2024 – 25INDIVIDUAL INCOME TAX UPDATE

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BIO

Blaise C. Bender is President and Managing Shareholder of Blaise C. Bender, PC a law firm that concentrates on tax matters and tax planning for individuals, businesses, partnerships and LLCs,. He also provides representation on tax issues and controversies impacting individuals and businesses, assists in business and non-profit development, mergers and acquisitions, contractual and transactional analysis, general counsel assistance and business and estate succession planning. He has also provided expertise to various members of Congress on legislative matters impacting taxpayers.

Formerly a full-time college professor for over twenty years. He received his B.B.A in Accounting Degree and a Master's of Science in Finance from Texas A& M University. He also received an MPA in Taxation from UTSA and his Juris Doctor in Law from St. Mary's University.

Blaise is a member of the State Bar of Texas, and is a licensed CPA. He possesses over six years of experience in public accounting working for Arthur Andersen & Co., Deloitte Touche, and Ernest and Young. Blaise also served as a CFO and Controller in the private sector.

Blaise currently serves as Chairperson of Credit Human, FCU a $4 billion asset financial institution serving over 40 states. He also serves on the board of USIO, Inc. a publicly traded company engaged in automated payment acceptance and disbursement processing. Blaise chairs the audit committee of USIO, Inc. He is a member of the Texas Society of CPAs. He previously served as chairperson of the San Antonio Chapter of CPAs and Providence High School. Blaise serves as an advisor to various Congressional Representatives at the federal level in both the House and Senate on proposed tax legislation.

Blaise has conducted over 1,100 seminars and workshops throughout Texas and the United States and has numerous publications in tax and accounting. His seminars include an Annual Federal Tax Updates, Individual Tax Updates. Business Tax Updates, Merger and Acquisitions, Cryptocurrency Issues, Hobby Loss Issues, Real Estate Taxation, Pass-Throughs including Partnerships and S Corporations, Investment Diversification. Agricultural Tax Matters and Succession Planning to name a few. He also has numerous publications on tax matters, succession planning and governance. He has received numerous awards for his service in education and continuing education including the TXCPA Recognition for Meritorious Service to the Public Accounting and the Fellow Award in 2019 from the San Antonio Chapter of CPAs.

A native of San Antonio, Blaise graduated from Churchill High School and resides in San Antonio with his wife Dr. Julie S. Bender, a local veterinarian, along with there two four legged children, Daphne and Cookie.

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SECTION I:

TAX RATES, REPORTING AND FILING STATUS

I. Tax Rates

A. Tax Rates for 2024 (Rev. Proc. 2023 – 34; IR 2023 – 208)

Married Individuals Filing Joint Returns and Surviving Spouses

Taxable Income	Tax Liability
Not over $23,200.	10% of taxable income.
Over $23,200 but not over $94,300.	$2,320 plus 12% of the excess over $23,200.
Over $94,300 but not over $201,050.	$10,852 plus 22% of the excess over $94,300.
Over $201,050 but not over $383,900.	$34,337 plus 24% of the excess over $201,050.
Over $383.900 but not over $487,450.	$78,221 plus 32% of the excess over $383,900.
Over $487,450 but not over $731,200.	$111,357 plus 35% of the excess over $487,450.
Over $731,200.	$196,669.50 plus 37% of the excess over $731,200.

Heads of Households

Taxable income	Tax Liability
Not over $16,550.	10% of taxable income.
Over $16,550 but not over $63,100.	$1,655 plus 12% of the excess over $16550.
Over $63,100 but not over $100,500.	$7,421 plus 22% of the excess over $63,100.
Over $100,500 but not over $191,950.	$15,469, plus 24% of the excess over $100,950.
Over $191,950 but not over $243,700.	$37,417 plus 32% of the excess over $191,950.
Over $243,700 but not over $609,350.	$53,977 plus 35% of the excess over $243,700.
Over $609,350.	$181,954.50,plus 37% of the excess over $609,350.

Unmarried Individuals (other than Surviving Spouses and Heads of Households)

Taxable income	Tax Liability
Not over $11,600.	10% of taxable income.
Over $11,600 but not over $47,150.	$,1,160 plus 12% of the excess over $11,600.
Over $47,150 but not over $100,525.	$5,426,plus 22% of the excess over $47,150.
Over $100,525 but not over $191,950.	$17,168 plus 24% of the excess over $100,525.
Over $191,950 but not over $243,725.	$39,110.50 plus 32% of the excess over $191,950.
Over $243,725 but not over $609,350.	$55,678.50 plus 35% of the excess over $243,725.
Over $609,350.	$183,647.25 plus 37% of the excess over $609,350.

Married Filing Separately

Taxable income	Tax Liability
Not over $11,600.	10% of taxable income.
Over $11,600 but not over $47,150.	$,1,160, plus 12% of the excess over $11,600.
Over $47,150 but not over $100,525.	$5,426,plus 22% of the excess over $47,150.
Over $100,525 but not over $191,950.	$17,168 plus 24% of the excess over $100,525.
Over $191,950 but not over $243,725.	$39,110.50 plus 32% of the excess over $191,950.
Over $243,725 but not over $365,600.	$55,678.50 plus 35% of the excess over $243,725.
Over $365,600.	$98,334.75 plus 37% of the excess over $365,600.

Estates and Trusts

Taxable income	Tax Liability
Not over $3,100.	10% of taxable income.
Over $3,100 but not over $11,150.	$310, plus 24% of the excess over $3,100.
Over $11,150 but not over $15,200.	$2,242 plus 35% of the excess over $11,150.
Over $15,200.	$3,659.50,plus 37% of the excess over $15,200.

B. Tax Rates for 2025 (Rev. Proc. 2024 – 40; IR 2024 – 273)

Married Individuals Filing Joint Returns and Surviving Spouses

Taxable Income	Tax Liability
Not over $23,850.	10% of taxable income.
Over $23,850 but not over $96,950.	$2,385 plus 12% of the excess over $23,850.
Over $96,950 but not over $206,700.	$11,157 plus 22% of the excess over $96,950.
Over $206,700 but not over $394,600.	$35,302 plus 24% of the excess over $206,700.
Over $394.600 but not over $501,050.	$80,398 plus 32% of the excess over $394,600.
Over $501,050 but not over $751,600.	$111,462 plus 35% of the excess over $501,050.
Over $751,600.	$202,154.50 plus 37% of the excess over $751,600.

Heads of Households

Taxable income	Tax Liability
Not over $17,000.	10% of taxable income.
Over $17,000 but not over $64,850.	$1,700 plus 12% of the excess over $17,000.
Over $4,850 but not over $103,350.	$7,442 plus 22% of the excess over $64,850.
Over $103,350 but not over $197,300.	$15,912 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,500.	$38,460 plus 32% of the excess over $197,300.
Over $250,500 but not over $626,350.	$55,484 plus 35% of the excess over $250,500.
Over $626,350.	$187,031.50 plus 37% of the excess over $626,350.

Unmarried Individuals (other than Surviving Spouses and Heads of Households)

Taxable income	Tax Liability
Not over $11,925.	10% of taxable income.
Over $11,925 but not over $48,475.	$1,192.50 plus 12% of the excess over $11,925.
Over $48,475 but not over $103,350.	$5,578.50 plus 22% of the excess over $48,475.
Over $103,350 but not over $197,300.	$17,651 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,525.	$40,199 plus 32% of the excess over $197,300.
Over $250,525 but not over $626,350	$57,231 plus 35% of the excess over $250,525.
Over $626,350.	$188,769.75plus 37% of the excess over $626,350.

Married Filing Separately

Taxable income	Tax Liability
Not over $11,925.	10% of taxable income.
Over $11,925 but not over $48,475.	$1,192.50 plus 12% of the excess over $11,925.
Over $48,475 but not over $103,350.	$5,578.50 plus 22% of the excess over $48,475.
Over $103,350 but not over $197,300.	$17,651 plus 24% of the excess over $103,350.
Over $197,300 but not over $250,525.	$40,199 plus 32% of the excess over $197,300.
Over $250,525 but not over $375,800	$57,231 plus 35% of the excess over $250,525.
Over $375,800.	$101,077.25 plus 37% of the excess over $335,800.

Estates and Trusts

Taxable income	Tax Liability
Not over $3150.	10% of taxable income.
Over $3,150 but not over $11,450.	$315 plus 24% of the excess over $3,150.
Over $11,450 but not over $15,650.	$2,307, plus 35% of the excess over $11,450
Over $15,650.	$3,777, plus 37% of the excess over $15,650.

II. Filing Status Issues

A. Married Filing Joint Status

1. Married Filing Joint Status Applies to Nonresident Alien Spouse – Section 7703

a. The determination of whether an individual is married shall be made at the close of the taxable year. The exception would be if the spouse died during the taxable year. In that event such determination shall be made at the date of death and an individual legally separated from their spouse under a decree of divorce or separate maintenance shall not be considered married.

b. **Married Individuals Living Apart**. If an individual who is married and who files a separate return maintains as his or her home a household which constitutes for more than one half of the taxable year the

principal place of abode of a child (qualifying child) and such individual furnishes over half the cost of maintaining the household during the taxable year and during the last six months of said year the other spouse is not a member of the household such shall be considered as not married.

c. Section 7703 applies also to nonresident aliens.

Example

Elbasha v. Comm., TC Memo 2022 – 1. Married couple with wife living abroad and who is a nonresident alien does not entitle taxpayer to claim single filing status. The determination of whether an individual is married is made at the close of the tax year unless the spouse died during the year. A person is considered not married at the close the taxable year if they either are separated under a decree of divorce or separate maintenance agreement or furnishes over half of the cost of maintaining a household that does not include the spouse but does include a qualifying child**.**

2. Tax Return is Jointly Filed Despite Spouse Not Signing Return.

Example

Soni v. Comm., CA – 2; No. 22 – 829 – AG (7/27/24). The 2nd Circuit Court of Appeals affirmed the Tax Court's decision that the taxpayers tax return was jointly filed despite the fact one of the spouses did not sign the return. Of importance is that the spouse knew her return had to be filed, the spouse was an experienced business person, they had 5 joint returns previously prior to the tax year at issue.

3. Tacit Consent to a Joint Filing.

Example

Jones v. Comm., CA-9 2022-1 USTC 50111(2/3/22). The 9th Circuit Court of Appeals found the Tax Court did not err in concluding the taxpayer tacitly consented to the filing of a joint return. A joint tax return signed by one spouse on behalf of the other is valid so long as the nonsigning spouse tacitly consented to the filing. That is a facts and circumstance examination. In this case this taxpayer who did not sign tacitly agreed to the filing she provided her spouse with her W-2 and other tax information and she failed to file a separate return as married filing separate.

4. Name Changes – Tax 2024 – 57. Those who recently got married and use the new spouse's last name must report their name change to the Social Security Administration using Form SSA – 5. The name of the person's tax return must match what is on file with the SSA. Form 8822 is a form also to be used for any change of address to notify the IRS accordingly.

B. Qualifying Child

1. Definition of Qualifying Child – Section 152 (c). The definition of a qualifying child is required for the child tax credit, child care credit, and education credits. To satisfy the definition of a qualifying child the taxpayer must satisfy the following:

- The child must be related to the taxpayer (Section 152 (f) (1))
- The child must not have obtained the age of 19 by the end of the calendar year or must be a student who has not attained the age of 24 by the end of the calendar year and must be younger than the taxpayer. (Section 152 (c) (3) and (f) (2) an exception to this exists for a dependent who is totally personally disabled at any time during the tax year.

- The child must have the same place of abode as the taxpayer for more than one-half the year (Section 152 (c) (1) (B))
- The child must not provide more than one half is support for the tax year (Section 152 (c) (1) (D))
- The child must not have filed a joint return other than a claim for refund (Section 152 (d) (1) (E))

Example

Turner v. Comm., TC Memo 2024 – 20. Taxpayer' s home was not the principal place of abode for more than one-half of the year of a qualifying child or any other person who might qualify as the petitioner's dependent. That being so, the petitioner is not entitled to head of household filing status for the tax year at issue. The taxpayer did not qualify for head of household status because the household was not the principal place of abode for her and the grandchild for more than one-half the year. The child did not meet the definition of a qualifying child. The IRS is allowed to change her filing status from head of household to single and adjust the standard deduction accordingly.

2. Section 152(b)(3)(A) provides that a "dependent" does not include certain nonresident aliens.

Example

Di Giorgio Sr., v. Comm., TC Memo 2023-44. The taxpayer was not entitled to a dependency exemption deduction for the children of his second wife who, during the stated year, were nonresident aliens and had not been adopted by the taxpayer.

3. IR 204 – 294. The IRS Will Accept Duplicate Depended Returns Submitted within IP PIN

a. Beginning with the 2025 filing season, the IRS will accept Forms 1040, 1040-NR and 1040-SS even if a dependent was claimed on a previous return provided the primary taxpayer on the second return includes a valid identity protection personal identification number (IP PIN).

C. Qualifying Relatives

1. Section 152(a) defines a *"dependent"* to include a *"qualifying relative*."

2. To be a qualifying relative, an individual must:

- Not be a qualifying child of the taxpayer nor anyone else's qualifying child.
- The person must either have lived with the taxpayer for the entire year as a member of the household or be related to the taxpayer
- Have gross income less than the exemption amount for the calendar year and
- Receive more than one-half of their support from the taxpayer claiming the individual as a qualifying relative. (See Section 152(d)(1)(C))

3. For 2024, the exemption amount will be $5,000 (Rev. Proc. 2023 – 34; IR 2023 – 208)

4, For 2025, the exemption amount will be $5,200. (Rev. Proc. 2024 – 40; IR 2024 – 273)

Example

US v. Piatkowski, 133 AFTR 2d 2024 – 173. The taxpayer's filing status remains head of household as the dependents, who were the taxpayer's parents, met the definition of a qualifying relative, and met all

the tests, including living with the taxpayer for the entire year as a member of the household and being related to the taxpayer.

D. Head of Household

1. Rule. A U.S. citizen or resident alien who is unmarried or considered unmarried at the end of the tax year and who maintains as his or home a household that is the principal place of residence for certain qualifying individuals for more than one-half the year may file as a Head of Household (See Section 2(b)(1)).

2. **Qualifications.** To qualify as a Head of Household:

a. A U.S. citizen or resident alien must be married or considered unmarried on the last day of the tax year.

b. The taxpayer files a separate tax return;

c. Taxpayer pays more than one-half the cost of maintaining his or her household for the tax year. It is NOT sufficient that the taxpayer merely pays the expenses of the household to qualify for Head of Household status;

d. The taxpayer's spouse is not a member of the household during the last six months of the tax year; and

e. The household is, for more than six months of the year, the principal home of the taxpayer's child for whom the taxpayer can claim a dependency exemption or could claim such an exemption except for the special rules for divorced parents. (i.e.; either qualifying children or qualifying relatives).

Example

Pangelina v. Comm ., TC Memo 2024 – 5. Taxpayer filed as head of household claiming three qualifying children as dependents.. The Service determined the taxpayer was entitled to single status as the taxpayer offered no evidence that he was entitled to head of household status nor that the three dependents were qualifying children.

3. Tie–Breaking Rules For Qualifying Child -Section 152(c)(4). If an individual can be claimed as a qualifying child) by two or more taxpayers for a tax year beginning in the same calendar year, the tie-breaking rules.

a. If two or more taxpayers may claim an individual as a qualifying child for a tax year beginning in the same calendar year, the individual will be treated as the qualifying child of the taxpayer who is:

- a parent of the individual, or
- if the parent of the individual does not apply, the taxpayer with the highest adjusted gross income (AGI) for that tax year. (See Section 152 (c) (4) (A)

b. If more than one taxpayer who can claim an individual as a qualifying child is a parent of the individual, then any one of those parents may claim the individual as a qualifying child. (See Prop. Reg. 1.152 – 2 (g) (1) (i))

c. If the parents do not file a joint return together, the child will be treated as the qualifying child of:

- the parent with whom the child resided for the longest period of time during the tax year, or

- if the child resided with both parents for the same amount of time during the tax year, the parent with the higher AGI. (See Section 152 (c) (4) (B))

d. The same rule will apply where a child is a qualifying child of both parents who are registered domestic partners or partners in a similar formal relationship that isn't a marriage under state law.

e. If an individual's parents can claim the individual as a qualifying child but no parent does, another taxpayer may claim the individual as a qualifying child, but only if that taxpayer's AGI is higher than the highest AGI of any parent of the individual. (See Section 152 (c) (4) (C)))

4. Children of Divorced or Unmarried Parents – Form 8332

a. A taxpayer who is the custodial parent of either a qualifying child or qualifying relative who were ever married to the qualifying child or qualifying relatives non-custodial parent, may use Form 8332: Release of Claim to Exemption for Child of Divorced or Separated Parents to release the claim for the child or relative exemption to the Noncustodial Parent.

b. The custodial parent completes the form and signs it. The custodial then provides the form to the noncustodial parent who must attach the form or similar statement to the tax return for each year the exemption is claimed.

c. Part I of the form is completed if the custodial agrees to release the child exemption for the current tax year.

d. Part II is to be complete if the custodial agrees to release the child exemption for any future years. The specific years must be stated on the form.

e. The custodial and noncustodial parents are determined under Section 152 (e) and not under the decree of divorce or separation agreement. This is for divorces or separations that occurred after July 2, 2008. The rationale was to eliminate Private Letter Rulings on the determination of custodial and noncustodial. As such, a noncustodial parent cannot attack pages from the divorce decree to demonstrate an ability to claim a child.

f. Custodial Parent. The custodial parent is generally the parent who had custody of the qualifying child or qualifying relative for most of the tax year. Custody is referenced under Publication 501.

g. Custody. A parent can be considered to be a custodial parent if the child resides with the parent for the greatest number of nights during the tax year. A child is treated as having lived with a parent for a night the child sleeps at the parent's home regardless of whether or not the parents are present or in the company of a parent with whom the child does not sleep at a parent's home (vacation). If a parent works nights then the test would refer to days. If a child is not with either parent on a particular night the child is treated as living with the parent with whom the child normally would have lived for that night. An example would be a child staying over at a friend's house. However, if it cannot be determined with which parent the child normally would have lived or if the child would not have lived with either parent that night, the child is treated as not living with either parent for that particular night.

h. Support Test. The period is also deemed to be the custodial parent if they provided over half of the child support during the tax year. Specifically, the custodial parent is treated as having provided over half of the child support if the child received over half of the total support for the year from one or both of the parents and the child was in the custody of one or both parents for more than half the year. For the support test to apply, the parents must be either divorced or legally separated under a decree of divorce or separation

maintenance agreement, separated under a written separation agreement, or living apart at all times during the last six months of the year.

Note: The support test does not apply to parents who never married. In addition, if the support test applies and the other four dependency test are also met, the custodial parent can claim the exemption.

i. Exception. The custodial parent will not be treated as having provided over half of the child support if:

- The custodial parent agrees not to claim the child exemption by signing Form 8332 or providing a similar statement.
- The child is treated as having received over half of his or her support from a person under a multiple support agreement.
- A pre-1985 divorce decree a written separation agreement states that the noncustodial parent can claim the child as a dependent. Should be noted the noncustodial parent in this case must provide at least $600 for support during the year. This only applies to pre-1985 agreements.
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E. Nonresident Filing Issues

1. For the filing of 2024 returns, a nonresident alien, foreign trust or foreign estate will use Schedule P to report information and calculate the gain or loss of a transfer of an interest in a partnership that is either directly or indirectly engaged in the conduct of a trade or business within the United States or holds any US real property interest.

2. There is a revised Spanish version of the Form 1040 – NR for this upcoming tax season.

3. A nonresident alien is generally not entitled to receive a tax refund for deductions from taxable income involving personal exemptions under Section 151 (d) (5) (B) and Section 873 (b) (3). Specifically, personal exemptions prior to the Tax Cuts and Jobs Act were allowed with respect to income that was effectively connected with the conduct of trade or business in the United States.

Example

Bell v. US, 1:2022 CV 01875 (Fed. Cl 2024). The taxpayer is a nonresident alien seeking a refund of over $414,000. Taxpayer claimed he was entitled to personal exemption deductions without such reductions being reduced to zero under the Tax Cuts and Jobs Act and without it being associated with income effectively connected with US trade or businesses. Taxpayer argued that Congress's intent under the Act to disallow the deduction was for US citizens and not for nonresident aliens. The taxpayer is entitled to exemptions associate with income effectively connected with the trade or business in the United States.

4. If a taxpayer and spouse choose to treat the spouse as a nonresident alien or dual status alien as a US resident for 2024 there is a box to check in the filing status and the taxpayer enters the name of the nonresident alien or dual spouse alien accordingly.

F. Form 8867: Paid Preparer's Due Diligence Checklist

1. Form 8867, the tax preparer due diligence checklist for determining the eligibility of Head of Household Status, EITC, CTC/ACTC and AOTC has been revised.

2. For future years, a tax preparer not only must retain a copy of the form but any applicable `from later of:

- The due date of the tax return (not including extensions).
- The date the return was filed (if the taxpayer is signing a tax return prepared electronically filing the return).
- The date the return was presented to the taxpayer for signature.
- The date the taxpayer submitted to the tax preparer the return for which the taxpayers responsible for. Meaning, the signing of the return authorizing electronic filing.

3. The tax preparer due diligence penalty has increased to $650 for 2025 (the 2024 tax filing season). (See Rev. Proc. 2024 – 40)

G. IRS Publication 536

1. IRS Publication 536 used to provide guidance on what the taxpayer would do when the taxpayer has more deductions that income in a given year. In essence the publication described how to compute the net operating loss.

2. The IRS announced that Publication 536 will no longer be provided.

H. Estimated Tax Payments

1. Even if no tax return is filed for several years, estimated tax payments are still a requirement if liability exists.

Example

Standifird v. Comm., TC Memo 2024 – 30. The taxpayer did not file his individual income tax return for four years or make any estimated tax payments during that timeframe. The IRS determined income tax efficiencies and asserted additional taxes such as failure to file penalties and failure to pay estimated taxes. The IRS produced the taxpayer's transcript confirming no returns were filed in the court concluded the taxpayer was liable for the additions to tax including estimated tax penalties for not making quarterly estimated tax payments.

2. Revenue Ruling 2024 – 18. Estimated Tax Penalties for the First Three Quarters are Calculated at 8%.

a. The IRS has announced the interest rates for taxpayer underpayments and overpayments for all four quarters of 2024. These rates apply quarter by quarter. An 8% underpayment rate applies to computing penalties for underpayment of estimated tax. Other interest rates for underpayments and overpayments are:

• 8% for overpayments,
• 8% for underpayments,
• 5.5% for the portion of a corporate overpayment exceeding $10,000,
• 7% for corporate overpayments, and
• 10% for large corporate underpayments

References:

The Inflation Reduction Act of 2022 (IRA22), PL 117 – 169**.**

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION II:

INCOME AND EXCLUSIONS

I. Wages and Compensation

A. Social Security Wage Base

1. The Social Security Administration (SSA) is projecting that the Social Security wage base will increase from $160,200 to $168,600 in 2024 in all three of its forecasts. This is the second revision for 2024.

2. For 2025, the Social Security Administration announced the annual cost-of-living adjustment to the maximum amount of earnings is subject to the Social Security Tax will be $176,100.

B. Work Life Referral Services – IR 2024 – 110; Fact Sheet 2024 – 13

1. The IRS has issued frequently asked questions (FAQs) on the tax treatment of work-life referral services (sometimes called caregiver and caretaker navigation services), which are employer-funded benefits that help employees find resources and support for personal, work, or family challenges.

2. These services are typically integrated into employee assistance programs or bundled with other employer services and can include guidance on accessing child and elder care, health care, financial and legal services, and assistance with related paperwork and administrative tasks. In the announcement, the IRS provides that these services are de minimis fringe benefits, exempt from income and employment taxes (FICA, FUTA, and income tax withholding).

C. Frivolous Exclusion of Wages from Gross Income

Examples

Swanson v. Comm., TC Memo 2024 – 105. Taxpayer argued that wages should be excluded from gross income because the code does not impose a tax **on public school teachers and that such tax would violate the Uniformity Clause of the Constitution.** The court viewed this as another frivolous claim of the taxpayer.

Varela v. Comm., TC Memo 2024 – 92. Taxpayers had characterized and filed tax returns reporting zero wages and zero income. The Tax Court has consistently characterized returns that report zero wages or income as substantially incorrect and not containing information upon which correctness of any self assessment can be judged. Such reporting is viewed as frivolous in nature.

Wendell v. Comm., No. 4784-23 (U.S.T.C. May. 13, 2024). Taxpayer is a licensed physician and was employed by an anesthesiologist firm. He was issued a W-2 that showed more than $500,000 in wages and $140,000 in federal withholdings. The taxpayer for the year issue reported no taxable income but only reported the federal withholdings claiming a refund of the hundred $40,000**. In a statement attached the return date indicated that there was no federal taxable activity constituting taxable income**. Section 61 indicates a gross income consist of all income from whatever source derived including wages or monies paid for services. Taxpayers argue that the payments received were not for services rendered.

Mactaggart v. Comm., CA 5, 132 AFTR 2d 2023 – 5379. The Fifth Circuit upheld the Tax Court's decision assessing deficiencies against the taxpayer where the taxpayer offered only frivolous arguments as to why the income he received for services was not taxable. The taxpayer argued that the **income received should not be taxable because he was a nonresident alien despite working in the United States.**

Jenkins v. Comm., TC Memo 2023 – 102. The taxpayer had unreported wages and retirement distributions even though he received Forms W-2 and 1099. The taxpayer indicated he did not pick up the amounts because the **IRS failed to credit payments he made in prior years and until that was done he was not going to file.**

Harvey v. Comm., TC Memo 2023 – 95. The taxpayer states that while he received wages he is not liable to pay federal taxes citing Section 7701 (a) (9) which defines the term United States to include only the states and the District of Columbia and asserting that **the term income is not defined under Title 26 of the US code**. The taxpayer also states that the Supreme Court has repeatedly ruled the federal government cannot levy a tax on one's property and ultimately one's labor.

Hatfield III v. Comm., TC Memo 2023 – .93. Taxpayer argued he is a US citizen and not subject to income tax as such wages are not subject to taxation.

D. Form 4852: Substituted Form W – 2 and Form 1099 – R

1. If the taxpayer does not receive Form W – 2 from their employer by the end of February of each year, the taxpayer can contact the IRS for assistance. The IRS requires that the taxpayer provide there name, address, phone number, Social Security number and dates of employment. In addition, the Service requires the Taxpayer provide the employer's or payee's name address and phone number. The Service contacts the employer and requests the missing form. If the missing form is not received in time to file the return, Form 4852 can be used as the alternative.

2. Section 7434 does allow an individual to bring a civil lawsuit against another who files fraudulent information returns and to receive damages on account of such fraudulent actions. The individual seeking relief under this provision must prove that the defendant issued an information return which was fraudulent and that the defendant issued it willfully and with reckless disregard for the truth.

Example

Chen et al v. Wow Restaurant, LLC, DC MD Florida No. 8:23 – CB – 01502 (5/6/2024). The taxpayer received form W-2 from the employer reporting wages that were never allegedly received. The taxpayer alleged that she was required to accept W-2's reflecting wages and tips for the years 2020 – 2022 in amounts that were five times greater than the amounts the taxpayer actually received. The taxpayer was provided lodging in a company dormitory for 21 months and that was valued at approximately $250 per month. The employer filed payroll tax returns containing false and fraudulent information about the taxpayers wages. The taxpayer is allowed to seek relief under Section 7434 which involves the taxpayer being able to bring a lawsuit against the employer who fraudulently files information returns and to receive damages. The employer argued that this code provision does not apply because the corporate owner was separate from the Corporation and that there was no willfulness in filing fraudulent information returns and that the W-2s are not information returns. The court did not buy this and allowed the lawsuit to proceed.

E. Vesting of Restricted Stock Units Are Considered Wages at Time of Vesting – CCA 20237014

1. The Chief Counsel's Office address the tax treatment of restricted stock units paid to a US corporation's employees while they were performing services in the United States but who later transferred to a controlled foreign corporation and are performing services for that corporation solely outside of the United States at the time the restricted stock vested.

2. The chief counsel's office advised that the restricted stock units are considered wages for FICA purposes on the vesting date pursuant to Reg Section 31.312 (v) (2) – 1 (e) (7). The chief counsel also indicated the source of the restricted stock units income needs to be determined under the time basis method as indicated under Regulation Section 1.861 – 4 (b) (2) (ii) (E).

F. Changes Under SECURE 2.0 Impacting Amounts Reported on Form W – 2 (FS – 2024 – 29)

1. There are several provisions of SECURE 2.0 that impact reporting on W-2s.The provisions potentially affecting Forms W-2 (including Forms W-2AS, W-2GU and W-2VI) are:

- De minimis financial incentives;
- Roth Savings Incentive Match Plan for Employees (SIMPLE) and Roth Simplified Employee Pension (SEP) Individual Retirement Arrangements (IRAs); and
- Optional treatment of employer nonelective or matching contributions as Roth contributions.

2. De minimis Financial Incentives. SECURE 2.0 allows employers to provide the de minimis financial incentive to employees who elect to participate in the employer's provided retirement plan. If the employer does provide a de minimis financial incentive to employee, the incentive is included in the employee's wages and is subject to federal withholdings.

3. Roth Savings Incentives for Employees. Employers may add emergency savings accounts to a defined contribution plan to permit employees participating in the plan to make designated Roth contributions that later may be withdrawn subject to restrictions. The designated Roth contribution would be reported in box 12 and the applicable code to identify between a SIMPLE Roth and a Roth SEP IRA would be utilized. A simplified employee pension (SEP) arrangement or savings incentive match for employees may allow an employee to designate a Roth IRA as the IRA to which the contributions are made. Salary reduction contributions contributed to a Roth SIMPLE IRA or SEP IRA are subject to federal withholdings, Social Security tax and Medicare tax and they are included in boxes one, three and five of the W-2 they are reported using Code F for a SEP, code S for SIMPLE IRA.

4. Employer Nonelective or Matching Contributions as Roth Contributions. A plan that includes a qualified Roth contribution program may elect to make designated Roth contributions to the plan in lieu of elective deferrals. The designated Roth contributions are subject to federal withholdings, Social Security and Medicare taxes must be reported in boxes 1, three and five. These are separate reporting of any annual or yearly designated Roth contributions. Roth contributions to 401(k) plans will be reported using code AA in box 12, code BBE for 403 (b) plans and code EE for contributions under Section 457 plans.

5. Businesses can now complete and print various copies (excluding Copy A) of Forms W-2 (including Forms W-2AS, W-2GU and W-2VI) on IRS.gov for recipients. Any information entered on one copy (excluding Copy A) will automatically appear on the others. Copy A cannot be completed online to print and file with the Social Security Administration.

6. If a business filed 2023 Forms W-2 without following these new guidelines, they may need to file Form W-2c to correct any errors.

II. Interest Income

A. Income from US Savings Bonds used for Qualified Higher Education Expenses (Series EE & I Savings Bonds)

1. For 2024, the phase-out for excluding interest on U.S. savings bonds redeemed to pay qualified higher education expenses will begin at modified adjusted gross income (MAGI) above $96,800 ($145,200 on a joint return). (See Rev. Proc. 2023 – 34)

2. For 2025, the phase-out for excluding interest on U.S. savings bonds redeemed to pay qualified higher education expenses will begin at modified adjusted gross income (MAGI) above $99,500($149,250 on a joint return). (See Rev. Proc. 2024 – 40)

B. Taxable interest or Nontaxable Interest

1. Interest paid on a child support arrearage is taxable interest under Section 61 (a) (4). The taxpayer has the burden to demonstrate such payment is either child support or alimony pursuant to judicial documents.

Example

Rodgers v. Comm., TC, 2023 – 56. The amount of income reported on Form 1099-INT and which the taxpayer admitted receiving was taxable interest income, not nontaxable child support as she claimed. While payment was made in connection with child support arrearages that the ex-husband owed the taxpayer, the record clearly showed it was interest. The taxpayer's argument that the arrearage principal may have been larger than the amount the state determined was irrelevant, in that any increase in principal would just have resulted in increased interest. The taxpayer received the amounts under the state of Alabama that issued child support payment and said state issued Form 1099 – INT taxpayer acknowledges ex-husband did not make timely child support payments that he was obligated to make and that the state court order directed payments of child support and interest due to being in arrears.

C. Income in Respect of Decedent: Taxation of Accumulated Interest on Savings Bonds

1. Generally, the taxpayer who inherits a savings bond containing accrued interest must recognize the accrued interest in gross income in the year of receipt or redemption of the bond.

Example

Hitchman v. Comm., TC Summary 2023 – 18. The Tax Court held that a taxpayer who inherited a savings bond from his father, then had the bond reissued in his name and redeemed it, had to include the accumulated interest on the bond in his gross income. The court rejected the taxpayer's argument that his interest income was limited to the interest that accrued from the time he had it reissued in his name; the court found that because the taxpayer's father did not report any interest income on the bond while he owned it, the interest therefore accumulated, and when the taxpayer redeemed the bond the accumulated interest was includible in his income as income in respect of a decedent under Section 691(a).

D. Nontaxable Loan Proceeds

1. Loan associated with a nontaxable event must still meet valid debtor-creditor relationship for interest to exist.

Example

Aulisio Jr. v. Comm., TC Memo 2024 – 29. Taxpayer, a CPA, failed to report interest income from a trust indicating that the amount received representing nontaxable loan proceeds rather than interest income. Taxpayer argued that his friend who prepared his return mistook loan deposits as income. The loan was not evidenced by any instrument and there was no valid debtor-creditor relationship to establish the loans existed much less to be nontaxable. Taxpayer went back and amended the return to include the interest to avoid penalties. The avoidance of the penalties did not prevail.

III. Qualifying Dividend Income and Capital Gains

A. 2024 Rates – Rev. Proc. 2023 – 34; IR 2023 – 208

1. For 2024, the 0% capital gains rate applies to adjusted net capital gain of up to:

- $94,050 for joint returns and surviving spouses
- $47,025 for single and married taxpayers filing separately
- $63,000 for head of household
- $3,150 for estates and trusts

2. For 2024, the 15% capital gains tax rate applies to adjusted net capital gain over the amount subject to the 0% rate, and up to:

- $583,750 for joint returns and surviving spouses
- $291,850 for married taxpayers filing separately
- $551,350 for heads of household
- $518,900 for single individuals
- $15,450 for estates and trusts

3. The 20% capital gains tax rate applies to adjusted net capital gain over the above 15% rates.

B. 2025 Rates – Rev. Proc. 2024 – 40; IR 2024 – 273

1. For 2025, the 0% capital gains rate applies to adjusted net capital gain of up to:

- $96,700 for joint returns and surviving spouses
- $48,350 for single and married taxpayers filing separately
- $64,750 for head of household
- $3,250 for estates and trusts

2. For 2025, the 15% capital gains tax rate applies to adjusted net capital gain over the amount subject to the 0% rate, and up to:

- $600,050 for joint returns and surviving spouses
- $300,000 for married taxpayers filing separately

- $566,700 for heads of household
- $533,400 for single individuals
- $15,900 for estates and trusts

3. The 20% capital gains tax rate applies to adjusted net capital gain over the above 15% rates.

C. Substantiation

1. Taxpayers may rely on third-party reports (Form 1099 – DIV and Form 1099 – INT) showing income when there is not a reasonable dispute as to the accuracy of said forms.

Example

Scott v. Comm., TC Memo to 2023 – 141. Taxpayer's Form 1040 was the subject of a routine audit examination for the tax year 2019. The return omitted Form 1099 – DIVs. The evidence indicated that the taxpayer had received the dividends but failed to report dividends and capital gain distributions in the amount of $90 and $644. An additional tax liability was assessed. The taxpayer filed a petition with the court. It should be noted the taxpayer also received a distribution the form of Form 1099 – R and claimed an exemption from the tax. That exemption was denied. The taxpayer claimed that her income had not changed over 10 years making the same amount over that time. The taxpayer did not dispute receiving the forms nor could she provide any evidence disputing the amounts included income other than saying I got them and was not aware I need to report them on the return.

2 Notice 2024 – 11; 2024 – 2 IRB: List of Treaties Meeting Qualified Foreign Dividend Requirement Updated

a. The IRS has issued a notice updating the list of treaties related to qualifying dividends treatment. Under Section 1 (h) (11), a dividend paid to an individual shareholder from either domestic corporation or a *qualified foreign corporation* is subject to the reduced rate associated with capital gain treatment. The notice is effective with respect to dividends paid to the country of Chile after December 19, 2023. With respect to the country of Hungary is applicable for dividends paid on or after January 8, 2023 and with respect to Russia for dividends paid on or after January 1, 2023. The other countries and their effective dates are included in the notice.

D. Transactions Questioning Whether Capital Gains Treatment Exists or Not

Examples

Saccato v. Comm., TC Memo 2023 – 96. The taxpayer argued that sales proceeds from the property did not belong to him. The taxpayer purchased real property but had the warranty deed recorded the transfer listing the taxpayer's name as trustee of a trustee established. The deed did not indicate any consideration paid for the purchase of the property. The trust transferred the property to other individuals including the taxpayer again with no consideration. The taxpayer indicated the purpose of the transaction was to facilitate a subsequent sale while obscuring the fact the taxpayer was the true owner of the property. The property was subsequently sold and a check was issued to 1/3 party and not the trustee of the trust. The IRS examined the transaction and indicated the sale of the property would be capital gains attributable to the taxpayer as the taxpayer was the true owner of the property. Outside of the deed, there was no evidence of the existence of the trusts creating an evasive behavior to have the gain attributable to the taxpayer individually.

Kamal v. Comm., TC Memo 2023 – 80. Married couple had unreported income from the sale of the husband's stock. Husband admitted receiving amounts from the sale of stock in connection with a merger between his former employer in its parent company. The taxpayer did receive Forms 1099 – B showing net capital gains from stock trades. The taxpayer failed to offer any argument or evidence to dispute receiving capital gains and dividends on the matter. The court did give him a credit proportion that was considered qualifying dividends in nature.

E. Virtual Currency and Digital Assets

1. Final Regulations on Reporting Requirements for Digital Assets – TD 10000

a. The Service has issued final regulations for reporting digital assets and guidance on information reporting along with the determination of the amount realized and basis for certain digital asset sales and exchanges.

b. The regulations require custodial brokers to report various sales and exchange transactions beginning in 2026 is for transactions in calendar year 2025.

c. The final regulations require reporting by custodial brokers, who are brokers that take possession of digital assets being sold by their customers. Such brokers include operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, digital asset kiosks, and certain processors of digital asset payments. Real estate professionals are also required to report the fair market value digital assets paid by buyers and received by sellers in real estate transactions with closing dates on or after January 1, 2026.

d. The final regulations do not require that taxpayers report transaction identifications on their Form 1099 – DA. However, they must collect the information and retain it for seven years and make it available to the IRS upon request.

e. The Regulations provide for backup withholding.

2. IR – 2024 – 18. The digital asset question will appear on all income tax forms including 1040, 1041, 1065, 1120, 1120S and Form 990. The question must be answered by all taxpayers not just those who are engaged in a transaction involving digital assets in 2024.

a. At any time during the tax year, 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)?

b. The question is to be answered yes if the taxpayer:

• received digital assets as payment for property or services provided,
• received digital assets resulting from a reward or award,
• received new digital assets resulting from mining, staking and similar activities,
• received digital assets resulting from a hard fork (a branching of a cryptocurrency's blockchain that splits a single cryptocurrency into two),
• disposed of digital assets in exchange for property or services,
• disposed of a digital asset in exchange or trade for another digital asset,
• sold a digital asset, or
• otherwise disposed of any other financial interest in a digital asset.

c. The question is to be answered no if the activities were limited to one or more of the following:

• holding digital assets in a wallet or account,
• transferring digital assets from one wallet or account they own or control to another wallet or account they own or control,
• acquiring digital assets as an inheritance or bequest, or
• purchasing digital assets using U.S. or other real currency, including through electronic platforms.

