion made permanent.
- Credit amount increased to $2,200 per child under 17.
- Refundable portion remains $1,700 (indexed).
- $500 Other Dependent Credit made permanent.
- Phase-out thresholds: $400k joint, $200k single/HOH.
- SSN required for taxpayer & child (enforced automatically).
- Example: Two children under 17 → $4,400 total credit.

Permanent Estate & Gift Tax Exemption Expansion

- TCJA’s doubled exemption extended permanently.
- Exemption raised to $15M per person ($30M per couple).
- Indexed annually using 2025 as new base year.
- Unified credit offsets about $6M of tax.
- Effective for estates of decedents dying and gifts made after Dec. 31, 2025.
- Stabilizes estate planning and intergenerational transfers.

Alternative Minimum Tax (AMT) Relief & Modifications

- AMT exemption made permanent (no expiration).
- Inflation base year updates:
- – $1M threshold (MFJ): base = 2025.
- – $109,400 (MFJ), $70,300 (single): base = 2017.
- Phaseout begins at $1M for MFJ (was $1.25M).
- Phaseout rate doubles: 25% → 50%.
- Protects middle-income taxpayers while maintaining progressivity.

Mortgage Interest Deduction – Permanent & Modified

- $750,000 mortgage cap remains permanent.
- Mortgage Insurance Premiums (PMI) now deductible as interest.
- Example:
-   – $400k mortgage, $14k interest, $2.5k PMI → $16.5k deductible.
- No reversion to $1M cap.
- PMI permanently reclassified as qualified residence interest.

Casualty Loss Deduction – Permanent & Expanded

- Deduction limited to federally declared disasters permanently.
- Enhanced rules extended:
- – No itemization required.
- – 10% AGI floor removed.
- – $500 per-loss floor (vs. $100).
- Includes state-declared disasters recognized by Treasury.
- Applies to all U.S. territories and possessions.

Moving Expense Deduction & Exclusion

- Suspension made permanent after 2025.
- Military exception preserved for active-duty moves.
- New eligibility for intelligence community relocations.
- Limits deduction to mandated relocations under official orders.
- Prevents abuse while supporting federal service mobility.

Opportunity Zones – Permanent Renewal & Expansion

- OZ program made permanent with recurring 10-year designations starting July 1, 2026.
- Redefined eligibility based on income and poverty tests.
- Introduces Qualified Rural Opportunity Funds (QROFs):
- – 30% bonus step-up for rural areas.
- Removes 2026 deferral cliff.
- New reporting: fund activity, job creation, housing data.

Opportunity Zone Example

- Investor invests $500k in rural QROF (Mar 1, 2027).
- 5-year hold → 30% step-up ($150k excluded).
- 10-year hold → 100% OZ gain excluded.
- No expiration date for deferral.
- Encourages long-term rural reinvestment with transparency.

Qualified Small Business Stock (QSBS) Expansion

- New phased exclusion system:
- – 3 yrs: 50% exclusion
- – 4 yrs: 75% exclusion
- – 5+ yrs: 100% exclusion
- Asset cap increased $50M → $75M.
- Per-issuer limit: $15M or 10× basis (indexed post-2026).
- Gains fully excluded from AMT.
- Applies to stock acquired after July 4, 2025.

QSBS Example – Jane’s Investment

- Acquired Aug 1, 2026, gain = $2M.
- – 3-year sale → $1M excluded (50%).
- – 5-year sale → $2M excluded (100%).
- Encourages mid- to long-term holding in small business equity.
- Indexed $15M cap increases annual investment flexibility.

Summary – Permanence & Policy Impact

- Permanently codifies TCJA’s reforms.
- Extends key provisions: lower rates, standard deduction, CTC, AMT relief.
- Adds senior, rural, and small business incentives.
- Reduces uncertainty from sunset provisions.
- Effective mainly for tax years after Dec. 31, 2025.

ONE BIG BEAUTIFUL BILL – INDIVIDUAL PROVISIONS

OBBB — Individual Provisions (Overview)

- Scope: deductions, credits, exclusions, SALT, tips/overtime, ABLE/529, energy terminations.
- Theme: permanence + targeted temporary relief (2025–2028) + identity rules.
- Effective dates vary; many after 12/31/2025; some from 2025 or 7/4/2025.

Termination of Misc. Itemized Deductions — Except Educators

- Sec. 67(g) permanent: 2%-of-AGI miscellaneous itemized deductions remain nondeductible.
- Educator expenses: above-the-line $300 (2025) retained; expanded scope (instructional activity; PE/health supplies; coaches/admins).
- Post-2025: excess educator expenses may be itemized.
- Effective: years after 12/31/2025.

Itemized Deduction Limitation (Pease-like)

- Reduction = 2/37 (~5.41%) of the lesser of (total itemized) or (TI+itemized over 37% bracket threshold).
- Apply after other caps; §199A unaffected.
- Example: Single 2026 — TI $726,350; itemized $60k; threshold $626,350 → haircut 2/37×$60k=$3,243.24; allowed $56,756.76.
- Effective after 12/31/2025.

Qualified Transportation Fringe (QTF)

- Bicycle reimbursements remain taxable (excluded from QTF exclusion).
- Inflation base-year for non-bicycle QTF changed 1998→1997.
- Effective after 12/31/2025.

Wagering Losses — New 90% Cap

- Two caps: (1) limited to gains; (2) ≤90% of losses.
- Expanded definition includes otherwise-allowable costs of wagering activity.
- Examples: A) $50k wins/$60k losses → $50k deduction. B) $50k wins/$52k losses → $46.8k deduction ⇒ $3.2k taxable.
- Effective after 12/31/2025.

ABLE — Contributions & Saver’s Credit; 529→ABLE

- Increased ABLE contribution feature made permanent; inflation base-year coordination change.
- Saver’s Credit: after 2026, ABLE contributions qualify; max credit $2,100 after 12/31/2026; SECURE 2.0 coordination repealed.
- 529→ABLE rollovers permanent after 12/31/2025.

Hazard Duty Areas — Permanent & Expanded

- Sinai permanent; adds Kenya, Mali, Burkina Faso, Chad (while hostile fire/imminent danger pay applies).
- Effective 1/1/2026.

Student Loan Discharge — Death/Disability

- Exclusion permanent for federal & qualifying private loans; 108(f)(5) broader temporary exclusion not extended.
- SSN reporting required; omission = math/clerical error.
- Effective for discharges after 12/31/2025.

SALT Limitation — New 2025–2029 Structure

- Applicable amounts: 2025 $40k MFJ/Single ($20k MFS); 2026 $40.4k/$20.2k; 2027–2029 +1%/yr; 2030+ reverts to $10k/$5k.
- Phaseout: 30% of MAGI over threshold (2025 $500k MFJ/$250k others; 2026 $505k/$252.5k). Floor $10k.
- Example 2026 MFJ MAGI $600k → allowed $11,900; MAGI $900k → $10k.

No Tax on Tips — §224 (2025–2028)

- Deduction up to $25k of qualified tips; phaseout $100 per $1k over $300k MFJ/$150k others; fully out at $550k/$400k.
- Requires SSN; MFJ for married; Form 4137 reporting; IRS list of tipped occupations due ≤90 days from 7/4/2025.
- Example 2026 Single: $20k tips; MAGI $155k → deduction $19,500.

No Tax on Overtime — §225 (2025–2028)

- Deduction of qualified OT pay; limits \$25k MFJ/\$12.5k others; phaseout \$100 per \$1k over \$300k/\$150k; fully out at \$550k/\$275k.
- W-2 Box 19 reporting; SSN required; MFJ for married.
- Example 2026 MFJ: OT \$20k; MAGI \$310k → deduction \$19k.

No Tax on Car Loan Interest (2025–2028)

- Deduct up to $10k interest on new personal-use vehicles; VIN required.
- Vehicle: first use by taxpayer; final assembly in U.S.; GVWR <14k lb; excludes fleet/leases/salvage.
- Phaseout starts $200k MFJ/$100k others; ends $250k/$150k.
- Lender 1098-style reporting (≥$600 interest).

Trump Accounts & Pilot Program

- §530A custodial IRA-like for minors; contributions nondeductible, ≤$5k/yr (indexed after 2027); index funds only; ABLE rollover path.
- Pilot §6434: refundable $1,000 deposit for births 2025–2028 (election with SSN; no offsets).
- Employer §128: ≤$2,500 excluded; §139J qualified-entity contributions excluded; §6659 penalties for ineligible claims.

Adoption Credit & Tribal Determinations

- Up to $5,000 refundable portion (no carryforward of refundable part); indexing bases updated (2001 general; 2024 refundable).
- Tribal governments’ special-needs determinations treated like states’.
- Effective generally after 12/31/2024.

Dependent Care Assistance (DCAP) Exclusion Raised

- §129 excludable benefits: $7,500 ($3,750 MFS) after 2025.
- Coordinate with CDCTC to avoid double-using same expenses.

Child & Dependent Care Tax Credit (CDCTC)

- Max rate 50%; phases to 35% by ~AGI $43k; then toward 20% above AGI $75k ($150k MFJ); minimum 20% above ~$103k ($206k MFJ).
- Expense caps remain $3k (1 dependent)/$6k (2+).
- Effective after 12/31/2025.

Credit for SGO Donations (Post-2026)

- 100% credit up to $1,700; state credit reduces federal credit; 5-year carryforward.
- SGO must be 501(c)(3) public charity; ≥90% to scholarships; ≥10 students at different schools; income ≤300% AMI; anti-earmark/related-party rules.
- Student scholarships excluded (new §139K).

529 Plans — K-12 & Credentialing

- K-12: adds curriculum/materials, online content, qualified tutoring, tests, dual enrollment, licensed therapies; K-12 tuition cap $20k/yr after 12/31/2025.
- Postsecondary credentials: recognized programs/exams/CE via WIOA, VA WEAMS, DoD COOL, ICE/NCCA/ANSI, state/fed licenses, apprenticeships, or Treasury-Labor ID.

Farmland Capital Gain Installment Option

- Sale to qualified farmer; 10-year farm-use history; 10-year deed restriction on non-farm use.
- Elect to pay gain tax in 4 equal annual installments; acceleration on default/death/cessation.
- Example: \$800k gain → \$160k tax → \$40k × 4.

Energy & EV Credits — Terminations

- Used EV §25E: no credit for vehicles acquired after 9/30/2025.
- New EV §30D: no credit for vehicles acquired after 9/30/2025.
- Refueling §30C: ends for property in service after 6/30/2026.
- 25C: ends for improvements after 12/31/2025; 25D: ends for expenditures after 12/31/2025; 45L: ends for homes acquired after 6/30/2026.

Dyed Fuel Excise Refund

- Refund without interest for dyed diesel/kerosene removed from terminal if §4081 tax paid and fuel qualifies under §4082(a); excess claim penalties under §6675.
- Effective 180 days after 7/4/2025.

AOTC/LLC — SSN/EIN Identification Rules

- Taxpayer SSN required; student SSN if claiming for dependent; AOTC also requires institution EIN.
- Omission treated as math/clerical error; credit can be disallowed.
- Effective after 12/31/2025.

PTC Eligibility Narrowed (Post-2026)

- PTC available only to citizens or specific eligible aliens; exchanges must verify immigration/income/residence/coverage; advance PTC barred for ineligible.
- Effective tax years after 12/31/2026; plan verification for plan years ≥ 1/1/2027.

PTC Disallowed During Medicaid Ineligibility (Alien Status)

- Strikes 36B(c)(1)(B); if ineligible for Medicaid due to alien status, also ineligible for PTC during that period.
- Effective after 12/31/2025.

Practitioner Checklist — Action Items

- SALT modeling; tips/overtime W-2/4137 tracking; educator above-line + itemized; ABLE/529 expansions; energy/EV timing; SSN/EIN capture for education credits; farmland sale elections; gambling recordkeeping; military hazard area checks.

ONE BIG BEAUTIFUL BILL – SELECT PROVISIONS AFFECTING SCHEDULE C AND F

OBBB – Schedule C & F: Key Changes (Overview)

- Who's affected: Sole proprietors (Sched C), farmers (Sched F), trusts/estates with passthroughs.
- Themes: Permanent §199A, 100% bonus, §179 expansion, R&E expensing, reporting relief, EBL made permanent, meals clarifications.
- Timing: Many rules effective for years after 12/31/2025; some retro/transition pieces earlier.

§199A QBI – Permanent Extension & Enhancements

- Permanent §199A 20% deduction for QBI, REIT dividends, PTP income.
- Expanded phase-in thresholds for W-2/UBIA limits and SSTB phase-out:
- Single: +$75k band (to $272,300 for 2026 illustration)
- MFJ: +$150k band (to $544,600 for 2026 illustration)
- Minimum QBI deduction: $400 if ≥$1,000 active QBI and material participation.
- Indexing: $400 minimum and $1,000 floor indexed starting 2027 (base=2025).
- Effective: TYs beginning after 12/31/2025.

§199A QBI – Threshold Mechanics (2026 Illustration)

- Phase-in windows where W-2 wage/UBIA tests apply and SSTB phases out:
- MFJ: $394,600 → $544,600 (was $394,600 → $494,600)
- Single: $197,300 → $272,300 (was $197,300 → $247,300)
- Planning: More headroom before wage/property limits bite; SSTBs retain deduction longer.

§199A QBI – Practical Examples

- Example A (Sched C, MFJ, non-SSTB): TI $500k, QBI $300k, W-2 $0, UBIA $800k → Within phase-in: compute via W-2/UBIA formula; expanded window may preserve full 20%.
- Example B (Sched C, Single, SSTB): TI $255k, QBI $150k → Still within SSTB phase-in; partial deduction available due to higher band.
- Example C (Minimum deduction): TI $60k, QBI $1,200 active, material participation → Deduction at least $400.

100% Bonus Depreciation – Permanent (§168(k))

- Full expensing revived & made permanent for qualified property acquired after 1/19/2025.
- Covers most 20-year-or-less MACRS property: machinery, equipment, certain improvements; includes specified fruit/nut plants planted/grafted after 1/19/2025.
- Binding contract rule: Property under binding contract before 1/20/2025 not eligible for 100%.
- Effective: Acquisition after 1/19/2025 (see transition slide).

100% Bonus – Transition Elections (2025–2027)

- Taxpayers may elect reduced bonus % for the first TY ending after 1/19/2025:
- •Standard property: 40% (2025 placements), 20% (2026), 0%/20% (2027 depending facts)
- Long production period/noncommercial aircraft: 60% (2025), 40% (2026), 20% (2027)
- Use cases: smooth taxable income, coordinate with §179/QBI, state conformity issues.

R&E (Domestic) – Full Expensing Restored

- Amounts paid/incurred in TYs beginning after 12/31/2024:
- Immediate deduction of domestic R&E tied to a trade or business.
- Software development explicitly treated as domestic R&E (fully deductible).
- Optional election: amortize ≥60 months from benefit month; consistency required unless IRS consent to change.

R&E – Coordination & Retro Relief

- Research credit now limited to domestic R&E for years after 2024; §280C coordination applies (deduction reduced by credit).
- Acceleration relief: For costs capitalized 2022–2024, elect to accelerate remaining unamortized deductions over 1-year or ratably over 2 years starting first TY after 2024.
- Small business retro election: Avg receipts ≤$31M (non–tax shelter) may apply changes back to TYs after 12/31/2021 via amended returns filed by 7/4/2026.

R&E – Exclusions & Boundaries

- Not eligible: land acquisition/improvements; depreciable/depletable property; mineral exploration; foreign research.
- Cross-code coordination: §41 (credit), §56 (AMT), §59(e), §1202 interactions updated.
- Planning: segregate domestic vs foreign R&E, track software costs separately.

Business Meals – Clarified Deductibility (§274)

- Disallowances retained post-2025: employer-provided convenience meals (§119) and de minimis facility meals (§132(e)) remain nondeductible.
- Fully deductible: cost of food & beverages sold to customers (§274(e)(8)).
- New 100% deductibility: food & beverages for crews of fishing vessels (§274(n)(2)(C)) and U.S. fish processing facilities north of 50° N outside metro areas (§143(k) reference).
- Effective: TYs after 12/31/2025.

§179 Expensing – Bigger Limits (2025)

- Dollar limit increased to $2,500,000; phase-out threshold to $4,000,000 for TYs beginning after 12/31/2024.
- Indexing begins 2026 (base year 2024).
- Use with 100% bonus: prioritize §179 for assets not bonus-eligible; consider state conformity; watch taxable income limitation under §179.

Third-Party Network Transactions – De Minimis Repeal Reset

- Restores prior §6050W thresholds: reporting only if >$20,000 AND >200 transactions.
- Effective for calendar years beginning after 2021 (retro relief from ARPA changes).
- Backup withholding coordination: §3406 applies only if BOTH thresholds are met (except prior-year reportables).
- Effective for backup rule: calendar years after 12/31/2024.

Info Reporting Threshold – Non-Employee Pay (§6041)

- Threshold increased from \$600 → \$2,000 after 12/31/2025.
- Indexing: new §6041(h) provides annual inflation adjustments starting 2027; rounded per statute.
- Impact: fewer 1099-NECs for micro-payments; still collect W-9s and track thresholds.

§461(l) Excess Business Loss (EBL) – Permanent & Modified

- EBL limitation made permanent.
- Threshold indexing: base year updated to 2024; reference date 12/31/2025. For 2025: $313k single / $626k MFJ; amounts likely lower in 2026 per new indexing path.
- EBL disallowed becomes §172 NOL carryforward.

§461(l) EBL – Example (2026 Single)

- Business income \$200k; deductions \$1,000k ⇒ loss \$800k; other income \$50k.
- Assume 2026 EBL threshold ~\$260k (illustrative).
- Allowed current-year business loss offset: \$260k; excess \$540k → NOL carryforward.
- Result: TI ≈ –\$210k (NOL), remainder used in later years.

Schedule C/F Planning – QBI + §179 + Bonus

- Stacking order tips:
- • Use 100% bonus to reduce QBI? Deduction lowers QBI and §199A; model both ways with §179 vs bonus.
- • Expanded §199A windows may preserve more deduction despite expensing.
- • Consider transitional bonus elections to manage taxable income spikes.

Schedule F Focus – Equipment & R&E

- Farmers benefit from 100% bonus on machinery/implements; §179 higher dollar limits help for used assets and certain improvements.
- Domestic ag software/tooling (farm management, precision ag) treated as R&E may be immediately deducted if development is domestic.
- Meals: fishing processors north of 50° N get 100% deductibility (industry-specific).

Recordkeeping & Forms – What Changes

- Vendors/TPAs: 1099-NEC threshold jumps to $2,000 after 2025; update payables systems.
- Platforms: §6050W thresholds revert; fewer 1099-Ks for small sellers.
- R&E: track domestic vs foreign, software categories, election statements for amortization/acceleration.
- Bonus/§179: maintain acquisition dates, binding contract certifications, placed-in-service logs.

Effective Dates – Quick Grid

- §199A: TYs after 12/31/2025.
- 100% bonus: acquired after 1/19/2025 (transition elections apply 2025–2027).
- R&E expensing: TYs after 12/31/2024; retro small-biz election by 7/4/2026.
- Meals fishing crews/processing: TYs after 12/31/2025.
- §179 limits: TYs after 12/31/2024 (index 2026+).
- §6050W reset: after 2021; §3406 coord after 12/31/2024.
- §6041 threshold $2,000: TYs after 12/31/2025.
- §461(l) permanent: TYs after 12/31/2026; thresholds calc updated after 12/31/2025.

ONE BIG BEAUTIFUL BILL - SUMMARY OF SIGNFICANT PROVISIONS BROKEN DOWN BY YEAR OF ENACTMENT

For Details – View Manual

- This section re-textualizes the provisions already covered into a breakout by year effective.

ONE BIG BEAUTIFUL BILL – IRS RELEASED GUIDANCE

See Manual and Updates

- This section is continually changing with updates on the legislation.
- Refer to any updates and manual for points to discuss.

OTHER RECENT PRACTICE DEVELOPMENTS

SCOTUS: Loper Bright v. Raimondo (June 28, 2024) — Chevron Overruled

- Core holding: No automatic Chevron deference for agency interpretations of ambiguous statutes.
- APA role: Courts must exercise independent judgment on statutory authority; consider but need not defer to agency views.
- Immediate result: D.C./1st Cir. judgments vacated and remanded.

Loper Bright — Background & Facts

- Agency: National Marine Fisheries Service (NMFS) under MSA/APA.
- Rule: Required observers on vessels; 2020 change shifted cost (≈$710/day) to industry if gov't observer unavailable.
- Lower courts: Upheld under Chevron step-two (reasonable interpretation).

Loper Bright — What Replaces Chevron?

- Skidmore deference persists: Courts may give 'due respect' proportional to persuasiveness, consistency, thoroughness.
- Legislative rules: Where Congress expressly delegates, courts confirm the delegation, its boundaries, and 'reasoned decision-making' within those bounds.
- No reflexive deference merely due to ambiguity.

Loper Bright — Stare Decisis & Reliance

- Prior outcomes preserved: Case holdings that specific actions were lawful are still binding.
- Methodology change going forward: New/ongoing disputes judged without Chevron.
- Practice: Separately assess existing reliance positions vs. forward-looking planning.

Loper Bright — IRS/Treasury Implications

- Reg challenges: Expect more APA lawsuits against Treasury/IRS regulations and sub-regulatory guidance.
- Rulemaking: Heavier emphasis on statutory text, legislative history, comment responsiveness, quantitative impact.
- Audit/litigation: Increased forum shopping; venue strategy matters.

Loper Bright — Practitioner Checklist

- Re-underwrite positions anchored in Chevron deference.
- Elevate Skidmore factors: thoroughness, reasoning, consistency with prior/ later guidance.
- Strengthen admin records via robust comment letters.
- Track congressional delegations of authority and limits per section.

Loper Bright — Client Communication Slides (1/2)

- Messaging: 'Courts won’t automatically side with agency interpretations.'
- Impact: Potential volatility in regs; timelines for finality may extend.
- Action: Monitor open regs; be prepared for shifts; document positions and alternatives.

Loper Bright — Client Communication Slides (2/2)

- Risk: More uncertainty for long-range planning (e.g., credits, elections, methods).
- Opportunities: Strategic challenges for unfavorable rules; potential refunds/protective claims if applicable.
- Governance: Update risk registers and engagement letters for increased dispute risk.

SCOTUS: Corner Post v. Federal Reserve (July 1, 2024) — 6-Year Clock Resets at Injury

- Holding: For APA claims, the 6-year statute (28 U.S.C. §2401(a)) starts when a plaintiff is first injured by final agency action, not at rule publication.
- Effect: New market entrants can challenge older rules upon first harm.

Corner Post — Case Context

- Reg II (debit-card interchange) published 2011; prior challenge failed in 2014.
- Corner Post opened 2018; sued in 2021; lower courts dismissed as untimely.
- SCOTUS reversed: claim accrues at injury, not issuance.

Corner Post — Tax Practice Implications

- IRS regulations: Expect revived facial challenges by newly-affected taxpayers.
- Refund constraints remain: Income tax refund claims still bound by strict timing under the Code.
- Strategy: Identify clients newly impacted by older regs; evaluate APA pathways.

Corner Post — Risk & Opportunity Matrix

- Risk: Regulatory instability, extended litigation tails.
- Opportunity: Fresh windows to contest unfavorable legacy rules.
- Action: Map clients to affected regimes; consider protective claims, model alternates.

Circular 230 — Framework & Status

- Authority: 31 U.S.C. §330; governs practice before IRS.
- Eligibility: Attorneys/CPAs/EAs (not suspended/disbarred) have full rights; others largely limited to returns they prepared.
- Status: Last full update 2014; proposed regs REG-116610-20 (Dec. 26, 2024); >700 comments; public hearing Mar. 6, 2025.

Circular 230 Proposed Regs — Major Topics

- Tax return preparation standards
- Contingent fees and disreputable conduct
- Knowledge of error/omission duties
- Appraiser rules and standards
- Best practices (security, continuity, mental impairment)

Circular 230 Comments — Highlights (1/2)

- Contingent fees: Critics argue bans limit access to representation; suggest allowing except for original returns.
- Limited practice rights: Concerns about expanding non-credentialed preparer rights; potential impact on EA credential.

Circular 230 Comments — Highlights (2/2)

- Appraisals: Objections to exclusive USPAP reference; calls to recognize other standards; dispute over IRS disqualification scope.
- Best practices: Pushback on making data-security/mental-capacity checks mandatory.
- CE: Broaden topics (tech/practice mgmt); oppose provider user fees.

Circular 230 — Firm Readiness Actions

- Gap-assess policies against proposed text (contingent fee usage, error disclosure advice, appraisal reliance).
- Update engagement letters; define client responsibilities.
- Train for likely final rules; watch for EO-linked regulatory freeze delays.

AICPA SSTS (Effective 1/1/2024) — New Structure

- Reorg into practice-based framework; new standards added.
- Applies to AICPA members; often mirrored in state rules.

SSTS — Data Protection (Sec. 1.3)

- Reasonable efforts to safeguard taxpayer data.
- Map to GLBA/FTC Safeguards Rule; align with firm WISP.
- Document vendor diligence and access controls.

SSTS — Reliance on Tools (Sec. 1.4)

- Tools enhance efficiency and understanding, but do not replace professional judgment.
- Validate inputs/outputs; understand model limitations; retain workpapers showing review.

SSTS — Tax Representation (SSTS No. 4)

- Covers representation before any taxing authority; complements Circular 230.
- Embed competency, COI, integrity/objectivity standards; define scope in engagement letters.

WISP — Why It Matters Now

- GLBA + FTC Safeguards Rule = mandatory WISP.
- IRS Pub. 5708 (Aug. 2024) offers small-firm template covering the nine elements.

WISP — Nine Core Elements (1/3)

- 1) Designate qualified security lead.
- 2) Risk assessment: data, systems, threats.
- 3) Safeguards: access controls, MFA, encryption at rest/in transit.

WISP — Nine Core Elements (2/3)

- 4) Vendor/Service-provider oversight.
- 5) Change management & secure development.
- 6) Data inventory, retention, and disposal lifecycle.

WISP — Nine Core Elements (3/3)

- 7) Monitoring & logging; anomaly detection.
- 8) Incident response plan (IRP) with roles and timelines.
- 9) Annual testing/training; board/partner reporting.

WISP — New FTC Breach Reporting

- Report security events affecting ≥500 individuals to FTC within 30 days of discovery (Safeguards Rule portal).
- Coordinate with IRS/state notifications per Pub. 5708.
- Maintain evidence (timelines, notices, remediation).

OPR Alert (2025-12) — Self-Reporting Benefits

- While not required, timely self-reporting may reduce sanctions.
- OPR learns via state boards/courts; concurrent suspensions possible.
- Create internal ethics hotline/escalation path; preserve privilege where appropriate.

PTIN Verification & Complaints

- IRS to verify PTINs more aggressively; thousands unrenewed/fake.
- Form 14157 digitized to report preparer misconduct.
- Action: Centralize PTIN renewal tracking; audit firm roster.

TDS Transcripts — Phone Workflow (IR-2024-136)

- As of 4/8/24, request via Practitioner Priority Service (866-860-4259) for SOR delivery.
- Enhanced caller auth: verify Short ID from e-Services.
- Fallback: If not verified, transcripts mailed to taxpayer address of record.

Offer in Compromise — Form 656-B (Rev. 4-2024)

- Must use current booklet; verify eligibility before paying fees.
- Key conditions: Filing/estimate compliance; at least one billed period; not in bankruptcy; employers current on deposits.
- Beware promoters; lien and compliance obligations may be burdensome.

Rev. Proc. 2025-23 — Automatic Method Changes

- Supersedes parts of 2024-23; updates the automatic list under 2015-13.
- Generally: Attach Form 3115 and file duplicate as required.
- Action: Screen for opportunities (inventory, depreciation, revenue recognition, capitalization).

IRS Notices from E-Payment Delays

- IRS reported delays in processing some electronic payments.
- Taxpayers may receive erroneous notices; retain payment confirmations and bank proof.
- Advise clients: Do not re-pay if proof exists; respond to notices with evidence.

Digital Asset Reporting — Extended Relief (Notice 2025-33)

- Broker Form 1099-DA reporting/backup withholding relief extended through 2026.
- Action: Update broker/client communications; maintain documentation for basis/ proceeds until rules finalize.

Estate Closing Letter — User Fee Reduced

- Interim final and proposed regs reduce fee from $67 to $56.
- Budget impact: modest; track effective date and comment deadline.

CCA 202511015 — Theft Loss Guidance

- Deductible under §165(c)(2) when tied to profit-seeking transactions (e.g., investment scams).
- Not deductible as personal loss under §165(c)(3) (e.g., romance/kidnapping scams) under TCJA limits.
- Ponzi safe harbor (RP 2009-20) inapplicable to the scenarios examined.

Recurring Schedule C Losses — §183 Exposure

- IRS CI flagged multi-year losses (3-of-5 rule not met).
- Indictment example (2017–2019) shows criminal exposure.
- Practice: Apply §1.183-2(b) factors; contemporaneous books; consider entity/operations changes.

Scam Alert — EFIN Phishing

- Impersonates software vendors seeking EFIN documents 'for verification.'
- Tells preparer to fax e-File Application Summary; red flags include odd fax numbers and foreign footers.
- Do not respond; report to TIGTA and phishing@irs.gov.

Scam Alert — 'New Client' Bait

- Email posing as a prospective client sends malware link/attachment.
- Policy: Never click unknown links; verify sender via separate channel; sandbox attachments; limit macro execution.

BOI Reporting — Narrowed to Foreign Reporting Companies (Per IFR)

- Announced shift: Domestic entities and U.S. beneficial owners no longer required to file BOI.
- Foreign entities registered to do business in the U.S. must report foreign beneficial owners (timelines tied to IFR publication/registration).
- Litigation expected; monitor for reversals/clarifications.

ID.me — PTIN Sign-In Modernization

- PTIN access moving to ID.me authentication.
- Those with existing ID.me can reuse credentials; others must create with photo ID + device camera.
- Enables access to Tax Pro Account, e-Services, other IRS portals.

Security Summit 2025 — Five-Week Campaign

- Week 1: New scams (new-client, EFIN/PTIN/CAF phishing, phone/text/mail).
- Week 2: Phishing response steps.
- Week 3: WISP requirements refresher.
- Week 4: Security tools and best practices.
- Week 5: Identity-theft signs and reporting routes.

IRS e-Services Chatbot

- FAQ-style virtual assistant now on e-Services pages.
- Use for common questions; avoid sharing PII; route case-specific issues to secure channels.

Privacy & Governance — DOGE/USDS Access Disputes

- Executive actions restructured USDS ('DOGE'); sought wide agency IT access.
- Multiple lawsuits; TRO limits access to BFS payment systems; §6103 confidentiality cited.
- TIGTA/GAO inquiries; former officials emphasize strict limits on taxpayer-file access.

Action Plan — Litigation/Positioning

- Inventory client positions relying on Chevron; reevaluate under Skidmore.
- Identify older regs newly injuring clients (Corner Post); assess APA claims.
- Strengthen comment strategies; collect empirical support.

Action Plan — Security & Compliance

- Update WISP and breach-reporting playbook (FTC 30-day threshold ≥500).
- Migrate PTIN users to ID.me; verify Short IDs.
- Train staff on scams; run phishing simulations; enforce MFA.

Action Plan — Operations & Client Comms

- Use new OIC 656-B; manage client expectations.
- Explain digital asset reporting relief and basis recordkeeping.
- Prepare FAQs on BOI status for domestic vs. foreign entities.

VIRTUAL CURRENCY

Why IRS Cares / Return Questions

- 1040 has prominently asked about virtual currency / digital assets since 2021.
- Draft 2024 1040 question: “At any time during 2024, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?”
- IRS reminds taxpayers to report income/gain/loss from all taxable transactions, regardless of whether a third-party information return was issued.
- AICPA (Aug. 29, 2022) recommended a simpler question focused on ‘taxable events.’

IRS Definitions

- Virtual currency: digital representation of value (not USD/foreign fiat) that functions as unit of account, store of value, medium of exchange.
- Convertible virtual currency can be exchanged for real currency (e.g., Bitcoin).
- IRS generally uses “virtual currency” to refer to convertible virtual currency used as a medium of exchange.
- Digital assets (IRS site, 6/15/2023): include cryptocurrency, stablecoins, and NFTs.