3. Airdrops and Hard Forks – IRS FAQ Updated August 13, 2024

a. Airdrops. A taxpayer does not have gross income under Section 61 as a result of a hard fork of a cryptocurrency the taxpayer owns if the taxpayer does not receive units of a new cryptocurrency (IRS FAQ #22).

b. Hard Fork. A hard fork is unique to distributed ledger technology and occurs when a cryptocurrency on a distributed ledger undergoes a protocol change resulting in a permanent diversion from the legacy or existing distributed ledger. A hard fork may result in the creation of a new cryptocurrency on a new distributed ledger in addition to the legacy cryptocurrency on the legacy distributed ledger. When a taxpayer receives cryptocurrency from an airdrop following a hard fork, the taxpayer has ordinary income equal to the fair market value of the new cryptocurrency when it is received, which is when the transaction is recorded on the distributed ledger, provided the client has dominion and control over the cryptocurrency so that they can transfer, sell, exchange, or otherwise dispose of the cryptocurrency (IRS FAQ # 24).

Examples

Bob holds 50 units of Crypto R, a cryptocurrency. On Date 2, the distributed ledger for Crypto R experiences a hard fork, resulting in the creation of Crypto S. On that date, 25 units of Crypto S are airdropped to Bob's distributed ledger address, and Bob has the ability to dispose of Crypto S immediately following the airdrop. Bob now holds 50 units of Crypto R and 25 units of Crypto S. The airdrop of Crypto S is recorded on the distributed ledger on Date 2 at Time 1, and, at that date and time, the fair market value of Bob's 25 units of Crypto S is $50. Bob receives the Crypto S solely because Bob owns Crypto R at the time of the hard fork. After the airdrop, transactions involving Crypto S are recorded on the new distributed ledger and transactions involving Crypto R continue to be recorded on the legacy distributed ledger.

Bob received a new asset, Crypto S, in the airdrop following the hard fork; therefore, Bob has an accession to wealth and has ordinary income in the taxable year in which the Crypto S is received. Bob has dominion and control of Crypto S at the time of the airdrop, when it is recorded on the distributed ledger, because Bob immediately has the ability to dispose of Crypto S. The amount included in gross income is $50, the fair market value of Bob's 25 units of Crypto S when the airdrop is recorded on the distributed ledger. Bobs's basis in Crypto S is $50, the amount of income recognized.

4. Notice 2024 – 57. The notice provides that brokers are not required to file information returns and furnish payee statements for certain digital assets. These include these include the following:

- Wrapping and unwrapping transactions that involve the transfer of a single type of digital asset native to a secured distributed ledger in return for another digital asset that is redeemable solely for a digital asset and is identified coal to the digital asset except it is wrapped in executing contract. It also involves the transfer or redemption of a digital asset in return for another digital asset regardless of whether other digital assets attributable to the transfer are also received or credited.

- Liquidity Provider Transactions that involve the transfer of a digital asset into an automatically executing contract and the receipt of the different digital asset that represents an interest in a pool of digital assets

- Staking transactions which above the transfer of a digital asset from an automatically executing contract regardless of whether the receipt includes the receipt or crediting of additional digital assets as a validation or reward for the use of the digital asset.

- Digital asset market participants such as lending of digital assets.

- The short sales of digital assets.

5. IR 2024 – 12 and Announcement 2024 – 4. The IRS has issued an announcement informing businesses that they do not have to report the receipt of digital assets in the same way they must report the receipt of cash until the IRS issues final regulations under Section 6050I. The Infrastructure Investment and Jobs Act revised the rules requiring taxpayers engaged in a trade or business to report cash receipts of more than $10,000 by adding digital assets to the definition of cash. However, this provision of the new law requires the IRS to issue regulations before it goes into effect. Until the IRS publishes regulations, businesses that receive digital assets will not be required to include those digital assets when determining whether the cash value received in a transaction exceeds the $10,000 reporting threshold and must be reported on Form 8300, Report of Cash Payments over $10,000 Received in a Trade or Business, within 15 days of receiving the cash.

6. The IRS has released a draft of the 2025 Form 1099-DA (Digital Asset Proceeds From Broker Transactions), an information return that reports digital asset transactions to be furnished by brokers.

a. Beginning January 1, 2025, the new form is generally expected to be included with federal income tax returns by taxpayers who answer "yes" to the question asking if they, at any time during the relevant tax year, received, sold, exchanged, or disposed of a digital asset or financial interest in a digital asset.

b. Common digital assets include cryptocurrencies, stablecoins, and non-fungible tokens. Form 1099-DA reflects proposed regulations released last year under Proposed Reg 1.6045 – 1. that sought to clear up confusion around digital asset issues such as how the definition of a "broker" under the Infrastructure Investment and Jobs Act applies to centralized exchanges, payment processors, and decentralized finance centers.

7. Rev. Proc. 2024 – 28. This Revenue Procedure will permit taxpayers to rely on any reasonable allocation of units of unused basis to a wallet or account that holds the same number of remaining digital asset units based on the taxpayer's records of such unused basis and remaining units. Allocation must be reasonable in nature and must be made as of January 1, 2025.

8. Gift Tax Issues. Under IRS Tax Tip 2023 – 45, if a transaction involving a digital asset is a gift Form 709: US Gift (and Generation Skipping Transfer) return must be filed. Assuming the gift exceeds the threshold of exclusion.

9. Notice 2023 – 50. The IRS in this notice announced it intends to issue guidance on the tax treatment of nonfungible tokens (NFTs) as collectibles. In the notice, the IRS states that it will utilize a look-through analysis in determining if an NFT should be treated as a collectible; i.e., it will analyze whether an NFT's

associated right or asset falls under the definition of a collectible in the Code to make the determination. For example, if a gem is a collectible under Sec. 408(m), then an NFT certifying ownership of a gem also is a collectible.

a. An NFT is a unique digital identifier that is recorded using distributed ledger technology and may be used to certify the authenticity and ownership of an associated right or asset. This is often associated with blockchain technology and other distributed ledgers that use digital systems to record, share, and synchronize transactions where the details of the transactions are recorded simultaneously on multiple networks. An EFT can be associated with the entry of data encoded on a distributed ledger that is used to identify ownership of the tokens and NFT falls in that category.

10. CCA 202302011. No Deductible Loss for Substantial Decline in Cryptocurrency Value. The taxpayer claimed a worthless stock deduction under Section 165. This section provides a deduction for losses that are evidenced by closed or completed transactions, fixed by identifiable events and actually sustained during the tax year. The taxpayer is not to have abandoned or otherwise disposed of the Cryptocurrency and the Cryptocurrency was not worthless because it still had value. As such, the taxpayers loss was denied. The CCA further indicated that even if the taxpayer sustained a loss, the loss will be disallowed because of the suspension of the 2% AGI miscellaneous deduction associate with itemized deductions. This deduction is associated with a capital asset becoming worthless during the tax year. Section 165 (g) (2) defines a securities a share of stock in a corporation, a right to subscribe for, or to receive, a share of stock in a corporation or evidence of indebtedness issued by a corporation or a government/political subdivision thereof with interest coupons or in a registered foreign. Cryptocurrency is none of these items listed in Section (g) (2) and as such does not apply. This is not to say that a capital gain or loss cannot occur in a Cryptocurrency but it is not within the definition of a security for purposes of being worthless.

11. Protocol Upgrade – CCA 202316008. The taxpayer who held 10 units of cryptocurrency native to the blockchain distributed ledger that underwent a protocol upgrade that changed the mechanism by which future transactions were validated, did not realize gain or loss on those units as a result of protocol upgrade. The protocol upgrade did not alter past transactions or blocks previously validated and added to the blockchain, including subject units.

12. Rev. Rul. 2023 – 14. Proof of State Validation Rewards

a. Taxpayers must include the fair market value (FMV) of proof-of-stake validation rewards in their gross income for the tax year in which they gain dominion and control over the validation rewards.

b. The ruling applies to cash-method taxpayers who stake cryptocurrency native to a proof-of-stake blockchain and receive additional units of cryptocurrency when validation occurs. The FMV is determined as of the date and time the taxpayer gains dominion and control over the validation rewards.

c. Proof of stake is a way to decide which user or users validate new blocks of transactions and earn a reward for doing so correctly.

d. Ethereum, the second-largest digital asset, switched last year to proof of stake from proof of work. Bitcoin uses proof of work.

e. Under Section 61, instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion" are included in gross income. Unless otherwise provided by a Code or regulatory provision, any receipt of property constitutes gross income in the amount of its fair market value at the date and time at which it is reduced to the taxpayer's undisputed possession.

Example

CCA 202444009. Taxpayer needs to include the fair market value of certain rewards in their gross income if the amount remains frozen as of December 31 of the tax year at issue. The rewards related to digital assets in a platform held for investment purposes. The rewards were associated with validation and staking previously distributed following a backup or withholding timeframe. Rewards can be sold exchanged or transferred by the taxpayer. Prior to the freezing due to a bankruptcy petition, the taxpayer was in receipt of the digital assets in the amounts had been previously credited to his account.

13. Lack of Reporting and Clean Hands Doctrine. The Clean Hands Doctrine against a government agency applies only to conduct immediately related to a controversy of a direct nature.

Example

Kim v. Comm., TC Memo 2023 – 91. The IRS received information reports from a virtual currency exchange regarding the taxpayers transactions in Bitcoin's, Litcoins and Ethereum during the tax years 2013 through 2017. The taxpayer reported no gains or losses on these cryptocurrencies. For 2017, the taxpayer received an information return from the virtual currency exchange reporting $18.5 million of proceeds from transactions. On the 2017 Schedule D, the taxpayer reported gross proceeds in that amount but claimed a basis of over $18.4 million reporting a short-term capital gain of just under $50,000. The service indicated the taxpayer had failed to report short-term capital gains for prior years 2013 through 2016. The taxpayer did not dispute the amount for the character of the capital gains determined in the delinquencies. The taxpayer contended the virtual assets gave rise to these gains were completely wiped out in 2020 as result of Covid – 19. The taxpayer's basis for the claim was that the actions or omissions of the IRS in response to the epidemic caused that harm and that under the Clean Hands Doctrine, the IRS is barred from collecting taxes on the years at issue. The court found that when relevant, the cleans hands defense applies only to conduct immediately related to the cause in controversy. The government's response to the Covid epidemic had no relationship whatsoever to the taxpayers tax liabilities. As such the tax liabilities were recognized.

14. Notice 2023 – 34. The Service has modified Notice 2014 – 21 which provides the convertible currency is treated as property for federal tax purposes in order to remove a statement in the background section that virtual currency does not have legal tender in any jurisdiction because certain foreign jurisdictions have now enacted laws that treat bitcoin as legal tender. The Service noted the revisions to not affect the answers as far as the convertibility of virtual currency. These FAQs concluded that the convertible virtual currency is not treated as currency that could generate a foreign currency gain or loss for federal tax purposes.

15. Real Estate Purchase with Digital Assets.

a. Amendments to Treas. Reg. §1.6045-1, finalized in June 2024, expandS reporting requirements for brokers involved in digital asset transactions, including those associated with real estate sales. Under the new rules, real estate reporting persons (like title companies, attorneys and other closing agents) now face additional requirements when digital assets are used in real estate transactions. These rules focus on reporting digital asset transactions as part of property sales, which helps ensure that taxable events are properly recorded when digital assets (such as cryptocurrencies) are used to pay for real property.

b. Real estate reporting persons must report several details about the digital assets used in the transaction, including:

• the type and amount of digital assets used,

• the gross proceeds from the sale,
• the transaction date, and
• whether the consideration was cash, other digital assets, or property

c. These transactions will now be reported on Form 1099-DA, which includes the buyer's personal identifying information, the specific digital asset, and the gross proceeds from the digital asset sale.

d. In addition, IRS added new reporting on Form 1099-S where digital assets are used as consideration in real property sales. Under these rules, reporting will include details such as the type and quantity of digital assets, the gross proceeds, the transaction date, and the nature of the consideration (whether cash, other digital assets, or property).

e. These proposed changes are expected to take effect for transactions starting in January 1, 2026.

F. Qualified Opportunity Zone (QOF)

1. Reporting Requirements

a. A taxpayer must annually report any QOF investment, as well as any deferred capital gains and the disposition of any QOF investments during the tax year, to the IRS on a Form 8997: Initial and Annual Statement of Qualified Opportunity Fund (QOF) Investments.

b. Form 8997 must be attached to the taxpayer's timely filed federal tax return, including extensions

c. The failure to file Form 8997 will result in an inclusion event that terminates the taxpayer's qualifying investment in a QOF and triggers recognition of any deferred gain.

d. In addition, an entity that elected (or is electing) to be a QOF must annually file Form 8996: Qualified Opportunity Fund, with its timely filed federal tax return, including extensions.

e. Form 8996 is used to report that the QOF meets the investment standards in Section 1400 Z – 2 or to figure the penalty if the entity fails to meet those investment standards.

f. A QOF must file Form 8996 even in years the entity has no taxable income.

2. Deferral Income Recognition – PLR 202249005

a. The taxpayer's gross income from the sale of stated parcel that occurred during a startup period could be treated as gross income derived from the conduct of a trade or business in a qualified opportunity zone satisfying deferral provided the taxpayer adopted a new or revised working capital plan within 120 days of the end of the qualified disaster incident timeframe that satisfies the requirements of Code Section 1400 Z – 2 and that such plan utilizes those sales proceeds in a manner that the completion of the spending occurs in the working capital timeframe.

G. Like-kind Exchanges

1. Like-kind exchange provisions were previously finalized under TD 9935 (IR 2020 – 262).

2. Property is real property for purposes of a like-kind exchange if, on the date it is transferred, the property is classified as real property under local or state law jurisdiction where the property is located. For example,

state or local law would ascertain whether the property included a ditch or irrigation company. The characterization of the property as real property under state or local law definition also applies to personal property and intangible property. This is a change from the proposed regulations which did not give any consideration to state or local regulations.

3. Property is classified as real property if the property is:

- Classified under state and local law as a general rule;
- Specifically listed as real property in the Final Regulations or
- Considered real property based on facts and circumstances.

4. A determination that properties include personal property under state or local law does not preclude the conclusion that the property is real property for purposes of the final regulations.

5. Real property included land, land improvements, and improvement to land including both permanent structures and structural components. Inherent structures are buildings or other structures personally fixed to the real property that would remain affixed for an indefinite period of time.

Example of Real Property Determination for Like kind Treatment

PLR 202309007. Ranch owner performing a like-kind exchange of real property with water rights was allowed deferred gain treatment. Water rights fell within the regulations of Section 1031 as real property on the condition that the properties are held for productive use in a trade or business or investment.

6. With regards to tangible property if the property is currently affixed to real property and will ordinarily remain affixed to the property for an indefinite period of time then the property is considered inherently permanent or inherently permanent structure and thus real property for purposes of the like-kind exchange regardless of the purpose or use of the property or whether it contributes the production of income.

7. A structural component is characterized as real property if it is integrated into an inherently permanent structure regardless of whether the structural component contributes to the production of income. This means that machinery and equipment can be characterized as real property if they comprise an inherently permanent structure, a structural component, or real property as defined under state or local law.

8. Any inherently permanent structure building or structural component that is a distinct asset and is permanently affixed to the real estate and will ordinarily remain affixed to the real estate for an indefinite period of time. The determination of this is based on facts and circumstances.

9. Personal property is incidental to a real property exchange if, in a standard commercial transaction, the personal properties typically transferred together with the real property and the aggregate fair market incidental personal property transferred with the real property does not exceed 15% of the aggregate fair market value of the replacement real property.

10. PLR 202335002. Transferable development rights that the taxpayer proposes to use on property already owned and qualify as real property and fall with the definition of a like kind which is exchange for another property that the taxpayer intended to sell as part of the transaction.

11. Section 1245 exchanges still requires recognition.

Example

Gerhardt v. Comm., 160 TC No. 9. Taxpayers were not entitled to deferred gain on like-kind exchange involving the relinquishment of rental property in exchange for other rental property. Taxpayers did follow the like-kind exchange rules however stated gain had to be recognized as ordinary income because the property was depreciated under Section 1245.

12. Related parties involved in a like kind exchange must file Form 8824: Like kind Exchanges in the Year of the Exchange for the next two years. This only applies to related parties.

13. Option Agreements between related parties can give rise to scrutiny in a like kind exchange.

Example

Parkway Gravel, Inc. v. Comm., TC Memo 2024 – 59. Two cousins subsequently became owners of a road construction business. They desire to expand the business upon assuming ownership. They not only owned the entity in question but also formed a general partnership to develop real estate. The cousins were the sole partners of the partnership. In a desire to sell a parcel of land used in the business, the corporation granted the partnership and option to acquire the property for its appraised value. The assignment stipulated that it execute any gain on sale above the appraised value would be allocated to the partnership. An outside developer agreed to purchase the property for almost twice the appraised value. The Corporation entered into a like kind exchange to deferred their portion of the gain associated with the sale. Upon examination, the IRS claimed the option agreement invalided the sale between the buyer and the Corporation resulting in an assignment of income. The Service argued that the partnership was merely a conduit for the sale. The IRS indicated it was a sham transaction with no substantial economic effect. The Tax Court decided in favor of the taxpayer. The court indicated that the clarity and completeness of the documentation to obtain proper zoning and permits to secure the sale and the long history of maintaining a separation agreement among the entities was a factor in their favor and granted the like kind exchange treatment. In other words, the transaction had documentation to indicate not to separate books and records but everything up to the exchange was arm's-length.

H. Involuntary Conversion – Section 1033

1. General Rule. If property (as a result of its destruction in whole or in part, theft, seizure, requisition, or condemnation) is compulsory or involuntarily converted into property similar or related in service or used to the property so converted no gain shall be recognized.

Example

LTR 202318004. The Service rules that payments a limited partnership received from an entity on an agreement were not eligible for nonrecognition of gain under Section 1033. The taxpayer had to finish clearing certain areas before receiving payment. In addition, the new assets once replaced constituted eligible replacement property with respect to the converted assets sharing the same function with the taxpayer's current assets these did not make it dissimilar for exclusion of gain treatment.

I. Gain on Sale of Principal Residence

1. **Part Residence and Part Rental- Health Related**

a. Section 121 (b) (5) allows for computing the gain exclusion on the sale of a residence by allocating Gay to periods of nonqualified use which references the game that is not excluded. These periods of nonqualified use do not include a period or timeframe of temporary absences which cannot be seated aggregate of two years due to a change of employment, health conditions, or other unforeseen circumstances. These are facts and circumstances examination.

Example

Webert v. Comm., TC Memo 2022 – 32. Mrs. Webert was diagnosed with cancer, the same year she and her husband purchased the home in question. The Weberts alleged they resided in the home from 2005 through 2009 and experienced financial hardship due to Mrs. Webert's extensive medical treatments and related reduced working capacity. In 2009, the Weberts attempted to sell the home due to their medically related financial condition but were unsuccessful and decided to rent it from 2009 through 2015 as a last resort. The home was ultimately sold in 2015, resulting in a long-term capital gain, which they excluded from gross income under Sec. 121. The IRS disallowed the entire exclusion, arguing the Weberts did not use the home as their principal residence for at least two of the five years immediately preceding the sale. The Weberts argued that the sale was due to Mrs. Webert's health problems, therefore allowing a reduced exclusion under Sec. 121(c)(2)(B). The IRS moved for summary judgment on the exclusion issue. The court ruled that the Weberts had not met the principal residence use requirement during the required 2010 through 2015 period and granted summary judgment on that point. However, it found that a reduced exclusion was plausible, given Mrs. Webert's numerous health issues precipitating the sale. Nonetheless, the court explained, that as the reduced exclusion is also based on periods within five years before the sale that the home is used as a principal residence, the result of this reduced exclusion also appeared to be zero in the Weberts' case. Because neither party had addressed whether, as a matter of law, Mrs. Webert's health was a material fact, the court did not grant the IRS summary judgment on this point.

2. Furnishings that are part of the sale of the residence are not part of the gain exclusion.

Example

Forte v. Comm., 2:18 –CV – 00200 (D. C. Utah, 6 – 21 – 21). The District Court in Utah denied the taxpayer’s motion for summary judgment related to the sale of the residence. The issue before the court was whether the taxpayers were entitled to exclude from their gross income part of the gain from the sale of their home and whether they were entitled to reduce the amount of the taxable gain realized on the sale of a different home by the amount paid for furnishings that were sold with that home. The court denied the motion because it found there were 2 genuine issues of material fact regarding whether the couple's sale of the home was due to unforeseen circumstances. Concerning unforeseen circumstances that would entitle the taxpayers to partial exclusion from the sale of the residence. The taxpayer’s 2nd motion was denied and found they failed to cite any authority at the time to reduce the gain on the sale but all for furniture sold inside that home or with the sale of the home.

J. Bad Debt

1. A deduction is allowed for any debt that becomes worthless within the taxable year (See Sec. 166(a)(1)). A debt that becomes worthless, is a question of fact, but actual worthlessness is a condition that must be present for a bad debt deduction.

2. A debt is considered worthless when there are reasonable grounds for abandoning hope that the debt will be repaid and there is no longer any chance of the debt being collected. It is not necessary to wait until a debt becomes due to determine whether it is worthless, if the facts show that actual worthlessness exists before the due date (See Reg. Sec.1.166-2).

3. Worthlessness is generally evidenced by an insolvent debtor not timely servicing the debt and refusing to pay any part of the debt in the future, declaring bankruptcy, or simply disappearing. A lawsuit is needed to enforce payment where the surrounding facts and circumstances indicate that, in all probability, the action would not result in an enforceable judgment in favor of the lender (Reg. Sec.1.166-2(b)).

4. However, the debt must be a bona fide debt that arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money (See Reg. Sec.1.166-1(c)). The loan must be made with the understanding that it is to be repaid. Whether a debtor-creditor relationship exists depends on all the facts and circumstances, and generally no one fact is determinative. Factors to consider in determining whether there is a debtor-creditor relationship with a reasonable expectation of repayment are whether:

- The existence of a written promissory note;
- Interest is stated and being charged on the note;
- There is a fixed schedule for repayment;
- Collateral exists in exchange for the note;
- A demand for repayment exists;
- The records reflect a loan;
- Repayments are or will been made; and
- The borrower was solvent at the time of the loan (See Hunt v. Comm., T.C. Memo. 1989-335).

5. Nonbusiness Bad Debt

a. A nonbusiness bad debt must be totally worthless before it may be deducted, and it may be deducted by taxpayers other than corporations only as a short-term capital loss. (See Sec.166(d)(1)(B)).

b. An S corporation's nonbusiness bad debt is a separately-stated item (Rev. Rul. 93-36)

c. The deduction for a nonbusiness bad debt must be taken in the year in which the debt becomes totally worthless (See Reg. Sec.1.166-5(a)(2)).

d. When specific debts are deducted, there must be an explanatory statement attached to return, showing the name of the debtor and any related party interest to the taxpayer, the nature and amount of the debt, the date the debt became due to efforts made to collect the debt, and the reason for determining the debt to be worthless (See IRS Pub. 17).

6. Business Bad Debt

a. A business bad debt is a loss from the worthlessness of the debt that was either created or acquired in association with the trade or business or closely related to the trade or business when he became partially or totally worthless. The debt is closely related to the business at the primary motive for incurring the debt is a business reason. A bona fide debtor-creditor relationship is still required but the entire amount can be deductible if the debt is bona fide and in association with a valid trade or business.

b. Business bad debts are primarily the result of credit sales to customers. They can also be the result of loans to suppliers, clients, employees or distributors.

K. Losses - Capital or Ordinary

1. **Sale of Real Property at Loss**. Section 1221 (a) (1), states that a capital asset does not include "stock in trade of the taxpayer or the property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax year, or property held for the taxpayer primarily for sales to customers in the ordinary course of trade or business."

2. The term primarily refers to of first importance or principally as defined by the Supreme Court (See Malat v. Riddell, 383 US 569, 572 (1966). Hobson, the burden of proof for this restS with the taxpayer.

3. In determining whether the taxpayer held property primarily for the sale of customers the following factors are utilized: (Graves v. US 867F 2nd 199 (4th Cir., 1989)

- The purpose for which the property was acquired;
- The purpose which the property was held;
- Improvements, and their estate, makes the property by the taxpayer;
- The frequency, number and continue alley of sales;
- The nature and substantial ability of the transaction;
- The nature and extent of the taxpayer's business;
- The extent of advertising or the lack of advertising; and
- The listing of the property for sale directly or through a broker.

Examples

CCA 202309015. IRS indicated that taxpayers gain on sale of the LLC interest were ordinary income transactions because the taxpayer held such interest primarily in a percent of customers of the ordinary course of a trade or business.

Musselwhite v. Comm., TC Memo. 2022 – 57. The Tax Court determined that the taxpayers losses from the sale of 4 lots was capital loss and not ordinary loss as reported. The taxpayer in 2012 had the properties distributed to him from a pass-through entity less than 4 months later, the taxpayer sold the lots at a loss. The partnership's principal activities were that of investment. From the company's inception, real property was capitalized on the balance sheet of the Partnership and subsequently sold remained classified by the taxpayer as other investment and not as inventory. The real property was classified as other investment had characteristics similar to real property at issue. No amended returns were filed to correct the classification of the lots. Improvements to the lots were made prior to sale and development plan was in place but ultimately disregarded and no additional improvements occurred for 2 years prior to the sale. The court

considered the factors in Graves (see above). In applying the factors the court looked at the purpose for which the property was acquired and the purpose for which the property was held and noted that the purpose was that of investment no progress was made or even attempted to develop the properties for eventual sale the lack of development because the court to find that improvements in the extent made by the taxpayer was in the government's favor. In looking at the frequency, number and continuity of sales as well as the sustainability the court noted that after the partnership had distributed the property to the taxpayer only one sale had occurred. The court also noted that the taxpayers nature and extent of his business was that of an attorney and that the majority of his income was from his legal business and that the real estate sales was not an everyday activity. The court also noted the taxpayer hired a real estate broker to assist in marketing and selling the items. The court noted here that based upon the factors the lots were not viewed as inventory nor stock in trade nor property held primarily for sale to customers in the ordinary course of business. As such the capital losses were allowed.

L. Qualified Small Business Stock

1. Under Section 1202, noncorporate taxpayers can exclude a certain percentage of gain from the sale or exchange of qualified small business stock (QSB) held for more than 5 years. Generally, the stock in a C corporation that was originally issued after August 10, 1993 and on the date of the stock issuance the corporation is a Qualified Small Business and the taxpayer acquired the stock in its original issue in exchanged for money or property or compensation for services.

2. The term 'qualified small business stock" refers to any stock a C Corporation which was originally issued on or after August 10, 1993 if as of the date of issuance, such corporation is a qualified small business and such stock is acquired by the taxpayer and is original issue exchange for money or other property or as compensation for services provided to the corporation.

3. In addition, the aggregate gross assets of the corporation immediately after the issuance does not exceed $50 million in the Corporation.

4. The stock in the Corporation is not treated as qualified small business stock unless during substantially all of the taxpayers holding period the corporation meets the active business requirement. The corporation must be a C corporation.

5. The active business requirements are met by corporation timeframe during which at least 80% of the assets of the corporation are used in the active conduct of one or more qualified trade or business and the Corporation is an Eligible Corporation.

6. The term qualified trade or business refers to any trade or business other than the following:

• any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or 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,
• any banking, insurance, financing, leasing, investing, or similar business,
• any farming business (including the business of raising or harvesting trees),
• any business involving the production or extraction of products of a character with respect to which a percentage depletion deduction is allowable under this Section, and
• any business of operating a hotel, motel, restaurant, or similar business.

7. The taxpayer must hold a qualified small business stock for more than five years before selling in order to achieve the exclusion. Total amount of gain that can be excluded is equal to the greater of $10 million or 10 times the adjusted basis in the taxpayer stock.

8. 100% of the gain can be excluded stock issued on or after September 27, 2010.

9. Having said the above, outside of this generally 50% of the gain is excluded for stock issued on or after August 10, 1993 and before February 18, 2009 or 75% can be excluded for stock issued after February 17, 2029 and before September 27, 2010.

Example

T. Ju v. US, US Court of Federal Claims, 22 – 1815 T (March 18, 2024). The Court of Federal Claims ruled that stock sold by married individuals was not eligible to be treated as qualified small business stock under Section 1202. The taxpayers did not acquire most of the stock when it was originally issued, as was needed for said treatment. Neither did the taxpayers own most of the stock for five years, as required. The husband was a former university employee and named inventor on two patents. The university licensed those two patents to a company (C1) in return for cash and C1 shares. The husband later had a dispute with the university about the revenue from his patents. He and the university entered into a settlement agreement, which involved said stock and later on, its sale. The taxpayers paid taxes on proceeds from the sale of stock and a cash payment from the university. The tax payment for the sale of C1 stock was due only after the tax year2015 issuance of stock in the husband's name. Moreover, the husband did not show that he took on the benefits and burdens of stock ownership. Further, the taxpayers failed to prove that C1 was a qualified small business from 2003 through 2009, under Section 1202. The taxpayers offered no proof to show that C1's assets were under $50 million for the relevant period. As a genuine dispute existed on the timing of issuance of several shares and C1's value, no summary judgment was granted on this issue. There was a genuine issue of material fact over whether the total aforementioned cash payment equaled the amount the husband was owed for the patent license. There was also a genuine issue of material fact over whether the cash payment covered C1, another relevant entity, or both. The taxpayers failed to prove that the payment was all for the C1's license. This was the only patent license the husband showed he gave to the university. The court denied said cash payment to be treated as long-term capital gain.

IV. FORM 2555 – Foreign Source Income and the Foreign Income Exclusion

A. General Rule

1. U.S. citizens generally living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year or present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

2. Individuals who are not bona fide residents of a foreign country and fail to meet the 330-day physical presence test may be treated as dual if eligible for a waiver. Waivers may be issued to individuals who:

- Were bona fide residents of, or were present in, a foreign country for any period during which individuals were required to leave such foreign country because of war, civil unrest, or similar adverse conditions which precluded the normal conduct of business by such individuals; and

- Were able to establish to the IRS that the time requirements of the foreign earned income exclusion could reasonably have been expected to have been met but for the conditions of war, civil unrest, or similar adverse conditions. The IRS annually publishes a list of foreign countries where war, civil unrest, or adverse conditions exist, and where the individual taxpayer could not stay the full 330 days. (See Rev. Proc. 2014-25)

B. Foreign Earned Income Exclusion

1**. Foreign Earned Income Exclusion Amounts – 2024 and 2025**

a. The foreign earned income exclusion will be $126,500 in 2024. (See Rev. Proc. 2023 – 34; IR 2023 – 208)

b. The foreign earned income exclusion will be $130,000 in 2025. (See Rev. Proc. 2024 – 40; IR 2024 – 273)

C. Foreign Housing Exclusion

1. IRS Notice 2024 – 31. For 2024 the base housing amount is $20,240. Housing expenses of a qualified individual whose entire tax year is within the applicable period are limited to $37,950 in 2024. This notice also addresses high cost countries at the 30% rate and list those countries.

D. **Factors to Consider in determining whether a taxpayer is a bona fide resident of a foreign country. (Linde v. Comm. , TC Memo 2017 – 180., Also see Sohurek , CA 7, 1962, 9AFTR 2d 883)**

1. Over time, the courts have developed factors to ascertain whether a taxpayers a bona fide resident of a foreign country for purposes of the foreign income inclusion. Among the factors considered are the following:

- intention of the taxpayer;
- establishment of the taxpayer's home temporarily in the foreign country for an indefinite period;
- participation in the activities of the chosen community;
- physical presence in the foreign country consistent with the taxpayer's employment;
- nature, extent and reasons for temporary absences from the taxpayer's temporary foreign home;
- assumption of economic burdens and payment of taxes to the foreign country;
- status contrasted to that of transient or sojourner;
- treatment of the taxpayer's income tax status by his or her employer;
- marital status and residence of the taxpayer's family;
- nature and duration of the taxpayer's employment;
- good faith in making the trip abroad, e.g., whether for the purpose of tax evasion

b. No one factor supersedes others.

Examples

Diaz v. Comm., TC Memo 2024 – 45. Taxpayers, a married couple, were not entitled to a foreign income exclusion because they failed to prove that the closing agreement they had entered into was invalid. The husband was employed as a US defense contractor on a joint military base in Australia and was asked to sign a closing agreement with the IRS. In that agreement, the taxpayer had waived the right to claim the foreign income tax exclusion with respect to wages earned at the base. In exchange, Australia agreed that

no Australian income tax would be withheld from wages. The taxpayers argued the signatures appearing above their names were not there signatures but were forged. The husband was not a credible witness he testified to a very different version of the timeline at trial and he relied heavily on forensic evidence presented by different versions of his signature on various documents. The husband alleged reasons for refusing to sign the closing agreement was that he did not forfeit the benefits of claiming the income exclusion which made no economic sense. The taxpayers offered no explanation as to who would forge their signatures on the document. The forensic evidence regarding taxpayer signature pointed out that they failed to carry their burden of proving that there signatures on the documents were in fact forged. The taxpayers had waived their ability to claim the income exclusion accordingly.

Aubin v. Comm., TC Memo 2024 – 9. Taxpayer who executed closing agreement in which he waived his right to claim Section 911 foreign earned income exclusion for years during which he was working abroad for defense contracting co. in Australia, Tax Court rejected his argument that Section 7121 didn't apply to said agreement. Although taxpayer claimed that agreement didn't address "an actual liability" because none of years to which it related had ended, and 2 of those years had not yet begun, agreements under Section 7121 covered any period ending before or after agreement became effective.

Henaire v. Comm., TC Memo 2023 – 131. The taxpayer was not entitled to exclude foreign-earned income that the taxpayer had received in the form of wages for services she provided for the Corporation in Australia. The taxpayer began her employment with the organization she signed a closer agreement which she waived her right to make an election under section 911. The closing agreement was signed by the director of the IRS the taxpayer argued the director lacked authority to sign the agreement. The Tasker concluded the director signed the agreement acting as the authority under 1982 tax treaty between the US and Australia. Likewise, the taxpayer was not allowed to exclude the value of housing provided while she was working in Australia. The taxpayer did not establish that her employer provided her lodging for its own convenience that she was required to accept the logic as a condition of her employment or that the lodgings were on the employer's premises.

Clemons, Dr v. Comm., TC Memo 2022 – 95. The taxpayer was a computer software professional and claimed a foreign income exclusion for the year he lived in Germany working as a subcontractor for a German software company. The taxpayer met factors to determine that his tax home was in Germany. However, the taxpayer could not exclude the housing costs because he did not have credible evidence to show he incurred them and that they were not reimbursed by the foreign employer.

V. Foreign Currency and Transaction Reporting

A. FBAR Rules

1. If the US person has a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust or other type of foreign financial account and the amount exceeds $10,000 anytime during the year, the Bank Secrecy Act requires the US taxpayer to report the account yearly by filing electronically a Financial Crimes Enforcement Network (FinCEN) Form 114; Report of Foreign Bank and Financial Accounts (FBAR).

2. A US person, as well as certain domestic entities must file their report if:

a. The person has a financial interest in or signature authority (or other authority that is comparable to signature authority) over one or more accounts in a foreign country, and

b. The aggregate value of all foreign accounts exceeds $10,000 anytime during the calendar year.

3. An extension to file Form 114 is allowed for 6 month timeframe ending on October 15 to coincide with the filing of the taxpayers individual income tax return.

4. For taxpayers required to file Form 114 for the first time, any penalty for failure to timely request for file extension may be waived (See 2015 Highway Funding Bill)

5. Schedule B, Part III Foreign Accounts and Trusts. Form 1040, Schedule B, Part III must be completed if the taxpayer had over $1,500 of taxable interest or ordinary dividends; had a foreign account; or received a distribution from, or was a grantor of, or a transferor to, a foreign trust.

6. Line 7a and 7b of Part III requires a "yes" or "no" to the below two questions if the taxpayer has a signature authority over financial accounts in a foreign country of more than $10,000.

7. Form 114a, Record of Authorization to Electronically File FBARs must be signed by the taxpayer to allow third-party preparers to e-file the form. For those who are filing jointly, each spouse must sign the form. The form is not submitted with the electronic filing but is retained by the tax preparer for five years. Atty., CPAs, enrolled agents filing the FBAR on behalf of the client must register to become a BSA e-file or and file as an institution, rather than an individual.

8. There are exceptions to the FBAR reporting requirements. The exceptions are for the following US persons or foreign financial accounts:

- Certain foreign financial accounts jointly owned by spouses
- United States persons included in a consolidated FBAR
- Correspondent accounts
- Foreign financial accounts owned by a governmental entity
- Foreign financial accounts owned by an international financial institution
- Owners and beneficiaries of U.S. IRAs
- Participants in and beneficiaries of tax-qualified retirement plans
- Certain individuals with signature authority over, but no financial interest in, a foreign financial account
- Trust beneficiaries (but only if a U.S. person reports the account on an FBAR filed on behalf of the trust)
- Foreign financial accounts maintained on a United States military banking facility.
- Virtual currency

9. A person who holds a foreign financial account may have a reporting obligation even when the account produces no taxable income. The reporting obligation is met by answering questions on a tax return about foreign accounts (for example, the questions about foreign accounts on Form 1040 Schedule B) and by filing an FBAR.

B. Willful Failure to File and Penalty

1. A willful failure to file an FBAR may result in a civil penalty, which is assessed by the IRS. The penalty ranges from $129,210 up to 50% of the balance in the account at the time of the violation. (31 USC 5321(a)(5)(C))

2. Penalties for non-willful failures to file an FBAR are much lower: the maximum penalty is $12,921 per violation adjusted for inflation.

Example

US v. Hughes, CA 9 (8/21/2024) 134 AFTR2d 2024 – 5107. The 9TH Circuit Court of Appeals ruled that a District Court applied the correct legal standard in determining that an owner of two New Zealand businesses owed penalties for failing to disclose foreign bank account records and that the failure to disclose was willful. The court determined willfulness can also be established by proof of recklessness as well as subjective intent. The taxpayer indicated she knew of the reporting requirement but did not do so.

US v. Schwarzbaum, CA 11 (8/30/2024) 134 AFTR2d 2024 – XXXX. The 11th Circuit found that the willful penalty imposed on a taxpayer from filing the foreign bank account reporting requirements is subject to the Eighth Amendment excessive fines clause. The case involved a naturalized US citizen with bank accounts in Costa Rica and Switzerland for the taxpayer was aware of the filing requirement but and failed to report accounts for three years resulting in penalties of $300,000 penalty assessed on one low value account. The appellate court agreed with the District Court that the failure to file the reports was with recklessness and willful. However, the penalty must be one that is to serve solely a remedial purpose. The court noted that the willful penalties may be excessive irrespective of the magnitude of the financial injury caused to the government. The 11th Circuit was not persuaded by the first circuit court indicating such penalties are not excessive because they are designed to reimburse the government for generalized harm relating to concealment of money. The court determined Eighth Amendment analysis should be on account by account basis not an aggregate test. In this case the court determined that the penalty of $100,000 for willful violations was constitutionally excessive as to one of the taxpayers accounts as the balance never exceeded $16,000 for any relevant year and $100,000 per year fine for this account is grossly disproportional.

US v. Gaynor, 133 AFTR2d 2024 – 716. A Federal District Ct. in Florida concluded that a deceased heiress did not willfully evade FBAR reporting for three years where she answered no on the Schedule B regarding foreign accounts despite $ 31 million in a Swiss account and attempted to file back returns and FBAR through a silent disclosure provision.

US v. Kelly, 133 AFTR2d 2024 – 710. The Sixth Circuit Court of Appeals agreed with the lower District Court that the taxpayer's failure to file the FBAR report was willful and that he sought no professional advice prior to the closing of all his domestic bank accounts and opening accounts in Switzerland.

US v. Reyes, 133 AFTR2d 2024 – 468. A District Court judge found the taxpayers willfully failed to disclose your Swiss Bank accounts concluding that their statement on Schedule B that they had no interest in a foreign bank account showed that they recklessly disregarded the FBAR reporting obligations even though they stated they did not review their tax return.

US v. Malyari, 3:20 – C V – 1887 – IM., DC OR 1/24/2024). The Court determined the taxpayers had willfully failed to disclose qualifying foreign bank accounts for the years 20 2011 through 2023 and imposed the willful penalty of $604,860. The court determined that the violation was willful because it included the fact that the taxpayers knowingly and recklessly violated the rules. The taxpayers argue that they face significant barriers adjusting to American life and becoming proficient in the English language and that there limited English skills and limited knowledge of the intricacies of the American Tax System made them legitimately unaware of the reporting requirements. The court noted that were it to accept the taxpayers difficulties understanding English that fact would not insulate them from the reporting requirements.