Cryptocurrency & Blockchain Basics

- Cryptocurrency: virtual currency using cryptography; transactions recorded on a distributed ledger (blockchain).
- On-chain: transaction recorded on the ledger. Off-chain: facilitated off-ledger (still taxable if otherwise required).
- Blockchain’s distributed nature makes retroactive alteration difficult, supporting audit trails.

Baseline Tax Treatment — Property Rules

- Virtual currency is treated as property for U.S. federal income tax.
- Dispositions generally produce capital gain/loss if held as a capital asset; ordinary character if inventory or otherwise non-capital.
- Holding period determines long- vs short-term.
- Basis generally equals cost in USD (including fees/commissions). Amount realized = value received in USD.

Receiving Crypto for Services (Wages, Contract, Mining)

- Wages paid in crypto: FMV at receipt is wages subject to income tax withholding, FICA, FUTA; report on Form W-2.
- Independent contractors: FMV at receipt is ordinary income subject to SE tax; reportable on 1099-NEC, if applicable.
- Mining/other services: FMV at time included in income; that amount becomes basis in received units.
- Timing: for on-chain transactions, use the date/time recorded on the ledger (when dominion and control obtained).

Paying with Crypto for Services or Property

- Using crypto (held as capital asset) to pay for services/property triggers gain/loss: value of item received – basis in crypto used.
- If exchanging non-capital property for crypto, ordinary gain/loss applies.
- Basis of property received = FMV at the time of the exchange.

Transfers Among Own Wallets/Accounts

- Moving crypto between your own wallets/addresses/accounts is a non-taxable event (no disposition).

Specific Identification vs FIFO

- Taxpayers may specifically identify which units are disposed of; otherwise default FIFO per IRS FAQs.
- Specific ID requires records that tie unique digital identifiers (keys/addresses) or complete transaction info to:
    - • date/time acquired & basis and FMV when acquired
    - • date/time disposed & FMV when disposed; consideration received

Donations of Virtual Currency

- No gain/loss on donation to §170-eligible charities.
- Held >1 year: deduction generally equals FMV at date of gift; ≤1 year: lesser of basis or FMV.
- Substantiation applies: receipt; Form 8283 for >$500; qualified appraisal for >$5,000 non-publicly traded property.

Qualified Appraisal Requirement (CCA 202302012)

- Charitable donations >$5,000 require a qualified appraisal; crypto exchange price alone is not a qualified appraisal.
- “Reasonable cause” exception does not excuse failure to obtain a qualified appraisal when required.
- Failing appraisal rules can disallow the deduction even if the donation occurred.

Business Payments Using Crypto

- General rule mirrors property payments: report fixed/determinable income ≥$600 to U.S. non-exempt recipients.
- Independent contractors paid in crypto: Form 1099-NEC; report USD FMV on payment date.
- Other payments (e.g., rents, prizes) may require Form 1099-MISC; wages require Form W-2.

Backup Withholding

- Crypto payments are subject to backup withholding similar to other property payments.
- Solicit/payee TIN; backup withhold if TIN not provided or IRS notifies payor to withhold.

Form 1099-K Context

- For TPSOs, historic threshold (pre-2022): >200 transactions AND >$20,000 gross.
- ARP lowered threshold to $600 with no transaction count (statutory), but IRS provided transition relief for 2022 in Notice 2023-10.
- Monitor current IRS guidance each year for enforcement thresholds and transition relief.

FBAR (FinCEN Notice 2020-2)

- At present, a foreign account holding only virtual currency is not reportable on FBAR.
- If the account also holds reportable assets besides virtual currency, FBAR may apply.

Forks — Hard vs Soft

- Hard fork without receipt of new units: no income.
- Hard fork followed by an airdrop with dominion & control: ordinary income = FMV at receipt.
- Soft fork (no ledger split): no income.

Valuation Rules

- Exchange-facilitated trades: use exchange-recorded USD amount (or trading price if off-chain).
- Peer-to-peer: use explorer values (date/time) or other accurate FMV evidence; document method.
- If not traded with a published value: FMV equals value of property/services exchanged.

Gifts — Basis & Holding Period

- Recipient recognizes no income on receipt of a bona fide gift.
- Gain basis: donor’s basis + allocable gift tax; Loss basis: lesser of donor basis or FMV at gift date.
- Holding period tacks from donor.

Digital Asset Definition (IIJA & IRS)

- Digital asset: digital representation of value recorded on a cryptographically secured distributed ledger or similar tech.
- Includes crypto, stablecoins, NFTs; excludes closed-system tokens and pure DLT uses that don’t create transferable assets.

Form 8300 — ‘Cash’ Treatment & Announcement 2024-4

- IIJA treated digital assets as ‘cash’ for §6050I Form 8300 (> $10,000).
- Announcement 2024-4: until regs are issued, businesses need NOT include digital assets when applying the $10,000 threshold.
- Continue to file Form 8300 for cash (other than digital assets) exceeding $10,000.

Final Regs (TD 10000, 7/9/2024): 1099-DA Proceeds Reporting

- Brokers must report gross proceeds from sales/exchanges of digital assets on Form 1099-DA (customer statements too).
- Covers sales for cash, other digital assets, property subject to §6045, stored-value cards, broker services.
- Maintain records 7 years; transaction ID not required on 1099-DA (change from proposed).
- Non-custodial broker rules to come in separate regs; optional aggregate reporting for certain stablecoin/NFT sales over de minimis.

Who Is a ‘Broker’ (Expanded)

- Any person effecting sales/exchanges for others as agent, principal, or digital asset middleman.
- Includes: online/trading platforms, operators of noncustodial platforms, PDAPs, kiosk operators, hosted wallet providers, custodians, escrow/stock transfer agents, and real estate brokers when crypto is used in closings.
- Exclusions include: facilities-only exchanges, certain escrow agents/nominees, floor brokers w/o records of terms, stock transfer agents w/o proceeds info, hardware/software sellers of key-control tools only, miners/validators only, merchants receiving crypto for goods/services (not otherwise §6045 brokers), clearing orgs, certain debt issuers.

When & What to Report

- Gross proceeds: for sales after 2024; payee statements to customers.
- Basis & gain/loss: required for certain sales after 2025; only for assets acquired from AND held with the same broker after 2025 (covered).
- Real estate closings after 2025: reporting persons (title cos, closing attorneys, mortgage lenders, real estate brokers) must file 1099-S (seller) AND 1099-DA reporting FMV of digital assets paid by purchaser.
- Not covered here: reporting of hard forks (addressed elsewhere); wages/misc/third-party network reporting stays under W-2/1099-MISC/1099-K rules.

Transitional Relief (Notice 2024-56)

- No §6721/§6722 penalties for brokers failing to file/furnish 1099-DA for 2025 sales if they make good-faith efforts to file/furnish accurate/timely forms.
- Backup withholding relief:
    - • 2025: no backup withholding on digital asset sales.
    - • 2026: no backup withholding for preexisting customers if TIN matches via IRS TIN Matching.
    - • Until further notice: no backup withholding for sales for specified NFTs, real estate transactions by real estate reporting persons, and certain PDAP sales.

Transactions Temporarily Not Subject to Information Reporting (Notice 2024-57)

- Wrapping/unwrapping transactions.
- Liquidity provider transactions.
- Staking transactions.
- Lending of digital assets.
- Short sales of digital assets.
- Notional principal contracts.

Basis Allocation Transition (Rev. Proc. 2024-28)

- Final regs require single-wallet/account basis determination (consistent with §1012(c)(2)).
- Transition from prior FAQ interpretations that allowed ‘universal’ multi-wallet specific ID/FIFO.
- Reasonable allocation of ‘unused basis’ to remaining units per wallet/account as of 1/1/2025; methods:
  - • Specific unit allocation: complete before first 2025 disposition of that asset OR by 2025 return due date (incl. extensions).
  - • Global allocation method: document method by 1/1/2025; complete allocations by timing safe harbor; follow ongoing rules for 2025+ sales.
- Separate accounting required for post-1/1/2025 acquisitions within a wallet/account holding remaining units.

Draft 2024 Return Questions

- Same digital asset question is on draft Forms 1065 (p.4), 1120-S (p.3), 1120 (p.5), 1041 (p.3).
- 2024/2023 wording omits “gift,” aligning with focus on potentially taxable events.
- Practitioner alert: receipt of a 1099-DA requires checking “Yes” on 1040 per draft instructions.

Legal Tender Status (Notice 2023-34)

- IRS modified Notice 2014-21 to acknowledge some jurisdictions grant legal tender status to virtual currencies.
- FAQ treatment in Notice 2014-21 otherwise unchanged.

Staking Rewards (Rev. Rul. 2023-14)

- Staking rewards (direct or via exchange) are gross income when the taxpayer gains dominion and control.
- FMV measured at date/time dominion and control is obtained.

Protocol Upgrades (CCA 202316008)

- Protocol upgrades alone do not create a realization event under §1001; no new legally distinct entitlement.
- No §61 income absent an accession to wealth.

Losses, Worthlessness & Abandonment (CCA 202302011)

- No §165 deduction merely because value plummets if units still trade and taxpayer retains dominion/control.
- A deductible loss generally requires a closed and completed transaction fixed by an identifiable event (e.g., sale).
- Even if §165 applies, note §67(g) suspension of misc. itemized deductions through 2025 may disallow some losses claimed as misc. items.
- Planning pointer: consider arm’s-length sale to unrelated party to realize a capital loss; document proceeds (consider rounding up to $1).

Bankruptcy & Realization

- Pending exchange bankruptcy typically requires waiting for proceedings to conclude before loss is fixed.
- Realization event (sale, exchange, abandonment meeting standards) usually needed for tax loss recognition.

Theft Losses & Safe Harbors

- §165(c)(1) trade/business and §165(c)(2) transactions entered into for profit remain potentially deductible.
- §165(c)(3) personal casualty/theft generally disallowed 2018–2025 unless in federally declared disaster.
- Rev. Rul. 2009-9: theft loss in profit transaction is ordinary; deductible in discovery year absent reasonable prospect of recovery; amount invested net of withdrawals/recoveries plus reported/reinvested income.
- Rev. Proc. 2009-20: safe harbor for Ponzi-type schemes — loss year deemed at charging/complaint; safe-harbor deduction 95% (or 75% if pursuing third-party recovery) less actual/SIPC recoveries; detailed definitions of qualified investor/loss/investment and specified fraudulent arrangement.
- Where deducted: Schedule A line 16 & Form 4684 (Section B or C per safe harbor use).

DeFi Broker Rule Repealed (P.L. 119-5)

Congressional Review Act Repeal of TD 10021

- On Apr. 10, the President signed the joint resolution repealing TD 10021 (12/30/2024) that would have required certain DeFi 'digital asset middlemen' to report gross proceeds on 1099-DA for sales after 1/1/2027.
- Under the CRA, agency may not re-issue the same or substantially similar rule absent new statutory authorization.
- Budget score: JCT (JCX-11-25) ~$3.9B (2024–2034); CBO estimate ~$4.5B (2025–2035). First CRA use on tax regs.
- Future effects: more products may shift to DeFi; centralized-broker rules under TD 10000 remain (timing window for CRA passed). Possible additional withdrawals under executive guidance are being watched.

Client Intake Checklist — Digital Assets

- Answered ‘Yes’ to 1040 digital asset question? Any 1099-DA, 1099-K, 1099-NEC/MISC, W-2 with crypto?
- Wallet inventory: custodial vs self-custody; exchange accounts; cold storage.
- Basis records per wallet/account; specific ID documentation; FIFO defaults.
- Transactions: sales, swaps, spending, airdrops, staking rewards, mining, gifts, donations.
- Valuation sources used (exchange, explorer) with date/time.
- Loss events: sales for loss? theft? bankruptcy status? recovery prospects?
- Charitable gifts >$5,000: qualified appraisal and Form 8283?

Firm Readiness Checklist

- Update organizers to align with 2024 digital asset question & 1099-DA ingestion.
- WISP & data protection for wallet/exchange docs; secure client data exchange.
- Form 8300 policies reflecting Announcement 2024-4 (digital assets not counted until regs).
- 1099-DA/§6045 workflows (2025 sales reported in 2026); backup withholding policies per Notice 2024-56.
- Basis transition per Rev. Proc. 2024-28: document single-wallet/account approach by 1/1/2025; allocate unused basis.

RETURNS – SELECTED HIGHLIGHTS AND DEVELOPMENTS

TCJA – Due Diligence Expansion

- Section 6695(g): Due diligence now applies to Head of Household (HOH) claims.
- Previously applied only to EITC, CTC, and AOTC.
- Effective: Tax years after 2017.
- Form 8867 required for all applicable credits and HOH claims.

First-Time Penalty Abatement (FTA)

- Began in 2001; relief for failure to file, pay, or deposit penalties if compliant for prior 3 years.
- Must be requested; not automatic.
- Available for individual and excise tax filers (IRM 20.1.1.3.6).

FTA – Eligibility Requirements

- 1. No prior penalties in last 3 years.
- 2. All required returns filed or extended.
- 3. All taxes paid or installment plan in good standing.
- 4. Applies to one tax period only.
- 5. Not for event-based filings or prior late 1120S unpenalized.
- Practice Tip: Use Form 843 to request FTA.

Timely Mailing Rules

- SCA 1998-051: Certificate of Mailing not conclusive proof of timely filing.
- Only registered or certified mail provides statutory presumption.
- Postmark date controls if not certified.

Reinstating Tax-Exempt Status (Rev. Proc. 2014-11)

- Applies to organizations revoked for 3 years of non-filing.
- Provides procedures for reinstatement under §6033(j)(1).

FinCEN Form 114 (FBAR)

- Due Date: April 15.
- Automatic Extension to October 15.
- Mandated by Surface Transportation Act of 2015.
- No need to file extension request.

Identity Protection PIN (IP PIN)

- Six-digit code to prevent tax-related ID theft.
- Available to all taxpayers since 2021.
- Obtain via IRS Get an IP PIN tool.
- Must renew annually.

IRS Tax Transcript Access

- Five transcript types: Return, Account, Record of Account, Wage & Income, Non-filing.
- Access via: Online Account, Get Transcript by Mail, Form 4506-T, or phone.
- Practice Tip: Maintain an IRS online account.

IRS Case – False Returns

- U.S. v. Ndeye Amy Thioub (2024): IRS Agent indicted for false filings.
- Highlights importance of internal compliance.

Planning Ideas – Filing Returns

- File even if not required to claim credits/refunds.
- Extensions: Must make good-faith tax estimate.
- Reasonable Cause: Reliance on incorrect advice may qualify (U.S. v. Boyle).
- IRA contributions still due April 15.

Mailing and Delivery Services

- Certain UPS/FedEx options treated as USPS postmarks under §7502(f).
- Certified/Registered Mail deemed received on certification date.

Worker Classification (Rev. Rul. 2025-3 & Rev. Proc. 2025-10)

- Section 530 relief for independent contractors if:
- 1. Reporting consistency
- 2. Substantive consistency
- 3. Reasonable basis
- IRC §3509: Reduced tax rates if relief unavailable.

Worker Classification Scenarios

- Five IRS scenarios clarify Section 530 & §3509 applications.
- Rev. Proc. 2025-10 adds definitions, exceptions under §530(d)-(f).

IRS News – ADR Programs

- Fast Track Settlement (FTS) & Post-Appeals Mediation (PAM).
- Three pilot programs (2025–2027):
- - Issue-by-issue eligibility
- - Executive approval for denials
- - SB/SE 'Last Chance FTS' initiative.

IRS Appeals Final Regulations (T.D. 10030)

- Issued Jan. 15, 2025; effective Feb. 14, 2025.
- Defines scope of Appeals consideration and exceptions.

SECURE 2.0 Act Updates

- Catch-Up Contributions (ages 60–63): 150% of 2024 limit.
- Roth Catch-Up for wages >$145,000 (effective 2026).
- Automatic Enrollment required in 2025 for 401(k)/403(b) plans (with exceptions).

Public Feedback on Proposed Regs

- Requests for flexibility, clarity on Roth rule.
- Concerns: multiple employer plans, escalation, small business exceptions.
- Hearings (Apr 7–8, 2025): no new issues raised.

Additional IRS Updates

- 83 obsolete guidance docs revoked (Notice 2025-36).
- Refund tracking via IRS2Go/‘Where’s My Refund?’.

College Athletes & Taxation

- NCAA allows direct school payments (July 2025).
- NIL income = self-employment income.
- IRS may reclassify athletes as employees.
- Practitioners should advise on contracts & tax strategies.

AI IN TAX PRACTICE

AI in Tax: Why Now

- AI is transforming tax workflows, compliance, research, and client service.
- 77% expect a high/transformational impact within five years; 80% see AI as a force for good.
- Early adopters use ML, NLP, LLMs to boost efficiency and reduce manual work.
- Goal: demystify AI for CPAs with practical guidance and implementation roadmap.

Guide Roadmap

- 1) Fundamentals of AI for CPAs
- 2) Today’s uses: automation, research, prediction
- 3) Detailed use cases across compliance, planning, client service, practice ops
- 4) Implementation: pilots, training, ROI
- 5) Risks, ethics, regulation
- 6) A continuing-learning roadmap

Understanding AI: Key Concepts for CPAs

- AI simulates aspects of human intelligence.
- Core areas: Machine Learning (ML), Natural Language Processing (NLP), Generative AI, Large Language Models (LLMs), Retrieval-Augmented Generation (RAG).
- Think of AI as ultra-fast junior staff—requires oversight.

Machine Learning (ML): What It Does

- Learns from labeled data; predicts/categorizes new items.
- Example: classify deductible vs. nondeductible transactions.
- Features: merchant, description, category, date/amount, industry.
- Human-in-the-loop feedback improves accuracy over time.

ML Scenario: Transaction Classification

- 1) Data Collection & Labeling: staff apply IRS guidance; create labels (e.g., deductible vs. nondeductible).
- 2) Model Training: random forest/neural net learns from features.
- 3) Prediction: flags new transactions (e.g., Zoom = deductible; parking ticket = nondeductible).
- 4) Review Loop: staff corrections retrain the model.

ML Benefits in Practice

- Time savings on routine reviews
- Consistent application of rules across clients
- Audit defense via classification audit trail
- Scales to high volumes during tax season

Natural Language Processing (NLP): What It Does

- Understands/generates human language.
- Reads regulations, summarizes guidance, drafts memos, translates/simplifies text.

NLP Scenario: Reg Review & Memo Generation

- 1) Summarization: extracts relevant sections, compliance rules, effective dates.
- 2) Search & Extraction: conversational queries (e.g., thresholds, disallowed deductions).
- 3) Memo Drafting: tailored first drafts from prompts (e.g., §1202 sale).
- 4) Translation/Simplification: multilingual support and plain-English output.

NLP Benefits

- Speed: process thousands of pages quickly
- Accuracy & consistency of interpretations
- Productivity: frees time for analysis & client service

Generative AI: Creating Content

- Subfield of NLP: generates emails, summaries, memos, Q&A.
- Applied to client communications and research digests.

Generative AI: Examples in Practice

- 1) Draft client emails (e.g., hobby loss questions under §183)
- 2) Summarize IRS Notices/Tax Court opinions
- 3) Draft planning memos/whitepapers (e.g., §1202 QSBS)
- 4) Internal chatbot for staff knowledge and procedures

Generative AI: Benefits

- Scales to many queries simultaneously
- Consistent tone and technical depth
- Rapid drafting—seconds vs. hours
- Improves client experience and turnaround

Large Language Models (LLMs)

- Advanced NLP models (e.g., GPT-based) for Q&A, summarization, drafting.
- Use with human review for technical accuracy.

LLMs in Practice: Applications

- 1) Client Q&A (e.g., late S election under Rev. Proc. 2013-30)
- 2) Document summarization (e.g., 12-page Notice → 4-paragraph brief)
- 3) Draft technical memos and reports (e.g., §280E analysis)
- 4) Internal knowledge retrieval (e.g., §469 tests, listed property rules)

LLM Benefits

- Accelerates learning for junior staff
- 50–80% reduction in drafting/research time
- Consistency and higher-quality first drafts

Retrieval-Augmented Generation (RAG)

- Combines an LLM with a document retriever.
- Grounds answers in trusted sources (IRS, firm memos, client files).
- Reduces hallucinations; improves traceability.

RAG Scenario: §163(j) Memo

- Step 1: Retrieve prior memos, Form 8990 instructions, client returns/elections.
- Step 2: Generate a grounded memo citing sources (e.g., ADS use under §168(g)).
- Also supports real-time research, advisory letters, and tailored outputs.

RAG Benefits

- Factual accuracy & compliance confidence
- Productivity boost in research and review
- Custom outputs tied to client facts

AI Hallucinations: What & Why It Matters

- AI can generate plausible but incorrect content.
- Example: mis-citing §165(c)(3) for legal fees.
- Risks: mislead clients, compliance issues, credibility loss.

Mitigating Hallucinations

- 1) Fact-check citations against authoritative sources
- 2) Use RAG with citations/excerpts
- 3) Keep human review in the loop
- 4) Train on vetted, firm-specific knowledge
- Best Practice: Trust, but verify.

Current State: Adoption & Impact

- Efficiency gains: 4+ hours/week now; 12+ hours anticipated in 5 years.
- Use cases: IRS notice drafts, doc summaries, data entry, research.
- Democratization: small firms leveraging off-the-shelf tools.
- Concerns: security and quality control.

Case Study 1: Automating the Mailroom

- Problem: paper mail overload; lost notices/invoices.
- Solution: Power Automate + OCR + secure LLM; summaries piped to Jira.
- Result: 20-minute sprints; nothing gets lost; low incremental cost.

Case Study 2: Drafting Technical Memos

- Problem: complex goodwill impairment memos.
- Solution: Custom RAG bot using prior memos; tuned to firm style.
- Result: 4 hours → ~30 minutes of review; sparked further automation.

Case Study 3: Client-Facing Chatbot

- Problem: generate niche leads (succession planning).
- Solution: Website chatbot with curated context; helpful tone.
- Result: ~50 new contacts/3 months; quick, low-cost implementation.

Case Study 4: AI-Assisted Coding & Data

- Problem: heavy Excel/VBA tasks slowed delivery.
- Solution: ChatGPT/Claude generate macros and formulas on demand.
- Result: No outsourcing; faster execution and lower costs.

Case Study 5: Tax Research (Blue J)

- • Problem: nuanced, time-consuming research.
- • Solution: Ask Blue J provides cited answers and outcome prediction.
- • Result: Speed with citations; still requires verification for numbers.

AI in Compliance & Preparation

- Data capture: OCR + ML for W-2/1099/brokerage.
- Document classification & transaction categorization.
- Error detection via year-over-year/peer comparisons.
- Draft responses to IRS notices; flag planning opportunities.

AI in Research & Planning

- LLM Q&A with citations; scenario modeling.
- Outcome prediction and audit-risk analysis.
- Idea generation based on taxpayer profiles.
- Plain-English client summaries.

AI in Client Service & Communication

- Chatbots for FAQs/intake; personalized outreach.
- Draft emails/memos; analyze client histories for opportunities.
- Faster, more responsive service.

AI in Practice Management & Ops

- Email triage, meeting scheduling, action-item extraction.
- AI-assisted time tracking; document tagging and template suggestions.
- Training bots for procedures; analytics for realization and profitability.

Implementation: Getting Started

- Start small: pilot low-risk tools.
- Evaluate vendors: security, accuracy, compatibility, UX.
- Train staff on prompting and review standards.
- Set acceptable-use policies; protect confidentiality.
- Layer reviews for all AI-assisted work.

Ethics & Risk Management

- Confidentiality: avoid PII in public tools; prefer enterprise setups.
- Due diligence: verify facts/citations; CPA remains responsible (Circular 230/SSTS).
- Documentation: preserve review and validation trail.

Looking Ahead

- Upskilling: data literacy, AI fluency, critical review.
- Role shift: less rote work; more strategic advisory.
- Integration: AI embedded in everyday software.
- Client expectations: faster, tailored service.

Conclusion

- AI augments CPAs—does not replace them.
- Eliminates drudgery; elevates advisory value.
- Early adopters gain efficiency and competitive edge.
- Use wisely, ethically, and with rigorous oversight.

IRC 199A REFRESHER

Part 1 – The Calculation

- Objective – Understand how QBI is calculated with the different thresholds

QBI

- Is it simple?
- 20 percent of qualified business income will be the deduction right?
- Wrong
- Unfortunately, we’re seeing clients have issues with the calc
- Form 8995

Interaction with 21% Corp Rate

- Need to be weary of clients wanting to go C Corp because of 21 percent rate
- 21+20+3.8 = ?
- Never let the tax tail wag the dog

Key Terms

- **QBI:** Qualified Business Income
- **RPE:** Relevant Passthrough Entity
- **SSTB:** Specified Service Trade or Business
- **UBIA:** Unadjusted Basis Immediately after Acquisition of qualified property

Calculation

- First Threshold:
  - If below threshold, then lesser of 20% of QBI or taxable income
  - We don’t care about SSTB or non-SSTB
  - We don’t care about UBIA or W-2 wages

Calculation

- Second Threshold SSTB
  - Once we cross the first threshold, we care if it is an SSTB or not
  - If over the threshold, no QBI deduction

Calculation

- Second Threshold – Non-SSTB – Driven by W-2 Wages and UBIA

REIT and PTP Calc

- These get their own separate 20% bucket

Special Rules

- ***Coordination with alternative minimum tax.*** For purposes of determining alternative minimum taxable income under section 55, the deduction allowed under section 199A(a) for a taxable year is equal in amount to the deduction allowed under section 199A(a) in determining taxable income for that taxable year (that is, without regard to any adjustments under sections 56 through 59).
- ***Imposition of accuracy-related penalty on underpayments.*** 5% understatement for substantial understatements vs 10%.

Part 2 - SSTBs

- Objective – Understand which businesses are SSTBs

SSTBs

- (i) *Health*
- (ii) *Law*
- (iii) *Accounting*
- (iv) *Actuarial science*
- (v) *Performing arts*
- (vi) *Consulting*
- (vii) *Athletics*
- (viii) *Financial services*
- (ix) *Brokerage services*
- (x) *Investing and investment management*
- (xi) *Trading*
- (xii) *Dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2))*

- (xiii) *Any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners*

Health

- ***Meaning of services performed in the field of health.*** The *performance of services in the field of health* means the provision of medical services by individuals such as physicians, pharmacists, nurses, dentists, veterinarians, physical therapists, psychologists, and other similar healthcare professionals performing services in their capacity as such. The performance of services in the field of health does not include the provision of services not directly related to a medical services field, even though the services provided may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers, payment processing, or the research, testing, and manufacture and/or sales of pharmaceuticals or medical devices.

Example

- B is a board-certified pharmacist who contracts as an independent contractor with X, a small medical facility in a rural area. X employs one full time pharmacist, but contracts with B when X's needs exceed the capacity of its full-time staff. When engaged by X, B is responsible for receiving and reviewing orders from physicians providing medical care at the facility; making recommendations on dosing and alternatives to the ordering physician; performing inoculations, checking for drug interactions, and filling pharmaceutical orders for patients receiving care at X. B is engaged in the performance of services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

Example

- X is the operator of a residential facility that provides a variety of services to senior citizens who reside on campus. For residents, X offers standard domestic services including housing management and maintenance, meals, laundry, entertainment, and other similar services. In addition, X contracts with local professional healthcare organizations to offer residents a range of medical and health services provided at the facility, including skilled nursing care, physical and occupational therapy, speech-language pathology services, medical social services, medications, medical supplies and equipment used in the facility, ambulance transportation to the nearest supplier of needed services, and dietary counseling. X receives all of its income from residents for the costs associated with residing at the facility. Any health and medical services are billed directly by the healthcare providers to the senior citizens for those professional healthcare services even though those services are provided at the facility. X does not perform services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

Example

- Y operates specialty surgical centers that provide outpatient medical procedures that do not require the patient to remain overnight for recovery or observation following the procedure. Y is a private organization that owns a number of facilities throughout the country. For each facility, Y ensures compliance with state and Federal laws for medical facilities and manages the facility's operations and performs all administrative functions. Y does not employ physicians, nurses, and medical assistants, but enters into agreements with other professional medical organizations or directly with the medical professionals to perform the procedures and provide all medical care. Patients are billed by Y for the facility costs relating to their procedure and by the healthcare professional or their affiliated organization for the actual costs of the procedure conducted by the physician and medical support team. Y does not perform services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section.

Example

- Z is the developer and the only provider of a patented test used to detect a particular medical condition. Z accepts test orders only from health care professionals (Z's clients), does not have contact with patients, and Z's employees do not diagnose, treat, or manage any aspect of patient care. A, who manages Z's testing operations, is the only employee with an advanced medical degree. All other employees are technical support staff and not healthcare professionals. Z's workers are highly educated, but the skills the workers bring to the job are not often useful for Z's testing methods. In order to perform the duties required by Z, employees receive more than a year of specialized training for working with Z's test, which is of no use to other employers. Upon completion of an ordered test, Z analyses the results and provides its clients a report summarizing the findings. Z does not discuss the report's results, or the patient's diagnosis or treatment with any health care provider or the patient. Z is not informed by the healthcare provider as to the healthcare provider's diagnosis or treatment. Z is not providing services in the field of health within the meaning of section 199A(d)(2) and paragraphs (b)(1)(i) and (b)(2)(ii) of this section or where the principal asset of the trade or business is the reputation or skill of one or more of its employees within the meaning of paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

Law

- ***Meaning of services performed in the field of law -*** the *performance of services in the field of law* means the performance of legal services by individuals such as lawyers, paralegals, legal arbitrators, mediators, and similar professionals performing services in their capacity as such. The performance of services in the field of law does not include the provision of services that do not require skills unique to the field of law; for example, the provision of services in the field of law does not include the provision of services by printers, delivery services, or stenography services.

Accounting

- ***Meaning of services performed in the field of accounting.*** The *performance of services in the field of accounting* means the provision of services by individuals such as accountants, enrolled agents, return preparers, financial auditors, and similar professionals performing services in their capacity as such.

- ***- Meaning of services performed in the field of actuarial science.*** The *performance of services in the field of actuarial science* means the provision of services by individuals such as actuaries and similar professionals performing services in their capacity as such.

Performing Arts

- ***Meaning of services performed in the field of performing arts.*** The *performance of services in the field of the performing arts* means the performance of services by individuals who participate in the creation of performing arts, such as actors, singers, musicians, entertainers, directors, and similar professionals performing services in their capacity as such. The performance of services in the field of performing arts does not include the provision of services that do not require skills unique to the creation of performing arts, such as the maintenance and operation of equipment or facilities for use in the performing arts. Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of performing arts to the public

Example

- A, a singer and songwriter, writes and records a song. A is paid a mechanical royalty when the song is licensed or streamed. A is also paid a performance royalty when the recorded song is played publicly. A is engaged in the performance of services in an SSTB in the field of performing arts within the meaning of section 199A(d)(2) or paragraphs (b)(1)(v) and (b)(2)(vi) of this section. The royalties that A receives for the song are not eligible for a deduction under section 199A.

Example

- B is a partner in Movie LLC, a partnership. Movie LLC is a film production company. Movie LLC plans and coordinates film production. Movie LLC shares in the profits of the films that it produces. Therefore, Movie LLC is engaged in the performance of services in an SSTB in the field of performing arts within the meaning of section 199A(d)(2) or paragraphs (b)(1)(v) and (b)(2)(vi) of this section. B is a passive owner in Movie LLC and does not provide any services with respect to Movie LLC. However, because Movie LLC is engaged in an SSTB in the field of performing arts, B's distributive share of the income, gain, deduction, and loss with respect to Movie LLC is not eligible for a deduction under section 199A.

Consulting

- ***Meaning of services performed in the field of consulting.*** The *performance of services in the field of consulting* means the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems. Consulting includes providing advice and counsel regarding advocacy with the intention of influencing decisions made by a government or governmental agency and all attempts to influence legislators and other government officials on behalf of a client by lobbyists and other similar professionals performing services in their capacity as such. The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales (or economically similar services) or the provision of training and educational courses. For purposes of the preceding sentence, the determination of whether a person's services are sales or economically similar services will be based on all the facts and circumstances of that person's business. Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided. Performance of services in the field of consulting does not include the performance of consulting services embedded in, or ancillary to, the sale of goods or performance of services on behalf of a trade or business that is otherwise not an SSTB (such as typical services provided by a building contractor) if there is no separate payment for the consulting services. Services within the fields of architecture and engineering are not treated as consulting services.