C. Nonwillful Penalties

1. A US person who fails to report a reportable account on an FBAR may be subject to nonwillful penalty. The maximum amount for a non-willful penalty is $10,000 adjusted for inflation.

2. The failure to comply with the reporting requirements will not result in a penalty if the person's failure was due to reasonable cause. That is a facts and circumstance examination.

3. The Service will not impose a penalty for the failure to file the delinquent FBAR if the taxpayer properly reports on the tax return and paid all taxes on the income from the foreign financial accounts reported on the delinquent FBAR and the taxpayer had not previously been contacted by the IRS regarding income tax examination or request for delinquent returns for the years for which the delinquent forms are submitted.

4. Non- willful Penalty Applies on a Per Report Basis, not on a Per Account Basis.

a. Bittner v. US S. Ct. 10 – 28 – 23) 131 AFTR2d 2023 – 437. The US Supreme Court overturned the Fifth Circuit Court of Appeals and held that the $10,000 maximum Penalty for the non-willful failure to file an FBAR accrues on a per report basis not on a per account basis. The Ninth Circuit along with other district courts had held that the $10,000 penalty apply also on a per report basis and not in a per account basis. It is unclear the extent that this decision has a retroactive effect for assessments prior to 2023.

D. FBAR penalties are not taxes subject to the collection due process (CDP) requirements

1. In a recent Tax Court case, the court determined that FBAR penalties assessed against the taxpayer were the taxpayer was informed that funds would be withheld from the monthly Social Security to satisfy the penalty is allowed and the taxpayer is not allowed a collection due process hearing.

2. Tax Court indicated that the penalties are authorized and imposed by Title 31 not Title 26 which is associated with the Internal Revenue Code as such the Tax Court lacked jurisdiction. Under Title 31, the Treasury Secretary may impose a civil pendant any person it fails to file an FBAR as required by law as the penalty is a non-tax debt owed to the United States. (See Jenner v. Co., 163 TC No. 7)

E. Treaties May Protect Against FBAR Penalties

1. Lawful permanent resident of the US may not be liable for failing to file FBAR disclosing bank accounts in foreign country for being treated as a resident under a US – Mexico tax treaty

Aroeste v. US, 132 AFTR2d 2023 – 6577 (DC CA, 114/20/2023). The taxpayer was born in Mexico and live there all his life. He worked in Mexico until he retired in 2012. The taxpayers owned a condominium in Florida which they had used as a vacation home. No one lived in the vacation home on a full-time basis. The taxpayer always filed Mexican tax returns as a resident in Mexico. In 1984, the taxpayer applied for and received permanent residency status in the United States the green card. The status was never revoked. His wife became a naturalized US citizen in 2011 and she was a citizen during the tax years at issue. The parties agreed that the wife was a citizen and thus a US person required to file a Report of Foreign Bank and Financial Accounts (FBAR) for the tax years at issue. In 2012 and 13, the taxpayers had a financial interest or signature authority over five bank accounts in Mexico which exceeded in aggregate the balance of $10,000. With respect to their tax returns for 2012 and 2013, the taxpayers file an individual income tax return as married filing joint but did not submit Form 8833: Treaty Based Return Position Disclosure Under Section 6114 or 7701 (b) raising Article 4 of the US – Mexico income tax Convention. The taxpayer was previously advised to apply for and enter into the Offshore Voluntary Disclosure Program and the taxpayer did so but he did not file the FBAR for 2012 or 13. The taxpayer subsequently opted out of the disclosure

program based upon legal advice regarding the US – Mexico Tax Treaty the IRS open examination and the taxpayer submitted an amended return indicating they were not required to file under the treaty. The taxpayer subsequently amended the return a second time to indicate married filing separate status with the wife would file the FBAR the husband would not. The willful penalty was assessed for both 2012 and 2013. The taxpayers sued the United States seeking to recoup penalty payments. The issue is whether the husband was a US person who had a financial interest in or signature authority over a foreign financial account requiring the reporting if the foreign bank account exceeds $10,000 at any time during the calendar year. A US person includes a resident of the United States as well as resident aliens. It is undisputed the taxpayer obtained green card and it was never revoked. The taxpayer fit the definition of a resident alien who may be subject to the reporting requirements. The services position is that the forms required to be exempt were as the beneficiary. The daughter is a non-eligible designated beneficiary. Not filed timely and could not be accepted in an amended fashion. The taxpayer asserts that the US-Mexico treaty prevails over late filing of the tax forms. Specifically, the taxpayer asserts that the failure to file Forms 1040 and are and Form 8833 deprives individuals of the treaty's benefits. The taxpayer argues that a taxpayer that fails to meets the requirements of the filing the forms should have a penalty equal to $1,000 for each failure not the FBAR penalty. The court determined that although the taxpayer did not give timely notice of his treaty position in the forms, the taxpayer did not waive the benefits of the treaty as asserted by the IRS. Hence the lower penalty provision would apply. The court found that the taxpayer is a US person but ceased to be a lawful permanent resident of the United States because the taxpayer commenced to be treated as a resident of Mexico under the treaty. The taxpayer did not waive the benefits of the treaty and notified the secretary of the treasury of such treatment. The taxpayer is not under the treaty subject to the FBAR penalties under the treaty. The taxpayer is a US person but ceased to be treated as a lawful permanent resident of the United States because the taxpayer commenced to be treated as a resident of Mexico under the treaty and did not waive the benefits of the treaty. In addition, the government must refund the penalty assessed and abate. The taxpayer is charged with the thousand dollar penalty per failure to timely report the treaty position which would have been a total of $2,000.

F. Form 8938: Statement of Specified Foreign Financial Assets

1. Form 8938, "Statement of Specified Foreign Financial Assets," is to be used by individuals to report an interest in one or more specified foreign financial assets under Section 6038D. The instructions reflect changes in the reporting requirements associated with the following:

2. Form 8938 disclosure statement requires the reporting of the maximum value of foreign assets during the tax year. The disclosure statement should also provide information regarding financial accounts, including the name and address of the foreign financial institution in which the account is maintained and the account number. In addition, the disclosure statement should also provide the name and address of foreign issuers of stocks or security and information that is as needed to identify the class of such stock or security. Also, foreign asset disclosure is required with respect to the issuance of foreign contracts, instruments or other interests.

3. Foreign real estate is not a reportable asset, this would include a personal residence or rental property. However, if the real property is held in a foreign entity the interest in the entity is a specified foreign financial asset that must be disclosed on Form 8938 if the total value of the financial assets falls within the threshold of reporting.

4. Tangible assets such as art, antiques, jewelry, cars and other collectibles directly held by the taxpayer or not specified foreign financial assets requiring disclosure. This would include precious metals. However. gold certificates issued by foreign person are a specified foreign financial asset would require disclosure.

5. A foreign pension plan or deferred compensation plan must be reported on Form 8938. In general, the value of the taxpayer's interest in the foreign plan is the fair market value of his or her beneficial interest on the last day of the year. However, if the taxpayer does not know nor has reason to know the fair market value of the plan's beneficial interest because such value is not readily accessible the maximum value is the value of cash property distributed to the taxpayer during the year. If there were no cash or property distributions from the form plan during the year and the taxpayer simply cannot readily determine the value, then it would not be reported.

6. The threshold for reporting on Form 8938 are shown below:

	If Total Value of Foreign Financial Assets Exceed		
Not Living Abroad	**On Last Day of the Year**		**At Any Time during the Year**
Single and MFS	$50,000	or	$75,000
MFJ	$100,000	or	$150,000
Living Abroad	**On Last Day of the Year**		**At Any Time during the Year**
Single and MFS	$200,000	or	$300,000
MFJ	$400,000	or	$600,000

7. It should be noted that the form 8938 and the instructions have been converted from an annual revision to continuous use. Both the form instructions will be updated on an as needed basis.

8. The currency exchange rate converter generally is what is used for the conversion to US dollars. The link ishttps://fiscaldata.treasury.gov/currency-exchange-rates-converter/

VI. Cancellation of Debt (COD)

A. General Rule

1. Gross income includes income from the discharge of indebtedness. This applies equally to debts discharged by commercial lenders and those canceled by private lenders (See Section 61 (a) (12)).

2. In essence COD income can occur in any of the following circumstances:

- Modification of a debt, as defined in Regs. Section 1.1001-3;
- Issuance of equity in satisfaction of debt (see Sections 108(e)(8) and 108(e)(6));
- Acquisition of outstanding debt at a discount by a party related to the debtor, as defined in Section 108(e)(4);
- Issuance of a contingent value right or similar property right in satisfaction of debt;
- Discharge of the debt occurring either within or outside a bankruptcy proceeding; and
- An asset foreclosure or similar transaction satisfying the debt.

B. Forgiveness of Student Loan Debt

1. The American Rescue Plan Act of 2021 (ARPA) excluded from gross income in taxable years 2021 through 2025 amounts related to the discharge of certain student loan debt, whether federal or private. The exclusion is applicable to discharges of loans after December 31, 2020, and before January 1, 2026.

2. In a bankruptcy procedure forgiveness or discharge of debt can occur if there is undue hardship. This is the case with respect to student loan debt.

Example

In re Carney Bktcy Ct MA 131AFTR2d 2023 – 502. The taxpayer claimed discharge of her student loan debt was denied because of her failure to prove undue hardship. The taxpayer argued that she would be suffering the same hardship in terms of a cancellation or forgiveness of debt income that will result if or when the debt was forgiven. Her alternative request for cancellation that no income tax would arise from the discharge was also meaningless. She could not demonstrate that it was undue because it was mere speculative in nature at the time of the bankruptcy filing and she was seeking a Chapter 13 reorganization.

C. Insolvency can be a Reason for Exclusion from Gross Income

1. General Rule. Section 108(a) defines the amount of insolvency subject to exclusion from gross income to be the amount of liabilities exceeding the fair market value of assets. The burden to substantiate insolvency rests with the taxpayer.

Examples

Henry v. Comm., TC Memo 2024 – 79. Taxpayers cancellation of debt income exclusion was rejected by the IRS. Taxpayer maintained that he was insolvent when debts were canceled. Taxpayer acknowledged he received income from cancellation of debt and admitted he provided no information concerning his claim of insolvency. He asked at the Tax Court to provide additional information of his insolvency. The income recognition was not included in the IRS notice to him of additional liability. As such, the Service bears the responsibility to demonstrate the taxpayer was in fact solvent. Since the IRS was late the insolvency position stood and the cancellation of debt was excluded from income..

Patacsil v. Comm., TC Memo 2023 – 8. Married couple attempted to exclude cancellation of debt income for the year that the lender discharged a loan that the taxpayers claimed they were entitled to an exclusion of income based on insolvency. The taxpayers offered no evidence that their assets including were less than their liabilities. The inclusion or reference of a potential adverse adjustment in obtaining an employment lawsuit as a contingency does not establish insolvency. In addition, the taxpayers did not present evidence that the assets on a fair market value basis were less than the liabilities. Fair market value immediately before the cancellation is a requirement. The taxpayers presented as far as real property a Zillow number. The court does not accept that as a valid appraisal. The court requires either an appraisal or a broker price opinion as far as insolvency versus solvency is concerned.

Ahaiwe v. Comm., TC Summary 2023-7. The taxpayer claimed an exclusion from income for canceled debt related to a credit card arguing he was insolvent at the time the debt was canceled. In support of his position, the taxpayer relied upon in insolvency worksheet he created but this did not meet the requirement of the worksheet necessary for substantiation purposes. The worksheet nor testimony established how the assets were valued at the balances of liabilities were not able to be confirmed by independent evidence.

2. The insolvency worksheet and supporting documentation are required to have the exclusion from gross income accepted.

Example

White v. Comm., TC Memo 2023 – 7. The taxpayer was entitled to take advantage of the insolvency exception to exclude from gross income cancellation of debt income received in connection with the discharge of the business loan. The taxpayer attached worksheets at the time of the filing of the return showing that the debt had exceeded her assets and that she was insolvent at the time the business loan was discharged. The IRS argued that the loan was in association with equity and not debt. In the event the court deemed it debt, the IRS argued that an acceleration of payment is not to be construed as associated with a bona fide debt arrangement. In this particular case, the debt was associated with real property and was part of a landlord-tenant situation. The landlord did not pursue litigation for the outstanding liabilities that does not preclude the arrangement from not meeting the definition of a bona fide debtor-creditor arrangement. Even though the lessor did not sue the taxpayer or take other action other than eviction this does not mean that the debt was not otherwise bona fide debtor-creditor arrangement

3. Defined Benefit Pension Plans. The Service has announced in action on decision that it will not acquiesce to the decision in the Schiener case (TC Memo 2017 – 32). In that case, the Tax Court held an interest in a defined benefit pension plan is not an asset for purposes of applying the insolvency exclusion under Section 108.

4**. Related Party Debt.** In determining insolvency of the taxpayer related party debt is not part of the determination of insolvency. Advances between related entities must establish a bona fide debtor-creditor relationship to be successful as a bad debt deduction.

D. Capital Gain v COD on Real Property Sales. – Parker v Comm., TC Memo 2023 – 104.

1. COD income exists if a COD is not part of a sale or exchange of real property that is nonrecourse in nature.

Example

Parker v. Comm., TC Memo 2023 – 104. Exterra Realty Partners, LLC wasn't an S corporation involved in real estate development. Mr. Parker was a 100% shareholder of the LLC and the CEO. Exterra was the sole member of PLF – XIII, LLC and PLF – XIV, LLC (PLF entities). These entities were disregarded entities. PLF – XIII was the sole member of Montevina Phase I, LLC, and PLF – XIV, LLC was the sole member of Montevina Phase II, LLC (Montevina) which were also disregarded entities. The Exterra entities, through the Montevina entities, purchased several acres of real property with loans that were obtained from an unrelated third-party lender. The Exterra entities contributed 1.5 million to Montevina entities for phase 1 and phase 2 development. In addition, Mr. Parker personally signs a guarantee for payment of all the loans. Several of these loans were nonrecourse. A couple of loans were secured by a pledge of the PLF's membership interest in the Montevina entities. Approximately six months after the purchase and the loans the Exterra entities agreed to sell the property to unrelated third-party purchasers. Likewise, the PLF entities agreed to sell their soul membership interest as well. The buyers as part of the sale agreed to assume Mr. Parker's personal guarantee obligations and appropriate consent and release agreements were executed. The unrelated third-party lender agreed to cancel the unpaid balance of several of the Mezzanine loans. The language indicated that the cancellation was in connection with the proposed sale of all interest. The amount realized from the sale was over $40.5 million in the amount of debt canceled in association with the sale was approximately $12.7 million. Exterra filed its 1120S and reported gross receipts of $53.2 million consisting of the debt assumed by the buyer of the real property and the cancellation of the loans. An amended return was subsequently filed and Form 982: reduction of Tax Attributes due to Discharge of Indebtedness was attached. It resulted in a reduction in gross receipts of

approximately $12.7 million in association with Exterra being insolvent to that amount. One loan that was forgiven by the third party was not included on the K-1. The petitioner reported the $ 12.7 million as capital gains. The IRS disputed. The court indicated that if nonrecourse debt relief is conditioned upon a sale or exchange of property the amount of debt relief is included in the amount realized and is not cancellation of debt income. Also, the amount realized includes the amount of liabilities from which the transferor is discharged as a result of a sale or disposition. The service was taking the position that two of the loans that were eventually canceled were deep-handed upon the sale of the property. Those loans were nonrecourse and are includable in income as an amount realized on the sale of the property and are thus capital gain treatment.

E. Cancellation of Debt and Disregarded Entity

1. What is considered a discharge of debt in association with the disregarded entity.

Example

Jacobowitz v. Comm., TC Memo 2023 – 107. The taxpayer had an LLC in which he was the sole member. The LLC, through the taxpayer, executed a promissory note and security agreement for a business line of credit with the bank. Default occurred. The taxpayer claimed the cancellation of debt income should not be attributable to him personally but to the LLC. The taxpayer never filed Form 8832 electing to be treated as a corporation. For all purposes, he was treated as a disregarded entity. Cancellation of debt with respect to a disregarded entity is attributable to the individual taxpayer. In addition, the taxpayer failed to show the debt was discharged before the year at issue. The taxpayer also attempted to treat the cancellation of debt as capital gains claiming that as an LLC the bank never agreed that the LLC would surrender in any property in association with the line of credit and that the interest accrued was not associated with ordinary and necessary expenses of the business.

VII. Personal Injury Awards

A. Compensation for Injury or Sickness and Punitive Damages – Section 104

1. Generally, compensation for personal injuries and sickness is excludable from gross income. The following are generally excludable:

a. Amounts received under Workmen's Compensation

b. Amount of damages received (other than punitive damages) on account of a personal physical injury or physical sickness. The exception excludes only physical injuries but not emotional distress because of age, race, gender, or disability, libel, slander and other nonphysical wrongs.

Example

Roma v. Comm., TC Memo 2023 – 142. Formerly married couple received settlement from former landlord in connection with housing discrimination suit. The settlement agreement showed the payments were made primarily in return for the taxpayer's timely vacating the apartment and not on account of personal injuries or sickness. Taxpayers claim the payments were made at least in part to settle various legal actions they brought against the landlord including future claims. That argument was not persuasive in that the taxpayers argued emotional distress in association with leaving and not demonstrating any direct physical injuries or sickness.

c. Amounts received for accident or health insurance for personal injuries or sickness

d. Amounts received as a pension, annuity for personal injuries or sickness resulting from active service in the Armed forces, public health service for foreign service.

e. Amounts received as disability income attributable injuries occurred as a direct result of a terrorist or military action.

2. Often several amounts received by compromise, mediation, arbitration or judgment are includable in gross income. The item that the settlement replaces must be considered. The following are generally includable as ordinary income:

a. Interest on any award.

b. Compensation for lost wages or lost profits.

c. Damages for patent or copyright infringement, breach of contract, tortious interference with a business operation.

d. Backpay and damages for emotional distress under Title VII the Civil Rights Act of 1964.

e. Attorney's fees and costs where the online recovery is included in gross income.

f. Attorney's fees and costs way to wasn't going awards where the online recovery is included in gross income.

3. IR 2023 – 81. The IRS posted FAQs on its website that address the income tax consequences of state compensation payments received by victims of forced, involuntary all coerced sterilization. Under the FAQ, some states compensate victims under state programs. These compensations are pursuant to state legislation. In general, the FAQ states the compensation payments for fored sterilization are excluded from gross income because the payments are compensatory damages for physical injuries.

4. Amounts received by the employee through an accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts are attributable to contributions by the employer which were not includable in the gross income of the employee or are paid by the employer. (See Section 105 (a))

5. Workmen's Compensation

a. Service-connected disabilities generally excludable from gross income.

Examples

Tuma. Se. v. Comm., TC Memo 2024 – 71. The IRS determined that the taxpayers railroad benefits and Social Security benefits received in the year at issue are not amounts that are associated with a disability excluded under Section 104. Merely making a claim that they are associated with disability is not enough.

Scott v. Comm., TC Memo 2024 – 27. The taxpayer received civil service retirement disability payments that were determined to be includable in the taxpayer's gross income because the payments were not attributable to an injury or illness sustained through the husband's active service in the arm forces. The

exclusion of the payments under Section 104 does not apply. The taxpayer excluded the amounts on the federal return contending that the payments did not constitute taxable income. There was no evidence to suggest that the payments at issue were attributable to injury or illness sustained through the husband's active service in the Armed Forces.

b**. IRS Letter Ruling 202416001. Section 130 Qualified Assignment of Liability** Section 130 Qualified Assignment of Liability. Section 130 provides an amount received for agreeing to a qualified assignment which is an assignment of the liability to make periodic payments as damages or as compensation under the Workmen's Compensation Act or an account of a personal injury or sickness, are excludable from income to the extent the amounts did not exceed the arrogant cost of the qualified funding asset. The exclusion is associated with the process of assigning settlements to third parties who in turn paid the personal injury claimants a steady income stream over a timeline as opposed to a lump sum payment. The letter ruling provides a favorable interpretation of these structured settlement agreements allowing continued use of indexed annuities as a favorable payment treatment to claimants. The Service in the letter ruling indicated that the periodic payments are fixed and determinable as required and that the contract will not fail to be a qualified funding asset despite the value increasing over time in the stock market.

c. Disability Payments Are Taxable if Premiums are Paid by the Employer

Example

Linford v, Coom., TCS 2023 – 17. The taxpayer received disability insurance from his employer. Under the terms of the policy, employees are not required to contribute to the policy premiums. The company pays 100% of the premiums. The taxpayer was approved and received disability payments. The taxpayer received a W-2 accordingly. The taxpayer did not report the payments indicating that they are excludable from gross income. Section 105 (a) states that if amounts of the disability payment were paid under policy for which the contributions/premium payments were made by the company employer, the exclusion of those payments does not apply. The taxpayer must include those payments as gross income.

6. Employment Discrimination. Rewards for employment discrimination or settlements do not fall within the Section 104 exclusionary requirements.

Examples

Estate of Finnegan v. Comm., TC Memo 2024 – 42. Several taxpayers were not entitled exclude settlement payments they received from their gross income. The taxpayers had entered into settlement agreements in a case related to their claims against defendants employed by the state of Indiana. In the settlement agreements, the taxpayers agreed to execute written documentation fully release the defendants from liability. The taxpayers urge the Tax Court to find the damage awards to the taxpayers were for posttraumatic stress disorder of a physical nature to the brain. However, the settlements made no such reference to posttraumatic stress disorder. On that basis the amounts were not deemed to be of a physical nature to warrant exclusion under Section 104. Furthermore, the taxpayer's original lawsuit never asserted of physical claim against the state or the defendants. Rather, constitutional violations were asserted. The jury awarded the taxpayers compensatory damages as a result of the lawsuit for each of the constitutional violations. As such the amounts were not excludable from gross income.

Mcghee v. Comm., TC Memo 2023-97. Damage award which taxpayer received in connection with wrongful termination/discrimination suit were taxable to him in year received was upheld. IRS met its minimal evidentiary burden linking taxpayer to said income with his stipulation to receiving damages, and he didn't show that any exclusion applied.

VIII. Rental Property and PAL Rules

A. Section 469

1. Section 469 limits the taxpayer's ability to deduct the losses from businesses in which he or she does not materially participate, and this limitation also applies to rental activities. The passive activity loss rules apply at the individual level and extend beyond tax shelters to businesses reported on Schedule C, E, F and flow through entities such as partnerships, LLCs, S Corp. and trusts.

2. A passive activity loss is defined as the excess of the aggregate losses from all passive activities for the taxable year over the aggregate income from all passive activities for that year. (See Section 469(d)(1))

3. A passive activity is any trade or business in which the taxpayer does not materially participate.(See Section 469(c)(1)). A taxpayer is treated as materially participating in an activity only if his or her involvement in the operations of the activity is regular, continuous, and substantial. (See Section 469(h)(1))

4. In essence, losses and credits from passive activities are deductible to the extent they exceed income from all activities. In other words, they are deductible as losses to the extent of income.

5. There have always been two primary exceptions to this rule. The exceptions are associated with the status of being a real estate professional and secondly, the ability to deduct up to $25,000 of rental losses from actively managed real estate.

6. The rule remains that any passive activity loss not currently deductible is suspended and becomes deductible in a subsequent year which the taxpayer either has net passive activity income or completely disposes of the passive activity property to an unrelated party.

7. Generally, any rental activity is per se a passive activity (See Section 469 (c) (2)). It is the taxpayer burden to overcome this by demonstrating material participation or the taxpayer is a real estate professional.

8. The regulation list exceptions to the definition. Specifically, an activity involving the use of property is not a rental activity for a taxable year if:

- The average period of customer use for the property is 7 days or less;
- The average period of customer use for such property is 30 days or less, and significant personal services are provided by or on behalf of the owner of the property connection with making the property available for use by customer;
- Extraordinary personal services are provided by on behalf of the owner of the property connection with making such property available for use by customers;
- The rental of such properties treated as incidental to a non-rental act the taxpayer; the taxpayer customarily makes the property available during defined business hours for nonexclusive use by various customers; or
- The provision of the property for use in an activity conducted by a partnership, S corporation or joint venture in which the taxpayer owns an interest is not a rental activity.

Example

Rogerson v. Comm., 132 AFTR 2d 2023 – 5382. The Tax Court determined that the taxpayer's yacht related activity where the yachts were intended to be chartered was a rental activity under Section 469. The court noted the term passive activity includes rental activities.

Cardulla v. Comm., TC Memo 2023 – 89. The taxpayer reported expenses exceeding rental income on 6 properties he owns. 4 of the properties were vacant land and one was an uninhabitable house due to earthquake damage. There was one with there was actual rental income of a legitimate nature. There was a lack of substantiation for the deductions and the taxpayer was incorrectly advised to take depreciation or land.

9. Section 280A – Disallowance of Certain Expenses in Connection with Business Use of home, rental, vacation homes, etc.

a. Except as otherwise provided, in the case of a taxpayer who is an individual or an S corporation, no deduction shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence. This limitation shall not apply to any deduction allowable to the taxpayer without regard to its connection with his trade or business or with his income-producing activity.

b. In general, Section 280A provides that where a dwelling unit is used by a taxpayer *as a residence*, the taxpayer cannot claim a net rental loss.

c. In such cases, deductions attributed to rental use are limited to the excess of gross rental income over the portion of the expenses otherwise allowable (such as mortgage interest and taxes which are allowable without regard to their connection to a business or investment) that are attributable to the rental activity. If the property is not used as a personal residence, all of the rental related expenses, subject to the passive activity and at-risk rules, are deductible.

d. More specifically, Section 162 (a) allows a deduction for ordinary and necessary expenses paid or incurred during the tax year in carrying on a trade or business. Section 212(1) and Section 212(2) allow a deduction for ordinary and necessary expenses paid or incurred in connection with an activity engaged in for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

e. Section 280A(d)(1) provides that a taxpayer (also known as a host) does not have to pay tax on income they earn from actually renting a unit for fewer than 15 days during the year if they also use the unit themselves as a residence.

f. Taxpayers or hosts are considered to use the unit as a residence if they use it for personal purposes during the tax year for more than the greater of:

- 14 days or
- 10% of the total days during the year they rent it to others at a fair rental value.

g. A unit can be a room or an entire residence as the case may be.

h. A unit is not rented at fair rental value for any day it is used for personal purposes, which includes use for any part of a day by the taxpayer, another person who holds an interest in the unit, or a family member of the taxpayer or other person with an interest in the unit.

i. Personal use can include, but is not limited to, the property being used by the owner for personal purposes, any other person who uses the property for personal purposes if that person owns part of the property,

family members of the owner unless rented for use, anyone who pays less than fair rental value and any agreement that allows owner to use the property for other than rental purposes.

j. Personal use does not include days where the owner works substantially full time repairing or maintaining the property, even if family members simultaneously used the property for recreational purposes.

k. Personal use does not include days with the owner uses the property as a primary residence before or after renting it or offering it for rent so long as the property was rented or the attempt to have it rented occurred for at least 12 consecutive months or a period of less than 12 months if the property was sold exchange at the end of the tax year.

Examples

Sinopoli v. Comm., TC Memo 2023-105. The taxpayers were entitled to take deductions on their personal returns for rent expenses which corp. paid for use of the taxpayers' homes for business meetings in their residences above amounts IRS allowed. While the taxpayers failed to present any written documentation showing that all claimed meetings occurred during years at issue, they did establish one meeting per month for stated months in 2 of 3 years at issue, as the IRS had already allowed. They also established with their testimony that some meetings occurred during the remaining year, and were accordingly entitled to rent deductions for 12 meetings for that year. However, the taxpayers failed to establish the reasonableness of rent; rather, it appeared that the taxpayers adopted tax savings scheme to distribute corp.'s earnings to themselves through purported rent payments, claim rent deductions, and exclude rent from their gross income.

Conrad v, Comm., TC Memo 2023 – 100. The taxpayers were the majority owners of an S corporation. The corporation paid the taxpayer for management services and accounting services. The payments were as if the taxpayers were independent contractors. This was never challenged or disputed by the IRS. Each of the taxpayers claimed a deduction for business use of their home. In the case of the husband, the IRS found that the office home was not used exclusively as the principal place of business. The corporation paid rent to the taxpayers for the office space. The rent was reported on Schedule E and expenses including taxes and interest were offset against it. The taxpayers admitted that often the office was used for personal purposes particularly when family members arrived. As such, the deductible expenses were limited to the rental income.

10. While the taxpayers who rent out a unit for less than 15 days a year do not have to recognize income from the rental, they also cannot deduct expenses incurred in renting out the unit.

11. If clients rent their home or other unit for 15 days or more during the year, the taxpayer will need to report this activity when filing their individual income tax return unless the activity is operated as a partnership, S corporation, or other entity and reported on that entity's return, either on a Schedule C: Profit or Loss From Business, as trade or business income subject to self-employment tax, or on Schedule E: Supplemental Income and Loss, as rental income, not subject to self-employment tax but possibly subject to net investment income tax.

12. Recharacterization of Rental Income to nontaxable repayment of Loan

Example

Henry v. Comm., TC Memo 2024 – 79. Taxpayer claim to recharacterize rental income reported from certain properties as nontaxable. Specifically as a repayment of an alleged loan to investors on properties purchased. There were no loan documents nor deeds to corroborate the taxpayers claim.

13. REITs and Section 856 (d) Qualified Rents from Real Property

a. IRS Letter Ruling 202413004. Storage fees received by a limited liability company from unrelated third parties under a storage agreement for the use of space at properties were viewed as rent from real property within the meaning of Section 856 (d). The taxpayer represented that, with respect to each storage agreement, the rent attributable to personal property which that would be leased would not exceed 15% of the total rent for the taxable year paid by the tenant for both real and personal property leased under the storage agreement.

B. Material Participation

1. An individual is treated as participating "materially" for the taxable year if the individual's participation meets one of the participation tests listed in Reg. Sec. 1.469-5T(a)(1)-(7).

- The individual participates in the activity for more than 500 hours during such year;
- The individual's participation in the activity for the taxable year constitutes substantially all of the participation in such activity of all individuals (including individuals who are not owners of interests in the activity) for such year;
- The individual participates in the activity for more than 100 hours during the taxable year, and such individual's participation in the activity for the taxable year is not less than the participation in the activity of any other individual (including individuals who are not owners of interests in the activity) for such year;
- The activity is a significant participation activity (for the taxable year, and the individual's aggregate participation in all significant participation activities during such year exceeds 500 hours;
- The individual materially participated in the activity for any five taxable years (whether or not consecutive) during the ten taxable years that immediately precede the taxable year;
- The activity is a personal service activity and the individual materially participated in the activity for any three taxable years (whether or not consecutive) preceding the taxable year; or
- Based on all of the facts and circumstances the individual participates in the activity on a regular, continuous, and substantial basis during such year.

Example

Lin v. Comm., TC Memo 2023 – 37. A married couple was not entitled to deduct rental activity losses during the year they rented the basement in their three-story home to a friend at a below fair rental price. The taxpayers claim there were $30,000 of losses that yielded only $3,000 of income. They claim the losses were comprised of maintenance, repairs, legal fees, HOA fees, and depreciation. There was no allocation provided. Regarding the HOA fees, they are not deductible as well as the depreciation because they did not

own the house. The taxpayer ran an aerospace business activity through various entities and was also a boat enthusiast with yachts that he intended to charter. The Tax Court previously indicated the taxpayer materially participated in his aircraft activities. But he was prevented from applying losses from rental activities to offset the active income he received. The court determined that his yacht chartering activities rose to the level of rental property. The court indicated that the taxpayers participation in an activity is material if the involvement in the operations is regular, continuous and substantial. (Section 469 (h) (1)).

2. Section 469 (h) (1) states that an activity is material if the taxpayer is involved in the operations on a regular, continuous and substantial basis.

Example

Rogerson v. Comm., 132 AFTR2d 2023 – 6624 (CA 9). The taxpayer ran an aerospace business activity through various entities and was also a boat enthusiast with yachts that he intended to charter. The Tax Court previously indicated the taxpayer materially participated in his aircraft activities. But he was prevented from applying losses from rental activities to offset the active income he received. The court determined that his yacht chartering activities rose to the level of rental property. The court indicated that the taxpayers participation in an activity is material if the involvement in the operations is regular, continuous and substantial. (Section 469 (h) (1) on appeal, the taxpayer attempted to argue that his aerospace business was not active in nature because it required little of his time to run the business.. Originally, the Tax Court rejected the taxpayer's argument stating that the taxpayer's ability to respond to detailed inquiry so quickly shows he had a detailed knowledge level of every aspect of the business. The appeals court noted that Section 469 (h) does not impose a minimum hours requirement to find the taxpayers participation is material. Rather, the standard is materiality is based on regular, continuous and substantial in nature. The court determined that the activities of the charter evinces fell within the definition of short-term rental.

C. Real Estate Professionals

1. A taxpayer's rental real estate activities in which he or she materially participates are not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which the taxpayer performs services. This means that real estate investors who qualify are permitted to deduct their rental real estate losses against other income sources (e.g., commissions, wages, etc.) (See Sec.469(c)(7)). The eligibility requirements include the following:

a. The taxpayer owns an interest in the real property. (See (Reg. Sec.1.469–9(b)(6)).
b. More than 50% of the individual's personal services during the tax year must be performed in real property trades or businesses in which the individual materially participates, and
c. The individual must perform more than 750 hours of service in those same trades or businesses.
d. The total time spent in any combination real estate related activities is used to determine if the 50% and the 750-hour tests are met.
e. Real property trade or business means "*any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage or trade or business"* (See Section 469(c)(7)(C)).

2. Aggregation of Rental Real Estate When a Real Estate Professional

a. Each interest of the taxpayer in rental real estate is to be considered as a separate activity, but a taxpayer **may elect** to treat all interests in real estate, including real estate held through pass-through entities, as one activity (See Section 469(c)(7)(A)).

b. The aggregation option permits the investor to meet the material participation test after cumulatively materially participating in all the real estate rentals. Without the aggregation option, the investor would be required to materially participate in each activity, making it more difficult to get around the passive loss limitations.

c. The election to treat all interests in rental real estate as a single rental real estate activity is binding for all future years unless there is a material change in a taxpayer's facts and circumstances.

d. The taxpayer makes the election by filing a statement with his or her original income tax return. This statement must contain a declaration that the taxpayer is a qualifying taxpayer for the taxable year and is making the election pursuant to Section 469(c)(7)(A) (See Reg. Sec.1.469-9(g)).

e. Taxpayers that are real estate professionals may make a late election to group rental activities if they represent on a statement, filed under penalty of perjury that they meet the following requirements:

- The only reason that the election was not made timely was not because the taxpayer did not file the statement with his or her return the first year, they became a real estate professional.

- The taxpayer fought all required federal tax return consistent with the requested grouping for all years including and following the year the taxpayer intended the grouping to be effective.

- The taxpayer timely filed each return that would've been affected by the election if the grouping has been timely filed and the tax bill we treated as having timely filed the return was filed within six months after the due date including extensions.

- The taxpayer had reasonable cause the failure to meet the requirements to file timely.

3. Substantiation

a. With respect to the evidence that may be used to establish hours of participation, the extent of an individual's participation in an activity may be established by any reasonable means.

b. Time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means. Reasonable means may include, but are not limited to, the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries (See Reg. Sec. 1.469-5T(f)(4)).

Examples

Gossain v. Comm., TC Memo 2024 – 97. Taxpayers rented out property and provided audit activity logs stating that husband worked on the property 751 hours for 2009, 751 hours for 2010, 757 hours for 2011, 753 hours for 2014, and 752 hours for 2016. A second rental property was purchased in 2016. The taxpayer had a full-time job working at least 40 hours a week. Taxpayer argues he materially participate in the rental properties for the timeframe stated herein. The court looked at whether the taxpayer was a real estate professional. The logs were not contemporaneous. The hours in question include personal work on the property when it was not rented.

Foradis and Moore v. Comm., TC Summary 2024 – 13. The couple filed a joint return claiming a rental real estate loss deduction of $22,376 from their newly constructed carriage house property. Both taxpayers work full-time jobs earning over $75,000 each. The taxpayer spent time constructing the carriage house after work and on weekends and while maintaining full-time employment. The property began as a short-term rental operation managed by a real estate management company. The court found that the taxpayer who claim to be a real estate professional failed to meet the more than 50% of all personal services test. The taxpayer testified to spending approximately 2,500 hours constructing the carriage house. The court found this claim implausible given his full-time employment of about 2,000 hours per year. The court concluded the taxpayer could not prove he spent more than half of this total personal services on the rental real estate during the year at issue and thus did not qualify as a real estate professional as such the losses were limited.

D. **Section 274 Substantiation Requirements - Rule**

1. Section 274(d) imposes stricter substantiation requirements for deductions claimed for, among others, expenses of travel (including meals and lodging while away from home) and listed property.

2. No such deduction is allowed unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating his or her own statement the amount, time and place, and business purpose for each expenditure.

3. Adequate records for this purpose include an account book, log, or similar record and documentary evidence that together are sufficient to establish each element of the expenditure.

4. To be adequate, records must be prepared or maintained in such a manner that each recording of an element of expenditure is made at or near the time of the expenditure or use.

5. It should be noted however that if a log is not contemporaneous other sufficient credible evidence can be considered. This is often the case when the taxpayers are forced to reconstruct efforts as a result of a casualty event. Other sufficient evidence can include the taxpayer's own statements as well as oral testimony if the testimony can evolve the elements of cost, amount, time, place, and date of the expenditure.

6. Temporary Treasury Regulation § 1.274-5T(b)(2)(ii) defines the term "time" as "dates of departure and return for each trip away from home, and number of days away from home spent on business," and subdivision (iii) defines the term "place" as "destinations or locality of travel, described by name of city or town or other similar designation." For certain property, such as an automobile, the taxpayer must also establish the amount of business use "based on the appropriate measure (i.e., mileage for automobiles and the total use of the listed property for the taxable period." See subpara. (6)(i)(B).

E. Reporting Matters

A. Schedule E vs. Schedule C.. In general, taxpayers who rent buildings, rooms, homes or apartments in which they provide basic services such as heat, light, trash collection and cleaning of public areas will report income and expenses on Schedule E.

2. However, Schedule C's use when the taxpayer or host provides substantial services in connection with the property or rental that is associated with a trade or business or if they are operating as a real estate dealer.

a. Substantial services is not defined and that is part of the problem.

b. It appears that substantial services are for the primary convenience of the tenant. This could include regular cleaning or maid service. It needs to be emphasized this is a subjective test.

3. Apportionment of Deductions

a. If there is any personal use of a dwelling unit or vacation home that taxpayers rent out, they must separate expenses for rental use versus personal use.

b. Generally, if the entire unit or home is being rented, the portion of the total expenses treated as rental expenses is determined by multiplying the total expenses by a fraction, with the denominator being the number of days the dwelling unit is used during the year and the numerator being the total number of days it is rented at fair value.

c. Allowable rental expenses are deducted on Schedule E or C, and allowable personal expenses are deducted on Schedule A: Itemized Deductions, if the taxpayer itemizes (e.g., mortgage interest).

F. Renting A Room out of a Residence

1. Taxpayers who rent out part of a residential unit and continue to occupy or have personal use of the remaining portion must first divide expenses attributable to both rental and personal use.

a. This would include mortgage interest, utilities on the entire property. The allocation must be between the portion of the residential unit used exclusively for rental purposes and the portion of it used for personal purposes as though they were separate pieces of property.

2. The allocation is generally one that is considered reasonable in nature. To that extent it can be one of two types:

a. Allocation based on square footage of the rental unit versus the entire residential property.

b. Allocation based upon the rental unit versus the total number of rental units in the residence. They can use any reasonable method for dividing the expense.

3. If the rental portion of the dwelling unit was used for less than the entire year, the deductible amount of the expenses for the rental portion of the dwelling unit is then determined by multiplying the total expenses for the rental portion of the property by a fraction, with the denominator being the number of days the portion of the dwelling unit is used during the tax year and the numerator being the total number of days the portion of the dwelling unit is rented at fair value.

a. In addressing the computation,, any day the portion of the unit is not rented is treated as a personal-use day.