Example

- D is in the business of providing services that assist unrelated entities in making their personnel structures more efficient. D studies its client's organization and structure and compares it to peers in its industry. D then makes recommendations and provides advice to its client regarding possible changes in the client's personnel structure, including the use of temporary workers. D does not provide any temporary workers to its clients and D's compensation and fees are not affected by whether D's clients used temporary workers. D is engaged in the performance of services in an SSTB in the field of consulting within the meaning of section 199A(d)(2) or paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

Example

- E is an individual who owns and operates a temporary worker staffing firm primarily focused on the software consulting industry. Business clients hire E to provide temporary workers that have the necessary technical skills and experience with a variety of business software to provide consulting and advice regarding the proper selection and operation of software most appropriate for the business they are advising. E does not have a technical software engineering background and does not provide software consulting advice herself. E reviews resumes and refers candidates to the client when the client indicates a need for temporary workers. E does not evaluate her clients' needs about whether the client needs workers and does not evaluate the clients' consulting contracts to determine the type of expertise needed. Rather, the client provides E with a job description indicating the required skills for the upcoming consulting project. E is paid a fixed fee for each temporary worker actually hired by the client and receives a bonus if that worker is hired permanently within a year of referral. E's fee is not contingent on the profits of its clients. E is not considered to be engaged in the performance of services in the field of consulting within the meaning of section 199A(d)(2) or (b)(1)(vi) and (b)(2)(vii) of this section.

Example

- F is in the business of licensing software to customers. F discusses and evaluates the customer's software needs with the customer. The taxpayer advises the customer on the particular software products it licenses. F is paid a flat price for the software license. After the customer licenses the software, F helps to implement the software. F is engaged in the trade or business of licensing software and not engaged in an SSTB in the field of consulting within the meaning of section 199A(d)(2) or paragraphs (b)(1)(vi) and (b)(2)(vii) of this section.

Athletics

- The *performance of services in the field of athletics* means the performance of services by individuals who participate in athletic competition such as athletes, coaches, and team managers in sports such as baseball, basketball, football, soccer, hockey, martial arts, boxing, bowling, tennis, golf, skiing, snowboarding, track and field, billiards, and racing. The performance of services in the field of athletics does not include the provision of services that do not require skills unique to athletic competition, such as the maintenance and operation of equipment or facilities for use in athletic events. Similarly, the performance of services in the field of athletics does not include the provision of services by persons who broadcast or otherwise disseminate video or audio of athletic events to the public.

Example

- C is a partner in Partnership, which solely owns and operates a professional sports team. Partnership employs athletes and sells tickets and broadcast rights for games in which the sports team competes. Partnership sells the broadcast rights to Broadcast LLC, a separate trade or business. Broadcast LLC solely broadcasts the games. Partnership is engaged in the performance of services in an SSTB in the field of athletics within the meaning of section 199A(d)(2) or paragraphs (b)(1)(vii) and (b)(2)(viii) of this section. The tickets sales and the sale of the broadcast rights are both the performance of services in the field of athletics. C is a passive owner in Partnership and C does not provide any services with respect to Partnership or the sports team. However, because Partnership is engaged in an SSTB in the field of athletics, C's distributive share of the income, gain, deduction, and loss with respect to Partnership is not eligible for a deduction under section 199A. Broadcast LLC is not engaged in the performance of services in an SSTB in the field of athletics.

Financial Services

- The *performance of services in the field of financial services* means the provision of financial services to clients including managing wealth, advising clients with respect to finances, developing retirement plans, developing wealth transition plans, the provision of advisory and other similar services regarding valuations, mergers, acquisitions, dispositions, restructurings (including in title 11 of the Code or similar cases), and raising financial capital by underwriting, or acting as a client's agent in the issuance of securities and similar services. This includes services provided by financial advisors, investment bankers, wealth planners, retirement advisors, and other similar professionals performing services in their capacity as such. Solely for purposes of section 199A, the performance of services in the field of financial services does not include taking deposits or making loans, but does include arranging lending transactions between a lender and borrower.

Example

- G is in the business of providing services to assist clients with their finances. G will study a particular client's financial situation, including, the client's present income, savings, and investments, and anticipated future economic and financial needs. Based on this study, G will then assist the client in making decisions and plans regarding the client's financial activities. Such financial planning includes the design of a personal budget to assist the client in monitoring the client's financial situation, the adoption of investment strategies tailored to the client's needs, and other similar services. G is engaged in the performance of services in an SSTB in the field of financial services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

Example

- H is in the business of franchising a brand of personal financial planning offices, which generally provide personal wealth management, retirement planning, and other financial advice services to customers for a fee. H does not provide financial planning services itself. H licenses the right to use the business tradename, other branding intellectual property, and a marketing plan to third-party financial planner franchisees that operate the franchised locations and provide all services to customers. In exchange, the franchisees compensate H based on a fee structure, which includes a one-time fee to acquire the franchise. H is not engaged in the performance of services in the field of financial services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(viii) and (b)(2)(ix) of this section.

Brokerage

- The *performance of services in the field of brokerage services* includes services in which a person arranges transactions between a buyer and a seller with respect to securities (as defined in section 475(c)(2)) for a commission or fee. This includes services provided by stock brokers and other similar professionals, but does not include services provided by real estate agents and brokers, or insurance agents and brokers.

Investing and Investment Management

- The *performance of services that consist of investing and investment management* refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services, including providing advice with respect to buying and selling investments. The performance of services of investing and investment management does not include directly managing real property.

Trading

- The *performance of services that consist of trading* means a trade or business of trading in securities (as defined in section 475(c)(2)), commodities (as defined in section 475(e)(2)), or partnership interests. Whether a person is a trader in securities, commodities, or partnership interests is determined by taking into account all relevant facts and circumstances, including the source and type of profit that is associated with engaging in the activity regardless of whether that person trades for the person's own account, for the account of others, or any combination thereof.

Securities

- T*he performance of services that consist of dealing in securities (as defined in section 475(c)(2))* means regularly purchasing securities from and selling securities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in securities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, the performance of services to originate a loan is not treated as the purchase of a security from the borrower in determining whether the lender is dealing in securities.

Commodities

- T*he performance of services that consist of dealing in commodities (as defined in section 475(e)(2))* means regularly purchasing commodities from and selling commodities to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in commodities with customers in the ordinary course of a trade or business. Solely for purposes of the preceding sentence, gains and losses from qualified active sales as defined in paragraph (b)(2)(xiii)(B)(*1*) of this section are not taken into account in determining whether a person is engaged in the trade or business of dealing in commodities.

Partnership Interests

- T*he performance of services that consist of dealing in partnership interests* means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business or regularly offering to enter into, assume, offset, assign, or otherwise terminate positions in partnership interests with customers in the ordinary course of a trade or business.

Example

- J is in the business of executing transactions for customers involving various types of securities or commodities generally traded through organized exchanges or other similar networks. Customers place orders with J to trade securities or commodities based on the taxpayer's recommendations. J's compensation for its services typically is based on completion of the trade orders. J is engaged in an SSTB in the field of brokerage services within the meaning of section 199A(d)(2) or paragraphs (b)(1)(ix) and (b)(2)(x) of this section.

Skill or Reputation

- The term *any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners* means any trade or business that consists of any of the following (or any combination thereof):
  - **(A)** A trade or business in which a person receives fees, compensation, or other income for endorsing products or services;
  - **(B)** A trade or business in which a person licenses or receives fees, compensation, or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or any other symbols associated with the individual's identity; or
- **(C)** Receiving fees, compensation, or other income for appearing at an event or on radio, television, or another media format.

Example

- K owns 100% of Corp, an S corporation, which operates a bicycle sales and repair business. Corp has 8 employees, including K. Half of Corp's net income is generated from sales of new and used bicycles and related goods, such as helmets, and bicycle-related equipment. The other half of Corp's net income is generated from bicycle repair services performed by K and Corp's other employees. Corp's assets consist of inventory, fixtures, bicycle repair equipment, and a leasehold on its retail location. Several of the employees and K have worked in the bicycle business for many years, and have acquired substantial skill and reputation in the field. Customers often consult with the employees on the best bicycle for purchase. K is in the business of sales and repairs of bicycles and is not engaged in an SSTB within the meaning of section 199A(d)(2) or paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

Example

- L is a well-known chef and the sole owner of multiple restaurants each of which is owned in a disregarded entity. Due to L's skill and reputation as a chef, L receives an endorsement fee of $500,000 for the use of L's name on a line of cooking utensils and cookware. L is in the trade or business of being a chef and owning restaurants and such trade or business is not an SSTB. However, L is also in the trade or business of receiving endorsement income. L's trade or business consisting of the receipt of the endorsement fee for L's skill and/or reputation is an SSTB within the meaning of section 199A(d)(2) or paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

In Exchange for Business Interest

- For purposes of paragraphs (b)(2)(xiv)(A) through (C) of this section, the term *fees, compensation, or other income* includes the receipt of a partnership interest and the corresponding distributive share of income, deduction, gain, or loss from the partnership, or the receipt of stock of an S corporation and the corresponding income, deduction, gain, or loss from the S corporation stock.

Example

- M is a well-known actor. M entered into a partnership with Shoe Company, in which M contributed her likeness and the use of her name to the partnership in exchange for a 50% interest in the partnership and a guaranteed payment. M's trade or business consisting of the receipt of the partnership interest and the corresponding distributive share with respect to the partnership interest for M's likeness and the use of her name is an SSTB within the meaning of section 199A(d)(2) or paragraphs (b)(1)(xiii) and (b)(2)(xiv) of this section.

De Minimis Rule

- ***Gross receipts of $25 million or less.*** For a trade or business with gross receipts of $25 million or less for the taxable year, a trade or business is not an SSTB if less than 10 percent of the gross receipts of the trade or business are attributable to the SSTB.
- For purposes of determining whether this 10 percent test is satisfied, the performance of any activity incident to the actual performance of services in the field is considered the performance of services in that field.
- ***Gross receipts of greater than $25 million.*** For a trade or business with gross receipts of greater than $25 million for the taxable year, use 5% instead of 10%.

Example

- Landscape LLC sells lawn care and landscaping equipment and also provides advice and counsel on landscape design for large office parks and residential buildings. The landscape design services include advice on the selection and placement of trees, shrubs, and flowers and are considered to be the performance of services in the field of consulting under paragraphs (b)(1)(vi) and (b)(2)(vii) of this section. Landscape LLC separately invoices for its landscape design services and does not sell the trees, shrubs, or flowers it recommends for use in the landscape design. Landscape LLC maintains one set of books and records and treats the equipment sales and design services as a single trade or business for purposes of sections 162 and 199A. Landscape LLC has gross receipts of $2 million. $250,000 of the gross receipts is attributable to the landscape design services, an SSTB. Because the gross receipts from the consulting services exceed 10 percent of Landscape LLC's total gross receipts, the entirety of Landscape LLC's trade or business is considered an SSTB.

Example

- Animal Care LLC provides veterinarian services performed by licensed staff and also develops and sells its own line of organic dog food at its veterinarian clinic and online. The veterinarian services are considered to be the performance of services in the field of health under paragraphs (b)(1)(i) and (b)(2)(ii) of this section. Animal Care LLC separately invoices for its veterinarian services and the sale of its organic dog food. Animal Care LLC maintains separate books and records for its veterinarian clinic and its development and sale of its dog food. Animal Care LLC also has separate employees who are unaffiliated with the veterinary clinic and who only work on the formulation, marketing, sales, and distribution of the organic dog food products. Animal Care LLC treats its veterinary practice and the dog food development and sales as separate trades or businesses for purposes of section 162 and 199A. Animal Care LLC has gross receipts of $3,000,000. $1,000,000 of the gross receipts is attributable to the veterinary services, an SSTB. Although the gross receipts from the services in the field of health exceed 10 percent of Animal Care LLC's total gross receipts, the dog food development and sales business is not considered an SSTB due to the fact that the veterinary practice and the dog food development and sales are separate trades or businesses under section 162.

Services and Property to SSTB

- **General Rule.** If a trade or business provides property or services to an SSTB within the meaning of this section and there is 50 percent or more common ownership of the trades or businesses, that portion of the trade or business of providing property or services to the 50 percent or more commonly-owned SSTB will be treated as a separate SSTB with respect to the related parties.
- ***50 percent or more common ownership.*** Direct or indirect ownership by related parties within the meaning of sections 267(b) or 707(b).

Example

- Law Firm is a partnership that provides legal services to clients, owns its own office building and employs its own administrative staff. Law Firm divides into three partnerships. Partnership 1 performs legal services to clients. Partnership 2 owns the office building and rents the entire building to Partnership 1. Partnership 3 employs the administrative staff and through a contract with Partnership 1 provides administrative services to Partnership 1 in exchange for fees. All three of the partnerships are owned by the same people (the original owners of Law Firm). Because Partnership 2 provides all of its property to Partnership 1, and Partnership 3 provides all of its services to Partnership 1, Partnerships 2 and 3 will each be treated as an SSTB under paragraph (c)(2) of this section.

Example

- Assume the same facts as in Example 1 of this paragraph (c)(2), except that Partnership 2, which owns the office building, rents 50 percent of the building to Partnership 1, which provides legal services, and the other 50 percent to various unrelated third party tenants. Because Partnership 2 is owned by the same people as Partnership 1, the portion of Partnership 2's leasing activity related to the lease of the building to Partnership 1 will be treated as a separate SSTB. The remaining 50 percent of Partnership 2's leasing activity will not be treated as an SSTB.

Trade or business of performing services as an employee

- **General Rule.** The trade or business of performing services as an employee is not a trade or business for purposes of section 199A and the regulations thereunder.

Use of EIN

- For purposes of determining whether wages are earned in a capacity as an employee as provided in paragraph (d)(1) of this section, the treatment of an employee by an employer as anything other than an employee for Federal employment tax purposes is immaterial. Thus, if a worker should be properly classified as an employee, it is of no consequence that the employee is treated as a non-employee by the employer for Federal employment tax purposes.

Presumption

- An individual that was properly treated as an employee for Federal employment tax purposes by the person to which he or she provided services and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed, for three years after ceasing to be treated as an employee for Federal employment tax purposes, to be in the trade or business of performing services as an employee with regard to such services

Rebuttal

- Upon notice from the IRS, an individual rebuts the presumption by providing records, such as contracts or partnership agreements, that provide sufficient evidence to corroborate the individual's status as a non-employee.

Example

- A is employed by PRS, a partnership for Federal tax purposes, as a fulltime employee and is treated as such for Federal employment tax purposes. A quits his job for PRS and enters into a contract with PRS under which A provides substantially the same services that A previously provided to PRS in A's capacity as an employee. Because A was treated as an employee for services he provided to PRS, and now is no longer treated as an employee with regard to such services, A is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with regard to his services performed for PRS. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles (including the common-law employee classification rules), A is not an employee, any amounts paid by PRS to A with respect to such services will not be QBI for purposes of section 199A. The presumption would apply even if, instead of contracting directly with PRS, A formed a disregarded entity, or a passthrough entity, and the entity entered into the contract with PRS.

Example

- C is an attorney employed as an associate in a law firm (Law Firm 1) and was treated as such for Federal employment tax purposes. C and the other associates in Law Firm 1 have taxable income below the threshold amount. Law Firm 1 terminates its employment relationship with C and its other associates. C and the other former associates form a new partnership, Law Firm 2, which contracts to perform legal services for Law Firm 1. Therefore, in form, C is now a partner in Law Firm 2 which earns income from providing legal services to Law Firm 1. C continues to provide substantially the same legal services to Law Firm 1 and its clients. Because C was previously treated as an employee for services she provided to Law Firm 1, and now is no longer treated as an employee with regard to such services, C is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services C provides to Law Firm 1 indirectly through Law Firm 2. Unless the presumption is rebutted with a showing that, under Federal tax law, regulations, and principles (including common-law employee classification rules), C is not an employee, C's distributive share of Law Firm 2 income (including any guaranteed payments) will not be QBI for purposes of section 199A. The results in this example would not change if, instead of contracting with Law Firm 1, Law Firm 2 was instead admitted as a partner in Law Firm 1.