4. Taxpayers can deduct the expenses associated the rental portion on Schedule E. It should be noted that the Passive Loss Limitations and At Risk limitations may apply if a loss occurs. The taxpayer should be advised of these limitations in the tax preparer should examine IRS Publication 527: Residential Rental Property.

5. The expenses that are deductible for the personal- use portion of the property, such as home mortgage interest and real estate taxes, are taken on Schedule A as itemized deductions.

6. Taxpayers do not have to divide the expenses between rental and personal use for the items that relate only to the rental portion, such as painting, repairs, or a second phone line. These expenses are deductible as rental expenses. They are also allowed to claim a depreciation deduction on furniture and equipment attributable to the rental property.

G. Self-Employment Tax Issues Regarding Rentals

1. Generally, rents from rental arrangements are not subject to self-employment tax.

2. Section 1402 (a) (1) provides an exclusion from such self-employment income for gross income that individuals other than real estate dealers earn from *"rentals from real estate and from personal property leased with the real estate."*

3. A real estate dealer is *"an individual who is engaged in the business of selling real estate to customers with a view to the gains and profits that may be derived from such sales."* (See Section 1221)

4. The regulations also provide that *"an individual who merely holds real estate for investment or speculation and receives rentals therefrom is not considered a real-estate dealer."* The courts have traditionally used the following factors (Winthrop, Ada Belle v. Tomlinson, (CA-5) 69-2 USTC ¶9686, 417 F2d 905)):

- The reason and purpose the property was acquired and/or disposed;
- The length of time the property was held;
- The number and frequency of sales, usually annually;
- The continuity of sales or sales-related activity over a period of time;
- Overall reluctance to sell the property;
- The substantiality of the gain obtained on the sale
- The extent to which the taxpayer or his or her agents engaged in sales activities by developing or improving the property, soliciting customers, or advertising;
- The substantiality of sales when compared with other sources of the taxpayer's income; and
- The desire to liquidate unexpectedly obtained land holdings
-

H. CCA 202151005- Income from Short-term Rental Includable in Self Employment Income

1. The Service recently in a CCA discussed 2 examples when income from short-term rentals is includable in self-employment income. Under Section 1402 (a)(1), net rental income generally is not included as income subject to self-employment tax unless the income is received by a real estate dealer or the rent includes substantial services provided to the occupant for the occupants convenience.

2. A rental activity is not a passive activity if the average period of customer use the property is 7 days or less in addition, rental activity is not passing if the taxpayer materially participates in the activity (Section 469)

Example 1

Individual who is not real estate dealer has been renting a fully furnished vacation property via an online. The individual provides daily housekeeping services, access to Wi-Fi, a beach and recreation equipment for occupants during their stay and prepaid vouchers for ride share services between the property and

nearby business. The customers used the property on average for 7 days. The activity is not considered a rental activity for purposes of the passive activity loss rules. The CCA notes that the taxpayer provided services for the occupants that are not clearly required to maintain the property in condition for occupancy and are of **such a substantial nature** that the compensation for those services constitutes a material portion of the rent. As such the net rental income is included in income subject to self-employment tax.

Note: The assumption is the activity is not a rental activity because of the seven day or less average requirement. Further, the assumption is that the taxpayer materially participates within the meaning of Section 469 (h) (1). As such the activity is not passive in nature. Thus, the net rental income is subject to self-employment tax because what the taxpayer provides is substantial services beyond what is required to maintain the space in a condition suitable for occupancy.

Example 2

An individual who is not a real estate dealer has a business renting fully furnished rooms and bathrooms in their home via an online rental marketplace. Renters only have access to the common areas of the home to enter and exit the room and bathroom and have no access to other common areas such as the kitchen and laundry area. The taxpayer cleans the room and bathroom in between each occupants stay. For the tax year at issue, the average period of customer use of the property 7 days and the taxpayer materially participates in the activity. The activity is not passive for purposes of the passive activity loss rules. Taxpayer's net income from renting of the living quarters is not income subject to self-employment tax because no services are rendered to the occupants. Taxpayer cleans and maintains the property so that it remains suitable for occupancy. The services are not furnished primarily for the occupants convenience.

Note: the net rental income is not subject to self-employment tax even though the taxpayer may materially participate in the activity which would make the activity active in nature. It is not subject to self-employment tax because the taxpayer is not providing substantial services beyond what is required to maintain the space in a suitable condition for occupancy.

I. Reg § 1.1402(a)-4. Rentals from Real Estate

1. Rentals from real estate and the deductions attributable thereto, unless the rentals are received by the taxpayer in the course of a trade or business as a real estate dealer are excluded from self-employment tax as a general rule.

2. Obviously, a taxpayer who holds real estate for investment or speculation and receives rentals is not a real estate dealer.

3. Where a real-estate dealer holds real estate for investment or speculation in addition to real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, only the rentals from the real estate held for sale to customers in the ordinary course of his trade or business as a real-estate dealer, and the deductions attributable thereto, are included in determining net earnings from self-employment; the rentals from the real estate held for investment or speculation, and the deductions attributable thereto, are excluded.

4. Under Regulation 1.1402 (c) – 4, payments or the use or occupancy of entire private residences or living quarters in duplex or multiple-housing units are generally rentals from real estate. Except in the case of real-estate dealers, such payments are excluded in determining net earnings from self-employment even though such payments are in part attributable to personal property furnished under the lease.

5. Likewise, payments for the use or occupancy of rooms or other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, or payments for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rentals from real estate; consequently, such payments are included in determining net earnings from self-employment.

6. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only.

7. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, the collection of trash, and so forth, are not considered as services rendered to the occupant.

8. Substantial Service Dilemma. The exclusion of rental activities from self-employment tax does not apply if substantial services are provided to the tenant or occupant. The determination of substantial services is a facts and circumstance examination.

a. The Regulation states that substantial services provided by a landlord or homeowner to a tenant/occupant involve a level of service that exceeds those usually or customarily rendered in connection with the rental of rooms or other spaces of occupancy.

b. In applying the above example there is no bright line test to determine substantial services. In examining the CAA the closest definition or test of substantial services is whether or not the occupant or tenant is receiving a **convenience or a benefit from the services provided**.

9. Despite the exposure for self-employment tax, the taxpayer if they provide substantial services and there is a loss the passive activity rules and at risk rules may place a limitation period. In the alternative, if the self-employment tax is not applicable the taxpayer may have some exposure under Section 1411 to the net investment income tax.

10. The Service has determined that if the taxpayer provide substantial services to an occupant/guest the income may need to be reported on Schedule C is the subject to self-employment tax. From a planning perspective, taxpayers may wish to consider alternatives such as moving the property into a S Corporation to mitigate FICA tax. Despite that movement, the taxpayer still would have to demonstrate material participation even in an S Corporation to obtain a loss deduction in the event that occurs.

11. To date there are no revenue rulings, revenue procedures, court cases that have addressed a definition of substantial services. This is going to be an issue going forward in the gig economy.

12. Obviously, and as previously stated, if the client does not provide substantial services then the net income from the rental would not be subject to self-employment tax and would be identified on Schedule E. It is still important to meet the 14 day or 10% test so that the deductions can occur.

J. Texas Law

1. 85R HB 2551. Texas has a definition of short-term rental. A short-term rental is any residential property including a single-family dwelling or unit in a condominium, cooperative or timeshare that is rendered wholly or partly for a fee for a period no longer than 30 consecutive days.

2. Note, this broad definition leaves great latitude for municipalities and county and city governments to assess occupancy and hotel taxes on a local level.

3. Airbnb. As of May 1, 2017, Airbnb's were required to collect and remit the state hotel occupancy tax on short-term rentals booked through Airbnb. A taxpayer should not report any of their Airbnb rental receipts to the Comptroller on the Texas Hotel Occupancy Tax Report (Form 12 – 100). The reason is that Airbnb will report rental receipts and remit the state hotel occupancy tax to the Controller for its host rentals. Host are responsible for collecting the state hotel occupancy tax and remitting it to the Comptroller of Public accounts.

a. Taxpayers that do not use Airbnb and advertise themselves are required to collect the state hotel occupancy tax and are likely required to pay local occupancy taxes as well. It is our understanding the Comptroller will be increasing audits in 2023 as result.

b. Taxpayers may close or state hotel occupancy tax account if, after May 1, 2017, they offer all of their short-term rentals through Airbnb. Those who do not close their accounts must file a report showing zero receipts or be subject to a $50 non-filer penalty.

c. A taxpayer that uses a third party such as Airbnb would not be liable for the state hotel occupancy tax collected after May 1, 2017 because they are using Airbnb and they have agreed to pay the tax on behalf of the home host.

d. Each county in the state of Texas can also set up in addition to the state hotel occupancy rate a local rate as well. Examples of that are provided below:

Comal County

Guests who book Airbnb listings that are located in the Water Oriented Recreational District of Comal County, TX will pay the following tax as part of their reservation:

- Lodging User Fee: 3% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, please visit the WORD of Comal County website.

Harris County

Guests who book Airbnb listings that are located in Harris County, TX will pay the following tax as part of their reservation:

- Harris County Hotel Occupancy Tax: 7% (unincorporated areas) or 2% (incorporated areas) of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, visit the Harris County Hotel/Motel Occupancy Tax website.
- Harris County Houston Sports Authority Hotel Occupancy Tax: 2% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, visit the Harris County Hotel/Motel Occupancy Tax website.

Abilene

Guests who book Airbnb listings that are located in the City of Abilene, TX will pay the following tax as part of their reservation:

- Hotel and Motel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, visit the City of Abilene tax information website.

Conroe

Guests who book Airbnb listings that are located in the City of Conroe, TX will pay the following taxes as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees for reservations 29 nights and shorter. For detailed information, visit the Conroe Hotel Occupancy Tax Collections website.

Corpus Christi

Guests who book Airbnb listings that are located in the City of Corpus Christi, TX will pay the following taxes as part of their reservation:

- Hotel/Motel Occupancy Tax: 9% of the listing price including any cleaning fees for reservations 29 nights and shorter. For detailed information, please visit the City of Corpus Christi, TX website.

Galveston

Guests who book Airbnb listings that are located in the City of Galveston, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 9% of the listing price including any cleaning fees, for reservations 30 nights and shorter. For detailed information, visit the Galveston Hotel Occupancy Tax website.

Garland

Guests who book Airbnb listings that are located in the City of Garland, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, please visit the City of Garland Tax website.

Glen Rose

Guests who book Airbnb listings that are located in the City of Glen Rose, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, visit the Glen Rose City Tax website.

Houston

Guests who book Airbnb listings that are located in the City of Houston, TX will pay the following taxes as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees for reservations 28 nights and shorter. For detailed information, visit the City of Houston Hotel Occupancy Tax website.

Irving

Guests who book Airbnb listings that are located in the City of Irving, TX will pay the following tax as part of their reservation:

Hotel Occupancy Tax: 9% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, please visit the City of Irving Financial Services website.

Kyle

Guests who book Airbnb listings that are located in the City of Kyle, TX will pay the following taxes as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees for reservations 29 nights and shorter. For detailed information, visit the City of Kyle Hotel Occupancy Tax website.

Mansfield

Guests who book Airbnb listings that are located in the City of Mansfield, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, visit the City of Mansfield tax information website.

McKinney

Guests who book Airbnb listings that are located in the City of McKinney, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 29 nights and shorter. For detailed information, please visit the City of McKinney Tax website.

Plano

Guests who book Airbnb listings that are located in the City of Plano, TX will pay the following tax as part of their reservation:

- Hotel Occupancy Tax: 7% of the listing price including any cleaning fees, for reservations 30 nights and shorter. For detailed information, visit the Plano Hotel Occupancy Taxes website.

4. HOA's and Short Term Rentals in Texas

a. Is conducting or engaging with Airbnb or VRBO allowed as a residential use?

This issue was addressed in 2018 via the *Tarr v. Timberwood Park Owners Ass'n, No. 16-1005, 2018* Tex. LEXIS 442 (May 25, 2018). In this case the taxpayer purchased his home in San Antonio but was transferred for work purposes to Houston. He used VRBO as well as forming his own leasing company to manage the rental property in San Antonio. He paid the hotel occupancy tax both state and local level. All the rentals were short-term. The homeowners association said him correspondence indicating that this was a violation of the homeowners association, covenants and deed restrictions. The homeowner filed a lawsuit seeking to refer the short term rentals did not violate the deed restrictions regarding residential use. The Association claimed that the rental violated residential use. The Texas Supreme Court overturned the lower court's and indicated that the homeowners association was incorrect in its restriction. The State Supreme Court cited Section 202.003 of the Texas Property Code that allows for a liberal interpretation of covenants regarding homeowners associations. The court determined that the definition of residential use could be interpreted more broadly. Specifically, the Supreme Court indicated that the restrictive covenant advocated by the homeowners association did not expressly forbid short-term leasing.

b. Homeowners Association changes rules and restrictions.

The issue obviously is whether a homeowners association can change its roles and restrict if not eliminate short-term rental leases. In order for this to occur, a majority of the owners within the subdivision or HOA would have to agree to adopt new restrictive covenants that restrict or deprive existing owners of their rights under the prior restrictive covenants.

Example

Chu v. Windermere Lakes Homeowners Ass'n, Inc., No. 14-21-00001-CV, 2022 WL 3723181, at *1 (Tex. App. Aug. 30, 2022). The Homeowner brought a lawsuit against the homeowners association for changing the rules and refusing the ability of the homeowner to continue with short-term rentals that had previously been allowed under a prior restrictive covenant. In this particular case, homeowners Association had in place restrictions providing no activity which is not related to single-family residential purposes shall be performed by any lot in the Association. Homeowners association then subsequently change the restriction by following their own bylaws to amend their rules to prevent any homeowner from leasing their property for less than 180 days. The homeowner argued that the new restrictions were invalid. Among her arguments was a notion of her being grandfathered in because she was under the old restrictions. In addition she argued that the modified restrictions should be void because it injures her rights and the rights of potential tenants to utilize her home. The appellate court determined that the restrictions that were changed were valid and that the homeowner had to be bound by the changes. For the change to have been permissible the court determined that the change was reasonable and that the amendment reinforced the existing or prior covenant of single family use that was consistent with the general plan for the subdivision.

K. Passive Activity Losses and Credit Limitations and Imposition of Tax Under Section 1411.

1. Section 1411 is associated with the net investment income tax and is assessed on net investment income.

2. To avoid the net investment income tax the taxpayer must demonstrate that they are not subject to the passive activity loss and credit limitations and that they in fact materially participate and met the material participation requirements under Temp Regulation Section 1.469 – 5T (a) (4).

3. In order to establish material participation under Temp Regulation Section 1.469 – 5T (a) (4), the taxpayer must establish such by reasonable means. This can include contemporaneous daily time reports, logs, or similar documents are not required if the extent of such participation may be established by other reasonable means.

4. Reasonable means for purposes may include but are not limited to the identification of services performed over a period of time and the approximate number of hours spent performing such services during such period, based on appointment books, calendars, or narrative summaries.

Example

Senty v. Comm., No. 22 – CV – 283 – WMC (W D Wisc. 124/15/23). The taxpayer was seeking a refund of Section 1411 net investment income tax assessed against him on an IRS audit. The husband had indicated he materially participate in three entities. Specifically he claimed that he could demonstrate material participation because he spent at least 100+ hours on each activity and such exceeded 500 hours resulting in material participation. The taxpayer lacked documentation to demonstrate material participation. The taxpayer stated he did not maintain a work counter appointment book, law, journal, timesheet or any of the document to keep track of hours and the type of work he did. He also rarely used email or text for work and though he claimed he did business through phone calls he did not produce any phone records instantiate his time. The taxpayer requested that he be allowed to post event re-creation to summarize the task done. The court did not allow this is or has to be significant third-party credible witness testimony which he could not produce.

IX. Section 165 Losses

A. General Rule

1. Section 165(a) allows a deduction for *"any loss sustained during the taxable year and not compensated for by insurance or otherwise."*

2. The basis for determining the amount of the deduction for any loss shall be the adjusted basis for determining the loss from the sale or other disposition of the property. (See Section 160 5B)

3. In the case of an individual taxpayer the deduction shall be limited to losses incurred in a trade or business, losses incurred in a transaction entered into for profit, though not conductive the trade, or and except as otherwise provided, loss of property not connect with the trade or business or transactions entered into for profit if such losses arise from fire, storm, shipwreck or other casualty or from theft business.(See Section 165 (c).

4 Any theft loss arising from theft shall be treated as sustained or the taxable year in which the taxpayer discovers the loss.

Examples

Shuat v. Comm., TC Memo 2024 – 103. The taxpayer did not provide any reliable evidence indicating when a purported theft had occurred. The taxpayer indicated his investment in and loans to a company all occurred before 2019. The taxpayer knew before 2019 that the company was a financial failure, improper activity had occurred and that he would not recover his investment. For these reasons the taxpayer failed to demonstrate that his purported losses were discovered in 2019. This would have entitled him to a loss deduction for the year. The loss being denied also denied his net operating loss carryover.

Giambrone v. Comm., TC Memo 2020 – 145. The taxpayers had a successful mortgage finance business they decided to start a federally chartered savings and loan bank. Losses did occur from the get-go but the taxpayers had more capital to cover the increasing losses. Upon a regulator examination, the taxpayers were advised that they would be increase operating restrictions resulting in them seeking additional capital. They sought additional capital from an unrelated third party by selling 75% of the business to the unrelated third party causing the taxpayer's share of the business to be reduced substantially. The third-party they sought the additional capital from was involved in a fraud scheme and the thrift was subsequently shut down. The taxpayers claimed theft losses of 95% of the value of their investment in the thrift business on their tax returns. The taxpayer cited Rev. Proc 2019 – 20 that provided an optional safe harbor for taxpayers to experience losses in certain investment arrangements discovered to be criminally fraudulent. The court found that the safe harbor treatment must be elected on the taxpayers return in the year of discovery of the theft. This had not occurred. The brothers also claimed that they had suffered a theft of their controlling interest in the institution. It was determined that the third party was ordered to repay restitution and that should have been a factor in determining if the taxpayers had a reasonable prospect of recovery prior to taking the theft deductions on the return. The taxpayers were never named as victims with respect to the fraud scheme. The reasonable prospect of recovery had occurred in a subsequent timeframe.

5. Decline in value and Theft Loss.

Example

Pascucci v. Comm., TC Memo 2024 – 43. The taxpayer was not entitled to a theft loss deduction or losses from the declining cash value of separate accounts for variable life insurance policies after unraveling of a high profile Ponzi scheme. The taxpayer never owned the assets in the stated account at the time the theft occurred. Likewise, the taxpayer was not a qualified investor in the insurance policies and was not entitled to any theft deduction safe harbor.

X. Other Gross Income Recognition Matters

A. Gambling Winnings and Losses

1. Gambling income. Gambling income isn't limited to in-person winnings at horse races, and casinos. It may also include winnings from playing online games and participating in television game shows. Gambling income includes both cash winnings and the fair market value of prizes, such as cars and trips.

2. Payors required to report income. Anyone who pays out gambling winnings must issue the winner a Form W – 2 G: Certain Gambling Winnings when the taxpayer's winnings are:

- $1,200 or more (not reduced by the wager) from a bingo game or slot machine,
- $1,500 or more (reduced by the wager) from a keno game,
- More than $5,000 (reduced by the wager or buy-in) from a poker tournament,
- $600 or more and at least 300 times the amount of the wager (except winnings from bingo, slot machines, keno, and poker tournaments) reduced, at the option of the payer, by the wager, or
- Subject to federal income tax withholding (either regular gambling withholding or backup withholding).

3. A payer that withholds tax from a gambler's winnings should always file a Form W-2G with the IRS (and provide a copy to the winner) that shows how much the individual won and the amount of tax withheld.

4**.** Taxpayers who have gambling winnings must report all such income on Form 1040, U.S. Individual Income Tax Return, or Form 1040 – SR, U.S. Tax Return for Seniors. This includes amounts that are not reported on a Form W – 2 G.

5. Gambling winnings are reported on Schedule 1 (Form 1040).

6. Generally, income tax is withheld from gambling winnings of more than $5,000 from a:

- sweepstakes,
- wagering pool,
- poker tournament,
- lottery, or
- any other wager if the proceeds are at least 300 times the amount of the bet.

7. Usually, income tax is withheld at a flat 24% rate. Income tax is not usually withheld from gambling winnings from bingo, keno, and slot machines.

B. Gambling Losses

1. Gambling losses are an itemized deduction taken on Schedule A (Form 1040). Nonprofessional gamblers can't deduct gambling losses that exceed the gambling income reported on their return. Gambling losses can be claimed up the amount of gambling income as "Other Itemized Deductions" on Schedule A.

Examples

Kalk v. Comm., TC Memo 2024 – 82. Taxpayer was entitled to deduct gambling losses up to the amount of her gambling winnings to the extent substantiated. The taxpayer substantiated losses with casino win loss statements. The taxpayer did not obtain deductions for other years because of the lack of substantiation the signing in of a casino member card is not enough to substantiate deduction.. The court will allow a non-contemporaneous documentation to prove losses as well as bank statements.

Bright v. Comm., Tax Court Docket No. 10095 – 22 (5/4/23). The taxpayer hired to prepare a report his gambling activity on Schedule C showing $240,895 of gross receipts in equal amount of expenses. The IRS determined that taxpayer was not a professional gambler and that his winnings should be reported as miscellaneous income and is losses should be a miscellaneous itemized deduction. Taxpayer did not know how the return preparer calculate his winnings on Schedule C a since he was unable to establish that his winnings were less than what he reported on return, the court agreed with the Service that the gambling winnings were $240,895. The taxpayer failed to establish gambling losses in the amount he reported on the return. Records did establish that he and losses of no less than $191,756.

C. Qualified Transportation Fringe Benefits

1. Prior to the implementation of Tax Cuts and Jobs Act, the value of qualified transportation fringe benefits provided by an employer to an employee was excluded from the employee’s gross income subject to monthly limits.

2. Qualified transportation fringe benefits were defined as consisting of:

- Commuter transportation in a commuter highway vehicle
- Transit Passes
- Qualified Parking
- Qualified bicycle commuting reimbursement

Note: qualified bicycle commuting reimbursement is not an exclusion for tax years beginning after December 31, 2017 before January 1, 2026.

3. Employers may provide employee with one or more of these benefits at the same time. However, they must not exceed a monthly excludable limit. The excludable limit is exempt from withholdings and payment of employment taxes, is not reportable on the employee's form W – 2 and thus is not includable in income.

4. For 2024, an employee will be able to exclude up to $315 a month for qualified parking expenses, and up to $315 a month of the combined value of transit passes and transportation in a commuter highway vehicle. (See Rev. Proc. 2023-34)

5. For 2025, an employee will be able to exclude up to $325 a month for qualified parking expenses, and up to $325 a month of the combined value of transit passes and transportation in a commuter highway vehicle. (See Rev. Proc. 2024 – 40)

D. Working Condition Fringe Benefits

1. Working condition fringe benefits include property or services that, if the employee had paid for the property or service, the cost would have been allowable as a business expense deduction to the employee. That is, if the cost of an item is an allowable business expense deduction for the employee, it may be excludable from the employee's wages as a working condition fringe benefit if provided by the employer. (See Section 132(d))

2. To be excludable as a working condition fringe benefit, all the following must apply:

- The benefit must relate to the employer's business,
- The expense would have been an allowable business expense deduction to the employee if the expense had been paid personally, and
- The business use must be substantiated with records.

3. Cash payments or cash equivalents are not working condition fringe benefits. However, they may be excludable to represent reimbursements paid under an accountable plan.

E. De Minimis Fringe Benefits

1. De minimis fringe benefits include any property or service, provided by an employer for an employee, the value of which is so small in relation to the frequency with which it is provided, that accounting for it is unreasonable or administratively impracticable. The value of the benefit is determined by the frequency it's provided to each employee, or, if this is not administratively practical, by the frequency provided by the employer to the workforce as a whole. (See Section 132(e); Treas. Reg. Section 1.132-6(b))

a. In other words, the benefit provided must not be routine but occasional or infrequent in nature.

2. There is no value threshold for the benefit to qualifies de minimis. The determination is a fact and circumstance examination. The service has taken the position in Publication 5137 that a benefit value $ 100 does not qualify as the minimum. Having said that, the service in the same publication has provided a nonexhaustive list of excludable de minimis fringe benefits which include the following:

- Personal use of photocopier (no more than 15% of total use)
- Group meals, employee picnics
- Theater or sporting event tickets
- Occasional coffee, doughnuts or soft drinks
- Flowers or fruit for special circumstances
- Local telephone calls
- Traditional birthday or holiday gifts (not cash) with a low FMV
- Commuting use of employer's car if no more than once per month
- Employer-provided local transportation
- Personal use of cell phone provided by employer primarily for a business purpose

3. Occasional meals or the reimbursement for occasional meals can qualify for the exclusion. Occasional meals or monies provided for such can be an exception inscrutable if three conditions are met:

- The meal is reasonable value and not provided regularly or frequently.
- Overtime work necessitates an extension of the employee's normal work schedule.
- The meal is provided for overtime work to enable the employee to work in the meal is provided on the employer's premises.

4. If the meal is provided as part of a company policy they are not excludable because the benefit is required and is not viewed as occasional in nature.

5. Commuting involving unsafe conditions. – Treasury Regulation 1.61 – 21 (k) (1)

a. Under a special rule, transportation provided for commuting (occasionally or regularly) to a qualified employee solely because of unsafe conditions, may be valued and included in wages at $1.50 per trip, with the remainder excludable.

b. For this purpose, "unsafe conditions" exist if a reasonable person would, under the facts and circumstances, consider it unsafe for the employee to walk to or from home, or to walk or use public transportation at the time of day the employee must commute.

c. A "qualified employee" for this purpose is one who:

- Performs services during the year;
- Is paid on an hourly basis;
- Is not exempt under the Fair Labor Standards Act (FLSA) of 1938;
- Is within a classification to which the employer actually pays, or has specified in writing that it will pay, overtime pay of at least 1 ½ times the regular rate provided in FLSA Section 207; and
- Received pay of not more than a specified dollar amount for the year ($130,000 for 2020
- Treas. Reg. Section 1.61-21(k)(6)

d. For this special rule to apply the following conditions must be met:

- The he employee would ordinarily walk or use public transportation for commuting;
- A written policy is in place under which transportation is not provided for personal purposes other than commuting because of unsafe conditions; and
- The employee does not use the transportation for personal purposes other than commuting because of unsafe conditions. Treas. Reg. Section 1.61-21(k)(1)

Example

Abel is a qualified employee and works as a data entry clerk for a corporation. Her normal hours of work are 10 PM to 7 AM. Public transportation is the only means of transportation available to her. She's considered unsafe by a reasonable person at the time she is required to commute from home to the job. Employer hires a car service to pick her up at home each evening and bring her to work and return her home each morning when she finishes her work. The amount includable in her income is a dollar 50 for the one-way commute from home to work each day because the transportation is deemed unsafe at that time of day. The fair market value the commute from work to home each morning is includable because unsafe conditions do not exist for the trip.

F. No Additional Cost Services

1. A service provided to employees that does not impose any substantial additional cost on the employer may be excludable as a no-additional-cost fringe benefit. A "no-additional-cost service" is a service the employer offers to its customers in the ordinary course of the line of business in which the employee performs substantial services, and the employer incurs no substantial additional cost (including foregone revenue) in providing the service to the employee. (See Section 132(b))

2. To determine whether the employer incurs any substantial additional cost, include lost or foregone revenue as a cost. An employer is considered to incur substantial additional costs if the employer or employees spend a substantial amount of time in providing the service to the employee receiving the service, even if their time spent would otherwise be idle or if the service is provided outside normal business hours. Determine whether an employer incurs substantial additional cost without regard to any amounts paid by the employee for the service. (See Treas. Reg. Section 1.132-2(a)(5))

3. If the no additional cost benefit is only provided to highly compensated employees it is not excludable from income. (See Treas. Reg. Section 1.132 – 8)

Example

Mihalik v. Comm., TC Memo 2022 – 36. Taxpayer was a retired airline pilot they had to include in gross income the value of standby airline tickets that were provided to their adult relatives under the airlines retiree benefits program. The taxpayers argue that it was a no additional cost service excluded amount. That argument failed in face of the facts that the adult relatives were not the taxpayer's dependents and that they did not qualify as an employee. Likewise the taxpayer was retired and no longer met the definition of employee for the exclusion under this provision.

G. Prizes and Awards

1. Under Section 74 (a), prizes and awards are taxable to the recipient as gross income.

2. However prizes and awards made primarily recognition of religious, charitable, scientific, educational, artistic, literary or civic achievement can be excludable from gross income if:

s. The recipient was selected WITHOUT any action on his or her part to enter the contest;

b. The recipient is not required to render substantial future services as a condition to receive the prize or award;

c. Upon the recipient's request, the payor must immediately transfer the prize or award to a governmental unit or qualified tax-exempt organization.

Example

Convers v. IRS, Tax Court Docket No. 13969 – 18. The taxpayer was a senior in high school and was awarded a car by a local car dealership during its annual strive to drive competition. The taxpayer accepted to the car and registered it in her name. The strive to drive program was an academic initiative that encourage good grades and attendance for local high school seniors. Students did not enter their names in the competition. High schools automatically enter students names who had perfect attendance for good grades into the drawing. At the end of the school year, the dealership randomly picked the name from the qualified high school seniors. The taxpayer asserted that receiving the car was a gift should be excludable from income the IRS indicated it was a prize or award and that the fair value of the vehicle was taxable. The Tax Court agreed with the IRS. The Tax Court never discussed the issue of gift. Rather, the Tax Court indicated the dealership gave the taxpayer something of value to reward her for her good grades and perfect attendance which makes clear that that value is includable in gross income.

H. Crowdfunding Distributions – FS – 2024 – 28

1. The IRS on's website released a fact sheet reminding taxpayers that crowdfunding distributions may be includable in gross income of the person receiving them depending upon facts and circumstances.

2. In addition, the crowdfunding site or its payment processor may be required to report these distributions to the IRS on Form 1099 – K.

3. Crowdfunding involves funding a project by raising contributions of a large number of people typically through online websites. Often they are associated with a charitable cause that does not involve a recognized 501(c)(3).

4. The American Rescue Plan Act of 2021 clarifies that crowdfunding websites or their payment processors may not be required to file Form 1099 – K with the IRS or furniture to the persons whom the distributions are made if the payments are not made in exchange for goods or services.

5. Originally, the reporting threshold for Form 1099 – K were distributions to a person exceeding $20,000 from more than 200 transactions.

6. Notice 2023 – 10 and Notice 2023 – 74. For 2024, the IRS announced a plan threshold to be reduced to $5,000 as a phase in of the new 1099 – K reporting requirement.

7. The IRS also indicated that in some instances it may be possible to treat these distributions as gifts. The service acknowledged that some contributions may qualify as a gift if it is made as a result of the contributors detached and disinterested generosity.

I. Home Energy Rebates Not Includable in Gross Income – IRS Announcement 2024 – 19

1. Rebates paid at the time of sale under two home energy rebates programs that were created in the Inflation Reduction Act are not includable in the individual purchases gross income or cost basis.

2. The Inflation Reduction Act of 2022 appropriated money and authorized the Energy Department to administer to rebate programs under Sections 50121 and 50122, one for whole house retrofits and the other for high energy home electrification projects.

3. A rebate paid to or on behalf of a purchaser will be treated as a purchase price adjustment and is not includable in the purchases gross income under Section 61.

4. A rebate paid the time of sale is not includable in the purchases cost basis under Section 1012. By way of illustration, if the purchaser receives a $500 rebate at the time of sale of the property with the sales price of $600, the purchases cost basis in the property is $100.

5. The amount of rebate provided later constitutes an adjustment to basis under Section 1016. By way of illustration, if a purchaser spent $600 to buy eligible property but later receives a $500 rebate purchasers cost basis is reduced to $100 when the rebate was provided.

6. The payor of the rebate is not required to file information return with the IRS or seek a statement to the purchaser to report the payments of a rebate to the purchaser.

7. Rebate payments made directly to a business taxpayer in connection with the business taxpayer sale of goods or services to a purchaser are not excluded from the taxpayer's gross income.

8. The rebates coordinate with Section 25 C credit that allows taxpayers receive a credit up to 30% of certain qualified expenditures that go toward energy efficient improvements to the home.

9. Taxpayers to receive rebates under the Department of Energy home energy rebate programs and who are also eligible for the credit must reduce the amount of the qualified expenditures used to calculate the credit by the amount of the rebate.

10. The taxpayer purchases an item or the item is eligible for both rebates and the Section 25 C credit, to determine the amount paid for the item, the taxpayer allocate the rebates pro rata individually itemized expenditures as a share of the total project cost.

Example

A taxpayer receives a $2,000 rebate for a whole house energy savings retrofit and allocates it proportionately, 60% to $3,000 in qualifying expenditures for a heat pump ($1,200 of the $2,000 rebate) and 40% to $2,000 in qualifying expenditures for insulation ($800 of the $2,000 rebate). The taxpayer may treat the amount paid or incurred for the heat pump as $1,800 ($3,000 less $1,200 allocated portion of the rebate) and the amount paid or incurred for the installation is $1,200 ($2,000 less the $800 allocated portion of the rebate).

J. Constructive Receipt from IRA is Gross Income

Example

Hubbard v. Comm., TC Memo 2024 – 16. The taxpayer was liable for taxes with respect to a distribution from his IRA because he constructively received the income when he criminally forfeited his IRA. The Tax Court has ruled that when a taxpayer forfeits their IRA to the government due to a criminal conviction it is an involuntary distribution that is includable in income. The taxpayer argued that since the sales proceeds were paid directly to the government the taxpayer never had dominion or control over the funds and as such the constructive receipt doctrine does not apply. The taxpayer also argued he did not take any willful or voluntary act to distribute the IRA that was forfeited. The Tax Court concluded that they funds were not under his control but that the taxpayer constructively received the funds by having received the economic benefit through the satisfaction of his forfeiture liability to the government. Willful or purposeful cause is not part of the conversation in terms of determining tax liability.

K. Qualified Wildfire Relief Payments

1. If the taxpayer receives such payments during the years these are nontaxable, the taxpayer should consult Publication 547.

L. Annuities – Section 72

1. Gross Income includes any amounts received as an annuity, whether for a certain timeframe or during one or more lives, under an annuity agreement, endowment, or life insurance contract.

2. If any amount is received as an annuity for a timeframe of 10 years or more or during one or more lives under any portion of an annuity, endowment, or life insurance contract such portion shall be treated as a separate contract, the investment in such contract shall be allocated pro rata between each portion the contract for which amounts are received as an annuity and the portion the contract for which amounts are not received as an annuity and a separate annuity starting date shall be determined with respect to each portion of the contract for which amounts are received as an annuity.

3. Gross income does not include that part of any amount received as an annuity which bears the same ratio to such amount as the investment in the contract bears to the expected return of the contract. The portion of the amount received as an annuity which is excluded from gross income shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

Examples

IRS Letter Ruling 202445015. A contract (C1) would be treated as an annuity contract under Code Sec. 72. C1 was approved for use by an issuer (I1). C1 and the amounts paid under C1 met the requirements of Reg. §§1.72-1(b) and (c), 1.72-2(a)(1) and (b)(3), and 1.72-4(b)(1) as an annuity contract and annuity payments. C1 was purchased "by making periodic payments" of premium for a promise by a life insurance company to pay the beneficiary a given sum for a specified period. This period could terminate at death, and was used to provide long-term income security. In addition, the guarantee payments and conversion annuity payments would be taxable as "amounts received as an annuity" under Section 72(b). No additional contract charges would be due after C1 obligations were fixed. And I1 was obligated to pay the guarantee payments until the taxpayer's death. The total amount payable was determinable from C1 using mortality tables and sound actuarial theory. C1 could not be monetized at the discretion of the taxpayer other than through receipt of guarantee payments or exercise of the option to receive conversion annuity payments.

IRS Letter ruling 202444003. Guarantee payments and conversion annuities made by a life insurance company are taxable as an amount received as an annuity. A taxable brokerage or similar investment account owned by the taxpayer would not cause the annuity to have a cash value or surrender value under Section 72 and would not otherwise be part of the annuity contract. Under this section the aggregate amount of premiums or other consideration paid for the annuity would equal the sum of all contract charges plus any conversion premiums paid by the taxpayer.

M. Social Security

1. Current Rule: Social Security benefits are taxable up to 85% if income exceeds $25,000 (single) and $32,000 (MFJ). The values have not been adjusted since 1984.

2. Social Security Benefits are Taxable even if partially Offset by Workers Compensation

Example

Ecret v. Comm., TCM 2024 – 23. The taxpayer was injured on the job in 2014. She received $42,000 in Workmen's Compensation benefits from the state. She also received $55,248 of Social Security benefits of which $19,866 was attributable to 2019. The balance of $35,382 reflected retroactive benefits attributable to 2016 through 2018. Under both Social Security and Workmen's Comp. limits the amount of combined Worker's Compensation and Social Security benefits that an individual may receive in a given year cannot exceed 80% of his or her average current earnings. The average current earnings is a benchmark determined by Social Security and it is a monthly benchmark. In this case the benchmark for the taxpayer was $4,059. When a payment of Social Security benefits causes the individual's combined benefits to exceed the 80% threshold Social Security must stop dispersing benefits. The undisbursed benefits are set to be an offset by the Workmen's Compensation payments. The taxpayer had $19,866 in Social Security benefits. Of this $7,200 of such benefits were distributable to the taxpayer. Social Security did not distribute the remaining $12,666 on account of the workers compensation offset. The taxpayer nonetheless is required to treat this some as Social Security benefits for federal tax purposes.

3. The incoming administration is to discuss the elimination of any taxation Social Security placing it in a nontaxable status in 2025. It is anticipated proposed legislation will be made to this effect in 2025.

N. Section 529 Plans

1. The SECURE Act Made Two Changes to Section 529 Plans

a. Student loans. Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) provided that up to $10,000,reduced by the amount of distributions so treated for all prior taxable years, could be withdrawn from a Section 529 plan for the purpose of paying principal or interest on any qualified education loan of the beneficiary or his or her siblings. This is effective for distributions made after December 31, 2018.

b**. Apprenticeship programs**. SECURE also provided that a qualified distribution includes tuition, books, supplies, and equipment required for Apprenticeship Programs if the program is properly registered and certified by the Department of Labor. This is effective for distributions made after December 31, 2018.

2. SECURE 2.0 Allows Rollover to Roth IRA Beginning in 2024 for Some Section529 Plans

a. Beginning in 2024, some Section 529 funds may be rolled over tax-free to a Roth IRA for the beneficiary in a trustee-to-trustee transfer. This change allows unused college savings to be transferred to the beneficiary's retirement account without taxes.

b. The life-time rollover limit is $35,000 and the Section 529 account must have been open for at least 15 years. The annual rollover amount cannot exceed the annual contribution limit for Roth IRAs, but there are no AGI limits. Section 529 contributions and earnings on those contributions in the last 5 years may not be rolled over.

3. Distributions for Elementary and Secondary School Tuition Are Qualified

a. TCJA modified Section529 plans to allow such plans to distribute not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private, or religious elementary or secondary school. This limitation applies on a per-student basis, rather than a per-account basis. Thus, under the provision, although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of $10,000 in distributions free of tax, regardless of whether the funds are distributed from multiple accounts. Any excess distributions received by the individual would be treated as a distribution subject to tax under the general rules of Section 529.

b. The term "elementary or secondary" means kindergarten through grade 12 as determined under state law, the same as for the Coverdell education savings account (See Notice 2018-58).

References:

The Inflation Reduction Act of 2022 (IRA 22), PL 117 – 169**.**

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION III:

ADJUSTMENTS TO GROSS INCOME

I.. Health Savings Accounts

A. 2024 Figures – Rev. Proc 2023-23

1. The 2024 maximum contribution to an HSA that may be made for calendar 2024 by an individual with self-only coverage will be $4,150, a $300 increase from 2023. For an individual with family coverage, the maximum contribution will be $8,300, which is $550 higher than the current limit of $7,750.

2. The $1,000 "catch-up" additional contribution that may be made by individuals who are age 55 or older before the end of the tax year is unchanged

3. Likewise, the HDHP must have an annual deductible of at least $1,600 for self-only coverage ($100 higher than for 2023) or $3,200 for family coverage (a $200 increase).

4. The, annual out-of-pocket expenses, including deductibles, co-payments, and other amounts exclusive of premiums may not be more than $8,050 for self-only coverage or $16,100 for family coverage — increases, respectively, of $550 and $1,100.

B. 2025 Figures – Rev. Proc 2024-25

1. The 2025 maximum contribution to an HSA that may be made for calendar 2025 by an individual with self-only coverage will be $4,300, a $150 increase from 2024. For an individual with family coverage, the maximum contribution will be $8,550, which is $250 higher than the current limit.

2. The $1,000 "catch-up" additional contribution that may be made by individuals who are age 55 or older before the end of the tax year is unchanged.

3. Likewise, the HDHP must have an annual deductible of at least $1,650 for self-only coverage ($50 higher than for 2024) or $3,300 for family coverage (a $200 increase).

4. The, annual out-of-pocket expenses, including deductibles, co-payments, and other amounts exclusive of premiums may not be more than $8,300 for self-only coverage or $16,600 for family coverage.

C. Notice 2024 – 75: Expanded List of Preventive Care Services for High Deductible Health Plans

1. To be eligible to contribute to a health savings account, an individual must be covered by a high-deductible health plan (HDHP).

2. The HDHP may not provide coverage for health care below the statutorily determined high deductible amount; however, expenses paid for preventive care can be paid by the HDHP below the deductible.

3. Notice 2024-75 expands the list of preventive care benefits that can be provided by a HDHP to include over-the-counter oral contraceptives and male condoms.

4. The Notice clarifies when breast cancer screening, glucose monitors for individuals diagnosed with diabetes, and certain insulin products are treated as preventive care benefits.

II. Medical Savings Accounts

A.. 2024 – Rev. Proc. 2023 – 34; IR 2023 – 208

1. Self-only coverage. For taxable years beginning in 2024, the term " high deductible health plan" as means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,800 and not more than $4,150, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $5,550.

2. Family coverage. For taxable years beginning in 2024, the term " high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $5,550 and not more than $8,350, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $10,200.

B. 2025 – Rev. Proc. 2024 – 40; IR 2024 – 273

1. Self-only coverage. For taxable years beginning in 2025, the term " high deductible health plan" as means, for self-only coverage, a health plan that has an annual deductible that is not less than $2,850 and not more than $4,300, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $5,700.

2. Family coverage. For taxable years beginning in 2025, the term " high deductible health plan" means, for family coverage, a health plan that has an annual deductible that is not less than $5,700 and not more than $8,550, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits do not exceed $10,500.

C. Limit on Health FSA Salary Reduction Contributions under a Cafeteria Plan

1. 2024. For purposes of determining whether health FSA benefit will be a "qualified benefit" for the 2024 plan year, the cafeteria plan must provide the employee may not elect to have a salary reduction contributions exceeding $3,200. (See Rev. Proc. 2023 – 34; IR 2023 – 208)

2. 2025. For purposes of determining whether health FSA benefit will be a "qualified benefit" for the 2025 plan year, the cafeteria plan must provide the employee may not elect to have a salary reduction contributions exceeding $3,300. (See Rev. Proc. 2024 – 40; IR 2024 – 273)

III. Student Loan Interest Deduction

A. General Rule

1. A taxpayer may deduct the lesser of $2,500 or the amount of interest paid on a qualified student loan. The deduction is subject to a phased-out based upon modified adjusted gross income in association with the taxpayers filing status.

2. The loan must be a qualified student loan. A qualified student loan is a loan the taxpayer took out only to pay qualified education expenses that were:

- For the taxpayer, spouse, or a person who was your dependent when the taxpayer took out the loan;
- Paid or incurred within a reasonable period of time before or after the taxpayer took out the loan;
- For education provided during an academic period for an eligible student.

B. Thresholds

1. For 2024, the deduction phases out ratably for taxpayers other than joint filers with MAGI between $80,000 and $95,000, and MAGI between $165,000 and $195,000 for joint filers. (See Rev. Proc. 2023-34)

2. For 2025, the deduction phases out ratably for taxpayers other than joint filers with MAGI between $85,000 and $100,000, and MAGI between $170,000 and $200,000 for joint filers. (See Rev. Proc. 2024 – 40)

IV. Educators Expense Deduction

A. IR 2024 – 219

1. The educator expense deduction remains capped $300 per educator. In other words, a joint filing can claim up to $600 if both spouses are eligible.

2. The tax benefit covers out-of-pocket expenses on classroom items like books, supplies, and equipment (including computers and software) as well as COVID-19 safety measures such as masks, disinfectants, and air purifiers.

3. Costs for homeschooling or nonathletic supplies for courses in health or physical education are not included.

4. The tax benefit may also be used to offset expenses for professional development courses relevant to teaching, though the IRS said it could be more advantageous to use other educational tax benefits like the lifetime learning credit.

V. Alimony

A. Audit Risk Item.

1. The IRS is indicated that many taxpayers are taking a deduction for alimony and a corresponding taxpayer is not including it in income. The Service will give greater scrutiny to the deduction of alimony on tax return as a result.

B. Current Rules on Alimony

1. Alimony is generally deductible from gross income by the payor an includable in the income of the payee. For payments made to, or on behalf of, former spouses to qualify as a deduction certain requirement must be met and they include the following:

- Payment must be made in cash (transfer of property or services do not qualify).
- Payments must be received by spouse (or on behalf of spouse, i.e., indirect alimony).
- Payment is required under divorce or written separation agreement (i.e., no voluntary Payments).

- There is nothing in the agreement designating the payment is not alimony or that the payment is not taxable to the recipient spouse.
- Payee and payer spouse cannot live together (no joint return).
- Alimony must stop after payee spouse's death (state statutes may require if agreement Silent!)
- Payments are not related to a child-related contingency (e.g., child reaches age 18).
- Recapture may be required if "excess front-loading" (i.e., if the alimony payments in the first year exceed the average payments in the second and third year by more than $15,000 and to the extent the payments in the second year exceed the payments in the third year by more than $15,000).

Note: Lump sum payments can qualify as alimony. Likewise debt payments cannot qualify.

Examples

Rojas v. US 22-70232 (CA – 9, 2024). The Ninth Circuit affirmed the tax court's decision in determining that a married couple was not entitled to deduct family support payments made by the husband to the ex-wife. According to the divorce documents, the payments were subject to a child -related contingency. The taxpayer argued that the contingency does not apply because a California Superior Court had already determined there was no current child support order in place. The taxpayers further argued that the Full Faith and Credit Act precluded the Tax Court and the iris from relitigating whether family support provisions are child support for tax purposes. The Superior Court's decision simply clarified the category of support as labeled in the divorce decree without commenting on the nature of the support for tax purposes. As such, the Full Faith in Credit Act does not limit nor bar the iris for the Tax Court from relitigating unresolved questions.

Martino, Jr. v. Comm., TC Memo 2024 – 18. The taxpayer was not entitled to an alimony deduction for payments made to the ex-wife because the payments did not qualify as alimony under the IRS code. During the years at issue, alimony was treated differently since it was generally deductible the payor and taxable to the payee. To qualify as alimony, the payments had to satisfy various conditions. One of the conditions for the payment to be considered alimony stated that the divorce decree must not designate such payment is a payment which was not includable in gross income and not allowable as a deduction. As such, a non-alimony designation be clearly reflected in the court document. In this case, no single document specify the precise payments to which the taxpayers ex-wife was entitled. The divorce instrument consisted of multiple documents executed over a time frame including the settlement agreement, the divorce decree and consent and contempt orders. The consistent import of the instrument was at the taxpayers payments did not constitute alimony but were installment payments in discharge of property settlement. The switch from a lump sum payment to installment payments to the taxpayers default does not convert the settlement to alimony. The taxpayer argued he was entitled to an alimony deduction because the final consent order issued by the Lower Court did not explicitly state the payments were not includable in gross income of the ex-spouse. The Tax Court read the final order in conjunction the divorce decree and the prior lower court orders. Entirety of the payment was allocated to non-alimony associated with property settlement.

2. Alimony deduction was allowed for healthcare previous purchase with pretax wages.

Leyh v. Comm., 157 TC 7. The taxpayer and his spouse had separated and signed an agreement incident to their divorce. Husband promise to pay wife alimony until the final divorce was granted. As part of the agreement, husband paid for her health and vision insurance. Husband paid over $10,000 in insurance premiums as pretax payroll reductions through his employer's cafeteria plan. On his tax return he filed married filing separately and excluded the premium payments and claimed a deduction for alimony in the amount of the health insurance payments. The IRS disallowed the deduction claiming it was a double deduction by deducting as alimony payments as spouse health insurance premiums that were paid to him

as compensation but excluded from gross income. The Tax Court held that the husband was entitled to deduct the premiums as alimony. The court noted the husband received the health insurance compensation when the parties were still married and state law recognizes only divorce not a legal separation. The final decree of divorce was not issued until a year later therefore the taxpayers could have filed a joint return and avoid the alimony issue altogether. The wife would then not have been required to include any portion of payments in her income. However, because she was required to include the alimony payments allowed the taxpayer husband is allowed to claim a corresponding deduction. The court indicated there was no risk of a windfall to the husband.

3. Prenuptial Agreements

a. IRS Letter Ruling 202426011. The IRS has ruled that payments received by a taxpayer pursuant to an agreement and prior to the final judgment of divorce constitutes alimony received by the taxpayer and is thus includable in the taxpayer's gross income. The taxpayer's receipts of any amounts payable pursuant to a prenuptial agreement constitutes alimony to the taxpayer and are includable in the taxpayer's income in the year received. The payments received by the taxpayer under the agreement and after the agreement was incorporated but not merged into the final decree of divorce constitutes alimony in the year received.

B. Transfer Incident to a Divorce

1. Under Section 1041, no gain or loss is recognized on a transfer of property from an individual to a spouse or former spouse if the transfer is incident to the divorce. A transfer property is incident to the divorce if the transfer occurs within one year after the date the marriage ceases or is related to the cessation of the marriage.

2. A transfer is related to the cessation of the marriage if it is pursuant to a written divorce or separation agreement and the transfer occurs within six years of the divorce.

3 A transfer of property incident to a divorce can include business property or the transfer of business interests and thus not result in the transfer being considered a taxable event. (See Belote v. Comm. TCM 2016 – 113)

VI. Retirement and Individual Retirement Accounts

A. Traditional IRA Contributions –2024; IR 2023 – 203; Notice 2023-75

1. The contribution amount is the lesser of:

- $7,000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

2. Catch-up Contribution. For 2024, the taxpayer can make a catch-up contribution of $1,000 if they are age 50 or older.

3. MAGI Phase out Limitation. For 2024, the active participation MAGI limitation phase- out is as follows:

Filing Status	**Amount**
Single (HOH)	$77,000 – $87,000
Married Filing Joint	$123,000 – $143,000
Married Filing Separately	$0 – $10,000

4. For 2024, a nonworking spouse may make IRA contributions based on the earned income of his or her spouse. For an IRA contributor who is not covered by workplace retirement plan and is married to one who is covered, the MAGI deduction phase out for 2024 is between $230,000 – $240,000.

B. Traditional IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80

1. The contribution amount is the lesser of:

- $7,000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

2. Catch-up Contribution. For 2025, the taxpayer can make a catch-up contribution of $1,000 if they are age 50 or older. The SECURE 2.0 Act of 2022 allows for an annual cost of living adjustment starting next year.

3. MAGI Phase out Limitation. For 2025, the active participation MAGI limitation phase- out is as follows:

Filing Status	**Amount**
Single (HOH)	$79,000 – $89,000
Married Filing Joint	$126,000 – $146,000
Married Filing Separately	$0 – $10,000

4. For 2025, a nonworking spouse may make IRA contributions based on the earned income of his or her spouse. For an IRA contributor who is not covered by workplace retirement plan and is married to one who is covered, the MAGI deduction phase out for 2024 is between $236,000 – $246,000.

4. Traditional IRA contributions must be actually made to be deductible.

Example

Pope v. Comm., TCS 2024 – 15. The taxpayer contributed $4,911 to a Section 401(k) plan. The taxpayer self- prepared their return and deducted IRA contribution of $14,000. The taxpayer indicated that they came up with the IRA deduction by adding the Section 401(k) contribution to the estimate of the taxpayer's deferred compensation from statements provided by the retirement plan. This computation was then listed as an IRA deduction on the return. The Tax Court advised the taxpayer that they should read the instructions or hire CPA to prepare their return. Obviously, the deduction is not allowed.

C. Roth IRAs Contributions – 2024; IR 2023 – 203; Notice 2023-75

1. The contribution amount is the lesser of:

- $7, 000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

a. **a. Catch-up Contribution**. For 2024, the taxpayer can make a catch-up contribution of $1000 if they are age 50 or older.

2. Limitation. For 2024, the maximum contribution to a Roth IRA is the lesser of $7,000 for the individuals' compensation for the year. The contribution limit is reduced to the extent that a taxpayer makes contributions to any other IRA for the same tax year. The Roth IRA MAGI threshold is shown below:

Filing Status	**Amount**
Single (HOH)	$146,000 – $161,000
Married Filing Joint	$230,000 – $240,000
Married Filing Separately	$0 – $10,000

D. Roth IRA Contributions – 2025; IR 2025 – 285; Notice 2024 – 80

1. The contribution amount is the lesser of:

- $7, 000 or
- the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan.

2. **Catch-up Contribution**. For 2025, the taxpayer can make a catch-up contribution of $1000 if they are age 50 or older. The SECURE 2.0 Act of 2022 allows for an annual cost of living adjustment starting next year.

3. Limitation. For 2024, the maximum contribution to a Roth IRA is the lesser of $6,000 for the individuals' compensation for the year. The contribution limit is reduced to the extent that a taxpayer makes contributions to any other IRA for the same tax year. The Roth IRA MAGI threshold is shown below:

Filing Status	**Amount**
Single (HOH)	$150,000 – $165,000
Married Filing Joint	$236,000 – $246,000
Married Filing Separately	$0 – $10,000

E. Other Retirement Plan Amounts

1. Defined Benefit Plan.

- For 2024, the maximum single life annuity for a defined benefit plan will be $275,000. (Notice 2023-75, 2023-47 IRB)
- For 2025, the maximum single life annuity for a defined benefit plan will be $280,000 (Notice 2024 – 80)

2. Defined Contribution Plan.

- For 2024, the maximum annual addition to a defined contribution plan will be $69,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)
- For 2025, the maximum annual addition to defined contribution plan will be $70,000 (Notice 2024 – 80)

3. Annual Contribution Limit

- For 202**4**, the maximum amount of compensation that can be taken into account under any qualified plan allocation or benefit formula will be $345,000. (Notice 2023-75)
- For 2025, the maximum amount of compensation that can be taken into account under a qualified plan allocation or benefit formula will be $350,000. (Notice 2024 – 80)

4. SIMPLE Plan.

- For 202**4**, the amount of the deferral is $16,000. (Notice 2023-75)
- For 2025, the amount deferral is 16,500 left. (Notice 2024 – 80

5. SEP

- The dollar amount will remain the same for 2024 and 2025. (Notice 2023-75, 2024 – 80)

6. 401(k) or 403(b) Plan.

- For 202**4**, the maximum amount of deferral is $ 23,000. (Notice 2023-75)
- For 2025, the max amount deferral $23,500 (Notice 2024 – 80)

7. Highly Compensated Employee.

- For 2024, the minimum compensation of an employee owning less than 5% of the stock of the employer to be treated as a highly compensated employee shall be $155,000. (Notice 2023-75)
- For 2025, the minimum compensation of employee owning less than 5% the stock of the employer to be treated as a highly compensated employee shall be $160,000

8. Key employee in top-heavy plan.

- For 2024, the dollar limit is $ 220,000. (Notice 2023-75)
- For 2025 the dollar limit is $230,000. (Notice 2024 – 80)

9. Government, etc. deferred compensation plans.

- For 2024, the limit on deferrals is $ 23,000. (Notice 2023-75)
- For 2025, the limit on deferrals is $23,500 (Notice 2024 – 80)

F. SECURE 2.0 Act – RMD's

1. IRS Continues to Change Applicability Date for Final RMD Regulations – Notice 2024 – 35, 2024 – 19 IRB

a. The Service has again provided transition relief for RMD's and changed the applicability date of the final RMD regulations. The final regulations that the IRS intends to issue will not apply for determining RMD's before January 1, 2025.

b. The notice provides that:

- A defined contribution plan that failed to make a specified RMD will not be treated as having failed to satisfy Section 401 (a) (9) solely because it did not make that distribution, and
- Taxpayers who did not take a specified RMD will not be subject to the excise tax under Section 4974.

c. A specified RMD is any distribution that would be required to be made in 2024 for the year in which the employee (or designated beneficiary) died if that payment would be required to be made to:

- An employee's designated beneficiary because the employee or IRA owner (account owner) died in 2020, 2021, 2022, or 2023 on or after the account owner's required beginning date, and the beneficiary is not using the lifetime or life expectancy payments exception, or
- A beneficiary of an eligible designated beneficiary who died in 2020, 2021, 2022, or 2023, and that eligible designated be piece of shipped neficiary was using the lifetime or life expectancy payments exception.

G. IRS Issues Final and Proposed RMD Regulations Reflecting SECURE and SECURE 2.0 Act

1. The IRS has issued final regulations updating the required minimum distribution (RMD) rules applicable to qualified plans, including 401(k) plans, to reflect changes made by the SECURE and SECURE 2.0 Acts. These regulations generally follow proposed regulations released in 2022, with some changes and clarifications.

a. Ann. 2025 – 02, 2025 – 2IRB. The Service has announced that the final regulations are required minimum distributions will not apply until the 2026 distribution calendar year.

2. The IRS has also released proposed regulations addressing additional RMD issues under the SECURE 2.0 Act that are specifically reserved in the final regulations.

3. The final rules generally apply when determining RMDs for calendar years beginning on or after January 1, 2025, using a reasonable, good faith interpretation of SECURE Act amendments and, for 2023 and 2024 distribution calendar years, SECURE 2.0 Act amendments.

4. Distributions Beginning During Employees Life. Generally, the required beginning date (RBD) is April 1 of the year after the later of the year the employee reaches the applicable age or retires. The applicable age varies:

- 70-1/2 for those born before July 1, 1949;
- 72 for those born on or after July 1, 1949, and before January 1, 1951;
- 73 for those born on or after January 1, 1951, and before January 1, 1959; and

- 75 for those born on or after January 1, 1960.

a. Plans can provide for a uniform RBD of the calendar year following the year an employee attains age 70-1/2 for administrative ease. The proposed regulations would resolve a conflict in the SECURE 2.0 Act regarding applicable ages for employees born in 1959 by providing an applicable age of 73.

5. The final regulations reflect the Code's changes regarding RMDs for designated beneficiaries of employees who die before their RBD, including that only "eligible" designated beneficiaries may receive distributions over their life expectancy.

a. The final regulations provide that the non-eligible designated beneficiaries of a decedent's account where the decedent died after their required beginning date (RBD) must take annual distributions for years 1-9 using the age of the beneficiary for the calculation of the RMD account. The entire account balance must be distributed by the end of the 10th year. If the decedent dies before the RBD, the beneficiary is not required to take distributions before the 10th year.

Example

Jane is age 65 and died June 1, 2024. She owned a traditional IRA and named her daughter as a non-eligible designated beneficiary. She does not have to take RMDs during years 1 – 9 because her mother died before her required beginning date (RBD). The daughter must withdraw the entire inherited IRA by the end of the 10th year. However, if Jane was 75 at the time of her death she would have passed the beginning date for RMD's. The daughter would be required to take the RMD four years 1 – 9 based upon Jane's life expectancy and again must withdraw the entire balance by the end of the 10th year.

b. The 10 year timeframe ends on December 31 of the 10th year after the calendar year of the account owner's death. It is not the 10th year anniversary of the date of death.

c. If a non-designated beneficiary does not take RMD's in years 1 – 9 or does not withdraw the balance in the inherited IRA by the end of the 10th year in excess accumulation penalty applies

d. If an employee's entire interest is in a designated Roth account, no lifetime distributions are required.

6. Eligible Designated Beneficiary. An eligible designated beneficiary is a designated beneficiary who is:

- A surviving spouse
- A minor child
- Disabled
- Chronically Ill or
- 10 or fewer years younger than the employee

Example

S.Y. Liu v. Kaiser (DC ND Cal . 23 – CB – 03109 – AMO) An individual was not entitled to her sister's death benefits arising from a pension plan (the plan) under the Employee Retirement Income Security Act (ERISA). The individual's sister did not complete the benefit election process before her death – she did not finalize the selection of a Benefit Starting Date or designate the individual as her beneficiary. Since the plan participant did not make a valid benefit election before her death to designate the individual as her beneficiary, the individual was not entitled to benefits under a plain reading of the plan. The individual asserted that under Section 401 (a) (9) (E) (ii), an "eligible designated beneficiary" included an individual

who is not more than 10 years younger than the employee, and, because the individual was less than 10 years younger than her sister, she was an eligible designated beneficiary under the Plan. However, this Code Section did not apply here, as it applies only to defined contribution plans and not defined benefit plans such as the plan. Even if it did, it would not render the individual her sister's designated beneficiary.

a. Minor Children. The final regulations clarify the 10 year rule for the decedents of minor children. Specifically, children are considered minors until they reached their 21st birthday regardless of the age of the majority defined in state law. The stretch RMD rules thus apply until the child's 21st birthday. After the 21st birthday the 10 year rule applies.

Example

During 2024 Moe, age 10, inherited an IRA from his mother. Moe is a designated beneficiary and can receive distributions based on his single life expectancy until he reaches age 21. Upon reaching age 21, he must withdraw the funds based on the 10 year rule. Since his mother had not reached her required beginning date (age 73) at the time of her death, Moe is not required to take RMD's in years 1 – 9. He must withdraw the full account balance by the end of the 10th year. If Moe had inherited his mother's IRA when mom died at age 75, he would continue taking RMD's based on his single life expectancy even after reaching age 21. In years 1 – 9 he would take RMD's. However, in year 10 the remaining balance is withdrawn.

b. Disabled or Chronically Ill. Beneficiaries under the age of 18 must have a medically determinable physical or mental impairment resulting in marked and severe functional limitations and expected to result in death or to be of the long and indefinite duration.

i. A safe harbor allows beneficiaries to be deemed disabled for RMD purposes if they are determined to be disabled by the Social Security Commissioner.

ii. Documentation of a disability or chronic illness must be provided to the plan administrator no later than October 31 of the calendar year following the calendar year of the employee's death.

iii. In certain cases, certifications from licensed health care practitioners are required. Plan administrators may not rely on a beneficiary's self-certification of disability or chronic illness.

7. Partial account purchase of annuity contracts. A plan may allow employees to elect to have an RMD distributed for a calendar year in an amount equal to the excess of the total of the required amount for that year over the annuity amount.

a. As an alternative to the general bifurcation rule, a plan may allow an employee to satisfy the RMD requirement applicable to the annuity contract and the remaining account balance by adding the fair market value of the annuity contract to the remaining account balance and treating the payments under the annuity contract as distributions from the individual account.

b. Under the proposed regulations, the fair market value of the annuity would be determined as of December 31 of the calendar year preceding the distribution calendar year.

8. Distributions after employee's death. The final regulations maintain the requirement in the 2022 proposal for continued annual distributions when employees die on or after their RBD.

a. The annual distributions generally must continue when an individual has started RMDs, even though the Code provides that full distribution must be made by the tenth anniversary of the employee's death.

Also maintained is the obligation for ongoing annual distributions for a period of up to ten years following:

- the death of an eligible designated beneficiary who was taking life expectancy payments, or

- attainment of the age of majority by an eligible designated beneficiary who was a minor child of the employee receiving life expectancy payments.

9. Surviving spouses. Consistent with the SECURE 2.0 Act, a surviving spouse who is the employee's sole beneficiary may elect to be treated as the employee for certain purposes.

a. The proposed regulations would provide that if the employee dies before the RBD and the sole beneficiary is the surviving spouse who is subject to the life expectancy rule, then the spouse would automatically be treated as making the election.

b. If the employee dies on or after the RBD, then the corresponding election would not apply automatically, unless the plan's written terms made the election automatic.

10. Multiple designated minor beneficiaries. If an employee has more than one child as eligible designated beneficiaries, a full distribution is not required until ten years after the youngest of the employee's children who are designated beneficiaries attains the age of majority or, if earlier, ten years after the last of those minor children dies.

11. Designated Roth accounts. When determining the account balance subject to the RMD rules, amounts held in a designated Roth account are disregarded. Under the proposed regulations, distributions from designated Roth accounts would not count toward satisfying any RMD but could be rolled over to a Roth IRA if they otherwise qualified as eligible rollover distributions.

12. Corrective distributions. The final regulations provide an automatic waiver of the Section 4974 excise tax associated with a beneficiary's failure to take a RMD in the calendar year in which an individual died if that individual had not already satisfied the RMD for that year, provided that the failure is corrected by the end of the following calendar year. This corrective distribution is not eligible for rollover.

a. Under the proposed regulations, if a missed RMD is corrected by a distribution in a subsequent calendar year, the RMD for that subsequent year would have to be made in addition to the corrective distribution.

13. Trusts as designated beneficiaries. Certain beneficiaries of a see-through trust are regarded as beneficiaries of an employee if specific conditions are met. The trust must

- be valid under state law or would be if it had corpus;
- be irrevocable or become irrevocable upon the employee's death;
- have identifiable beneficiaries; and
- meet documentation requirements.

a. When determining whether there are identifiable beneficiaries, beneficiaries are treated as if they could receive amounts in the trust representing the employee's interest in the plan, regardless of whether those amounts are disbursed directly to the beneficiaries or indirectly for their benefit . For example, in the case of payments to a custodial account for the benefit of a minor child.

b. With respect to the documentation requirement, the plan administrator may require a trustee to provide a list of trust beneficiaries with a description of the conditions on their entitlement, instead of a trust document.

H. SECURE 2.0 Provisions Taking Effect in 2024.

1. Catch-up. For taxpayers who are at least age 50 before the end of the tax year, the IRA contribution deductible amount will be increased by catch-up contribution amount of $1,000 which is now indexed for inflation.

2. Employer Matching Contributions for Student Loan Payments. Employers can make matching contributions under a 401(k) plan, 403(b) plan, 457 plan or SIMPLE IRA plan with respect to qualified student loan payments.

3. No Early Withdraw Penalty for Emergency Personal Expenses. The 10% early withdrawal penalty will not apply to an emergency personal expense distribution from an eligible defined contribution plan. The withdraw can occur once yearly. The administrator of the plan may rely on the employee's self-certification as to the personal emergency. A limitation of $1,000 applies. If the withdrawn amount is re-contributed within three years it does not become taxable.

4. Additional Nonelective Contributions to SIMPLE Plans. Employers may make additional nonelective contributions of up to 10% of compensation for each eligible employee with at least $5,000 of compensation for the year. These nonelective contributions may not exceed $5,000 for any employee for the tax year.

5. Increase in SIMPLE Plan Contribution Limits. The maximum contribution limit is 110% of $10,000 adjusted for inflation in effect for the tax year 2024 for as long as the employer meets certain qualifications including having no more than 25 employees or elect for the increase to apply. If neither of these applies the $10,000 amount would be the application. The catch-up limit is 110% of the catch-up dollar amount in effect for 2024. The catch-up requirement is at age 50. An employer with more than 25 employees will be allowed to provide the hundred and 10% deferral limit only if the employer provides a 4% matching contribution or 3% employer contribution.

6. Starter 401(k)s and Safe Harbor Deferral only 403 (b)'s. Employers that do not currently maintain a plan may set up a starter 401(k) deferral only arrangement or a safe Harbor deferral only 403(b) plan. These plans are treated as meeting nondiscriminatory tests. For both automatic enrollment and participation requirements apply. No employer contributions may be made in employee contributions are limited to $7,000 indexed for inflation in 2024. The additional $1,000 catch-up at age 50 also applies..

7. Tax-free Rollovers from 529 plans to Roth IRAs. The 529 plan has been maintained for 15 years, a distribution is not included in income nor subject to the early withdrawal penalty if it is a direct transfer from the 529 plan to a Roth IRA maintains the designated beneficiary of the 529 plan.

8. Adoption of Discretionary Amendments. Discretion plan amendments that increase participants benefits can be adopted by the due date of the employer's tax return.

9. Designated Roth Accounts exempt from predeath RMD rules. While the account owners alive RMD's are not required from designated Roth accounts beginning in 2024.

10. Surviving Spouse Election to use Uniform Lifetime kept able to determine RMD. A surviving spouse who is the only beneficiary of the deceased plan participant or IRA owner plan may elect to have

RMDs determined using the Uniform Lifetime Table rather than the Single Life Table. This allows special beneficiaries to avoid having to roll the inherited benefits into an IRA to get the benefit of a longer distribution and smaller RMD obligations.

11. Catch-up Contributions for Highly Compensated Employees must be Designated Roth Contributions. If a participant in a 401(k), 403(b) or 457 plan whose wages for the preceding year exceed $ 145,000 make catch-up contributions, those contributions must be designated Roth contributions made under an employee election. The catch-up contributions are made on an after-tax basis. The catch-up is at age 50 and $145,000 will be indexed for inflation. Notice 2023 – 62 delayed the effective date of this change to 2026.

I. Notice 2024 – 2

1. The Notice provides guidance in a question-and-answer format with respect to issues under the following sections of the SECURE 2.0 Act:

- 101 – expanding automatic enrollment in retirement plans
- 102 – modification of credit for small employer pension plan startup costs
- 112 – military spouse retirement plan eligibility credit for small employers
- 113 – small immediate financial incentives for contributing to a plan
- 117 – contribution limit for SIMPLE plans
- 326 – exception to the additional tax on early distributions from qualified plans for individuals with a terminal illness
- 332 – employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year
- 348 – cash balance
- 350 – safe harbor for correction of employee elective deferral failures
- 501 – provisions relating to plan amendments
- 601 – SIMPLE and SEP Roth IRAs
- 604 – optional treatment of employer contributions or nonelective contributions as Roth contribution

2. Automatic Enrollment for New Plans A less an exception applies Section 101 requires new 401(k)s and 403(b) plans to automatically roll participants at a minimum initial rate of 3% of their compensation. The rate must be increased by 1% each year until it reaches at least 10%. This requirement applies to plan years beginning after 2024 but does not apply to plans established prior to December 29, 2022. The notice provides the following clarifications regarding mandatory automatic enrollment:

a. A plan is "established" on the date the plan is adopted, even if the plan takes effect after the adoption date. So, a plan adopted prior to December 29, 2022 (a pre-enactment plan), is exempt from mandatory automatic enrollment, even if the plan first became effective after enactment of SECURE 2.0.

b. In the case of the merger of two single employer pre-enactment plans, the merged plan is treated as a pre-enactment plan. The result is the same if a single employer pre-enactment plan is merged with a pre-enactment plan maintained by more than one employer.

c. If a pre-enactment plan is merged with a plan established after the enactment of SECURE 2.0, the general rule is that the mandatory automatic enrollment provisions of SECURE 2.0 apply to the merged plan. However, an exception applies in the case of certain business mergers and acquisitions if the plan merger is accomplished within the coverage transition period defined in the Internal Revenue Code (IRC), which

generally is by the end of the plan year following the corporate merger or acquisition. Another exception applies if a "new" plan is merged with a pre-enactment plan maintained by more than one employer (e.g., a multiple employer plan). In such cases, the pre-enactment plan remains grandfathered, but the portion of the merged plan attributable to the "new" plan would be subject to the mandatory automatic enrollment requirements of SECURE 2.0.

d. If a plan is spun off from a pre-enactment plan, the spun-off plan is also treated as a pre-enactment plan. However, if the plan from which the new plan was spun off was a plan maintained by more than one employer that was established before December 29, 2022, the spun-off plan is treated as a pre-enactment plan only if the participants in the spun-off plan were previously treated as participating in a pre-enactment plan.

e. Section 414A(c)(2)(B) of the Code provides that, in the case of an employer adopting a plan maintained by more than one employer after the date of the enactment of section 101 of the SECURE 2.0 Act, section 414(c)(2)(A) of the Code does not apply to that employer, and section 414A(a) applies with respect to that employer as if that plan were a single plan.

f. Section 101(c) of the SECURE 2.0 Act provides that the amendments made by section 101 apply to plan years beginning after December 31, 2024.

3. Small Immediate Financial Incentives (De minimis). Section 113 of the Act provided that a *de minimis* financial incentive (one not paid for with plan assets) provided to employees who elect to participate in the plan will not violate the contingent benefit rule, which prohibits conditioning any benefit—other than employer matching contributions—on a decision to participate in the plan. This provision also provides relief from the prohibited transaction rules in the IRC and the Employment Retirement Income Security Act (ERISA). The notice includes the following clarifications regarding these incentives:

a. A financial incentive is de minimis only if it does not exceed $250 in value.

b. A plan can only offer de minimis financial incentives to employees who do not have deferral elections already in effect.

c. A plan can provide de minimis financial incentives in installments that are contingent on the employee continuing to defer, even if those installments are paid over more than one plan year.

s. A de minimis financial incentive is includible in the employee's gross income and wages and is subject to applicable withholding and reporting requirements, unless the incentive satisfies an exception under the IRC (e.g., nontaxable fringe benefits).

4. Deadlines for Plan Amendments. Section 501 of the Act generally provides for a plan amendment deadline on the last day of the first plan year beginning on or after January 1, 2025 for any changes made to the plan by the Act for subsequent regulations.. The notice does change the deadlines for plan amendments as follows:

a. The guidance provides a new plan amendment deadline of December 31, 2026, for qualified plans and 403(b) plans. For governmental 401(a) and 403(b) plans, the plan amendment deadline is extended to December 31, 2029.

b. The plan amendment deadline for applicable collectively bargained plans is extended to December 31, 2028.

c. For governmental 457(b) plans, the plan amendment deadline is extended to the later of December 31, 2029, or, if applicable, the first day of the first plan year beginning more than 180 days after the date of notification by the Treasury secretary that the plan was administered in a manner that is inconsistent with the requirements of Section 457(b) of the Code.

5. Roth Employer Contributions. Section 604 of the Act allows a 401 (a) plan, including 401(k) plan, 403(b) plan or 457 (b) plan to permit employees to designate employer matching or nonelective contributions. These are nonforfeitable at the time they are received as designated Roth contributions the provision was effective for contributions made after December 29, 2022. The notice makes the following clarifications regarding designated Roth employer contributions:

a. Rules similar to the rules for designated Roth elective contributions apply to designated Roth employer contributions, except that Roth employer contributions need not satisfy the rules applicable to elective contributions, such as the special distribution restrictions and inclusion in the ADP test. For example, designation of employer contributions as Roth contributions must be made no later than the time that the contribution is allocated to an employee's account and must be irrevocable. Also, designated Roth employer contributions are subject to income inclusion treatment and separate accounting rules. In addition, an employee must have an effective opportunity to make (or change) their designation of a Roth employer contribution election at least once during each plan year.

b. A designated Roth employer contribution is includible in gross income for the taxable year in which the contribution is allocated to the individual's account. An employer contribution may be designated as a Roth contribution only if the employee is fully vested in the contribution at the time it is allocated to the employee's account.

c. If employer contributions are subject to a vesting schedule, an employee's right under the plan to designate 100% vested employer contributions as Roth contributions will not be treated as failing to satisfy Section 401(a)(4) of the IRC, even if that right is not currently available to a group of employees (i.e., because they are not 100% vested).

d. Designated Roth employer contributions are not wages for purposes of federal income tax withholding. However, an employee who designates an employer contribution as a Roth contribution may need to increase their withholding or make estimated tax payments to avoid an underpayment penalty.

e. Roth employer contributions made to a 401(a) or 403(b) plan are not wages for purposes of FICA and FUTA taxes.

f. Roth nonelective contributions to a governmental 457(b) plan are wages for purposes of FICA but only if FICA taxes normally apply to such employees (such as state and local government employees who are not members of a state or local retirement system). Roth nonelective contributions made to a governmental 457(b) plan are not subject to FUTA taxes.

g. The reporting obligations that apply to Roth employer contributions are the same as if, upon allocation to that account, the contribution had been directly rolled over to a designated Roth account in the plan as an in-plan Roth rollover. Thus, designated Roth employer contributions are reported in boxes 1 and 2a of Form 1099-R, and code "G" is used in box 7.

h. Plans may limit the contribution sources (i.e., deferrals, matching contributions, and/or nonelective contributions) that are eligible to be designated as Roth contributions. However, the right to make designated Roth contributions is a right or feature subject to the requirements of Section 401(a)(4).

6. **SIMPLE Plans**. The notice does discuss Section 117 additional employer contributions to a Savings Incentive Match Plan for employees (SIMPLE) individual retirement account or SIMPLE 401 (k) plan by increasing the annual salary reduction/elective contribution limits and the limit on additional catch-up contributions beginning at age 50.

a. The act allows for an increase to both the annual salary reduction contribution/elective contribution limit and the limit on additional catch-up contributions beginning at age 50 for a SIMPLE IRA plan or a SIMPLE 401(k) plan for certain eligible employers. For some of those eligible employers, the increased limits apply automatically; while other of those eligible employers must make an election for the increased limits to apply and must also make additional employer contributions. The increased limits are 110 percent of the otherwise applicable limits for 2024.

b. The increased limits apply automatically in the case of an eligible employer described in section 408(p)(2)(E)(iv) that has no more than 25 employees who received at least $5,000 of compensation for the preceding calendar year. For an employer that has more than 25 employees who received at least $5,000 of compensation for the preceding year, the increased limits apply only if the employer makes an election for the increased limits to apply. If the employer makes an election for the increased limits to apply, the employer must provide higher matching or nonelective contributions,

c. An employer that must make an election to apply the increased limits must take formal written action to make an election to reflect the increased limits and should maintain documentation of the election in the plan's records. An employer (including employers for whom the increased limits apply automatically) must reflect the increased limits in the plan terms.

d. If an employer makes an election to apply the increased limits, the employer must make matching contributions equal to the employee's salary reduction contributions or elective contributions that do not exceed 4 percent (increased from 3 percent) of the employee's compensation or make a nonelective contribution of 3 percent (increased from 2 percent) of the employee's compensation (regardless of whether the employee elects to make contributions).

e. The employer must notify employees of the increased limits. The notice must be included in the annual employer notification that informs employees of the opportunity to enter into a salary reduction agreement or to modify a prior agreement. In the case of an employer for whom the increased limits apply pursuant to an election, the employer also must notify employees of the increased matching contribution or increased nonelective contribution. The employer should also (1) notify the SIMPLE IRA plan's or SIMPLE 401(k) plan's financial institution and payroll provider of the increased limits, and (2) keep records of all actions concerning the increased limits. However, the employer does not need to notify the IRS of the election to apply the increased For 2024 the increase in both the annual salary reduction contribution/elective contribution limit is 110%

7. SIMPLE IRA

a. Under section 408(p)(2)(D), an employer that maintains a SIMPLE IRA plan for a calendar year generally is not permitted to maintain another plan, contract, pension, or trust described in section 219(g)(5)(A) or (B) to which contributions were made or benefits were accrued for service in the year.

b. Prior to the act, if a distribution comes from a SIMPLE IRA within the first two years of the individual's participation in the plan, the individual could only roll over the distribution to another eligible retirement plan if the other eligible retirement plan was a SIMPLE IRA.

c. The Act allows an employer to elect at any time during the year to terminate qualified salary reduction arrangement under a SIMPLE IRA plan if the employer establishes and maintains a safe harbor 401(k) plan to replace the terminated arrangement.

d. The Act also indicates the limit on rollovers of a distribution from a SIMPLE IRA plan does not apply if an employer terminates the qualified salary reduction arrangement and establishes a section 401(k) or section 403 (b) plan provided that the amount is paid in a rollover contribution.