Example

- E is an engineer employed as a senior project engineer in an engineering firm, Engineering Firm. Engineering Firm is a partnership for Federal tax purposes and structured such that after 10 years, senior project engineers are considered for partner if certain career milestones are met. After 10 years, E meets those career milestones and is admitted as a partner in Engineering Firm. As a partner in Engineering Firm, E shares in the net profits of Engineering Firm, and also otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner. E is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services E provides to Engineering Firm. However, E is able to rebut the presumption by showing that E became a partner in Engineering Firm as a career milestone, shares in the overall net profits in Engineering Firm, and otherwise satisfies the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

Example

- F is a financial advisor employed by a financial advisory firm, Advisory Firm, a partnership for Federal tax purposes, as a fulltime employee and is treated as such for Federal employment tax purposes. F has taxable income below the threshold amount. Advisory Firm is a partnership and offers F the opportunity to be admitted as a partner. F elects to be admitted as a partner to Advisory Firm and is admitted as a partner to Advisory Firm. As a partner in Advisory Firm, F shares in the net profits of Advisory Firm, is obligated to Advisory Firm in ways that F was not previously obligated as an employee, is no longer entitled to certain benefits available only to employees of Advisory Firm, and has materially modified his relationship with Advisory Firm. F's share of net profits is not subject to a floor or capped at a dollar amount. F is presumed (solely for purposes of section 199A(d)(1)(B) and paragraphs (a)(3) and (d) of this section) to be in the trade or business of performing services as an employee with respect to the services F provides to Advisory Firm. However, F is able to rebut the presumption by showing that F became a partner in Advisory Firm by sharing in the profits of Advisory Firm, materially modifying F's relationship with Advisory Firm, and otherwise satisfying the requirements under Federal tax law, regulations, and principles (including common-law employee classification rules) to be respected as a partner.

Part 3 – W-2 Wages

- Objective – Calculate Amount of W-2 wages for QBI purposes

Definition

- Definition of W-2 wages. Section 199A(b)(4)(A) provides that W-2 wages means, with respect to any person for any taxable year of such person, the sum of the amounts described in section 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Thus, W-2 wages include: (i) the total amount of wages as defined in section 3401(a); (ii) the total amount of elective deferrals (within the meaning of section 402(g)(3)); (iii) the compensation deferred under section 457; and (iv) the amount of designated Roth contributions (as defined in section 402A)

Three Methods

- Unmodified Box 1
- Modified Box 1
- Tracking Wages

Unmodified Box 1

- *Unmodified box method*. Under the unmodified box method, W-2 wages are calculated by taking, without modification, the lesser of— (
- A) The total entries in Box 1 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer; or
- (B) The total entries in Box 5 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer.

Modified Box 1

- *Modified Box 1 method*. Under the Modified Box 1 method, the taxpayer makes modifications to the total entries in Box 1 of Forms W-2 filed with respect to employees of the taxpayer. W-2 wages under this method are calculated as follows—
- (A) Total the amounts in Box 1 of all Forms W-2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the 7 taxpayer;
- (B) Subtract from the total in paragraph .02(A) of this section amounts included in Box 1 of Forms W-2 that are not wages for Federal income tax withholding purposes, including amounts that are treated as wages for purposes of income tax withholding under section 3402(o) (for example, supplemental unemployment compensation benefits within the meaning of Rev. Rul. 90-72); and
- (C) Add to the amount obtained after paragraph .02(B) of this section the total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the taxpayer for employment by the taxpayer and that are properly coded D, E, F, G, and S.

Tracking Wages Method

- *Tracking wages method*. Under the tracking wages method, the taxpayer actually tracks total wages subject to federal income tax withholding and makes appropriate modifications. W-2 wages under this method are calculated as follows—
- (A) Total the amounts of wages subject to federal income tax withholding that are paid to employees of the taxpayer for employment by the taxpayer and that are reported on Forms W-2 filed with SSA by the taxpayer for the calendar year; plus
- (B) The total of the amounts that are reported in Box 12 of Forms W-2 with respect to employees of the taxpayer for employment by the taxpayer and 8 that are properly coded D, E, F, G, and S.

Short Tax Years

- Use tracking wages method

Part 4 – UBIA

- Objective – Calculate Amount of UBIA for QBI purposes

General Rule

- The determination of the UBIA of qualified property must be made for each trade or business (or aggregated trade or business) by the individual or RPE that directly conducts the trade or business (or aggregated trade or business). The UBIA of qualified property is presumed to be zero if not determined and reported for each trade or business (or aggregated trade or business).

General Rule

- The term *qualified property* means, with respect to any trade or business (or aggregated trade or business) of an individual or RPE for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167(a) -
- **(A)** Which is held by, and available for use in, the trade or business (or aggregated trade or business) at the close of the taxable year;
- **(B)** Which is used at any point during the taxable year in the trade or business's (or aggregated trade or business's) production of QBI; and
- **(C)** The depreciable period for which has not ended before the close of the individual's or RPE's taxable year.

Improvements

- In the case of any addition to, or improvement of, qualified property that has already been placed in service by the individual or RPE, such addition or improvement is treated as separate qualified property first placed in service on the date such addition or improvement is placed in service for purposes of paragraph (c)(2) of this section.

Depreciable Period

- The term *depreciable period* means, with respect to qualified property of a trade or business, the period beginning on the date the property was first placed in service by the individual or RPE and ending on the later of -
- **(A)** The date that is 10 years after such date; or
- **(B)** The last day of the last full year in the applicable recovery period that would apply to the property under section 168(c), regardless of any application of section 168(g).

Interaction with Bonus

- The additional first-year depreciation deduction allowable under section 168 (for example, under section 168(k) or (m)) does not affect the applicable recovery period under this paragraph for the qualified property.

1031 and 1033

- The date on which replacement property that is of like-kind to relinquished property or is similar or related in service or use to involuntarily converted property was first placed in service by the individual or RPE is determined as follows -
- ***(1)*** For the portion of the individual's or RPE's UBIA, as defined in paragraph (c)(3) of this section, in such replacement property that does not exceed the individual's or RPE's UBIA in the relinquished property or involuntarily converted property, the date such portion in the replacement property was first placed in service by the individual or RPE is the date on which the relinquished property or involuntarily converted property was first placed in service by the individual or RPE; and
- ***(2)*** For the portion of the individual's or RPE's UBIA, as defined in paragraph (c)(3) of this section, in such replacement property that exceeds the individual's or RPE's UBIA in the relinquished property or involuntarily converted property, such portion in the replacement property is treated as separate qualified property that the individual or RPE first placed in service on the date on which the replacement property was first placed in service by the individual or RPE.

Example

- On January 5, 2012, A purchases Real Property X for $1 million and places it in service in A's trade or business. A's trade or business is not an SSTB. A's basis in Real Property X under section 1012 is $1 million. Real Property X is qualified property within the meaning of section 199A(b)(6). As of December 31, 2018, A's basis in Real Property X, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is $821,550.
- For purposes of section 199A(b)(2)(B)(ii) and this section, A's UBIA of Real Property X is its $1 million cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2).

Example

- The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, except that on January 15, 2019, A enters into a like-kind exchange under section 1031 in which A exchanges Real Property X for Real Property Y. Real Property Y has a value of $1 million. No cash or other property is involved in the exchange. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is $820,482.
- A's UBIA in Real Property Y is $1 million as determined under paragraph (c)(3)(ii) of this section. Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A.

Example

- The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, except that on January 15, 2019, A enters into a like-kind exchange under section 1031, in which A exchanges Real Property X for Real Property Y. Real Property X has appreciated in value to $1.3 million, and Real Property Y also has a value of $1.3 million. No cash or other property is involved in the exchange. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is $820,482.
- A's UBIA in Real Property Y is $1 million as determined under paragraph (c)(3)(ii) of this section. Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A.

Example

- The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, except that on January 15, 2019, A enters into a like-kind exchange under section 1031, in which A exchanges Real Property X for Real Property Y. Real Property X has appreciated in value to $1.3 million, but Real Property Y has a value of $1.5 million. A therefore adds $200,000 in cash to the exchange of Real Property X for Real Property Y. On January 15, 2019, A places Real Property Y in service. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is $820,482.
- A's UBIA in Real Property Y is $1.2 million as determined under paragraph (c)(3)(ii) of this section ($1 million in UBIA from Real Property X plus $200,000 cash paid by A to acquire Real Property Y). Because the UBIA of Real Property Y exceeds the UBIA of Real Property X, Real Property Y is treated as being two separate qualified properties for purposes of applying paragraph (c)(2)(iii)(A) of this section. One property has a UBIA of $1 million (the portion of A's UBIA of $1.2 million in Real Property Y that does not exceed A's UBIA of $1 million in Real Property X) and it is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A. The other property has a UBIA of $200,000 (the portion of A's UBIA of $1.2 million in Real Property Y that exceeds A's UBIA of $1 million in Real Property X) and it is first placed in service by A on January 15, 2019, which is the date on which Real Property Y was first placed in service by A.

Example

- The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, except that on January 15, 2019, A enters into a like-kind exchange under section 1031, in which A exchanges Real Property X for Real Property Y. Real Property X has appreciated in value to $1.3 million. Real Property Y has a fair market value of $900,000. Pursuant to the exchange, A receives Real Property Y and $400,000 in cash. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is $820,482.
- A's UBIA in Real Property Y is $900,000 as determined under paragraph (c)(3)(ii) of this section ($1 million in UBIA from Real Property X less $100,000 excess boot ($400,000 in cash received in the exchange over $300,000 in appreciation in Property X, which is equal to the excess of the $1.3 million fair market value of Property X on the date of the exchange over the $1 million fair market value of Property X on the date of acquisition by the taxpayer)). Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A.

Example

- The facts are the same as in *Example 1* of paragraph (c)(4)(i) of this section, except that on January 15, 2019, A enters into a like-kind exchange under section 1031, in which A exchanges Real Property X for Real Property Y. Real Property X has declined in value to $900,000, and Real Property Y also has a value of $900,000. No cash or other property is involved in the exchange. As of January 15, 2019, A's basis in Real Property X, as adjusted under section 1016(a)(2), is $820,482.
- Even though Real Property Y is worth only $900,000, A's UBIA in Real Property Y is $1 million as determined under paragraph (c)(3)(ii) of this section because no cash or other property was involved in the exchange. Pursuant to paragraph (c)(2)(iii)(A) of this section, Real Property Y is first placed in service by A on January 5, 2012, which is the date on which Real Property X was first placed in service by A.

Example

- C operates a trade or business that is not an SSTB as a sole proprietorship. On January 5, 2011, C purchases Machinery Y for $10,000 and places it in service in C's trade or business. C's basis in Machinery Y under section 1012 is $10,000. Machinery Y is qualified property within the meaning of section 199A(b)(6). Assume that Machinery Y's recovery period under section 168(c) is 10 years, and C depreciates Machinery Y under the general depreciation system by using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. As of December 31, 2018, C's basis in Machinery Y, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is $2,500. On January 1, 2019, C incorporates the sole proprietorship and elects to treat the newly formed entity as an S corporation for Federal income tax purposes. C contributes Machinery Y and all other assets of the trade or business to the S corporation in a non-recognition transaction under section 351. The S corporation immediately places all the assets in service.
- For purposes of section 199A(b)(2)(B)(ii) and this section, C's UBIA of Machinery Y from 2011 through 2018 is its $10,000 cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2). The S corporation's basis of Machinery Y is $2,500, the basis of the property under section 362 at the time the S corporation places the property in service. Pursuant to paragraph (c)(3)(iv) of this section, S corporation's UBIA of Machinery Y is $10,000, which is C's UBIA of Machinery Y. Pursuant to paragraph (c)(2)(iv)(A) of this section, for purposes of determining the depreciable period of Machinery Y, the S corporation's placed in service date of Machinery Y will be January 5, 2011, which is the date C originally placed the property in service in 2011. Therefore, Machinery Y may be qualified property of the S corporation (assuming it continues to be used in the business) for 2019 and 2020 and will not be qualified property of the S corporation after 2020, because its depreciable period will have expired.

Example

- LLC, a partnership, operates a trade or business that is not an SSTB. On January 5, 2011, LLC purchases Machinery Z for $30,000 and places it in service in LLC's trade or business. LLC's basis in Machinery Z under section 1012 is $30,000. Machinery Z is qualified property within the meaning of section 199A(b)(6). Assume that Machinery Z's recovery period under section 168(c) is 10 years, and LLC depreciates Machinery Z under the general depreciation system by using the straight-line depreciation method, a 10-year recovery period, and the half-year convention. As of December 31, 2018, LLC's basis in Machinery Z, as adjusted under section 1016(a)(2) for depreciation deductions under section 168(a), is $7,500. On January 1, 2019, LLC distributes Machinery Z to Partner A in full liquidation of Partner A's interest in LLC. Partner A's outside basis in LLC is $35,000.
- For purposes of section 199A(b)(2)(B)(ii) and this section, LLC's UBIA of Machinery Z from 2011 through 2018 is its $30,000 cost basis under section 1012, regardless of any later depreciation deductions under section 168(a) and resulting basis adjustments under section 1016(a)(2). Prior to the distribution to Partner A, LLC's basis of Machinery Z is $7,500. Under section 732(b), Partner A's basis in Machinery Z is $35,000. Pursuant to paragraph (c)(3)(iv) of this section, upon distribution of Machinery Z, Partner A's UBIA of Machinery Z is $30,000, which was LLC's UBIA of Machinery Z.

Part 4 – QBI Defined

- Objective – Calculate Amount of QBI

Defined

- The term *qualified items of income, gain, deduction, and loss* means items of gross income, gain, deduction, and loss to the extent such items are -
- **(A)** Effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting "trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or for "a foreign corporation" each place it appears); and
- **(B)** Included or allowed in determining taxable income for the taxable year.

Items that are not QBI

- **(A)** Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss, including any item treated as one of such items under any other provision of the Code. This provision does not apply to the extent an item is treated as anything other than short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.
- **(B)** Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G). Any amount described in section 1385(a)(1) is not treated as described in this clause.
- **(C)** Any interest income other than interest income which is properly allocable to a trade or business. For purposes of section 199A and this section, interest income attributable to an investment of working capital, reserves, or similar accounts is not properly allocable to a trade or business.

Items that are not QBI

- **(D)** Any item of gain or loss described in section 954(c)(1)(C) (transactions in commodities) or section 954(c)(1)(D) (excess foreign currency gains) applied in each case by substituting "trade or business (within the meaning of section 199A)" for "controlled foreign corporation."
- **(E)** Any item of income, gain, deduction, or loss described in section 954(c)(1)(F) (income from notional principal contracts) determined without regard to section 954(c)(1)(F)(ii) and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7).
- **(F)** Any amount received from an annuity which is not received in connection with the trade or business.

Items to not QBI

- **(G)** Any qualified REIT dividends as defined in paragraph (c)(2) of this section or qualified PTP income as defined in paragraph (c)(3) of this section.
- **(H)** Reasonable compensation received by a shareholder from an S corporation. However, the S corporation's deduction for such reasonable compensation will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.
- **(I)** Any guaranteed payment described in section 707(c) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such guaranteed payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.
- **(J)** Any payment described in section 707(a) received by a partner for services rendered with respect to the trade or business, regardless of whether the partner is an individual or an RPE. However, the partnership's deduction for such payment will reduce QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

751 Gains

- With respect to a partnership, if section 751(a) or (b) applies, then gain or loss attributable to assets of the partnership giving rise to ordinary income under section 751(a) or (b) is considered attributable to the trades or businesses conducted by the partnership, and is taken into account for purposes of computing QBI.

Guaranteed Payments Use of Capital

- Income attributable to a guaranteed payment for the use of capital is not considered to be attributable to a trade or business, and thus is not taken into account for purposes of computing QBI except to the extent properly allocable to a trade or business of the recipient. The partnership's deduction associated with the guaranteed payment will be taken into account for purposes of computing QBI if such deduction is properly allocable to the trade or business and is otherwise deductible for Federal income tax purposes.

Section 481

- Section 481 adjustments (whether positive or negative) are taken into account for purposes of computing QBI to the extent that the requirements of this section and section 199A are otherwise satisfied, but only if the adjustment arises in taxable years ending after December 31, 2017.