8. Under Section 601 of the Notice and SECURE 2.0 and allowances now made to permit an employee who participates in a SIMPLE IRA or SEP arrangement to designate a Roth IRA as the IRA for which contributions under the plan can be made.

a. Specifically, a Roth IRA will not be treated as a SEP unless the employee elects for the Roth IRA to be so treated.

b. Any contribution under a SEP made to a Roth IRA is not includable in the employee's gross income. Likewise, any contribution under a SIMPLE IRA which is made to a Roth IRA is not includable in the employee's gross income.

J. Retirement Rollovers

1. Amounts received from an IRA or qualified plan may be rolled over tax-free within 60 days of the date of the distribution. The IRS may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster or other events beyond the reasonable control of the individual subject to such requirement.

2. Self-Certification Procedure for Certain Failed 60-Day Rollovers Modified – Rev. Proc. 2020-45. This revenue procedure modifies and updates Rev. Proc. 2016-47, 2016-37 I.R.B. 346. Section 3.02(2) of Rev. Proc. 2016-47 provides a list of permissible reasons for self-certification of eligibility for a waiver of the 60-day rollover requirement.

a. Effective August 24, 2016, the IRS has provided a self-certification procedure designed to help recipients of retirement plan distributions who inadvertently miss the 60-day rollover time limit for properly rolling these amounts into another retirement plan or IRA.

b. A taxpayer may make a written certification to a plan administrator or an IRA trustee that a contribution satisfies the conditions in Section 3.02 of this revenue procedure. This self-certification has the effects described in Section 3.04 of this revenue procedure. Taxpayers may make the certification by using the model language in the appendix on a word-for-word basis or by using language that is substantially similar in all material respects. A copy of the certification should be kept in the taxpayer's files and be available if requested on audit.

c. Conditions for self-certification.

- The IRS must not have previously denied a waiver request with respect to a rollover of all or part of the distribution to which the contribution relates.
- The taxpayer must have missed the 60-day deadline because of the taxpayer's inability to complete a rollover due to one or more of the following reasons:
    - an error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates;

    - the distribution, having been made in the form of a check, was misplaced and never cashed;
    - the distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
    - the taxpayer's principal residence was severely damaged;
    - a member of the taxpayer's family died;
    - the taxpayer or a member of the taxpayer's family was seriously ill;
    - the taxpayer was incarcerated;
    - restrictions were imposed by a foreign country;
    - a postal error occurred;
    - the distribution was made on account of a levy under § 6331 and the proceeds of the levy have been returned to the taxpayer;
    - the party making the distribution to which the rollover relates delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information; or
    - the distribution was made to a state unclaimed property fund.
- The contribution must be made to the plan or IRA as soon as practicable after the reason or reasons listed in the preceding paragraph no longer prevent the taxpayer from rolling over the amount distributed (which includes any amount withheld for income tax) or a lesser amount if the taxpayer wants to roll over less than the total amount distributed or if part of the amount distributed is ineligible for rollover. This requirement is deemed to be satisfied if the contribution is made within 30 days after the reason or reasons no longer prevent the taxpayer from making the contribution.
- An IRA trustee that accepts a rollover contribution after the 60-day deadline reports on Form 5498 that the contribution was accepted after the 60-day deadline.

3. Inherited IRAs and Surviving Spouse Rollovers.

a**.** Taxpayer as surviving spouse would be treated as having acquired the IRA upon decedent's death passing to a trust of which the taxpayer was the sole trustee and beneficiary as if it was directly from the decedent rather than from the trust. Taxpayers eligible to roll over the IRA distribution to an IRA or establish and maintain an IRA in her own name provide the rollover occurs within 60 days. (PLR 202404003, 202322013, 202322014)

b. Surviving Spouse was eligible to roll over proceeds of IRA that were not in excess of stated percent of specified residue of trust to IRA set up and maintain in surviving spouse's name provided the rollover curve within 60 days after the proceeds were distributed. Except in the case of a rollover to a Roth IRA none of the proceeds would be includable in spouse's gross income. (PLR 202348009)

4. Waivers Granted Beyond self certification

a. PLR 202441015, 202430010, 202244029 – Fraud. Waiver 60 day rollover requirement with respect taxpayers attended transfer of stated amount from an IRA was allowed because the taxpayer was a victim of a fraud scheme.

b. IRS Letter Ruling 202218028 – Medical Condition and Spouse Death. The taxpayer had a severe medical condition diagnosed before the tax year at issue. She withdrew amounts from her 401(k) and IRA plan in the same year and failed to roll either distribution over. Her husband had manage her financial affairs but he died before the distributions were taken, the 60 day rollover period expired. The taxpayer survived and recovered from her health issues and submitted a request of waiver of the 60 day rollover requirement based upon medical condition and spouse's death. The taxpayer was required to prove the medical condition and death and the service waive the requirement.

c. IRS Letter Ruling 202214008 – Estate Named as Beneficiary. The decedent opened an IRA and named himself as the beneficiary. Upon his death, the custodian transferred the IRA to a beneficiary In the name of his estate. The taxpayer who had died had not reached age 72 so the benefits would've been subject to the five-year rule. The taxpayer left a will naming his surviving spouse as both executor of the estate and sole beneficiary of the estate. The IRS allows the taxpayer's surviving spouse to have the beneficiary IRA transferred to a new IRA in her name without tax consequences.

d. IRS Letter Ruling 202227005 – Joint Trusts. The decedent's IRA was payable to a joint trust that stated that any retirement assets will be allocated to a survivor's trust after the death of the first spouse. The decedent's two IRAs were transferred to a new inherited IRA at his death. With respect to the new IRA allocated to the survivor's trust, the taxpayer had the right to distribute the new IRA to the taxpayer or any part of it to the taxpayer. The taxpayer as the surviving spouse was also the trustee and sole beneficiary of the survivor's trust. The taxpayer who was the surviving spouse desire to rollover the inherited IRA into one or more IRAs in her individual name. Since no third-party could prevent the taxpayer from receiving the proceeds of the IRA and from rolling over the proceeds into her own IRA, the IRS allows the tax-free rollover of the inherited IRA.

e. IRS Letter Ruling 202423009. The IRS declined to waive the 60-day rollover requirement with respect to the distribution of an amount from a plan to a traditional individual retirement arrangement (IRA) with a financial institution. The taxpayer had participated in the plan and requested a trustee to trustee transfer of the amount from the plan to a traditional IRA, established by the financial institution. However, the amount was deposited into a Roth IRA. The waiver of the 60-day rollover requirement was not granted because the taxpayer did not demonstrate that they failed to accomplish a rollover of the amount due to any of the factors cited in Rev. Proc. 2003-16 or that financial institution error caused the taxpayer to miss the 60-day rollover period.

5. Bankruptcy Issues

a. Taxpayers are entitled to bankruptcy exemption relief regarding early retirement plan distributions made before turning age 59 ½ where the early distribution was also associated with a claimed disability exemption. (In re Majeski, Bktcy Ct MI 131 AFTR 2d 2023 – 655)

b. Taxpayers were entitled to bankruptcy exemption regarding IRA up to amount of IRA contribution limit for the stated year under bankruptcy, amounts in excess of the limit are considered excess distribution and are not exempt from the bankruptcy. (In re Brainard, Bktcy Ct 131 AFTR2d 2023-694)

c. Taxpayers are not entitled to bankruptcy exceptions involving improper rollovers of IRAs, Roth IRAs into 401(k)s and distributions as they are no longer considered essential characteristics of such with retirement funds protected from bankruptcy. (In re Jacobs, Bktcy Ct. 132 AFTR 2d 2023 – 5337)

d. Taxpayers lost their right to claim funds from IRA as exempt assets due to transfers of funds from the IRA to the taxpayer's businesses which were used to pay for both business and personal expenses. Such transfers are viewed as prohibited transactions under Code Section 4975 (c). Which caused the IRAs to lose their status as qualified IRAs and are now non-exempt property available for creditors. (In Re Langston, Bktcy Ct, ND Texas, 132 AFTR2d 2023 – 5067)

e. Qualified versus Nonqualified Plans. The taxpayer chose to participate in his employer's Section 409A deferred compensation plan was allowed only if the employee no longer contributed to the employer's 401(k) plan. Subsequently, the employer filed for bankruptcy protection. The employer liquidated the plan and made secure claim distributions to nonqualified participants believing that the taxpayer and other

employees were not qualify to participate originally in the 409A plan. Benefits were distributed less 20% federal withholdings. The bankruptcy court indicated could not orders the funds from a nonqualified plan be deposited into a qualified plan and that the taxes were properly withheld. The court determined that the employees including the taxpayer had been given enough disclosure that the Section 409A plan was not a qualified plan when the taxpayer voluntary decided to participate. (See Palaniappann v. Comm., No. 2:2 2 – CV – 01685 (DC Arizona 3/28//24)

K. Early Withdrawal Penalties

1. Section 72(t)(1) imposes a 10% additional tax on distributions from qualified retirement plans. However, Section 72(t)(2) lists the following exceptions to the imposition of the 10% additional tax on the distributions :

a. On or after the account owner reaches age 59 ½ .
b. The death of the account owner.
c. After the permanent disability of the account owner.
d. At age 55 if from an employer plan and separated from service (does not apply to IRAs).
e. A series of substantially equal periodic payments made for the life of the employee or the joint lives of the employee and his beneficiary.
f. Distribution made incident to a divorce or made to an alternate payee under a QDRO.
g. IRS levies.
h. For extraordinary medical expense that exceed 7 ½ % of AGI.
i. Qualified disaster-relief distribution not in excess of $100,000.
j. Public safety employees taking plan distributions if separating from service and over age 50.
k. Reservists called to active duty for at least 179 days.
l. For health insurance premiums during long term unemployment (12 consecutive weeks).- IRA ONLY
m. For qualified higher education expense – IRA ONLY.
n. For a qualified 1st time home buyer (a $10,000 lifetime limit) – IRA ONLY.
o. 10% Penalty Exception for Qualified Reservists
p. Financial Hardship Does not Count as far as an IRA. (Prichard V. Comm., TCM 2017 – 136; Cheves v. Comm., TCM 2017 – 22)

Examples

Moran v. Comm., TC Memo 2024 – 67. Taxpayer was under age 59 ½ and took a distribution from an IRA in the amount of $2,417. The IRS assessed the additional 10% tax on early retirement plan distributions. Taxpayer failed to provide any exception to the additional tax other than stating it was unfair.

Shlikas v. Comm., TCS 2024 – 10. The taxpayer's mother died leaving her home to the taxpayer and his brother jointly. The taxpayer withdrew $137,024 from his retirement account to purchase his brother's interest in the home. The taxpayer did report the amount withdrawn as income but did not treated as an early distribution subject to the 10% penalty. The taxpayer had not obtained age 59 ½ when he received the distribution. The distribution was early distribution subject to the tax. The taxpayer claimed he was eligible for the qualified first-time homebuyers exception to the imposition of the 10%. The Court noted that the distribution was made out of a 403 (b) and not ane IRA so it is not eligible for the exception.

Kohl v. Comm., TC Summary 2024 – 4. The taxpayer withdrew money from her IRA to pay rent and avoid eviction. The taxpayer stated that the 10% penalty should not apply based on the exception for

withdrawal for emergency expenses as enacted as part of SECURE 2.0. The change in the law applied only to withdraws from qualified retirement plans made after December 31, 2023 the court held it cannot prevent the county from being assessed against her.

Scott v. Comm., TC Memo 2023 – 141. Taxpayer failed to report Form 1099 – R taxable distribution in the amount of $14,386. The distribution was early distribution as the taxpayer had not reached the age of 59 ½ at the time of the distribution. The Form 1099 – R stated early distribution, no known exception. Taxpayer acknowledged receipt and was unaware of the 10% penalty to be assessed.

2. Other Penalty Free Provisions. The SECURE 2.0 Act adds a number of exceptions from the Section 72 (t) tax on early distributions from retirement accounts. These include the following:

a. Penalty Free Emergency Withdrawals. The new exception applies to certain distributions used for emergency expenses, which are used for meeting unforeseeable or immediate financial needs relating to necessary personal or family emergencies. One distribution is allowed per year of up to $1,000. Taxpayers have the option to repay the distribution within three years. No further emergency distributions are allowed during the three-year repayment period unless repayment has been made. The exception is available for distributions made after December 31, 2023.

b. Penalty-free withdrawals for domestic abuse victims. The act amends Section 72(t) to allow domestic abuse victims to take distributions of up to $10,000 (adjusted for inflation after 2024) from a qualified retirement plan without being subject to the 10% additional tax for early withdrawals. "Domestic abuse" includes physical, psychological, sexual, emotional, or economic abuse by a spouse or domestic partner. Employees or participants can self-certify that they qualify for the exception. The provision is effective for distributions made after December 31, 2023.

c. Penalty-free withdrawals for individuals with terminal illness. The act amends Section 72(t) to allow individuals with a terminal illness to take distributions from a qualified retirement plan without being subject to the 10% additional tax for early withdrawals. Employees or participants will need a physician's certification to qualify for the exception. A terminally ill person is defined as someone who has an illness or physical condition that can reasonably be expected to result in death in 84 months or less after the date of the certification. The provision is effective for distributions made after December 31, 2023.

d. Penalty-free withdrawals in connection with qualified disasters. The act allows penalty-free withdrawals of up to $22,000 for "qualified disaster recovery distributions." These are defined as any distribution made on or after the first day of the "incident period" of a qualified disaster and before 180 days after the "applicable date" for that disaster. Eligible individuals must have their principal place of abode within the qualified disaster area and must have sustained an economic loss as a result of the qualified disaster. The "incident period" means the period designated by the Federal Emergency Management Agency as the period during which the disaster occurred. The "applicable date" is the latest of (i) the date of enactment of the act, (ii) the first day of the incident period, or (iii) the date of the disaster declaration. Any amount of a qualified disaster recovery distribution that an individual must include in income will be included ratably over a three-year period. The provision applies to distributions with respect to disasters for which the incident period begins on or after January 26, 2021 (30 days after the enactment of the Taxpayer Certainty and Disaster Relief Act of 2020, P.L. 116-260). The provision is effective for distributions made after December 31, 2023.

e. Qualified Birth and Adoption Distributions. Distributions for the birth or adoption of a child of up to $5,000 per individual are penalty-free withdrawals from an IRA and a qualified pension plan. To meet the requirements of the qualified birth or adoption distribution, the individual must take a distribution during

the one-year period beginning on either the date of birth of the child, or the date of the final adoption of the child (under age 18). An individual taking a distribution for the birth or adoption of a child may make an additional contribution back to the plan from which the distribution was made or to an IRA within three years of the date of the distribution

f. Elimination of 10% additional tax on corrective distributions of excess contributions. The act provides that earnings attributable to excess contributions to an IRA that are returned by the due date for the taxpayer's return for the year (including extensions) are exempt from the Sec. 72(t) 10% additional tax.

3. Tax on excess contributions to certain tax-favored accounts and annuities

a. The 6% excise tax on excess contributions is a tax, not a penalty, and, consequently, no written supervisory approval was necessary, (See Coutrier v. Comm., TC Memo 2024-6).

b. Does SECURE 2.0 establish a finite statute of limitation barring the collection of the excess contribution tax ?

i. The Act provides that the filing of an income tax return on Form 1040 will start the running of a six-year statute of limitation, even if no Form 5329 is filed.

ii. However, there is no retroactive feature associated with the passage of SECURE 2.0 and excess contributions occurring prior to 2022. ((See Coutrier v. Comm., TC Memo 2024-6).

L. Tax Free Charitable Donation Limit from IRA – IR – 2024 – 289

1. The IRS reminded individual retirement arrangement (IRA) owners age 70Â½ and older that they can make tax-free charitable donations of up to $105,000 in 2024 through qualified charitable distributions (QCDs), up from $100,000 in past years.

2. For those aged 73 or older, QCDs also count toward the year's required minimum distribution (RMD).

3. The following are the steps for reporting and documenting QCDs for 2024:

- IRA trustees issue Form 1099 – R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., in early 2025 documenting IRA distributions.
- Record the full amount of any IRA distribution on Line 4a of Form 1040, U.S. Individual Income Tax Return, or Form 1099 – SR, U.S. Tax Return for Seniors.
- Enter "0" on Line 4b if the entire amount qualifies as a QCD, marking it accordingly.
- Obtain a written acknowledgment from the charity, confirming the contribution date, amount, and that no goods or services were received.

4. To ensure qualified charitable deductions (QCD) for 2024 are processed by year-end, IRA owners should contact their trustee soon. Each eligible IRA owner can exclude up to $105,000 in QCDs from taxable income. Married couples, if both meet qualifications and have separate IRAs, can donate up to $210,000 combined.

5. For 2024, the QCD limit is subject to annual adjustments for inflation.

6. For 2025, the limit will be $108,000 and Publication 526, Charitable Contributions and Publication 590 – B Distributions from Individual Retirement Arrangements (IRAs) have also been modified.

7. One issue with the expansion of the RMD is that SECURE does reduce the allowable QCD apply and IRA deduction allowed for a taxpayer over age 70 ½. Specifically, the amount of distributions not includible in gross income shall be reduced (but not below zero) by an amount equal to the excess of the aggregate amount of deductions allowed to the taxpayer for all taxable years ending on or after the date the taxpayer attains age 70½ over the aggregate amount of reductions for all taxable years preceding the current taxable year.

Example

Joe made traditional IRA contributions at age 71 and 72 for a total of $14,000. A few years later, Joe directs the custodian of his IRA to make a qualified charitable distribution of $25,000 to the Salvation Army. The first $14,000 of the distribution is not treated as a QCD. Thus, $14,000 will be included in Joe's income as a taxable distribution, and Joe may deduct $14,000 on his Schedule A as a charitable contribution.

References:

The Inflation Reduction Act of 2022 (IRA 22), PL 117 – 169.

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H. R. 1994, Setting Every Community Up for Retirement Enhancement Act of 2019

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION IV:
STANDARD DEDUCTIONS AND ITEMIZED DEDUCTIONS

I. Standard Deductions

A. 2024 Thresholds - Rev. Rul. 2023 – 34

1. For 2024, the basic standard deduction will be:

- Joint return or surviving spouse $29,200
- Single (not head of household or surviving spouse) $14,600
- Head of household $21,900
- Married filing separate returns $14,600

2. For an individual who can be claimed as a dependent on another's return, the basic standard deduction for 2024 will be $1,300, or $450 plus the individual's earned income, whichever is greater. The standard deduction may not exceed the regular standard deduction for that individual.

3. For 2024, the additional standard deduction for married taxpayers 65 or over or blind will be $1,550. For a single taxpayer or head of household who is 65 or over or blind, the additional standard deduction for 2024 will be $1,950.

B. 2025 Thresholds –Rev Rul 2024 – 40

1. For 2025, the basic standard deduction will be:

- Joint return or surviving spouse $30,000
- Single (not head of household or surviving spouse) $15,000
- Head of household $22,500
- Married filing separate returns $15,000

2. For an individual who can be claimed as a dependent on another's return, the basic standard deduction for 2025 will be $1,350, or $450 plus the individual's earned income, whichever is greater. The standard deduction may not exceed the regular standard deduction for that individual.

3. For 2025, the additional standard deduction for married taxpayers 65 or over or blind will be $1,600. For a single taxpayer or head of household who is 65 or over or blind, the additional standard deduction for 2025 will be $2,000.

C. Substitute Return and Standard Deduction

1. A taxpayer that did not file a return but allow the IRS or had the IRS prepared a substitute return does allow the taxpayer to take a standard deduction. However, a subsequent amended return claiming itemized deductions will be disallowed. Section 63 (e) (1) states that unless an individual makes an election no itemized deduction will be allowed for the tax year. Furthermore under Section 63 (e) (2) any election shall be made on the taxpayer's return and certain circumstances a taxpayers may change election with respect to itemized deductions but only when a return that was previously filed. A substituted return is not considered a previously filed return by the taxpayer. (See Salter v. Comm., TC Memo 2022 – 29)

II. Itemized Deductions

A. Medical Expenses

1. Standard Mileage Rate

a. 2024: The standard mileage rate for medical expenses is set at $0.21 per mile for 2024. (IR 2023 – 239)

b. 2025: Presently, for 2025, the standard mileage rate for medical expenses is $0.21 per mile. (IR 2024-312)

2.. 2024 Long Term Care Premium Limits - Rev. Proc. 2023 – 34

Not more than 40	**$470**
More than 40 but not more than 50	**$880**
More than 50 but not more than 60	**$1,760**
More than 60 but not more than 70	**$4,710**
More than 70	**$5,890**

3. 2025 Long Term Care Premium Limits - Rev. Proc. 2024 – 40

Not more than 40	**$480**
More than 40 but not more than 50	**$900**
More than 50 but not more than 60	**$1,800**
More than 60 but not more than 70	**$4,810**
More than 70	**$6,020**

4. Payments received under qualified long-term care insurance.

a. 2024. Amounts received under a qualified long-term care insurance contract are generally excludable as amounts received for personal injuries and sickness, subject to a per diem limitation, which will be $410 in 2024. (Rev. Proc 2023-34)

b. 2025. Amounts received under a qualified long-term care insurance contract are generally excludable as amounts received for personal injuries and sickness, subject to a per diem limitation, which will be $420 in 2025. (Rev. Proc 2024 – 40)

5. Notice 2024 – 71: Condoms are Considered Qualified Medical Expenses

a. The IRS established a safe harbor for expenses for the purchase of condoms to be treated as a qualified medical expense. As such, those expenses can be reimbursed by a health flexible spending arrangement, a health reimbursement arrangement, or a health savings account.

6. IR 2023-47, new IRS FAQ and what constitutes deductible medical expenses. The IRS has posted answers to FAQs about when certain costs related to nutrition, wellness and general health are deductible medical expenses paid or reimbursed under a health savings account, health flexible spending arrangement, Archer medical savings account, health reimbursement arrangement as well as deductible subject to the AGI limitation.

a. To be deductible, the qualified medical expenses must be incurred primarily to alleviate or prevent a physical or mental disability or illness.

b. Qualified medical expenses include the costs of diagnosis, cure, mitigation, treatment, or prevention of disease that affects any part or function of the body, as well as payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They also include costs for equipment, supplies and diagnostic devices, medicines and drugs that are prescribed by a doctor. Qualified medical expenses generally do not include expenses that are merely beneficial to general health.

c. The IRS' new FAQs cover questions about whether the costs of items such as gym memberships, weight loss programs and special foods can be deducted as qualified medical expenses. For example,

- FAQ 9 says that the cost of weight-loss programs is deductible or reimbursable by a medical savings account when the program treats a specific disease i.e., obesity, diabetes, hypertension, or heart disease diagnosed by a doctor.
- FAQ 10 says that gym memberships are deductible but only when the membership is purchased for the sole purpose of affecting a structure or function of the body (i.e., a prescribed plan for physical therapy to treat an injury) or for the sole purpose of treating a specific disease (i.e., obesity, hypertension, or heart disease) diagnosed by a physician.
- FAQ 12 finds that the costs of food and beverage is deductible but only when (1) the food or beverage doesn't satisfy normal nutritional needs, (2) the food or beverage alleviates or treats and illness, and (3) the need for the food or beverage is substantiated by a doctor. In this case the medical expense deduction is limited to the amount by which the cost of the food or beverage exceeds the cost of a product that satisfies normal nutritional needs.
- FAQ 13 says that the cost of over-the-counter drugs and medicines generally can't be deducted as a medical expense. However, these costs (and menstrual care products) may be paid or reimbursed by a medical savings account.

d. Qualified medical expenses generally do not include expenses that are merely beneficial to general health.

Example

PLR 202311001. Taxpayer purchase food for their five month old infant based on doctor's recommendation and taxpayer's belief that such could reduce infants risk of developing certain medical conditions in the feature even though the child had no known illness caused by that condition nor imminent probability of one. As such the deduction for said food is a medical expense was denied.

7. IR 2024-65: Misrepresentation on General Health and Wellness Expense Deductions. The IRS has issued an alert for taxpayers and health spending plan administrators to remember that personal expenses for general health and wellness are not considered medical expenses under the tax law. The warning came in response to aggressive marketing claims by some companies that misrepresent the circumstances under which food and wellness expenses can be paid or reimbursed under FSAs and other health spending plans. According to the IRS, notes from physicians that are solely based on self-reported data are insufficient as they fail to meet the requirement that the note be related to a diagnosis-specific activity or treatment. FSAs and other health spending plans that pay for, or reimburse, non-medical expenses are not qualified plans. If the plan is not qualified, all payments made to taxpayers under the plan, even reimbursements for actual medical expenses, are includible in income.

8. 7.5% AGI Threshold. For 2024, the threshold for deducting medical expenses is 7.5%. This threshold also applies for alternative minimum tax (AMT) purposes and is permanent in nature.

B. Taxes

1. The state and local income tax (SALT) deduction allows the tax reduction up to $10,000 ($5,000 if married filing separately) for a combination of property taxes in either state and local income taxes or sales taxes. This continues to be in existence for 2025.

2. New York v. Yellin (US 4 – 18 – 22). The US Supreme Court has declined to review an appellate case of the 2nd Circuit Court which upheld the $10,000 limit on the amount of state and local taxes (SALT) that can be claimed as a deduction on an individual income tax return. The suit was filed not only by the York but joined by Connecticut, Maryland and New Jersey. States sought to overturn the limitation on the basis of unconstitutionality indicating that the caps were targeted coercion against the states. The court did not address the states claim that the Limitation violated the 10th amendment and that he co-worst the states to abandon fiscal policies by either lowering their own taxes or cut spending.

2. Taxpayer has the burden of proof to show state and local taxes were paid, the IRS cannot arbitrarily deny such amounts.

Example

Schneider v. Comm., TC Memo 2022 – 104. Taxpayer was denied state and local tax deduction originally by the IRS despite the fact that having proven that the amount paid exceeded the standard deduction amount. The Tax Court indicated that the taxpayer is entitled to a deduction for state income taxes deducted on his W-2. That is all the substantiation that is required.

C. Interest Expense

1. Mortgage Interest Deduction Modified Through 2025

a. Acquisition Indebtedness Limitation. The Tax Cuts and Jobs Acts provides that for tax years beginning after December 31, 2017 and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married filing separately). For tax years beginning after December 31, 2025, the acquisition indebtedness goes back to $1 million ($500,000 for married filing separately).

2. Substantiation

a. Substantiation for interest expense requires the debt constituting acquisition and the debt must be associated with a qualified residence. In addition, the substantiation requirement also applies to mortgage insurance premium payments on a principal residence.

Examples

Tucker v, Comm., TC Memo 2023 – 87. The taxpayers were denied interest expense deductions for property the husband owned as a joint tenant with an unrelated third party. The taxpayers produce Forms 1098 from various banks but did not substantiate that the husband in fact made said payments.

Shilgevorkyan v. Comm., TC Memo 2023-12. The taxpayer was not entitled to mortgage interest deduction regarding property which one of taxpayer's brother originally purchased and taxpayer alleged a half interest in upon taxpayer's acquisition another brother. Taxpayer did not have legal title to property because the brother from whom he allegedly purchased his interest was only an accommodation party to construction loan and did not himself have interest to transfer to taxpayer. Taxpayer also did not hold equitable title. Taxpayer did not show that property qualified as his principal residence for these purposes in year at issue, during which he stayed at and listed another property as his residence

b. Substantiation also requires that the mortgage company applying the payment.

Example

Howland, Jr., et ux. v. Comm., TC Memo 2022 – 60. The taxpayers were a married couple and were denied mortgage interest expense deduction on their home for the year in which they had multiple loans secured by principal residence that was sold at foreclosure sale to bank. The bank in turn sold the residence to 3rd parties. The taxpayers argued that funds which bank received were to be applied to their outstanding interest before principal. However, they failed to show how bank in fact applied same and whether they had any remaining principal balance.

3. Home Equity Indebtedness – Section 163 (h) (3) (C) (i)

a. Under the Tax Cuts and Jobs Act deduction on home equity indebtedness was suspended from 2018 through 2025. Technically, the taxpayer cannot claim the deduction for interest on home equity debt whether the debt is new or old. Under the provision, interest on a home equity loan used to build in addition to an existing home is deductible. However, interest on that same loan used to pay personal living expenses is not deductible. There is a box to check on this respect to Schedule A.

D. Charitable Contributions

1. Standard Mileage Rate. The standard mileage rate is $.14 per mile for use of an automobile in services to a charitable organization. (Notice 2023 – 3). The standard mileage rate will remain the same for 2025.

2. Required Documentation for Charitable Contributions – Publication 1771

a. The IRS imposes recordkeeping and substantiation rules on donors of charitable contributions and disclosure rules on charities that receive certain quid pro quo contributions.

- Donors must have a bank record or written communication from a charity for any monetary contribution before the donors can claim a charitable contribution on their federal income tax returns.
- Donors are responsible for obtaining a written acknowledgment from a charity for any single contribution of $250 or more before the donors can claim a charitable contribution on their federal income tax returns.

- Charitable organizations are required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.

b. A donor cannot claim a tax deduction for any contribution of cash, a check or other monetary gift unless the donor maintains a record of the contribution in the form of either a bank record (such as a cancelled check) or a written communication from the charity (such as a receipt or letter) showing the name of the charity, the date of the contribution and the amount of the contribution.

c. For charitable contributions made by payroll deduction, the donor may use a pledge card prepared by or at the direction of the charitable organization, along with one of the following a pay stub, Form W-2, Wage and Tax Statement, or other employer-furnished document that shows the amount withheld and paid to a charitable organization.

d. If a donor makes a single contribution of $250 or more by payroll deduction, the pledge card or other document from the organization must also include a statement to the effect that the organization does not provide goods or services in whole or partial consideration for any contributions made to the organization by payroll deduction.

e. Each payroll deduction amount of $250 or more is treated as a separate contribution for purposes of the $250 threshold requirement for written acknowledgments.

f. Written Acknowledgment. A donor cannot claim a tax deduction for any single contribution of $250 or more unless the donor obtains a contemporaneous, written acknowledgment of the contribution from the recipient organization. An organization that does not acknowledge a contribution incurs no penalty; but, without a written acknowledgment, the donor cannot claim the tax deduction. Although it's a donor's responsibility to obtain a written acknowledgment, an organization can assist a donor by providing a timely, written statement containing:

i. the name of organization,
ii. the amount of cash contribution,
iii. a description (but not the value) of non-cash contribution,
iv. a statement that no goods or services were provided by the organization in return for the contribution, if that was the case,
v. a description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution,
vi. a statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits (described later in this publication), if that was the case.

g. A separate acknowledgment may be provided for each single contribution of $250 or more, or one acknowledgment, such as an annual summary, may be used to substantiate several single contributions of $250 or more. Letters, postcards or computer-generated forms with the above information are acceptable. An organization can provide either a paper copy of the acknowledgment to the donor, or an organization

can provide the acknowledgment electronically, such as via an email addressed to the donor.. Separate contributions of less than $250 will not be aggregated. An example of this could be weekly offerings to a donor's church of less than $250 even though the donor's annual total contributions are $250 or more.

h. For the written acknowledgment to be considered contemporaneous with the contribution, a donor must receive the acknowledgment by the earlier of the date on which the donor actually files his or her individual federal income tax return for the year of the contribution; or the due date (including extensions) of the return.

i. The acknowledgment must describe goods or services an organization provides in exchange for a contribution of $250 or more. It must also provide a good faith estimate of the value of the goods or services because a donor must generally reduce the amount of the contribution deduction by the fair market value of the goods and services provided by the organization. Goods or services include cash, property, services, benefits or privileges.

j. If a donor makes a single contribution of $250 or more in the form of unreimbursed expenses, for example, out-of-pocket transportation expenses incurred to perform donated services for an organization, then the donor must obtain a written acknowledgment from the organization containing a:

- description of the services provided by the donor
- statement of whether the organization provided goods or services in return for the contribution
- description and good faith estimate of the value of goods or services, if any, that the organization provided in return for the contribution
- statement that goods or services, if any, that the organization provided in return for the contribution consisted entirely of intangible religious benefits.

All Summary of Required Documentation for Charitable Deductions

Type	Documentation
Single cash contribution of less than $250	Cancelled check, bank record, credit card statement, or written acknowledgment from the charity. Sec.170(f) (17); IR-2006-192
Single cash contribution of $250 or more	Written acknowledgment from the charity. Sec.170 (f)(8)
Payroll deduction	Pledge card and W-2, paystub, etc. Sec.1.170A-13(c); Notice 2008-16
Noncash contributions less than $250	Written acknowledgment from the charity or other reliable record. Sec.1.170A-13(b)(1)
Noncash contribution of $250 but not more than	Written acknowledgment from the charity$ 500 1.170A-13(b)(3)
Noncash contribution over $500 under $5,000	Written acknowledgment from the charity and Form 8283, part A. Sec.1.170A-13(b)(3)
Noncash contribution of >$5,000	Written acknowledgment from the charity, appraisal and Form 8283, part B. Sec.170(f)(11)(c)
Noncash contribution > $500,000	Written acknowledgment from the charity, appraisal, and Form 8283, part B. Attach appraisal to the return.Sec.170(f)(11)(D)
Noncash contribution of auto, boat, or airplane with a value of $ 500 or more	Written acknowledgment from the charity. Attach Form1099-C and for 8283 Sec.170(e)(11)(c); IR-2006-192
Noncash contribution of publicly traded stock	Written acknowledgment from the charity and Form 8283, part A. Sec.1.170A-13 (c)(7)(xi)(B)
Noncash contribution of privately traded stock > $ 5,000	Written acknowledgment from the charity, and Form 8283-part B. If the privately traded stock is valued at $10,000 or more, attach an appraisal to the return.Sec.1.170A-13 (c)(2)(ii)(B)(1)
Noncash contribution of art valued at more than $20,000	Written acknowledgment from the charity, appraisal, Form 8283, part B. Appraisal and a photo of the art must be attached to the return. Rev. Proc. 96-15

Examples

Tucker v. Comm., TC Memo 2023-87. Taxpayers were not entitled to charitable contribution deduction above amount IRS allowed for cash donation to church. The taxpayers failed to satisfy the contemporaneous written acknowledgement requirement for cash donations greater than $250. Each written communication from church did not indicate whether church provided any goods or services in consideration for wife's purported contribution.

Braen et al v. Comm., TC Memo 2023-85. In consolidated cases involving a bargain sale transaction, taxpayers through their S Corporation were involved in zoning litigation. Subsequently, taxpayers contributed on undeveloped land to a charity in settlement of the litigation. The Tax Court determined the taxpayers failed to show the value of all consideration received as part of the sale and were not entitled to their proportionate share of charitable deductions. The taxpayers argued the bargain sale was made with donative intent however, contemporaneous written acknowledgments did not include description and good faith estimate of any goods or services received in exchange. The S Corp. did receive acknowledgment letters but failed to state any goods or services were received in exchange.

3. IR 2023 – 185: Danger of Improper Art Work Donation Deductions. The Service has issued information release caution taxpayers to be on the alert for promotions involving exaggerated artwork donation deductions. The basic scheme is for promoters to encourage taxpayers to buy artwork at a discounted price while promising that the art is worse and typically more than the purchase at the discounted price. The promoters encourage purchasers to purchase the artwork hold it for a year and then claim a charitable contribution upon a transfer to a valid charity. In essence the deduction would be an inflated fair market value. The IRS in the notice warns taxpayers about such schemes and that a qualified appraisal is still a requirement to be associated with the contribution.

4. Donative Intent Required for Charitable Contribution – 20233201 F. The chief counsel determined that a taxpayer could not claim a charitable contribution deduction because they did not intend to make a gift and there was nothing of value to contribute once the taxpayer sold the property in a bargain for exchange. In this situation the taxpayer had received an offer from Y to purchase property. Y made a substantial payment to the taxpayer. Subsequently the parties could not agree on a price and there were multiple appraisals of the property. The parties wound up in litigation and a settlement was reached where the parties acknowledge they had disagreements on the fair market value. In the end, the taxpayer accepted Y's initial offer for the property. The taxpayer claimed a charitable deduction for a bargain sale to Y which was a charity. The taxpayer deducted as a charitable contribution at amount equal to the difference between the appraised value the property and the amount the charity paid for the property. The chief counsel noted that after the parties had signed the settlement agreement, the taxpayer had no further rights in the property so it could not be allowed to attribute additional value to the property by way of a tax deduction on top of what had already been deemed. The chief counsel found that the difference between the charities payment and he prays that the property was not a charitable donation because the taxpayer had rejected the offer and had not intended to make a gift by rejecting the offer. Although the charity ultimately acquired the property, the taxpayer could not substantiate its claim chart will contribution deduction because it could not prove the fair market value of the property. The Form 8283 did not acknowledge the fair market value of the donated property and the charity never acknowledge that the property had value above the amount it offered at the time of purchase.

5. Qualified appraisal and other documentation for certain contributions

a. In the case of an individual, partnership, or corporation, no deduction shall be for any contribution of property for which a deduction of more than $500 is claimed unless such person meets the requirements with respect to such contribution.

b. In the case of contributions of property for which a deduction of more than $5,000 is claimed, the requirements of this subparagraph are met if the individual, partnership, or corporation obtains a qualified appraisal of such property and attaches to the return for the taxable year in which such contribution is made such information regarding such property and such appraisal as the Secretary may require.

c. Qualified Appraisal Requirement

i. A qualified appraisal is an appraisal document prepared by a qualified appraiser in accordance with generally accepted appraisal standards. These standards include:

ii. A qualified appraisal must include: (See Reg. Sec. 1.170A-17)

- Information about the contributed property, including a description in sufficient detail under the circumstances, taking into account the value of the property, that a person not generally familiar with the type of property can ascertain that the appraised property is the contributed property.
- In the case of real property or tangible personal property, the condition of the property.
- The valuation effective date, which must be no earlier than 60 days before the date of the contribution and no later than the due date, including extensions, of the tax return on which the deduction for the contribution is first claimed.
- The date, or expected date, of the contribution, not be earlier than 60 days before the date of the contribution and no later than the date of the contribution.
- The fair market value of the contributed property on the valuation effective date.

iii. The qualified appraiser must possess the required education and experience in valuing the type of property including successfully completing professional or college coursework in valuing the type of property pursuant to the appraisal, or earn a recognized appraisal designation.

Example

Oconee Landing Property, LLC v. Comm., TC Memo 2024 – 25. The taxpayer an LLC filing as a partnership, was entitled to a charitable contribution deduction of zero because it failed to secure and attached to his return a qualified appraisal of the contributed property. The property in question included a conservation easement. The partners who controlled the taxpayer had knowledge of facts that would cause a reasonable person to expect the appraiser falsely overstate the value of the donated property. The LLC being the donor and the appraiser had an agreement concerning the amount at which the property will be valued and the donor knew that such amount would exceed the fair market value of the property. Because the partners had knowledge of facts that will cause a reasonable person to expect the appraiser had falsely overstate the value of the donated property the appraisers were not qualified appraiser.

d. Exceptions to the substantiation can include a reasonable cause as to the lack of the documentation and not willful neglect.

Examples

Bass v. Comm., TC Memo 2023 – 41. The taxpayer made non-cash contributions to Goodwill, and the Salvation Army. The taxpayer attached Form 8283 indicating appraised values of $10,286 and the amount for purchase for $4,360. On Section B of the form the taxpayer indicated he donated the properties in good used condition. The taxpayer argued he made a total of 173 trips and received donation acknowledgment receipts for each trip. The taxpayer testified that the donated items reflected each trip at a fair market value less than $250 he did not need to have a qualified appraisal. Qualified appraisal applies to any and all similar items of property donated to one or more charities. Obviously since the amount exceeded $5,000 he was required to get an appraisal and failed to do so. The rationale the court indicated is that similar items are treated as one property requiring the appraisal at the $5,000 threshold.. The court indicated that for purposes of determining the $5,000 threshold, property, and all "similar items of property" donated to one or more charitable organizations is treated as one property (See Treas. Reg. 1.170A-13(c)(1)(i)). The phrase "similar items of property" is defined as "property of the same generic category or type, such as lithographs, paintings, photographs, books, clothing, jewelry, furniture, electronic equipment, household appliances, toys, and everyday kitchenware(See Treas. Reg. § 1.170A-13(c)(7)(iii))

Hoensheid v. Comm., TC Memo 2023-24. Taxpayers had contributed appreciating stock in a closely held corporation to a charitable organization that administered a donor advised fund. The contribution was denied for failing to meet the qualified appraisal requirement. Specifically, the appraisal did not sufficiently describe the qualifications of the appraiser, experience of the appraiser and stated incorrect contribution date. The taxpayers could not sure reasonable cause exception since they use financial services manager as the appraiser despite knowing the lack of experience the appraiser had with respect to the matter at hand.