Part 5 – Aggregation

- Objective – Understand aggregation and how it works for QBI

Aggregation

- 1. The same person or group of persons, directly or indirectly, owns 50 percent or more of each trade or business to be aggregated, meaning in the case of such trades or businesses owned by an S corporation, 50 percent or more of the issued and outstanding shares of the corporation, or, in the case of such trades or businesses owned by a partnership, 50 percent or more of the capital or profits in the partnership;
- 2. The ownership described in paragraph 1 exists for a majority of the taxable year in which the items attributable to each trade or business to be aggregated are included in income
- 3. All of the items attributable to each trade or business to be aggregated are reported on returns with the same taxable year, not taking into account short taxable years;

Aggregation

- 4. None of the trades or businesses to be aggregated is a specified service trade or business (SSTB) as defined in § 1.199A-5; and
- 5. The trades or businesses to be aggregated satisfy at least two of the following factors (based on all of the facts and circumstances):
- (A) The trades or businesses provide products and services that are the same or customarily offered together
- (B) The trades or businesses share facilities or share significant centralized business elements, such as personnel, accounting, legal, manufacturing, purchasing, human resources, or information technology resource
- (C) The trades or businesses are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group (for example, supply chain interdependencies).

Aggregation - Attribution

- 1. The individual’s spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and
- 2. The individual’s children, grandchildren, and parents.

Aggregation

- For each taxable year, individuals must attach a statement to their returns identifying each trade or business aggregated under the regulations. The statement must contain—
- (A) A description of each trade or business;
- (B) The name and EIN of each entity in which a trade or business is operated;
- (C) Information identifying any trade or business that was formed, ceased operations, was acquired, or was disposed of during the taxable year; and
- (D) Such other information as the Commissioner may require in forms, instructions, or other published guidance.

Aggregation vs IRC 469

- IRC 469 allows for our passive loss rules
- Grouping under 1.469-4T (trade or business)
  - Self Rentals
- Grouping under 1.469-9 (R/E professional)

Example

- A wholly owns and operates a catering business and a restaurant through separate disregarded entities. The catering business and the restaurant share centralized purchasing to obtain volume discounts and a centralized accounting office that performs all of the bookkeeping, tracks and issues statements on all of the receivables, and prepares the payroll for each business. A maintains a website and print advertising materials that reference both the catering business and the restaurant. A uses the restaurant kitchen to prepare food for the catering business. The catering business employs its own staff and owns equipment and trucks that are not used or associated with the restaurant.

Example

- Because the restaurant and catering business are held in disregarded entities, A will be treated as operating each of these businesses directly and thereby satisfies paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, A satisfies the following factors: Paragraph (b)(1)(v)(A) of this section is met as both businesses offer prepared food to customers; and paragraph (b)(1)(v)(B) of this section is met because the two businesses share the same kitchen facilities in addition to centralized purchasing, marketing, and accounting. Having satisfied paragraphs (b)(1)(i) through (v) of this section, A may treat the catering business and the restaurant as a single trade or business for purposes of applying § 1.199A-1(d).

Example

- Assume the same facts as in *Example 1* of paragraph (d)(1) of this section, but the catering and restaurant businesses are owned in separate partnerships and A, B, C, and D each own a 25% interest in each of the two partnerships. A, B, C, and D are unrelated.

Example

- Because under paragraph (b)(1)(i) of this section A, B, C, and D together own more than 50% of each of the two partnerships, they may each treat the catering business and the restaurant as a single trade or business for purposes of applying § 1.199A-1(d).

Example

- W owns a 75% interest in S1, an S corporation, and a 75% interest in PRS, a partnership. S1 manufactures clothing and PRS is a retail pet food store. W manages S1 and PRS.

Example

- W owns more than 50% of the stock of S1 and more than 50% of PRS thereby satisfying paragraph (b)(1)(i) of this section. Although W manages both S1 and PRS, W is not able to satisfy the requirements of paragraph (b)(1)(v) of this section as the two businesses do not provide goods or services that are the same or customarily offered together; there are no significant centralized business elements; and no facts indicate that the businesses are operated in coordination with, or reliance upon, one another. W must treat S1 and PRS as separate trades or businesses for purposes of applying § 1.199A-1(d).

Example

- E owns a 60% interest in each of four partnerships (PRS1, PRS2, PRS3, and PRS4). Each partnership operates a hardware store. A team of executives oversees the operations of all four of the businesses and controls the policy decisions involving the business as a whole. Human resources and accounting are centralized for the four businesses. E reports PRS1, PRS3, and PRS4 as an aggregated trade or business under paragraph (b)(1) of this section and reports PRS2 as a separate trade or business. Only PRS2 generates a net taxable loss.

Example

- E owns more than 50% of each partnership thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the following factors are satisfied: Paragraph (b)(1)(v)(A) of this section because each partnership operates a hardware store; and paragraph (b)(1)(v)(B) of this section because the businesses share accounting and human resource functions. E's decision to aggregate only PRS1, PRS3, and PRS4 into a single trade or business for purposes of applying § 1.199A-1(d) is permissible. The loss from PRS2 will be netted against the aggregate profits of PRS1, PRS3, and PRS4 pursuant to § 1.199A-1(d)(2)(iii).

Example

- Assume the same facts as *Example 4* of paragraph (d)(4) of this section, and that F owns a 10% interest in PRS1, PRS2, PRS3, and PRS4.

Example

- Because under paragraph (b)(1)(i) of this section E owns more than 50% of the four partnerships, F may aggregate PRS 1, PRS2, PRS3, and PRS4 as a single trade or business for purposes of applying § 1.199A-1(d), provided that F can demonstrate that the ownership test is met by E.

Example

- D owns more than 50% of the stock of each S corporation thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the grocery stores satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business. Only S1 and S2 satisfy paragraph (b)(1)(v)(B) of this section because of their centralized purchasing and accounting offices. D is only able to show that the requirements of paragraph (b)(1)(v)(B) of this section are satisfied for S1 and S2; therefore, D only may aggregate S1 and S2 into a single trade or business for purposes of § 1.199A-1(d). D must report S3 as a separate trade or business for purposes of applying § 1.199A-1(d).

Example

- Assume the same facts as *Example 6* of paragraph (d)(6) of this section except each store is independently operated and S1 and S2 do not have centralized purchasing or accounting functions.

Example

- Although the stores provide the same products and services within the meaning of paragraph (b)(1)(v)(A) of this section, D cannot show that another factor under paragraph (b)(1)(v) of this section is present. Therefore, D must report S1, S2, and S3 as separate trades or businesses for purposes of applying § 1.199A-1(d).

Example

- G owns 80% of the stock in S1, an S corporation and 80% of LLC1 and LLC2, each of which is a partnership for Federal tax purposes. LLC1 manufactures and supplies all of the widgets sold by LLC2. LLC2 operates a retail store that sells LLC1's widgets. S1 owns the real property leased to LLC1 and LLC2 for use by the factory and retail store. The entities share common advertising and management.

Example

- G owns more than 50% of the stock of S1 and more than 50% of LLC1 and LLC2 thus satisfying paragraph (b)(1)(i) of this section. LLC1, LLC2, and S1 share significant centralized business elements and are operated in coordination with, or in reliance upon, one or more of the businesses in the aggregated group. G can treat the business operations of LLC1 and LLC2 as a single trade or business for purposes of applying § 1.199A-1(d). S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in § 1.199A-1(b)(14) and meets the requirements of paragraph (b)(1) of this section.

Example

- Same facts as *Example 8* of paragraph (d)(8) of this section, except G owns 80% of the stock in S1 and 20% of each of LLC1 and LLC2. B, G's son, owns a majority interest in LLC2, and M, G's mother, owns a majority interest in LLC1. B does not own an interest in S1 or LLC1, and M does not own an interest in S1 or LLC2.

Example

- Under the rules in paragraph (b)(1) of this section, B and M's interest in LLC2 and LLC1, respectively, are attributable to G and G is treated as owning a majority interest in LLC2 and LLC1; G thus satisfies paragraph (b)(1)(i) of this section. G may aggregate his interests in LLC1, LLC2, and S1 as a single trade or business for purposes of applying § 1.199A-1(d). Under paragraph (b)(1) of this section, S1 is eligible to be included in the aggregated group because it leases property to a trade or business within the aggregated trade or business as described in § 1.199A-1(b)(14) and meets the requirements of paragraph (b)(1) of this section.

Example

- F owns a 75% interest and G owns a 5% interest in five partnerships (PRS1-PRS5). H owns a 10% interest in PRS1 and PRS2.
  Each partnership operates a restaurant and each restaurant separately constitutes a trade or business for purposes of section 162. G is the executive chef of all of the restaurants and as such he creates the menus and orders the food supplies.

Example

- F owns more than 50% of the partnerships thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, the restaurants satisfy paragraph (b)(1)(v)(A) of this section because they are in the same trade or business, and paragraph (b)(1)(v)(B) of this section is satisfied as G is the executive chef of all of the restaurants and the businesses share a centralized function for ordering food and supplies. F can show the requirements under paragraph (b)(1) of this section are satisfied as to all of the restaurants. Because F owns a majority interest in each of the partnerships, G can demonstrate that paragraph (b)(1)(i) of this section is satisfied. G can also aggregate all five restaurants into a single trade or business for purposes of applying § 1.199A-1(d). H, however, only owns an interest in PRS1 and PRS2. Like G, H satisfies paragraph (b)(1)(i) of this section because F owns a majority interest. H can, therefore, aggregate PRS1 and PRS2 into a single trade or business for purposes of applying § 1.199A-1(d).

Example

- H, J, K, and L own interests in PRS1 and PRS2, each a partnership, and S1 and S2, each an S corporation. H, J, K, and L also own interests in C, an entity taxable as a C corporation. H owns 30%, J owns 20%, K owns 5%, and L owns 45% of each of the five entities. All of the entities satisfy 2 of the 3 factors under paragraph (b)(1)(v) of this section. For purposes of section 199A the taxpayers report the following aggregated trades or businesses: H aggregates PRS1 and S1 together and aggregates PRS2 and S2 together; J aggregates PRS1, S1 and S2 together and reports PRS2 separately; K aggregates PRS1 and PRS2 together and aggregates S1 and S2 together; and L aggregates S1, S2, and PRS2 together and reports PRS1 separately. C cannot be aggregated.

Example

- Under paragraph (b)(1)(i) of this section, because H, J, and K together own a majority interest in PRS1, PRS2, S1, and S2, H, J, K, and L are permitted to aggregate under paragraph (b)(1) of this section. Further, the aggregations reported by the taxpayers are permitted, but not required for each of H, J, K, and L. C's income is not eligible for the section 199A deduction and it cannot be aggregated for purposes of applying § 1.199A-1(d)

Example

- L owns 60% of PRS1, a partnership, a business that sells non-food items to grocery stores. L also owns 55% of PRS2, a partnership, which owns and operates a distribution trucking business. The predominant portion of PRS2's business is transporting goods for PRS1.

Example

- L is able to meet paragraph (b)(1)(i) of this section as the majority owner of PRS1 and PRS2. Under paragraph (b)(1)(v) of this section, L is only able to show the operations of PRS1 and PRS2 are operated in reliance of one another under paragraph (b)(1)(v)(C) of this section. For purposes of applying § 1.199A-1(d), L must treat PRS1 and PRS2 as separate trades or businesses.

Example

- C owns a majority interest in a sailboat racing team and also owns an interest in PRS1 which operates a marina. PRS1 is a trade or business under section 162, but the sailboat racing team is not a trade or business within the meaning of section 162.

Example

- C has only one trade or business for purposes of section 199A and, therefore, cannot aggregate the interest in the racing team with PRS1 under paragraph (b)(1) of this section.

Example

- Trust wholly owns LLC1, LLC2, and LLC3. LLC1 operates a trucking company that delivers lumber and other supplies sold by LLC2. LLC2 operates a lumber yard and supplies LLC3 with building materials. LLC3 operates a construction business. LLC1, LLC2, and LLC3 have a centralized human resources department, payroll, and accounting department.

Example

- Because Trust owns 100% of the interests in LLC1, LLC2, and LLC3, Trust satisfies paragraph (b)(1)(i) of this section. Trust can also show that it satisfies paragraph (b)(1)(v)(B) of this section as the trades or businesses have a centralized human resources department, payroll, and accounting department. Trust also can show is meets paragraph (b)(1)(v)(C) of this section as the trades or businesses are operated in coordination, or reliance upon, one or more in the aggregated group. Trust can aggregate LLC1, LLC2, and LLC3 for purposes of applying § 1.199A-1(d).

Example

- PRS1, a partnership, directly operates a food service trade or business and owns 60% of PRS2, which directly operates a movie theater trade or business and a food service trade or business. PRS2's movie theater and food service businesses operate in coordination with, or reliance upon, one another and share a centralized human resources department, payroll, and accounting department. PRS1's and PRS2's food service businesses provide products and services that are the same and share centralized purchasing and shipping to obtain volume discounts.

Example

- PRS2 may aggregate its movie theater and food service businesses. Paragraph (b)(1)(v) of this section is satisfied because the businesses operate in coordination with one another and share centralized business elements. If PRS2 does aggregate the two businesses, PRS1 may not aggregate its food service business with PRS2's aggregated trades or businesses. Because PRS1 owns more than 50% of PRS2, thereby satisfying paragraph (b)(1)(i) of this section, PRS1 may aggregate its food service businesses with PRS2's food service business if PRS2 has not aggregated its movie theater and food service businesses. Paragraph (b)(1)(v) of this section is satisfied because the businesses provide the same products and services and share centralized business elements. Under either alternative, PRS1's food service business and PRS2's movie theater cannot be aggregated because there are no factors in paragraph (b)(1)(v) of this section present between the businesses.

Example

- PRS1, a partnership, owns 60% of a commercial rental office building in state A, and 80% of a commercial rental office building in state B. Both commercial rental office building operations share centralized accounting, legal, and human resource functions. PRS1 treats the two commercial rental office buildings as an aggregated trade or business under paragraph (b)(1) of this section.

Example

- PRS1 owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Under paragraph (b)(1)(v) of this section, PRS1 may aggregate its commercial rental office buildings because the businesses provide the same type of property and share accounting, legal, and human resource functions.

Example

- S, an S corporation owns 100% of the interests in a residential condominium building and 100% of the interests in a commercial rental office building. Both building operations share centralized accounting, legal, and human resource functions.

Example

- S owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Although both businesses share significant centralized business elements, S cannot show that another factor under paragraph (b)(1)(v) of this section is present because the two building operations are not of the same type of property. S must treat the residential condominium building and the commercial rental office building as separate trades or businesses for purposes of applying § 1.199A-1(d).

Example

- M owns 75% of a residential apartment building. M also owns 80% of PRS2. PRS2 owns 80% of the interests in a residential condominium building and 80% of the interests in a residential apartment building. PRS2's residential condominium building and residential apartment building operations share centralized back office functions and management. M's residential apartment building and PRS2's residential condominium and apartment building operate in coordination with each other in renting apartments to tenants.

Example

- PRS2 may aggregate its residential condominium and residential apartment building operations. PRS2 owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i) of this section. Paragraph (b)(1)(v) of this section is satisfied because the businesses are of the same type of property and share centralized back office functions and management. M may also add its residential apartment building operations to PRS2's aggregated residential condominium and apartment building operations. M owns more than 50% of each trade or business thereby satisfying paragraph (b)(1)(i

Part 6 – Rental Real Estate

- Objective – Understand rental real estate

- We will look to put together a lot of the concepts already discussed and see how we can apply them looking at rental real estate

Rental Real Estate

- What is rental real estate?
- Do we have a trade or business or just rental?
- What if we have an investment?

Trade or Business

- Look at IRC 162
- No clear definition
- First, a taxpayer must enter into and carry on the activity at issue with a good-faith intention to earn a profit. Second, the taxpayer must engage in the activity on a regular and continuous basis (see *Groetzinger*, 480 U.S. 23 (1987)).
- Case law
  - Continuous profit motive
  - IRC 183 – hobby losses

Trade or Business

- What does Real Estate Professional Status tell us?
- Do we need to issue 1099s?
- What else can we do to establish trade or business purpose?

Safe Harbor

- Separate books and records are maintained to reflect income and expenses for each rental real estate enterprise.
- For rental real estate enterprises that have been in existence less than four years, 250 or more hours of rental services are performed per year. For other rental real estate enterprises, 250 or more hours of rental services are performed in at least three of the past five years.
- The taxpayer maintains contemporaneous records, including time reports, logs, or similar documents, regarding the following: hours of all services performed; description of all services performed; dates on which such services were performed; and who performed the services.
- The taxpayer or RPE attaches a statement to the return filed for the tax year(s) the safe harbor is relied upon.
- Is it really needed though?