Lim & Chu v. Comm., TC Memo 2023 – 11. The taxpayers reported a non-cash charitable contribution deduction of over $1.6 million passing through to them from a pass-through entity created under tax scheme. The contribution amount exceeded the maximum allowable deduction. The taxpayers claiming $1.2 million deduction for the tax year and carried the balance forward to the next tax year. Section 170 (f) (11) disallows a deduction for certain non-cash charitable contributions unless specified substantiation documentation requirements are met. In this case of a contribution of property value in excess of $500,000, the taxpayer must obtain attached to the return a qualified appraisal. Qualified appraisal submitted could not be qualified because the appraiser prepared it in exchange for a prohibited appraisal fee. The prohibited appraisal fee was a percentage of the deductible amount up to $1 million plus an additional percentage of the deductible amount of assets exceeding $1 million in other words of sliding contingency fee. Furthermore, the appraiser was the individual who set up the tax scheme to begin with and that is also disallowed.

Izen v. US 38 F4th 459 (5TH Cir 2022.). The Fifth Circuit upheld the Tax Court's decision that the taxpayer was not entitled to a charitable contribution deduction for the donation of his 50% interest in an aircraft to an aeronautical heritage society because he did not provide a contemporaneous written acknowledgment. For a donation of a qualified vehicle, including an airplane, the value of which exceeds $500, the taxpayer must provide a contemporaneous written acknowledgment from the donee organization of the contribution, including the donor's name and TIN. An acknowledgment is contemporaneous if the charitable organization provides it within 30 days of the contribution. Additionally, the recipient organization must provide the IRS with the information contained in the acknowledgment. With his 2010 Form 1040-X the taxpayer, J provided a letter from the donee organization, but it was addressed to Philippe Tanguy, not Izen. Also, the letter did not mention Izen or include his TIN. Izen also submitted a copy of a donation agreement between him, Tanguy, and the society, but it, too, lacked his TIN. Finally, although Izen attached Form 8283 to his Form 1040-X, the Form 8283 did not include his TIN and was not signed contemporaneously. Izen argued that he substantially complied with the rules and that the documents he submitted should be read together with his tax return to support the claimed deduction. The court denied the substantial-compliance argument

because the doctrine of substantial compliance applies to a failure to meet a regulatory requirement, not a statutory requirement. Thus, taxpayers must strictly follow the documentation requirements set out by Congress in the statute to qualify for the charitable contribution deduction.

e. Qualified Appraisal Required to Deduct Charitable Contributions of Cryptocurrency – CCA 202302012. The Service disallowed taxpayers charitable contribution deduction of more than $5,000 of crypto current because the taxpayer failed to obtain a qualified appraisal of the donated crypto. The taxpayer's reliance on the cryptocurrency exchange value of the donated property is not a reasonable cause for not obtaining an appraisal. The Service indicated that the taxpayer must satisfy the substantiation requirements and that cryptocurrency is viewed as a non-cash charitable contribution. It is not deemed to be a readily valued property like cash, publicly traded securities, intellectual properties and certain vehicles. In addition, the Form 8283 was not completed properly to even allow for a reasonable cause exception.

6. Conservation Easements

a. Taxpayers can take a charitable deduction for qualified conservation contributions, which are contributions of a qualified real property interest to a qualified organization exclusively for conservation purposes (See Section 170(h)(1)).

b. A qualified real property interest for this purpose can be the taxpayer's entire interest in the property, a remainder interest or an easement that restricts the use of the property in perpetuity.

c. Conservation purposes under IRC Section 170(h)(4)(A) are as follows:

- preserving land for outdoor recreational use by, or education of, the general public;
- protecting relatively natural habitats of fish, wildlife or plants;
- preserving open space (including farmland or forest space) for scenic enjoyment of the general public or under a governmental conservation policy yielding significant public benefit; and
- preserving a historically important land area or a certified historic structure.

d. **Retain Surface Mining Rights in Conservation Easement**

i. North Donald La Property, LLC v. Comm., TC Memo 2023-50. The LLC filing as a partnership was denied a charitable contribution deduction for the conveyance of a conservation easement to a land Conservancy. The service argued that the limited warranty deed gave the former owners of the land over which the easement was granted a right to my subsurface clay. The owners claim that they intended to transfer all rights to access and exploit the clay reserving rights only to 75% of subsurface liquid and gaseous materials. The taxpayers argued further that even if there was evidence of the retention of rights they had relinquished such in an amended deed in which they relinquished to the LLC any right they had in the minerals located on the land including the clay. However, the amended deed indicated that such relinquishment could be withdrawn at any time.

ii. CCA 202236010. The chief counsel advisory indicated that the conservation easement does not satisfy the exclusive purpose of conservation or exclusively for conservation purposes when the terms of the deed allow the donor to use a surface mining method to extract subsurface minerals with the donee's approval. The only way that the easement is exclusively for conservation purposes is that the conservation is protected permanently, the chief counsel advisory found that because the donor had a retained qualified mineral interest the donor will be allowed to extract or remove minerals from the surface thus potentially destroying the conservation.

e. Perpetuity Issues and Conservation Easement Extinguishments. Section. 170(h)(1) allows a charitable contribution deduction for the contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A contribution is not exclusively for conservation purposes unless that purpose is protected in perpetuity.

i. If, after the creation of the easement, an unexpected event occurs that makes the continued use of the property for conservation purposes impossible or impractical, the conservation purpose can be treated as protected in perpetuity if the restrictions on the property are extinguished by a judicial proceeding and the donee uses all of its proceeds from any disposition of the property in a manner consistent with the original contribution.

ii. Under Regs. Sec. 1.170A-14(g)(6)(ii)a donee must receive a minimum amount of the proceeds from a future disposition. At the date of the donation, the donor must agree that the donee has a property right that has a value at least equal "to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time." That proportionate value must remain constant, and upon a subsequent disposition by judicial decree or a condemnation, the donee must be entitled to a share of the proceeds at least equal to that proportionate value.

f. Valuation Issues and Substantiation. Amount of Charitable Contribution Deduction did not equal easements fair market value because property contributed was inventory noninvestment.

Examples

JL Minerals, LLC v. Comm., TC Memo 2024 – 93. The taxpayer a partnership contributed a conservation easement on stated acres of real property. The Tax Court rejected the IRS's argument that the deduction is not allowable because the primary purpose of the donation was to obtain tax savings and did not carry donative intent. The Service's position was unfounded. The partnership provided sufficient appraisal and information for the deduction. The partnership's charitable donation of the conservation easement was exclusive for conservation purposes the easement protected plant communities and ecosystems natural to the county in a relatively natural state. The easement did reserve certain rights those rights were tied to enforceable restrictions presenting inconsistent use with the conservation purpose. The appraisal met the rules on being qualified and was a qualified appraisal the court found that while the appraisal was not perfect in nature it met the requirements under Section 170 (f) (11) and that reasonable persons with partnership knowledge would expect the appraiser's not to overvalue the easement in nature.

Corning Place Ohio, LLC v. Comm., TC Memo 2024 – 72. Charitable deduction for a tiered partnerships donation of conservation easement on renovated historic office building the Tax Court determined the deduction was not allowable the partnership did not make the contribution in the tax year at issue as required. Rather, the partnership made the donation at the time when it was a single member LLC that was disregarded before the start of the tax year for which it filed as a partnership. The single member LLC was the correct party to report the contribution.

Buckelew Farm, LLC v. Comm., TC Memo 2024 – 52. The partnership was entitled to a charitable contribution deduction for its donation to a tax exempt organization of a conservation easement. The Service had argued that the easement failed to provide the organization a proportionate share of the extinguishment proceeds as required under the regulations. The Court of Appeals for the 11th circuit in Hewitt v. Commissioner (21 F 4RG 1336) held that treasury regulation 1.170A – 14 (g) (6) (ii) was arbitrary and capricious and ruled to be invalid. The tax court rejected the IRS's argument that the easement fails to provide the organization a proportionate share of the extinguishment proceeds. The taxpayer had donative intent when it made the contribution. The Service argued that the contribution was

made only for personal profit of the managers by enticing potential investors with a tax deduction for the conservation easement. The IRS also argued that the easement deal was priced so the investors would substantially have savings that exceeded the amount of the contribution. The Service also argued without merit that the appraisal was not a qualified appraisal under the code. The Tax Court found that argument unpersuasive stating that a before value determination provided by the IRS's expert was based on comparable vacant sales and did not pertain to the matter at hand.

Savannah Shoals , LLC v. Comm., TC Memo 2024 – 35. The partnership was entitled to a charitable contribution deduction for the donation of an easement. The Service argued that the taxpayer was not entitled to a deduction because it failed to satisfy the heightened substantiation requirements applicable to non-cash charitable deductions. The appraisal provided sufficient information for the IRS to evaluate the deduction. The IRS argued that the appraised value was the wrong asset and that the appraised value of the property was that of the subsurface not the easement. The appraisal correctly indicated that it was an appraisal of an easement. The appraisal include a sufficient description of the donated property for a person who was not generally for me with easements to ascertain its proper value. Though the appraisal did not strictly comply with the qualified appraiser requirements, it provided enough information for the IRS to evaluate. The Tax Court found that the taxpayer's experts over estimated annual sales of aggregated sales from the proposed quarry and overstated potential profitability. In other words, while the valuation did pertain to the easement from a methodology perspective it was slightly overvalued in terms of being valued at investment value and not fair market value. The court adjusted it accordingly. Specifically, the court allowed a conservation easement deduction of $480,000 based upon the appraisal and not the 23 million as claimed by the taxpayer partnership. The court rejected the IRS determination that nothing should be awarded because the appraisal sales projections were optimistic. Optimism is not a criteria to automatically exclude an appraisal.

Valley Park Ranch, LLC v. Comm., 162 TC No. 6 Dec. 62, 442. The Tax Court has ruled against the IRS's denial of a conservation easement deduction by declaring a Treasury regulation to be invalid under the enactment requirements of the Administrative Procedure Act. An LLC conveyed a conservation easement of land to a foundation that was properly registered with the county clerk. The deed conveyed the easement in perpetuity, allowing for extinguishment only in cases where the conservation purposes became impossible to accomplish or if the property were to be condemned by the local government through eminent domain. The LLC then timely filed Form 1065, U.S. Return of Partnership Income, claiming a $14.8 million deduction under Section 170 (h) for conveyance of the easement, and included with the return Form 8283.The IRS disallowed the deduction stating the conservation purpose of the easement was not "protected in perpetuity" this in fact was not the case. In essence, the Tax Court agreed with the 11th circuit Court of Appeals invalidating the IRS regulation as opposed to the sixth circuit Court of Appeals that indicated the regulation was valid.

Excelsior Aggregates, LLC v. Comm., TC Memo 2024 – 60. The charitable contribution deduction claim for conservation easements taken by a partnership were not entitled to be allowed as a viable tax deduction. The record showed that other properties relatively close to the subject properties were bought and sold over a ten-year period at prices that generally were lower. Given this evidence, it was wholly implausible that a hypothetical willing buyer with knowledge of the relevant facts would purchase them for the prices determined by the taxpayer's expert. Further, regarding the third parcel of the subject property the Tax Court found the taxpayer's expert's valuation method to be the more reasonable approach. The taxpayer's expert conducted his comparable sales analysis in a manner appropriately tailored to the noncontiguous nature of the parcel. Accordingly, the fair market value of the fee simple interest in the property was correctly determined by the taxpayer's expert. In addition, the valuation was not based on the highest and best use of the property. The valuation was based on commercial mineral interest as opposed to residential use.

Carter v. Comm., TC Memo 2023 – 133. Taxpayers took charitable contribution deductions for partnership donations to a land trust of an easement. The Tax Court found the documentation and protection perpetuity requirements were met. The easement was qualified real property in the taxpayers were in town the deductions equal the fair market value the easements at the time of the contribution. The value of the easement was lowered due to a methodology issue as there was a lack of demonstration that the value was unique in nature to warrant a higher valuation.

Brooks v. Comm., 2024 USTC 50172. The Tax Court properly disallowed a married couple's (taxpayers) charitable deduction under Section 170(f)(8). The taxpayers failed both to satisfy the documentation requirements and to make a showing as to why they should be relieved from doing so. Such a misstatement was substantial, and the taxpayers did not show reasonable cause. The court concluded that the taxpayers' claimed value for the easement was more than 200 percent of its correct value.

h. IRS Has burden of Proving Lack of Reasonable Cause regarding Contemporaneous Written Acknowledgment.

Examples

Murfam Enterprises LLC v. Comm., TC Memo 2023 – 73. The taxpayer donated an easement to a qualified organization for a conservation. The land subject to the easement had been granted hog farming certificates by the state. The taxpayer claimed a charitable contribution deduction supported by an appraisal of the donated property. The appraisal value the property based on the foregone value of the hog farming certificates attached to the property. The Form 8283 did not include the taxpayer's basis in the land and was viewed is incomplete. he IRS reduced the deduction on the premise that the value of the hog-farming certificates was zero and the easement should have been valued according to the land's use as timberland. The taxpayer filed a petition in Tax Court asking the court to review the IRS's determination. In its response to the taxpayer's petition, the IRS made a new assertion that the deduction should be entirely disallowed because the taxpayer did not comply with the substantiation and reporting requirements when it failed to attach a fully completed appraisal summary to Form 8283. The taxpayer claimed reasonable cause on this aspect, citing reliance on its CPA. The court held that while Murfam did in fact fail to strictly or substantially comply with the reporting requirements of Sec. 170(f)(11), the IRS did not meet its burden of proof to show a lack of reasonable cause. Thus, the charitable contribution deduction was not entirely disallowed. The parties still disagreed as to the value of the easement and the amount associated with the deduction. The court considered the value of the forgone hog-farming certificates and redetermined the easement's value as only slightly lower than what the taxpayer had originally claimed.

Murphy Jr. v. Comm., TC Memo 2023 – 72. Taxpayers made charitable donations through an S corporation of conservation easements on lands and tracts that included a golf course. The Tax Court determined that the Form 8283 did not report the basis in the contributed property as such the taxpayers did not meet the substantiation and reporting requirements. The Service has the burden of proving lack of reasonable cause as to the taxpayers omission of basis. The IRS never challenged it and did not challenge it at trial. The easements were found to protect a conservation purpose in perpetuity despite the fact that there were rights reserved by the donor. However, those reserve rights were subject to the approval by the charity. The deductions were allowed.

7. Final Regulations on Syndicated Conservation Easement Transactions – TD 10007

a. The IRS issued final regulations that identified certain abusive syndicated conservation easement transactions and substantially similar ones as reportable listed transactions. The regulations released pertain to certain qualified conservation contributions made by partnerships and S Corporations. The final

regulations clarify that participants and material advisers must report these transactions to the IRS, including any transactions that were completed in tax years that are still open.

b. The final regulations cover three major classes of abusive syndicated conservation easement transactions

- Those that involve contributions occurring before December 30, 2022;
- Those for which a charitable contribution deduction is not automatically disallowed by Section 170(h)(7); and
- Those that substitute the contribution of a fee simple interest in real property for the contribution of a conservation easement.

c. The regulations disallow a federal income tax deduction for a qualified conservation contribution if the amount exceeds 2.5 times the sum of each partner's or S corporation shareholder's relevant basis.

d. Partnerships and S corporations must report the distributive share or pro rata share of any noncash charitable contribution, not just those that are qualified conservation contributions. If the donor is a partnership or an S corporation, the donor must provide a copy of its completed Form 8283, Noncash Charitable Contributions (Section A or Section B) to every partner or shareholder who receives an allocation of a charitable contribution under Section 170 for the property described in Form 8283 (Section A or Section B).

e. The regulations provide reporting requirements for partners and S corporation shareholders that receive a distributive share or pro rata share of any noncash charitable contribution made by a partnership or S corporation, regardless of whether the contribution isa qualified conservation contribution (and regardless of whether the contribution is of real property or other noncash property). Partners and S corporation shareholders must attach Forms 8283 (Section A or Section B) to their return.

f. The final regulations also modify the definition of "participant" to clarify that the class of participants includes participants in transactions that are the same as, or substantially similar to, syndicated conservation easement transactions.

g. These regulations are effective from June 28, 2024 for contributions after December 29, 2022.

E. Casualty Losses

1. The Further Consolidated Appropriations Act of 2020 provides special rules for qualified personal casualty and disaster -related relief. Specifically, if the taxpayer has a net disaster loss the amount of the deduction equals the sum of the net disaster loss and the excess that exceeds 10% of the taxpayers AGI using a floor of $500.

2. The Tax Cuts and Jobs Act provides that a taxpayer may claim a personal casualty loss only if the loss is attributable to a presidentially declared disaster area. This is still in play until the year 2025.

3. Automatic Extension of Filing Deadlines in Case of Individual Taxpayers Affected by Federally Declared Disasters (§7508A; Appropriations Act, Sec. 205, pg. 712) Automatic 60-day extension. In the case of any qualified taxpayer, a mandatory 60-day extension has been added to the one-year waiver of taxes and interest option that may be granted by the Secretary of Treasury.

4. A qualified taxpayer includes:

- An individual whose principal residence is in the disaster area,
- Any taxpayer if the principal place of business (other than the employee) is located in a disaster area,
- A relief worker assisting in a disaster area who is affiliated with a government or philanthropic organization,
- A taxpayer whose records show necessity to meet certain deadlines by reason of a Presidentially declared disaster or terrorist or military actions,
- Any individual visiting a disaster area who was killed or injured as a result of the disaster, and
- Solely with respect to filing a joint return, any spouse of the above-mentioned individual.

5. CAA2021 Provides New Disaster Relief (HR 133). The provisions of the Taxpayer Certainty and Disaster Tax Relief Act of 2021 (included in CAA2021) contained in the appropriations bill extend disaster relief for those in a qualified disaster area in 2021. In addition, the Act extends certain disaster relief provisions from the 2019 SECURE Act into 2022 and 2023.

6. This IRS webpage contains information to help taxpayers and tax practitioners with common tax-related questions after a disaster. A few highlights from the 38 FAQs follow:

- Disaster relief applies to the clients of tax preparers who are unable to file returns or make payments on behalf of the client because of a federally declared disaster.
- If the taxpayer is outside of the disaster area, he or she may qualify for relief if the preparer is in the federally declared disaster area and the preparer is unable to file or pay on the taxpayer's behalf.
- If an affected partnership or S corporation cannot provide the taxpayer with the records necessary to file his or her return, then the taxpayer is an affected taxpayer. Filing and payment deadlines are postponed until the end of the postponement period just like the affected partnership or S corporation.
- If a taxpayer properly claimed a casualty loss deduction on an original return and in a later year receives reimbursement for the loss, the taxpayer does not amend the original return. Instead, the taxpayer should report the amount of the reimbursement in gross income in the tax year in which the reimbursements were received, to the extent the casualty loss deduction reduced their income in the tax year that the taxpayer reported the casualty loss deduction.
- The IRS will not abate interest on balances due on liabilities for prior years.
- The IRS will consider waiving late payment penalties when the reason for the late payment is due to reasonable cause related to the disaster.

Example

Richey v. Comm ., TC Memo 2023 – 43. The Tax Court held that the IRS properly denied a $740,000 loss deduction for damages to a vacation home and boat that the taxpayer claimed was caused by a storm. The taxpayer failed to prove the damage was caused by the storm and more importantly, it was not in a federally declared disaster area.

F. **Miscellaneous Itemized Deductions Suspended**

1. Beginning in 2018

a. For tax years beginning after December 31, 2017 and before January 1, 2026, the deduction for miscellaneous itemized deductions that are subject to the 2% floor are suspended. This does include the deduction for tax preparation expenses. The 2018 Schedule A has been revised to eliminate these miscellaneous itemized deductions that were subject to the 2% floor.

b. This would also include miscellaneous itemized deductions subject to the 2% floor on Form 1041 as well.

c. The deductions that would be subject to the 2% limitation are in three broad categories:

- Unreimbursed Employee Expenses
- Tax Preparation Fees
- Other expenses which are generally on Schedule A, line 23

d. On the IRS website, the service lists the following as unreimbursed employee expenses which would now appear in 2018 to be non-deductible:

- Business bad debt of an employee.
- Business liability insurance premiums.
- Damages paid to a former employer for breach of an employment contract.
- Depreciation on a computer your employer requires you to use in your work.
- Dues to a chamber of commerce if membership helps you do your job.
- Dues to professional societies.
- Educator expenses.
- Home office or part of your home used regularly and exclusively in your work.
- Job search expenses in your present occupation.
- Laboratory breakage fees.
- Legal fees related to your job.
- Licenses and regulatory fees.
- Malpractice insurance premiums.
- Medical examinations required by an employer.
- Occupational taxes.
- Passport for a business trip.
- Repayment of an income aid payment received under an employer's plan.
- Research expenses of a college professor.
- Rural mail carriers' vehicle expenses.
- Subscriptions to professional journals and trade magazines related to your work.
- Tools and supplies used in your work.
- Travel, transportation, meals, entertainment, gifts, and local lodging related to your work.
- Union dues and expenses.
- Work clothes and uniforms if required and not suitable for everyday use.
- Work-related education.

e. The certain other expenses that are generally deductible Schedule A, line 23 generally refer to expenses that are ordinary and necessary and are paid to:

- Produce or collect income that is generally included in gross income,
- Manage, conserve or maintain property held for the production of income,
- Determine, contest, pay or claim a refund of any tax

f. These other expenses generally include the following:

- Appraisal fees for a casualty loss or charitable contribution.
- Casualty and theft losses from property used in performing services as an employee.
- Clerical help and office rent in caring for investments.
- Depreciation on home computers used for investments.
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust.
- Fees to collect interest and dividends.
- Hobby expenses, but generally not more than hobby income.
- Indirect miscellaneous deductions from pass-through entities.
- Investment fees and expenses.
- Legal fees related to producing or collecting taxable income or getting tax advice.
- Loss on deposits in an insolvent or bankrupt financial institution.
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to you.
- Repayments of income.
- Repayments of social security benefits.
- Safe deposit box rental, except for storing jewelry, and other personal effects.
- Service charges on dividend reinvestment plans.
- Tax advice fees.
- Trustee's fees for your IRA, if separately billed, and paid

2. Miscellaneous Expenses not subject to the 2% limitation.

- Amortizable premium on taxable bonds.
- Casualty and theft losses from income-producing property.
- Federal estate tax on income in respect of a decedent.
- Gambling losses up to the amount of gambling winnings.
- Impairment-related work expenses of persons with disabilities.
- Loss from other activities from Schedule K-1 (Form 1065-B), box 2.
- Losses from Ponzi-type investment schemes.
- Repayments of more than $3,000 under a claim of right.
- Unrecovered investment in an annuity.

References:

The Inflation Reduction Act of 2022 (IRA 22), PL 117 – 169**.**

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION V:

QUALIFIED BUSINESS INCOME DEDUCTION

I. Qualified Business Income Deduction

A. Overview

1. Section 199A was enacted on December 22, 2017 under the Tax Cuts and Jobs Act (P. L. 115 – 97) and was subsequently amended on March 23, 2018 by the Consolidated Appropriations Act of 2018, (P. L.. 115 – 141).

2. This code section provides for a deduction to non-corporate taxpayers based on the concept of Qualified Business Income (QBI) in association with a Qualified Trade or Business.

3. Noncorporate taxpayers refer to individuals that operate a sole proprietorship or operate through a pass-through entity as well as certain estates and trusts.

4. Hence, the deduction may be taken by individuals and by some estates and trusts.

5. The deduction is not available for:

- those that only possess wage income (Wages and Salaries),
- those that have business income earned through a C Corporation.
- a taxpayer that is a mere employee and has no ownership interest in a qualified trade or business.

The deduction is available for a taxpayer who has not only wage income but also possesses ownership interest in a sole proprietorship or in a pass-through entity such as a partnership or S Corporation.

6. Section 199A allows individuals and some estates and trusts a deduction up to 20% of their combined qualified REIT dividends and qualified PTP income, including qualified REIT dividends and qualified PTP income earned through pass-through entities. This component of the deduction is not limited by W – 2 wages or the unadjusted basis in qualified property.

7. As s a general rule, the Section 199A deduction is the lesser of:

- The *Combined Qualified Business Income Amount* of the taxpayer, or

- 20% of the excess, if any, of the taxable income of the taxpayer for the tax year over the net capital gains (Taxable Income - Net Capital Gains). (See Section 199A(c))

8. *Combined Qualified Business Income Amount* refers to an amount equal to:

The deductible amount for ***each*** *qualified trade or business,* as defined below.

+ 20% of the aggregate amount of qualified REIT dividends and qualified PTP income.

9. *The deductible amount for* ***each*** *qualified trade or business* is defined as the lesser between:

- 20% of the taxpayers Qualified Business Income (QBI) or
- The greater of:
    - 50% of W – 2 Wages (This represents W-2 Wages from either a sole proprietorship or allocable share from a pass-through entity, also known as the *Wage Limit*) or
    - 25% of the W – 2 Wages +2.5% of the unadjusted basis immediately after acquisition of Qualified Property. (This is also known as the *Wage/Basis Limit*)

+ 20% of the aggregate amount of Qualified REIT Dividends and Qualified PTP Income

10. The *Wages Limit* and *Wage/Basis Limit* must be provided from each pass-through entity (S Corporation or Partnership) that has or that pays wages and has unadjusted basis of after-acquired depreciable property that is qualified in nature and as defined in this provision.

11. Qualified Property refers to tangible, depreciable property that is:

- held by available for use in the qualified trade or business at the close of the taxable year,
- used at any point during the tax year in the production of qualified business income, and
- the depreciable period for which has not ended before the close of the tax year.

12. The *Wages Limit* and *Wage/Basis Limit* does not apply in all cases. The Wage Limit and Wage/Basis Limit does not apply if the taxpayer's taxable income before the qualified business income deduction is below a threshold amount.

13. **Threshold Amounts**

a. The threshold amounts for 2024 are as follows: (Rev. Proc. 2023-34):

Filing Status	**Taxable Income Before QBI**
Married Filing Joint	$ 383,900
Single and HOH	$191,950
Married Filing Separately	$191,950

b. The threshold amounts for 2025 are as follows: (Rev. Proc. 2024-40):

Filing Status	**Taxable Income Before QBI**
Married Filing Joint	$394,600
Single and HOH	$197,300
Married Filing Separately	$197,300

14. The application of the Wage Limit and Wage/Basis Limit is phased-in for taxpayers whose taxable income exceeds these threshold amounts. When the limitation applies, the limit is phased in when the taxpayer's taxable income exceeds the threshold amounts. Specifically, as follows:

- a phase in over the next $100,000 of taxable income for married filing jointly

- a phase in over the next $50,000 of taxable income for all other filers.

15. Prior to determining the deduction, the taxpayer must determine the taxpayer's taxable income before determining the Qualified Business Income deduction.

16. Hence, the deduction is not allowed in computing adjusted gross income but is a deduction reducing taxable income.

17. Hence, the first thing the tax preparer must do is determine taxable income before determining Qualified Business Income.

18. Taxable Income Is Below the Threshold Amount

If taxable income is below the threshold amount, the QBI deduction is 20% of each trade or businesses' QBI, subject only to the taxable income limitation.

19. Taxable Income is Above the Threshold Minimum, But Not Above the Maximum

If taxable income falls between the threshold and the top of the phase-in range, a limitation on the QBI deduction is phased in. The limitation phase-in reduces the QBI deduction by a percentage calculated with the numerator being the amount of taxable income in excess of threshold for the filing status and the denominator being $50,000 ($100,000 for MFJ).

20.Taxable Income is Above the Threshold Maximum

If a taxpayer's taxable income is above the threshold maximum, no QBI deduction is allowed unless the taxpayer has W-2 wages or UBIA allocable to the trade or business.

B. Who Can Claim the Deduction?

1. To reiterate, the Section 199A deduction is taken by individuals and by certain trusts and estates. The available sources for the deduction include the following:

- Individual owners of sole proprietorships,
- Rental properties, (Safe Harbor?)
- S corporations,
- Partnerships, and
- Certain trusts and estates

2. In other words, the qualified business income deduction is available to businesses that are a *qualified trade or business* which could include the above list or a combination thereof.

3. Specified Agricultural or Horticultural Cooperatives may claim a special entity level deduction that is substantially similar to the domestic production activity deduction under former Section 199. The amount determined with respect to such trade or business is reduced by the lesser of 9% of QBI with respect to the trade or business as is allocable to qualified payments received from the cooperative or 50% of the W-2 wages respect to the trade or business.

4. The deduction is not available for taxpayers that are:

- Employees with no equity or capital ownership in a business,
- Businesses that are characterized as specified service trade or business.

5. Except as otherwise provided, the deduction does not apply specified service trade or businesses. These types of businesses are generally defined under Section 1202(e)(3) (A). Section 199A (d) (2) defines a specified service trade or business by reference to Section 1202 (e) (3) (A), which includes among the businesses ineligible for the benefits of that section:

any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or 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.

6. However, businesses involving engineering and architecture are not considered specified service trade or businesses. Therefore they are eligible for the 20% deduction.

7. The deduction has no effect on adjusted basis of a shareholder or partner's interest nor does it have an impact on the S corporations AAA account.

8. The deduction does not reduce net earnings from self-employment tax nor does it impact net investment income tax.

9. For purposes of determining alternative minimum taxable income the deduction allowed under this provision equals the deduction allowed in determining taxable income for the year without regard to any alternative minimum tax adjustment.

10. **Specified Services Limitation**

a. The QBI Deduction Is Not Allowed for "Specified Service" Business Income

b. A *"specified service trade or business"* includes personal-service-type trades or businesses involved in the following performance of services: health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services (including investing and investment management, trading, or dealing in securities, partnership interests, or commodities), and any trade or business where the principal asset is the reputation or skill of one or more of its owners or employees.

c. The exclusion of SSTBs from QBI is subject to a phase-in over the same dollar range as the taxable income limitation phase-in.

II. Qualified Business Income – Section 1.199A – 3

A. Definition

1. *Qualified Business Income (QBI)* means , for any tax year, the net amount of *qualified items of income, gain, deduction and loss* with respect to aid any trade or business or aggregated trade or business.

2. Qualified Items of income, deduction, gain and loss. This refers to 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, and

b. Are included or allowed in determining taxable income for the taxable year.

The following items are not taken into account as qualified items of income, gain, deduction or loss and are thus not included in determining qualified business income:

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.

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.

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

3. It should be noted that all wages paid or incurred must be taken into account in computing QBI (if the requirements of this section and Section 199A are satisfied) regardless of the application of the W-2 wage limitation described in §1.199A-1(d)(2)(iv).

4. If an individual or an RPE directly conducts multiple trades or businesses, and has items of QBI that are properly attributable to more than one trade or business, the individual or RPE must allocate those items among the several trades or businesses to which they are attributable using a reasonable method based on all the facts and circumstances.

a. The proposed regulations had referenced a direct tracing method or an allocation based on gross income. These were specifically removed and the emphasis in the commentary was a reasonable method can be adopted but it must be applied on a consistent basis.

5. The individual or RPE may use a different reasonable method with respect to different items of income, gain, deduction, and loss. The chosen reasonable method for each item must be consistently applied from one taxable year to another and must clearly reflect the income and expenses of each trade or business.

6. The overall combination of methods must also be reasonable based on all facts and circumstances. The books and records maintained for a trade or business must be consistent with any such allocations method.

7. **Section 751 Gain.** 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. This refers to hot assets, appreciating inventory and unrealized accounts receivable.

8. **Guaranteed Payments for the 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.

a. The Service is taking the position that guaranteed payments for the use of capital are not attributable to a trade or business of the partnership because they are determined without regard to partnerships income. As such, they should generally not be considered part of QBI. Rather, such payments are considered more along the lines of interest income should be treated as interest income which is not includable in the computation.

9. **Section 481 Adjustments.** 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 is otherwise satisfied, but only if the adjustment arises in taxable years ending after December 31, 2017. Thus, only Section 481 adjustments that arise after December 31, 2017 are taken into account in determining QBI.

a. Income from installment sales and deferred cancellation of debt income arising in tax years ending before January 1, 2018 should not be taken into account for purposes of computing QBI. Several

commentators have recommended that items deferred under Revenue Procedure 2004 – 34, 2004 – C. B. 911 should be included in QBI. The IRS continues to study the issue and may issue a proposed regulation.

10. **Previously Disallowed Losses**. Generally, previously disallowed losses or deductions (including under Sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are taken into account for purposes of computing QBI. These losses shall be used, for purposes of Section 199A and these regulations, in order from the oldest to the most recent on a first-in, first-out (FIFO) basis. *However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under Sections 465, 469, 704(d), and 1366(d)), are not taken into account in a later taxable year for purposes of computing QBI.*

a. The Service in its commentary indicated that losses disallowed, suspended or limited under Sections 465, 469, 704(d), and 1366(d) ordering rule for the use of losses should be in the order from the oldest to the most recent on a FIFO basis.

b. The IRS is going to issue proposed regulations that treat previously suspended losses as losses from a separate trade or business for purposes of Section 199A.

11. **Net Operating Losses.** Generally, a net operating loss deduction under Section 172 is not considered with respect to a trade or business and therefore, is not taken into account in computing QBI. However, *an excess business loss under Section 461(l) is treated as a net operating loss carryover to the following taxable year and is taken into account for purposes of computing QBI in the subsequent taxable year in which it is deducted*.

12. **Other Deductions.** Generally, deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of Section 199A and this section are otherwise satisfied. For purposes of Section 199A only, deductions such as the following are considered other deductions:

- deductible portion of the tax on self-employment income under Section 164(f),
- the self-employed health insurance deduction under Section 162(l), and
- the deduction for contributions to qualified retirement plans under Section 404 are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis to the gross income received from the trade or business.

a. The commentary on the final regulation addressed this category of other deductions reiterated that *All deductions attributable to a trade or business should be taken into account for purposes of computing QBI except to the extent provided by section 199A and these regulations. Accordingly, §1.199A-3(b)(1)(vi) provides that, in general, deductions attributable to a trade or business are taken into account for purposes of computing QBI to the extent that the requirements of section 199A and §1.199A-3 are otherwise satisfied. Thus, for purposes of section 199A, deductions such as the deductible portion of the tax on self-employment income under section 164(f), the self-employed health insurance deduction under section 162(l), and the deduction for contributions to qualified retirement plans under section 404 are considered attributable to a trade or business to the extent that the individual's gross income from the trade or business is taken into account in calculating the allowable deduction, on a proportionate basis.*

b. The Treasury and IRS declined to address whether deductions for unreimbursed partner expenses, interest to acquire a partnership and S Corp interests and state and local taxes are attributable to a trade or business. It would appear that those are based on facts and circumstances.

13. **Section 1231.** Several commentators noted that whether a taxpayer has long-term capital gains or losses under Section 1231 is determined at the taxpayer level and not at the level of the trade or business for which QBI is determined.

a. The IRS determined that for purposes of Section 199A that taxpayers net their Section 1231 gains and losses from multiple trade or businesses to determine whether they have an excess gain.

b. Likewise, the recapture rules under Section 1231(c) continue to apply. Under this rule, a taxpayer that has a Section 1231 capital gain in the current year must look back any Section 1231 ordinary loss taken in the previous five years and convert a portion of the Section 1231 capital gain to ordinary gain based upon the previous losses taken.. That continues in determining QBI.

c. The final regulations remove reference to Section 1231 and state specifically that to the extent an item is not treated as an item of capital gain or capital loss under any other provision of the Code, it is taken into account as a qualified item of income, gain, deduction, or loss unless otherwise excluded by Section 199A or these regulations.

14. As discussed on the IRS website, FAQ 23 states that a taxpayer with a Schedule C Business does not necessarily have QBI equal to the net profit on the Schedule C. The Service is taking the position that with respect to the Schedule C business that the QBI be adjusted by any other items of gain or deduction related to the business, including but not limited to the following:

- gains from Form 4797,
- the deductible part of self-employment tax,
- self-employed health insurance,
- self-employed SEP, SIMPLE, and qualified plan deductions.

Amounts received as W-2 income, reasonable compensation from an S corporation, guaranteed payments from a partnership, and payments received by a partner for services under section 707(a) are not QBI and are not eligible for the deduction.

15. Under IRS, FAQ 33, health insurance premiums paid by the S corporation for a greater than 2% shareholder reduces qualified business income at the entity level by reducing ordinary income used to compute the allocable qualified business income share. If a taxpayer takes the self-employed health insurance deduction on their tax return. They are to include the deduction in calculating qualified business income from the S corporation. This may result in qualified business income being lower at both the entity and the shareholder level.

B. Qualified REIT Dividends

1. The term qualified REIT dividend means any dividend from a REIT received during the taxable year which:

- Is not a capital gain dividend, as defined in Section 857(b)(3), and

- Is not qualified dividend income, as defined in Section 1(h)(11).

2. The term qualified REIT dividend does not include any REIT dividend received with respect to any share of REIT stock that:

- Is held by the shareholder for 45 days or less (taking into account the principles of Section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend, or

- To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

C. Qualified PTP Income

1. The term qualified PTP income means the sum of:

The net amount of such taxpayer's allocable share of income, gain, deduction, and loss from a PTP as defined in Section 7704(b) that is not taxed as a corporation under Section 7704(a),

+

Any gain or loss attributable to assets of the PTP giving rise to ordinary income under Section 751(a) or (b) that is considered attributable to the trades or businesses conducted by the partnership.

2. The rules applicable to the determination of QBI also apply to the determination of a taxpayer's allocable share of income, gain, deduction, and loss from a PTP.

3. An individual's allocable share of income from a PTP, and any Section 751 gain or loss is qualified PTP income only to the extent the items meet the qualifications of Section 199A and this section, including the requirement that the item is included or allowed in determining taxable income for the taxable year, and the requirement that the item be effectively connected with the conduct of a trade or business within the United States.

4. For example, if an individual owns an interest in a PTP, and for the taxable year is allocated a distributive share of net loss which is disallowed under the passive activity rules of Section 469, such loss is not taken into account for purposes of Section 199A.

5. The specified service trade or business limitations also apply to income earned from a PTP.

6. Each PTP is required to determine its qualified PTP income for each trade or business and report that information to its owners as described in §1.199A-6(b)(3)

7. If a taxpayer receives a K-1 allocating a PTP loss, but loss is currently not allowable. Do to the passive activity rules. It is not used in computing the REIT/PTP component as it is not included in taxable income. Hence, it is not used in computing the QBI deduction. In a later year, when the losses allowable, lost, generated in 2018 would be used in computing the REIT/PTP component. (See IRS FAQ 31)

D. Mineral Interest

1. Both the proposed regulations and final regulations did not specifically include or exclude mineral interest or working interest from the Section 199A deduction. As such, taxpayers must look to other areas of the Internal Revenue Code for guidance.

2. In order to classify income from a mineral interest, the taxpayer must know how the income is derived. For federal tax purposes, a mineral interest is known as a bundle of legal rights that may be severed from the surface. Obviously, it is possible for the owner minerals not to own the surface layer. When mineral interests are separated in this way, there are generally two types of rights:

- Rights to receive lease benefits which include the right to receive bonus payments, delay rentals and royalties. When a mineral interest owner grants a lease, the right to develop is relinquished and vest with the lessee operator. That distinction is critical in the classification of royalties versus a working or operate interest

- Rights to develop the mineral estate often include the right to develop and produce the minerals. This is generally associated with a working or operating interest.