Aggregation

- Rental Aggregation

W-2 Wages - Trap

- Be careful with W-2 wages with real estate business and IRC 199A.
- Wages paid through the trade or business could affect IRC 469 calculations and which are available if we have a R/E pro

UBIA

- Commonly missed
  - Use MACRS life even if ACRS property
  - Watch out for credit reduction to basis in software. Need to use unadjusted basis prior to credit reduction

Small Business Safe Harbor

- Remember we have the small business safe harbor for repair expenses:
  - 10% of unadjusted basis of building or $10,000 (lesser)
  - Does it make sense to expense or capitalize for UBIA?

PASSIVE ACTIVITIES

Basic Operating Rules – Overview

- §469 limits passive losses and credits to passive income.
- Passive losses cannot offset active or portfolio income.
- Suspended losses carried forward until offset or disposition.
- Suspended credits allowed only when sufficient passive tax generated.
- Rules apply to individuals, estates, trusts, and personal service corporations (10%+ owner-employees).

Passive Activity Definitions

- 'Passive activity' = any trade or business in which the taxpayer does not materially participate.
- Rental activities are deemed passive unless exceptions apply.
- Working interests in oil & gas = non-passive if liability not limited.
- Limited partnerships = generally passive.
- Passive activity may include §212 for-profit activities not rising to a trade/business.

Interaction with Other Code Sections

- Passive character affects only §469 limits, not capital or other treatment (§1.469-1T(d)(1)).
- Capital loss rules (§1211) apply in addition to §469.
- Suspended losses not deductible for SE tax computations (§1.469-1T(d)(3)).
- Coordination with §§465, 704(d), 1366(d): basis, at-risk, and PAL rules interact sequentially.

Joint Filers & Passive Rules

- Joint filers treated as one taxpayer (§1.469-1T(j)).
- Each spouse tracks disallowed losses separately.
- Working interest rules apply separately per spouse.
- Post-joint filing: suspended losses traced to the specific spouse’s interest.

Defining and Identifying an 'Activity' (§1.469-4)

- Key for determining material participation, dispositions, and grouping.
- Same activity → one material participation test.
- Separate activities → separate participation tests.
- Scope critical for 'entire interest' disposition and 10% active participation test.

Grouping Rules Overview (§1.469-4)

- Taxpayer’s activities include those through §469 entities (C corps, S corps, partnerships).
- C corp activities groupable only for participation purposes.
- S corps & partnerships must first group; owners may further group.
- Rentals may group with business activities if insubstantial or same economic unit.

Appropriate Economic Unit Test (§1.469-4(c))

- Factors:
- 1. Similarities/differences in business types.
- 2. Common control.
- 3. Common ownership.
- 4. Geographic proximity.
- 5. Interdependencies (goods/services, customers, employees, records).
- • Multiple reasonable groupings allowed; consistency required unless facts materially change.

Rental Activities – General Rules (§469(c)(2))

- Rentals generally passive regardless of participation.
- Special exceptions for $25,000 active participation rule.
- 'Rental activity' = payments primarily for use of tangible property (§469(j)(8)).
- Six exceptions under §1.469-1T(e)(3)(ii) (short-term use, services, etc.).

Exceptions to Rental Classification

- 1. Avg. use ≤7 days.
- 2. Avg. use 8–30 days + significant personal services.
- 3. Extraordinary personal services (e.g., hospital).
- 4. Incidental rentals to investment/trade property.
- 5. Property made available during business hours.
- 6. Property used by entity in which taxpayer is owner (non-rental).

Rental Real Estate – $25,000 Active Participation Rule

- Up to $25,000 loss deductible against nonpassive income (§469(i)).
- Phased out 50% of AGI over $100,000.
- Active participation = bona fide management decisions (approve tenants, repairs, etc.).
- Must own ≥10% interest; available to estates ≤2 years post-death.

Material Participation – Overview (§1.469-5T)

- Material participation = regular, continuous, and substantial involvement.
- Work as employee-owner counts (§1.469-5(f)(1)).
- Investor-type work excluded unless day-to-day involvement.
- Spousal participation counts (§1.469-5T(f)(3)).

Seven Tests for Material Participation

- 1. >500 hours.
- 2. Substantially all participation.
- 3. >100 hours and no one else participates more.
- 4. Aggregate >500 hours across 'significant participation activities.'
- 5. Materially participated 5 of prior 10 years.
- 6. Personal service activity: any 3 prior years.
- 7. Facts-and-circumstances: >100 hours, regular, continuous, substantial involvement.

Anti-Abuse Rules – Recharacterization of Passive Income

- Prevents converting active/portfolio income to passive.
- Examples:
- – Significant participation income netted (§1.469-2T(f)(2)).
- – Developer rental/sale gains within 12 months reclassified nonpassive.
- – Self-rentals: income from property rented to taxpayer’s active trade is nonpassive (§1.469-2(f)(6)).
- – Equity-financed lending, intangible licensing = potential recharacterization.

Dispositions of Passive Activities (§469(g))

- Fully taxable disposition triggers suspended losses.
- Losses offset: 1) gain on sale, 2) passive income, 3) other income.
- Credits unaffected.
- Must dispose of entire interest (direct and indirect ownership).

Disposition Scenarios

- Installment Sale: losses released proportionally to gain recognition.
- Death: allowed only to extent > basis step-up (§1014).
- Gift: losses added to donee’s basis, disallowed for donor.
- Related-party sales: not triggering; losses remain suspended.
- Abandonment of entire activity qualifies as disposition.

Qualified Real Estate Professional (QREP)

- Removes rental from passive category if taxpayer meets:
- 1) >50% of personal services in real property trades/businesses;
- 2) >750 hours in those businesses; and
- 3) Material participation in each rental.
- Applies to individuals and closely-held C corps.
- Spouse’s work counts for material participation only; not for 750/50% tests.

Elections & Aggregation (§1.469-9)

- Default: each rental = separate activity.
- Election under §469(c)(7)(A) to treat all rentals as one activity.
- Binding for all future QREP years; revocable only on material change.
- Must attach statement: 'Taxpayer is a QREP and elects to treat all rentals as one activity.'

Selected Cases & IRS Rulings – Highlights

- Rev. Rul. 92-92: COD income traced to passive debt = passive.
- Rev. Rul. 95-5: Distributions > basis trigger proportionate activity dispositions.
- PLR 9505002: Condo rented ≤7 days avg not 'rental' → no $25k offset.
- PLR 9750001: Passive losses reducing SE income allowed when deductible for income tax.
- TAM 200747018: Grouping rental with nonrental allowed where insubstantial.

Court Decisions – Real Estate Professional

- Agarwal (2009): real estate agent = 'brokerage' → QREP qualified.
- Shiekh (2010): must file explicit aggregation election; Schedule E grouping insufficient.
- Smith (2014): hours preparing future rental (home) not counted.
- Windham (2017): QREP allowed full rental losses; aggregation election missing but met tests.
- Stanley (2015): detailed QREP/aggregation analysis; IRS nonacquiescence (AOD 2017-7).

Planning Ideas – Passive Activity Management

- Create passive income to absorb suspended losses.
- Loans to/from passive activities may reclassify interest income (§1.469-7).
- QREP status: maintain logs, elect aggregation early.
- Rentals ≤7 days can avoid 'rental' classification if materially participating.
- Rentals held mainly for appreciation: ensure rent ≥2% of FMV/basis to retain passive character.

Planning & Structuring Opportunities

- Material participation: target one of seven tests.
- Use spousal participation where possible.
- Developer rentals: hold >12 months to retain passive status.
- Non-depreciable rentals: ensure >30% depreciable basis to remain passive.
- Avoid PTPs for passive offset goals.
- Track grouping consistency (Reg. §1.469-4(e); Rev. Proc. 2010-13).

Rental Property – Self-Employment Tax (§1402)

- Rental income excluded from SE tax unless:
- – Taxpayer is a real estate dealer, or
- – Substantial services for occupants provided.
- CCA 202151005:
- – Situation 1 (Airbnb + daily maid services, amenities) → subject to SE tax.
- – Situation 2 (basic cleaning between stays) → not subject to SE tax.

Vacation Homes (§280A) – Key Limits

- Applies when dwelling used personally >14 days or >10% of rental days.
- Income excluded if rented <15 days (de minimis rule).
- Prorate deductions between personal/rental use.
- Losses limited to rental income; excess carried forward.
- §280A interacts with §469 – vacation homes subject to one or the other, not both.

Recent Developments & Reporting (Rev. Proc. 2010-13)

- Groupings/disclosures must be attached to original returns for tax years ≥2010.
- Must identify grouped activities by name, address, EIN.
- Regrouping allowed only when original grouping inappropriate or facts materially change.
- Failure to report → IRS treats each as separate activity.
- Exceptions for QREPs who elected to aggregate under §469(c)(7).

Planning & Practice Alerts

- Maintain contemporaneous logs for hours (especially for QREP claims).
- Consider grouping early for consistency.
- Review self-rental and triple-net leases for classification.
- Document at-risk, basis, and PAL tracking for each entity.
- Periodically review aggregation elections and groupings during audit prep.

KEY ESTATE AND GIFT TAX ISSUES

Simplified Procedure for Late Portability Election (Rev. Proc. 2022-32)

- Section 2010(c): Applicable exclusion amount = basic exclusion + DSUE (Deceased Spousal Unused Exclusion).
- 2022 basic exclusion: $12.06 million (inflation-adjusted).
- Portability election required for surviving spouse to use DSUE.
- Election made on Form 706; due 9 months after death (plus extensions).

Background – Prior Procedures

- Rev. Proc. 2017-34: Provided 2-year extension for estates below §6018(a) filing threshold.
- Estates missing that deadline could seek PLR relief under Reg. 301.9100-3.
- 9100 relief required demonstrating reasonable cause and no prejudice to IRS interests.
- Process was resource-intensive and required user fees.

Rev. Proc. 2022-32 – Key Expansion

- Supersedes Rev. Proc. 2017-34.
- Extends simplified filing window to 5 years after date of death.
- Applies to estates not required to file Form 706 under §6018(a).
- Eliminates need for a PLR and associated user fee.
- Designed to reduce IRS workload caused by repeated PLR requests.

Eligibility Requirements for Relief (§4.01, Rev. Proc. 2022-32)

- 1) Decedent:
- – Survived by a spouse.
- – Died after 12/31/2010.
- – U.S. citizen or resident at death.
- 2) Executor not required to file Form 706 under §6018(a).
- 3) Executor failed to file timely per Reg. 20.2010-2(a)(1).
- 4) Executor files complete Form 706 within 5 years of death per §4.01.

Filing Requirements Under Simplified Method

- Executor must file properly completed Form 706 by 5th anniversary of death.
- Include notation at top: “FILED PURSUANT TO REV. PROC. 2022-32 TO ELECT PORTABILITY UNDER §2010(c)(5)(A).”
- Return must comply with Reg. 20.2010-2(a)(7) simplified valuation rules for non-taxable estates.
- No user fee required; replaces PLR process entirely.

Executors Not Eligible for Relief

- Estates that timely filed Form 706 (with or without election) are not eligible.
- Timely filers either elected portability or affirmatively opted out per Reg. 20.2010-2(a)(3)(i).
- Relief available only to estates that did not file at all within the original or extended deadlines.

Impact of Late Election Relief on Surviving Spouse

- DSUE becomes available to surviving spouse or spouse’s estate retroactively.
- May apply to post-death transfers (gifts or estate transfers).
- No refund claim permitted after §6511(a) limitations period expires.
- Protective refund claim can preserve refund rights while awaiting DSUE election approval.

Practice Alerts – Portability Elections

- Executors of non-taxable estates should file portability return even if below threshold.
- Spouses may later need DSUE due to law changes or asset growth.
- Executors should consider filing a protective Form 706 if uncertain.
- Use correct language on return header per Rev. Proc. 2022-32 §4.01(2).
- Always confirm Form 706 properly reflects DSUE computation on Part 6, Section C.

Supreme Court Decision: Connelly v. United States (June 6, 2024)

- Issue: Whether a corporate obligation to redeem shares reduces FMV of stock for estate tax.
- Holding: Unanimous Court – redemption obligation does NOT reduce stock value.
- Life insurance proceeds increase the corporation’s value; no offset for redemption liability.
- Applies to valuation under §§2031 and 2033 for closely-held corporations.

Connelly – Facts and Impact

- Closely held corporation held life insurance to fund buy-sell redemption.
- Estate argued stock value should be reduced by redemption obligation.
- Court: Redemption liability benefits remaining shareholders, not the corporation.
- Life insurance proceeds are corporate assets included in value.
- Estate value cannot be reduced by expected redemption payment.

Comparison to Prior Case Law

- Estate of Blount (T.C. Memo 2004-116): Tax Court denied reduction; 11th Cir. (2005) reversed.
- Connelly aligns with Tax Court and 8th Cir. (2023) holdings.
- Supreme Court's ruling ends split – life insurance proceeds used for redemptions increase value.
- Confirms redemption agreements do not create offsetting corporate liability for estate tax valuation.

Planning Implications – Connelly Decision

- Cross-purchase agreements favored over redemption agreements.
- Life insurance held individually avoids inclusion in corporate value.
- For redemption agreements, consider additional life insurance funding to cover tax impact.
- Ensure business valuations account for corporate-owned policies as assets.
- Review and revise buy-sell structures in light of ruling.

Practice Alert – Structuring Buy-Sell Agreements

- Cross-purchase = each shareholder owns policy on others → avoids corporate inclusion.
- Redemption = corporation owns policy → increases value under Connelly.
- Hybrid approaches possible (trust or LLC ownership).
- Coordination with §2703 valuation rules and §2036/§2042 ownership inclusion essential.
- Review agreements before next valuation or estate planning cycle.

Final Regulations: Basis Consistency and Reporting (T.D. 9991)

- Implement §§1014(f) and 6035 under 2015 Surface Transportation Act.
- §1014(f): Beneficiary's basis cannot exceed value reported for estate tax.
- §6035: Executors must report basis and valuation information to IRS and beneficiaries.
- Penalties: §§6662(b)(8), 6724, and 6724(d) for noncompliance.

Background – Statutory Consistency Rule (§1014(f))

- Ensures alignment between estate valuation and beneficiary basis.
- Applies only to property that increased estate tax liability.
- Final value = value determined for estate tax, or if pending, reported on Form 706.
- Basis cannot exceed that final/declared value.

Reporting Obligations (§6035)

- Executors required to furnish 'Statement of Value' to IRS and each recipient.
- Filed with Form 706 within 30 days of final determination or return due date.
- Applies to property includible in the taxable estate under §2031.
- Beneficiaries must use consistent basis when reporting gains/losses.

T.D. 9991 – Final Reg Changes (Effective 9/17/2024)

- Minimal changes from 2016 proposed regs.
- Clarifies scope: Does not apply when no return required under §6018.
- Includes rules for supplemental statements when estate value changes.
- Confirms exception for returns filed solely for portability or GST elections.
- Executors should maintain valuation workpapers supporting reported values.

Practice Implications – Basis Reporting

- Executors should identify property subject to consistent basis.
- Maintain parallel records for assets reported on Form 706 and beneficiary reporting.
- Non-taxable estates filing Form 706 for portability are excluded from basis consistency.
- Confirm beneficiary basis adjustments match estate valuations.
- Review appraisals for consistency and audit readiness.

Compliance and Penalty Considerations

- Accuracy-related penalty: §6662(b)(8) – 20% penalty for inconsistent basis reporting.
- Failure to file statements = penalties under §6724.
- Executors must track receipt confirmations from beneficiaries.
- Use standardized reporting templates for Statements A & B under §6035.
- Document delivery and retention per IRS best practices.

Summary – Estate and Gift Tax Key Issues

- Rev. Proc. 2022-32: 5-year simplified DSUE election method; eliminates PLR need.
- Connelly (2024): Redemption obligations don’t reduce stock value; affects buy-sell planning.
- T.D. 9991: Final basis consistency regs effective 9/17/2024; clarifies reporting scope.
- Practice Priorities:
- – Encourage proactive portability filings.
- – Review business succession plans post-Connelly.
- – Implement consistent basis procedures for estate clients.

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Don Farmer
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