3. In examining the definition of qualified business income. It appears that portfolio income are generally excluded from qualified business income. However, working interest income are generally viewed as a trade or business activity. The support for this stems from Section 1411 which imposes the 3.8% tax on net investment income of the taxpayer above certain thresholds. The definition of net investment income includes royalties *other than those items derived from a non-passive trade or business.* S 469, which is the passive income provisions states that portfolio income can include royalties from a mineral interest unless derived in the ordinary course of a trade or business. This would appear to include all and gas royalties, overriding royalties, but this would not include those that are a dealer in royalties. (See Reg. Sec. 1.469 – 2T(c (3))

4. In addition Royalties are not burdened with production cost as of the sale or exchange world interest is generally treated as the sale or exchange of a capital asset. (Revenue Ruling 73 – 428)

5. A working interest generally is treated as a trade or business activity because it is burdened with the cost of production, development and operation. The income and losses generally treated as subject to self-employment tax**.** (See . Cokes v. Commissioner, 91 T.C. 222 (1988); and, Methvin v. Commissioner, T.C. Memo. 2015-81, aff'd, 2016 WL 3457623 (10th Cir. 2016) where it small individual working interest owner who is not designated the operator of an oil and gas property was held liable for self-employment tax on trade or business income.)

a. Likewise, there is nothing in the proposed nor final regulations of Section 199 a that states a working interest in all and gas is excluded from the definition of qualified trade or business. Assuming the working interest is assessing with a domestic trade or business, based upon the above, it appears that the working interest would be qualified business income associate with a qualified trade or business, and thus the deduction would be allowed.

6. In essence, mineral interest held for investment purposes only, are not likely to qualify for the 20% deduction, but non-investment like a working interest appears to be eligible. If the working interest is considered qualified business income eligible for the deduction, it should be identified as such is either on a K – 1 or Form 1099 – M ISC other than royalty.

III. Determination of W – 2 Wages – Regulation 1.199 A – 2

A. General Rule

1. The determination of W-2 wages must be made for each trade or business by the individual or RPE that directly conducts the trade or business(or aggregated trade or business). This is the case irrespective of taxable income of the individual taxpayer. It is particularly the case with RPE that is a qualified trade or business.

2. In the case of W-2 wages paid by an RPE, the RPE must determine and report W-2 wages for each trade or business (or aggregated trade or business) conducted by the RPE.

3. W-2 wages are presumed to be zero if not determined and reported for each trade or business (or aggregated trade or business).

4. Section 199A(b)(2)(B) provides limitations on the Section 199A deduction based on the W-2 wages paid with respect to each trade or business (or aggregated trade or business).

5. Section 199A(b)(4)(B) provides that W-2 wages do not include any amount which is not properly allocable to QBI for purposes of Section 199A(c)(1). This section provides a three step process for determining the W-2 wages paid with respect to a trade or business that are properly allocable to QBI.

a. Each individual or RPE must determine its total W-2 wages paid for the taxable year.

b. Each individual or RPE must allocate its W-2 wages between or among one or more trades or businesses.

c. Each individual or RPE must determine the amount of such wages with respect to each trade or business , which are allocable to the QBI of the trade or business (or aggregated trade or business).

B. Definition

1. Section 199A(b)(4)(A) provides that the term W-2 wages means with respect to any person for any taxable year of such person, the amounts paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

2. Thus, the term W-2 wages includes the following:

- the total amount of wages as defined in Section 3401(a)
- the total amount of elective deferrals (within the meaning of Section 402(g)(3)),
- the compensation deferred under Section 457,and
- the amount of designated Roth contributions (as defined in Section 402A).

3. For this purpose, the Forms W-2, “Wage and Tax Statement,” or any subsequent form or document used in determining the amount of W-2 wages, are those issued for the calendar year ending during the individual’s or RPE’s taxable year for wages paid to employees (or former employees) of the individual or RPE for employment by the individual or RPE.

4. Employees of the individual or RPE are limited to employees of the individual or RPE, this includes officers of an S corporation and employees of an individual or RPE under common law.

C. Wages Paid by a Person Other Than a Common Law Employer

1.. In determining W-2 wages, an individual or RPE may take into account any W-2 wages paid by another person and reported by the other person on Forms W-2 with the other person as the employer listed in Box c of the Forms W-2, provided that the W-2 wages were paid to common law employees or officers of the individual or RPE for employment by the individual or RPE.

2. In such cases, the person paying the W-2 wages and reporting the W-2 wage son Forms W-2 is precluded from taking into account such wages for purposes of determining W-2 wages with respect to that person.

3. Persons that pay and report W-2 wages on behalf of or with respect to others can include, but are not limited to, certified professional employer organizations under Section 7705, statutory employers under Section 3401(d)(1), and agents under Section 3504. The language seems to indicate that non-certified professional employee organizations and management companies that pay wages on behalf of employers would allow the employer to use the wages in determining the extent or application of the deduction for taxpayers that are subject to any limitation.

D. Requirements that Wages must be Reported on Returns Filed with the Social Security Administration (SSA)

1. The W-2 wages does not include any amount that is not properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return.

2. Each Form W-2 and the transmittal Form W-3, "Transmittal of Wage and Tax Statements," together constitute an information return to be filed with SSA. Similarly, each Form W-2c, "Corrected Wage and Tax Statement," and the transmittal Form W-3 or W-3c, "Transmittal of Corrected Wage and Tax Statements," together constitute an information return to be filed with SSA.

3. In determining whether any amount has been properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return, each Form W-2 together with its accompanying Form W-3 will be considered a separate information return and each Form W-2c together with its accompanying Form W-3 or Form W-3c will be considered a separate information return.

4. Section 6071(c) provides that Forms W-2 and W-3 must be filed on or before January 31 of the year following the calendar year to which such returns relate (but see the special rule in §31.6071(a) -T(a)(3)(1) of this chapter for monthly returns filed under §31.6011(a)-5(a) of this chapter).

5. Corrected Forms W-2 are required to be filed with SSA on or before January 31 of the year following the year in which the correction is made.

6. Corrected return filed to correct a return that was filed within 60 days of the due date. If a corrected information return (Return B) is filed with SSA on or before the 60th day after the due date (including extensions) of Return B to correct an information return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) then the wage information on Return B must be included in determining W-2 wages

7. If a corrected information return (Return D) is filed with SSA later than the 60th day after the due date (including extensions) of Return D to correct an information return (Return C) that was filed with SSA on

or before the 60th day after the due date (including extensions) of the information return (Return C), and if Return D reports an increase (or increases) in wages included in determining W-2 wages from the wage amounts reported on Return C, then such increase (or increases) on Return D will be disregarded in determining W-2 wages (and only the wage amounts on Return C may be included in determining W-2 wages).

8. If Return D reports a decrease (or decreases) in wages included in determining W-2 wages from the amounts reported on Return C, then, in determining W-2 wages, the wages reported on Return C must be reduced by the decrease (or decreases) reflected on Return D return (Return A) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return A) then the wage information on Return B must be included in
determining W-2 wages.

9. If a corrected information return (Return D) is filed with SSA later than the 60th day after the due date (including extensions) of Return D to correct an information return (Return C) that was filed with SSA on or before the 60th day after the due date (including extensions) of the information return (Return C), and if Return D reports an increase (or increases) in wages included in determining W-2 wages from the wage amounts reported on Return C, then such increase (or increases) on Return D will be disregarded in determining W-2 wages (and only the wage amounts on Return C may be included in determining W-2 wages).

10. If Return D reports a decrease (or decreases) in wages included in determining W-2 wages from the amounts reported on Return C, then, in determining W-2 wages, the wages reported on Return C must be reduced by the decrease (or decreases) reflected on Return D.

11. If an information return (Return F) is filed to correct an information return (Return E) that was not filed with SSA on or before the 60th day after the due date (including extensions) of Return E, then Return F (and any subsequent information returns filed with respect to Return E) will not be considered filed on or before the 60th day after the due date (including extensions) of Return F (or the subsequent corrected information return).

12. Thus, if a Form W-2c is filed to correct a Form W-2 that was not filed with SSA on or before the 60th day after the due date (including extensions) of the Form W-2 (or to correct a Form W-2c relating to Form W-2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the Form W-2), then this Form W-2c will not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for this Form W-2c (or corrected Form W-2), regardless of when the Form W-2c is filed.

E. Methods for Calculating W-2 Wages

1. In the case of an acquisition or disposition of a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business that causes more than one individual or entity to be an employer of the employees of the acquired or disposed of trade or business during the calendar year, the W-2 wages of the individual or entity for the calendar year of the acquisition or disposition are allocated between each individual or entity based on the period during which the employees of the acquired or disposed of trade or business were employed by the individual or entity, regardless of which permissible method is used for reporting predecessor and successor wages on Form W-2, “Wage and Tax Statement.”

2. The term acquisition or disposition includes an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets.

3. In the case of an individual or RPE with a short taxable year, the W-2 wages of the individual or RPE for the short taxable year include only those wages paid during the short taxable year to employees of the individuals or RPE , only those elective deferrals made during the short taxable year by employees of the individual or RPE and only compensation actually deferred under Section 457 during the short taxable year with respect to employees of the individual or RPE.

4. If an individual or RPE has a short taxable year that does not contain a calendar year ending during such short taxable year, wages paid to employees for employment by such individual or RPE during the short taxable year are treated as W-2 wages for such short taxable year.

5. After calculating total W-2 wages for a taxable year, each individual or RPE that directly conducts more than one trade or business must allocate those wages among its various trades or businesses. W-2 wages must be allocated to the trade or business that generated those wages. In the case of W -2 wages that are allocable to more than one trade or business, the portion of the W-2 wages allocable to each trade or business is determined in the same manner as the expenses associated with those wages are allocated among the trades or businesses under §1.199A-3(b)(5).

6. Once W-2 wages for each trade or business have been determined, each individual or RPE must identify the amount of W-2 wages properly allocable to QBI for each trade or business (or aggregated trade or business).

7. In the case of an RPE, the wage expense must be allocated and reported to the partners or shareholders of the RPE as required by the Code. The RPE must also identify and report the associated W-2 wages to its partners or shareholders.

8. In essence, amounts paid as W-2 wages to S corporation shareholder cannot be included in the determination of qualified business income. But, these amounts are included as W-2 wages for purpose of the application of the wage limitation.

F. Revenue Procedure 2019 – 11

1. This Revenue Procedure provides the methods for calculating the W-2 wages for purposes of the qualified business income deduction computation.

2. There are three methods applicable for calculating the W-2 wages. The three methods are as follows:

a. **Unmodified Box Method.** The W-2 wages calculated are determined by taking the lesser of:

- The total entries in Box 1 all W-2s filed with SSA by the taxpayer with respect to employees of the taxpayer or

- The total entries in Box 5 of all W-2s filed with SSA by the taxpayer with respect to employees of the taxpayer.

b. **Modified Box 1 Method.** The taxpayer makes modifications to the total entries in Box 1 of W-2s filed with respect to employees of the taxpayer. Under this approach, W-2 wages are calculated as follows:

(The total entries in Box 1 all W-2s filed with SSA by the taxpayer with respect to employees of the taxpayer) - (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 federal income tax withholdings + the total amounts reported in Box 12 of Forms W-2 that are coded as code D, E, F, G and S).

c. **Tracking Wages Method.** The taxpayer actually tracks total wages subject to federal income tax withholdings and makes appropriate modifications. The W-2 wages under this method are calculated as follows:

(Total amounts of wages subject to federal withholdings that are paid to employees of the taxpayer for employment and then a reported on Form W-2s filed with the SSA for the calendar year) + (the total amounts reported in box 12 a Form W-2s that are properly coded as D, E, F, G, and S)

3. The elective deferrals under box 12 refer to the following:

- Code D is for elective deferrals to a Section 401(k) cash or deferred arrangement plan (including a SIMPLE 401(k) arrangement);
- Code E is for elective deferrals under a Section 403(b) salary reduction agreement;
- Code F is for elective deferrals under a Section 408(k)(6) salary reduction Simplified Employee Pension (SEP);
- Code G is for elective deferrals and employer contributions (including nonelective deferrals) to any governmental or nongovernmental Section 457(b) deferred compensation plan;
- Code S is for employee salary reduction contributions under a Section 408(p)

4. For short tax years there is no annualization.

IV. UBIA Qualified Property

A. General Rules

1. 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).

2. 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).

3. In case of qualified property held by either a partnership or an S Corporation each partner or shareholder share of the UBIA of qualified property is the allocable share of the unadjusted basis in the case of an S corporation or in the case of a partnership how depreciation is allocated pursuant to the partnership agreement at the end of the tax year.

B. Definition

1. 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.

2. 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 this section.

3. Property is not qualified property if the property is acquired within 60 days of the end of the taxable year and disposed of within 120 days of acquisition without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the Section 199A deduction.

4. 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 :

- The date that is 10 years after such date, or

- 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).

5. The additional first-year depreciation deduction allowable under Section 168 does not affect the applicable recovery period for the qualified property.

6. The term unadjusted basis immediately after acquisition (UBIA) means the basis on the placed in service date of the property as determined under Section 1012 or other applicable sections of Chapter 1 of the Code, including :

- the provisions of subchapters O (relating to gain or loss on dispositions of property),
- the provisions of subchapters C (relating to corporate distributions and adjustments),
- the provisions of subchapters K (relating to partners and partnerships), and
- the provisions of subchapters P (relating to capital gains and losses).

7. UBIA is determined without regard to any adjustments for tax credits claimed by the individual or RPE *or to any adjustments for any portion of the basis which the individual or RPE has elected to treat as an expense (for example, under sections 179, 179B, or 179C).*

8. However, UBIA does reflect the reduction in basis for the percentage of the individual's or RPE's use of property for the taxable year other than in the trade or business.

Example

On January 5, 2012, Bubba purchases Real Property X for $1 million and places it in service in his trade or business. Bubba' s trade or business is not an SSTB. Bubba's basis in Real Property X is $1 million. Assume that Real Property X is qualified property within the meaning of Section 199A(b)(6). As of December 31, 2018, Bubba's basis in Real Property X, as adjusted under Section 1016(a)(2) for depreciation deductions under Section 168(a), is $821,550.

Bubba'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).

V. Aggregation – Regulation 1.199A – 4

A. General

1. An individual or RPE may be engaged in one or more trade or businesses. As a general rule, each trade or business is separate for purposes of applying the caps Section 199A limitations.

2. Regulation 1.199A – 4 provides an exception to the general rule to allow individuals and RPE's to aggregate trade or business is treating them as a single trade or business for purposes of the limitation associated with the Section 199A deduction.

3. Aggregation is purely voluntary it is not required.

4. Trade or businesses may be aggregated only if the individual taxpayer or RPE can demonstrate the following:

- The same person or groups of persons, directly or by attribution under Section 267(b) or 707(b) owns 50% or more of each trade or business to be aggregated. The 50% rule of such trade or businesses owned by S corporation refers to 50% or more of the issued and outstanding shares of the corporation. In the case of a partnership, the rule applies to 50% or more of the capital and profits of the partnership. It should be noted that the regulations do not require that every person involved in the ownership determination on an interest in every trade or business. The rule is satisfied so long as one person or group or persons holds a 50% or more ownership interest in each trade or business.;

- The ownership exists for a majority of the tax year, *including the last day of the tax year*, in which the items attributable to each trade or business to be aggregated are included in income;

- All the items attributable to each trade or business to be aggregated are reported on returns with the same tax year, not taking into account short tax years;

- None of the trade or businesses to be aggregated can be a specified service trade or business (SSTB); and

- The trades or businesses to be aggregated satisfy at least two of the following factors:

    - The trades or businesses provide products, property or services that are the same for customarily offered together.

- The trades or businesses share facilities or share certificates centralize business elements, such as personnel, accounting, legal, manufacturing, producing common human resources or information technology resources.

- The trades or businesses are operating coordination with, or reliance upon, one or more the businesses in the aggregated group.

B. Operating Rules

1. Individual Taxpayers

a. An individual taxpayer may aggregate trades or businesses operated directly or through an RPE to the extent an aggregation is not inconsistent with the aggregation of an RPE.

b. If an individual aggregates multiple trades QBI, W-2 wages, and UBIA of qualified property must be combined for the aggregated trades or businesses for purposes of applying the W-2 wage and UBIA of qualified property limitations.

c. An individual may not subtract from the trades or businesses aggregated by an RPE but may aggregate additional trades or businesses with the RPE's aggregation if the rules of this section are otherwise satisfied.

2. RPE's.

a. An RPE may aggregate trades or businesses operated directly or through a lower -tier RPE to the extent an aggregation is not inconsistent with the aggregation of a lower-tier RPE. This is a change as it was not in the proposed regulations. As such, the final rags permit an RPE to aggregate trade or businesses it operates directly or through lower tiered RPE's. The resulting aggregation must be reported not only by the RPE but by the owners of the RPE. An individual taxpayer upper tier RPE cannot separate the aggregation trade or business of the lower tier RPE but must maintain the lower tier RPE's aggregation.

b. If an RPE itself does not aggregate, multiple owners of an RPE need not aggregate in the same manner. If an RPE aggregates multiple trades or businesses, the RPE must compute and report QBI, W-2 wages, and UBIA of qualified property for the aggregated trade or business under the rules described in §1.199A-6(b).

c. An RPE may not subtract from the trades or businesses aggregated by a lower-tier RPE but may aggregate additional trades or businesses with a lower-tier RPE's aggregation if the rules of this section are otherwise satisfied.

VI. Losses

A. General Rule

1. If the total QBI amount is less than zero, the portion of the taxpayer's Section 199A deduction related to QBI is zero or the tax year.

2. The negative total amount is treated as negative QBI from a separate trade or business in the succeeding tax years.

3. The carryover rule does not affect the deductibility of the loss for purposes of other provisions of the internal revenue Code.

4. Likewise, if the combined amount of REIT dividends and qualify PTP income is less than zero, the portion of the taxpayer's Section 199 A deduction related to qualified REIT dividends and qualified PTP income is zero for the year.

5. The negative combined amount must be carried forward and used to offset combined amounts of REIT dividends and qualified PTP income in the succeeding tax years for purposes of this deduction.

B. Netting

1. If a taxpayers qualified business income from at least one trade or business, including an aggregated trade or business) is less than zero, the taxpayer must offset the QBI attributable to each trade or business (or aggregated trade or business) that produced net positive QBI with the QBI from each trade or business (or aggregated trade or business) that produced net negative QBI in proportion to the relative amounts of net QBI in the trade or business (or aggregate trade or businesses) with positive QBI.

2. If the taxpayers QBI from all trade or businesses combined or aggregated is less than zero, the QBI component is zero for the tax year. The negative amount is treated as negative QBI from a separate trade or business in the succeeding tax year for purposes of the deduction. The carryover does not impact the deductibility of the loss for purposes of other provisions of the Internal Revenue Code.
3. The W-2 wages and UBIA of qualified property from trade or businesses that produced the net negative QBI are not taken into account and are not carried over to the subsequent tax year.

VII. Trusts and Estates – Regulations 1.199A – 6

A. General

1. A trust or estate computes its Section 199A deduction based on the QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income that are allocated to the trust or estate.

2. An individual beneficiary of a trust or estate takes into account any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income allocated from a trust or estate in calculating the beneficiary's Section 199A deduction, in the same manner as though the items had been allocated from an RPE.

3. For purposes of this section and §§1.199A-1 through 1.199A-5, a trust or estate is treated as an RPE to the extent it allocates QBI and other items to its beneficiaries, and is treated as an individual to the extent it retains the QBI and other items.

B. Grantor Trusts

1. To the extent that the grantor or another person is treated as owning all or part of a trust under Sections 671 through 679, such person computes its Section 199A deduction as if that person directly conducted the activities of the trust with respect to the portion of the trust treated as owned by the grantor or other person.

C. Non-Grantor Trusts and Estates

1. A trust or estate must calculate its QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income. The QBI of a trust or estate must be computed by allocating qualified items of deduction described in Section 199A(c)(3) in accordance with the classification of those deductions under §1.652(b)-3(a), and deductions not directly attributable within the meaning of §1.652(b) -3(b) (other deductions) are allocated in a manner consistent with the rules in §1.652(b)-3(b).

2. Any depletion and depreciation deductions described in Section 642(e) and any amortization deductions described in Section 642(f) that otherwise are properly included in the computation of QBI are included in the computation of QBI of the trust or estate, regardless of how those deductions may otherwise be allocated between the trust or estate and its beneficiaries for other purposes of the Code.

3. The QBI (including any amounts that may be less than zero as calculated at the trust or estate level), W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income of a trust or estate are allocated to each beneficiary and to the trust or estate based on the relative proportion of the trust's or estate's distributable net income (DNI), as defined by Section 643(a), for the taxable year that is distributed or required to be distributed to the beneficiary or is retained by the trust or estate.

4. For this purpose, the trust's or estate's DNI is determined with regard to the separate share rule of Section 663(c), but without regard to Section 199A. If the trust or estate has no DNI for the taxable year, any QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income are allocated entirely to the trust or estate.

5. The threshold amount applicable to a trust or estate is $157,500 for any taxable year beginning before 2019. For taxable years beginning after 2018, the threshold amount shall be $157,500 increased by the cost-of-living adjustment as outlined in §1.199A-1(b)(12).

6. For purposes of determining whether a trust or estate has taxable income in excess of the threshold amount, the taxable income of the trust or estate is determined after taking into account any distribution deduction under Sections 651 or 661.

Example

Assume a trust is an irrevocable testamentary complex trust and a 25% partner in ABC, a family partnership that operates a restaurant which generates qualified business income and W-2 wages in 2018. ABC allocates gross income from the restaurant of $55,000 and expenses directly allocable of $50,000 to the trust consisting of $25,000 of W-2 wages, depreciation of $5000 in miscellaneous expenses of $20,000. The trust share of the unadjusted basis of qualified property in the partnership is $125,000. The partnership also distributed $5, 000 of cash to the trust in 2018. The trust also operates a bakery conducted through an LLC that is wholly owned by the trust. The LLC is treated as a disregarded entity. The bakery produced $100,000 of gross income and $150,000 of expenses directly allocable to the operations of the bakery. The $150,000 of expenses consisted of $50,000 of W-2 wages, $75,000 of rent expense and $25,000 of miscellaneous expenses. The bakery had no unadjusted basis of qualified property. The trust has chosen to aggregate the restaurant conducted through the partnership with the bakery conducted directly through the trust. In addition, the trust owns various investments that produce portfolio income. For 2018 this consisted of dividends of $25,000, interest income of $15,000 in tax exempt interest income of $15,000. Also, the trust had trustee commissions of $3000 in state and local taxes it paid up $5000. The net loss from the partnership and the bakery as a result was ($45,000). In determining the trust DNI for the taxable year, the distributive share of the expenses of the partnership are directly allocable to the distributive share of income from the partnership. The trust as a result had gross business income of $155,000 ($55,000 from the partnership and

$100,000 from the bakery). The trust had direct business expenses totaling $200,000 ($50,000 from the partnership and $150,000 from the bakery). In addition, $1000 of the trustees commissions and $1000 of state and local taxes are directly attributable to the trust business income. The trust has excessive business deductions of $47,000. This consists of the net business loss from both the partnership and the bakery of $45,000 plus the thousand dollars of trustee commissions and the thousand dollars of state and local taxes directly attributable to the business income. The trust is required to allocate the $47,000 of excess business deductions as follows:

- $15,000 to interest income
- $25,000 to dividend income
- $7000 to tax-exempt income.

As a result interest income reporting and dividend income reporting is zero and the tax exempt income is reduced from $15,000-$8000. The trust must allocate the balance of the trust commissions ($2000) and state and local taxes ($4000) to the trust remaining tax-exempt income resulting in the tax-exempt income being reduced further to $2000.

In 20 18, the trust as DNI of $2000. Under the trust agreement, the trustee distributes 50% of the DNI or $1000 to Moe, a discretionary beneficiary of the trust. The trustee is required to distribute under the agreement 25% of the DNI ($500) to Larry, a current income beneficiary. The trust retains the remaining 25% of DNI. As a result, Moe excludes $1000 of tax exempt interest income and be excludes $500 a tax-exempt income. Since the DNI consist at this point of nothing but tax-exempt income, the trust deducts nothing with respect to the distributions to the beneficiaries.

The trust had combined W-2 wages in 2018 of $75,000 and $125,000 of unadjusted basis in qualified property. However, the trust had negative QBI a $47,000. Since the $1000 trust distribution to Moe equals one half of the trust DNI, Moe has W-2 wages from the trust of $37,500. He also has wages of $2500 from a trade or business outside of the trust which he aggregated with the trust trade or business for a total of $40,000 of W-2 wages from the aggregate trade or business. Moe also has $100,000 of qualified business income from a non-trust trade or business in which he owns an interest. Since the thousand dollar trust distribution to him equals one half of the trust DNI his negative QBI from the trust is $23,500.. The negative amount can be offset against the positive amount leaving a combined QB I of $76,500. If his taxable income exceeds the threshold for 2018 by $200,000 then his tentative deduction is 20% of $76,500 or $15,300 limited under the wage limitation to $20,000 (50% times $40,000) hence his deduction is $15,300.

Asked to Larry, if it is assumed that his taxable income is below the threshold amount he is not subject to any wage limitation. The $500 trust distribution to him equals 25% of the trust DNI. Larry has a total of negative $11,750 of QB I and has no non-trust trade or business. As such his deduction is zero because it is a loss and would thus be carried over to the following year.

The trust has taxable income below the threshold amount and is also not subject to any wage limitation. Since the trust retained 25% of its DNI the trust is allocated the same amount as Larry was allocated, that being a loss of $11,750. Likewise it has no deduction and it is carried over to the following year.

D. ESBT

1. An electing small business trust (ESBT) is entitled to the deduction under Section 199A.

2. Any Section 199A deduction attributable to the assets in the S portion of the ESBT is to be taken into account by the S portion.

3. The S portion of the ESBT must take into account the QBI and other items from any S corporation owned by the ESBT, the grantor portion of the ESBT must take into account the QBI and other items from any assets treated as owned by a grantor or another person (owned portion) of a trust under Sections 671 through 679, and the non-S portion of the ESBT must take into account any QBI and other items from any other entities or assets owned by the ESBT.

4. For purposes of determining whether the taxable income of an ESBT exceeds the threshold amount, the S portion and the non-S portion of an ESBT are treated as a single trust.

VIII. Deduction for income attributable to Domestic Production Activities of Specified Agriculture or Horticultural Cooperatives

A. Introduction

1. In the case of a taxpayer which is a specified agricultural or horticultural cooperative, there shall be allowed as a deduction an amount equal to 9 percent of the lesser of:

- the qualified production activities income of the taxpayer for the taxable year, or
- the taxable income of the taxpayer for the taxable year.

2. The deduction allowable for any taxable year shall not exceed 50 percent of the W-2 wages of the taxpayer for the taxable year.

3. The term *"specified agricultural or horticultural cooperative"* means an organization to which part I of subchapter T applies which is engaged in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, or in the marketing of agricultural or horticultural products.

4. A specified agricultural or horticultural cooperative shall be treated as having manufactured, produced, grown, or extracted in whole or significant part any agricultural or horticultural product marketed by the specified agricultural or horticultural cooperative which its patrons have so manufactured, produced, grown, or extracted.

5. The W-2 wages of the taxpayer shall be determined in the same manner except that such wages shall not include any amount which is not properly allocable to domestic production gross receipts.

6. The taxable income of a specified agricultural or horticultural cooperative shall be computed without regard to any deduction relating to patronage dividends, per-unit retain allocations, and nonpatronage distributions.

7. In the case of any eligible taxpayer who receives a qualified payment from a specified agricultural or horticultural cooperative, there shall be allowed as a deduction for the taxable year in which such payment is received an amount equal to the portion of the deduction allowed which is allowed with respect to the portion of the qualified production activities income to which such payment is attributable and is identified by such cooperative in a written notice mailed to such taxpayer during the payment period.

8. The deduction allowed to any taxpayer shall not exceed the taxable income of the taxpayer determined without regard to the deduction. In addition, the taxable income of a specified agricultural or horticultural cooperative shall not be reduced by reason of that portion of any qualified payment as does not exceed the deduction allowable with respect to such payment.

9. The term *"qualified production activities income"* for any taxable year means an amount equal to the excess (if any) of the taxpayer's domestic production gross receipts for such taxable year, over the sum of the cost of goods sold that are allocable to such receipts, and other expenses, losses, or deductions (other than the deduction allowed under this subsection), which are properly allocable to such receipts. The Secretary shall prescribe rules for the proper allocation of items for purposes of determining qualified production activities income. Such rules shall provide for the proper allocation of items whether or not such items are directly allocable to domestic production gross receipt

10. For purposes of determining costs, any item or service brought into the United States shall be treated as acquired by purchase, and its cost shall be treated as not less than its value immediately after it entered the United States. A similar rule shall apply in determining the adjusted basis of leased or rented property where the lease or rental gives rise to domestic production gross receipts.

11. In the case of any property that had been exported by the taxpayer for further manufacture, the increase in cost or adjusted basis shall not exceed the difference between the value of the property when exported and the value of the property when brought back into the United States after the further manufacture.

12. The term "*domestic production gross receipts"* means the gross receipts of the taxpayer which are derived from any lease, rental, license, sale, exchange, or other disposition of any agricultural or horticultural product which was manufactured, produced, grown, or extracted by the taxpayer in whole or significant part within the United States. Such term shall not include gross receipts of the taxpayer which are derived from the lease, rental, license, sale, exchange, or other disposition of land. It shall not include any gross receipts of the taxpayer derived from property leased, licensed, or rented by the taxpayer for use by any related person.

13. In the case of oil related qualified production activities income, the proposal provides that the Section 199A(g) deduction is reduced by three (3%) percent of the least of the cooperative 's oil related qualified production activities income, qualified production activities income, or taxable income (determined without regard to the cooperative's Section 199A(g) deduction and any deduction allowable under Section 1382(b) and (c) (relating to patronage dividends, per -unit retain allocations, and nonpatronage distributions)) for the taxable year.

14. For this purpose, oil related qualified production activities income for any taxable year is the portion of qualified production activities income attributable to the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof during the taxable year.

15. The cooperative is treated as having manufactured, produced, grown, or extracted in whole or significant part any agricultural or horticultural products marketed by the cooperative if such items were manufactured, produced, grown, or extracted in whole or significant part by its patrons.

16. Domestic production gross receipts do not include any gross receipts of the cooperative derived from property leased, licensed, or rented by the taxpayer for use by any related person. In addition, domestic production gross receipts do not include gross receipts that are derived from the lease, rental, license, sale, exchange, or other disposition of land.

17. The Act limits the definition of specified agricultural or horticultural cooperative to organizations to which part I of subchapter T applies that (1) manufacture, produce, grow, or extract in whole or significant part any agricultural or horticultural product , or (2) market any agricultural or horticultural product that their patrons have so manufactured, produced, grown, or extracted in whole or significant part.

18. The definition no longer includes a cooperative solely engaged in the provision of supplies, equipment, or services to farmers or other specified agricultural or horticultural cooperatives.

19. All members of an expanded affiliated group are treated as a single corporation and the deduction is allocated among the members of the expanded affiliated group in proportion to each member's respective amount, if any, of qualified production activities income. In addition, for purposes of determining domestic production gross receipts, if all of the interests in the capital and profits of a partnership are owned by members of a single expanded affiliated group at all times during the taxable year of such partnership, the partnership and all members of such group are treated as a single taxpayer during such period.

20. In the case of a specified agricultural or horticultural cooperative that is a partner in a partnership, rules similar to the rules applicable to a partner in a partnership under Section 199A (f)(1) apply.

21. For a tax -exempt cooperative subject to tax on its unrelated business taxable income by Section 511, the proposal is applied by substituting unrelated business taxable income for taxable income where applicable.

22. The Section 199A(g) deduction is determined by only taking into account items that are attributable to the actual conduct of a trade or business.

23. The Act provides that an eligible patron that receives a qualified payment from a specified agricultural or horticultural cooperative is allowed as a deduction for the taxable year in which such payment is received an amount equal to the portion of the cooperative's deduction for qualified production activities income that is (i) allowed with respect to the portion of the qualified production activities income to which such payment is attributable , and (ii) identified by the cooperative in a written notice mailed to the patron during the payment period described in Section1382(d).

24. The patron's deduction of such amount may not exceed the patron's taxable income for the taxable year (determined without regard to such deduction but after taking into account the patron's other deductions under Section 199A(a)). A qualified payment is any amount that (i) is described in paragraph (1) or (3) of Section 1385(a) (i.e., patronage dividends and per-unit retain allocations), (ii)is received by an eligible patron from a specified agricultural or horticultural cooperative, and (iii)is attributable to qualified production activities income with respect to which a deduction is allowed to such cooperative.

25. An eligible patron is:

(i) a taxpayer other than a corporation, or
(ii) another specified agricultural or horticultural cooperative. The cooperative cannot reduce its income under Section 1382 for any deduction allowable to its patrons under this rule (i.e., the cooperative must reduce its deductions allowed for certain payments to its patrons in an amount equal to the Section 199A(g) deduction allocated to its patrons

26. The Act repeals the special deduction for qualified cooperative dividends. In addition, the proposal repeals the rule that excludes qualified cooperative dividends from qualified business income of a qualified trade or business. The proposal also clarifies that items f income excluded from qualified items of income, and thus excluded from qualified business income, do not include any amount described in Section 1385(a)(1)(i.e., patronage dividends).

27. Accordingly , qualified business income of a qualified trade or business includes any patronage dividend, per -unit retain allocation, qualified written notice of allocation, or any other similar amount received from a cooperative, provided such amount is otherwise a qualified item of income, gain, deduction,

or loss(i.e., such amount is (i) effectively connected with the conduct of a trade or business within the United States, and (ii) included or allowed in determining taxable income for the taxable year).

28. A reduced deduction for qualified payments received from a specified agricultural or horticultural cooperative In the case of any qualified trade or business of a patron of a specified agricultural or horticultural cooperative, the deductible amount determined under Section 199A(b)(2) for such trade or business is reduced by the lesser of (1) nine percent of the amount of qualified business income with respect to such trade or business as is properly allocable to qualified payments received from such specified agricultural or horticultural cooperative , or (2) 50 percent of the amount of W-2 wages with respect to such qualified trade or business that are properly allocable to such amount.

29. The Act clarifies that the repeal of Section 199 for taxable years beginning after December 31, 2017, does not apply to a qualified payment received by a patron from a specified agricultural or horticultural cooperative in a taxable year beginning after December 31, 2017, to the extent such qualified payment is attributable to qualified production activities income with respect to which a deduction is allowable to the cooperative under former Section 199 for a taxable year of the cooperative beginning before January 1, 2018. Such qualified payment remains subject to former Section 199 and any Section 199 deduction allocated by the cooperative to its patrons related to such qualified payment may be deducted by such patrons in accordance with former Section 199. In addition, no deduction is allowed under Section 199A for such qualified payments.

Example

Cooperative is a grain marketing cooperative with $5,250,000 in gross receipts during 2018 from the sale of grain grown by its patrons. Cooperative paid $4,000,000 to its patrons at the time the grain was delivered in the form of per-unit retain allocations and another $1,000,000 in patronage dividends after the close of the 2018 taxable year. Cooperative has other expenses of $250,000 during 2018, including $100,000 of W-2 wages .Cooperative has domestic production gross receipts of $5,250,000 and qualified production activities income of $5,000,000for 2018. Cooperative's Section 199A(g)deduction is $50,000 and is equal to the least of nine percent of qualified production activities income ($450,000),nine percent of taxable income ($450,000),or 50 percent of W-2 wages ($50,000).

Cooperative passes through the entire Section 199A(g)deduction to its patrons. Accordingly, Cooperative reduces its $5,000,000 deduction allowable under Section 1382(b) and (c) (relating to the $1,000,000 patronage dividends and $4,000,000 per-unit retain allocations) by $50,000. Patron's grain delivered to Cooperative during 2018 is two percent of all grain marketed through Cooperative during such year. During 2019, Patron receives $20,000 in patronage dividends and $1,000 of allocated Section 199A (g) deduction from Cooperative related to the grain delivered to Cooperative during 2018.

Patron is a grain farmer with taxable income of $75,000 for 2019 (determined without regard to Section 199A) and has a filing status of married filing jointly. Patron's qualified business income related to its grain trade or business for 2019 is $50,000, which consists of gross receipts of $150,000 from sales to an independent grain elevator, per -unit retain allocations received from Cooperative during 2019 of $80,000, patronage dividends received from Cooperative during 2019 related to Cooperative 's 2018 net earnings of $20,000, and expenses of $200,000 (including $50,000 of W-2 wages).

The portion of the qualified business income from Patron's grain trade or business related to qualified payments received from Cooperative during 2019 is $10,000, which consists of per-unit retain allocations received from Cooperative during 2019 of $80,000, patronage dividends received from Cooperative during 2019 related to Cooperative's 2018 net earnings of $20,000, and properly allocable expenses of $ 90,000 (including $25,000 of W-2 wages).

Patron's deductible amount related to the grain trade or business is 20 percent of qualified business income ($10,000)reduced by the lesser of nine percent of qualified business income related to qualified payments received from Cooperative ($900)or 50 percent of W-2 wages related to qualified payments received from Cooperative ($12,500)or $9,100. As Patron does not have any other qualified trades or business, the combined qualified business income amount is also $9,100. Patron's deduction under Section 199A for 2019 is $10,100, which consists of the combined qualified business income amount of $9,100, plus Patron's deduction passed through from Cooperative of $1,000.

IX. Rental Real Estate Activities

A. Rental Real Estate Activities as a Trade or Business and Rental Real Estate Enterprise Safe Harbor – IRS Notice 2019 – 07; Rev Proc 2019-38, 2019-42 IRB; IR 2019-158, 9/24/2019

1. The Service has finalized a proposed Revenue Procedure that it issued earlier this year. The Revenue Procedure provides a safe harbor under which a rental real estate enterprise will be treated as a trade or business solely for the purposes of the qualified business income deduction.

2. In Notice 2019-7, 2019-9 IRB 740, IRS issued a proposed version of a revenue procedure containing a safe harbor for treating a rental real estate enterprise as a trade or business solely for purposes of Section 199A.

3. The IRS has now finalized the safe harbor rules. The safe harbor is available to taxpayers who seek to claim the deduction under Section 199A with respect to a rental real estate enterprise as defined under "Rental real estate enterprise," below.

4. If the safe harbor requirements are met, the rental real estate enterprise will be treated as a single trade or business as defined in Section 199A(d) for purposes of applying the regs under Section 199A, including the application of the aggregation rules in Reg § 1.199A-4.

5. A relevant passthrough entity (RPE) includes a partnership (other than a publicly traded partnership) or an S corporation that is owned, directly or indirectly, by at least one individual, estate, or trust. (Reg § 1.199A-1(b)(10)) RPEs may also use this safe harbor. In order to rely upon the safe harbor, taxpayers and RPEs must satisfy all of the requirements of the revenue procedure.

6. Failure to satisfy the requirements of this safe harbor does not preclude a taxpayer or IRS from otherwise establishing that an interest in rental real estate is a trade or business for purposes of Section 199A.

7. Rental Real Estate Enterprise

a. Solely for purposes of the safe harbor, a rental real estate enterprise is defined as an interest in real property held for the production of rents and may consist of an interest in a single property or interests in multiple properties.

b. The taxpayer or RPE relying on the Revenue Procedure must hold each interest directly or through an entity disregarded as an entity separate from its owner under any provision of the Code.

c. Except for those property interests described as "Excluded real estate arrangements" taxpayers and RPEs may either treat each interest in similar property held for the production of rents as a separate rental

real estate enterprise or treat interests in all similar properties held for the production of rents as a single rental real estate enterprise.

d. For purposes of applying the Revenue Procedure, properties held for the production of rents are similar if they are part of the same rental real estate category. The two types of rental real estate categories for the purpose of combining properties into a single rental real estate enterprise are residential and commercial. Thus, commercial real estate held for the production of rents may only be part of the same enterprise with other commercial real estate, and residential properties may only be part of the same enterprise with other residential properties.

e. Once a taxpayer or RPE treats interests in similar commercial properties or similar residential properties as a single rental real estate enterprise under the safe harbor, the taxpayer or RPE must continue to treat interests in all similar properties, including newly acquired properties, as a single rental real estate enterprise when the taxpayer or RPE continues to rely on the safe harbor.

f. A taxpayer or RPE that chooses to treat its interest in each residential or commercial property as a separate rental real estate enterprise may choose to treat its interests in all similar commercial or all similar residential properties as a single rental real estate enterprise in a future year.

g. An interest in mixed-use property may be treated as a single rental real estate enterprise or may be bifurcated into separate residential and commercial interests. For purposes of the Revenue Procedure, mixed-use property is defined as a single building that combines residential and commercial units.

h. Rental real estate enterprise that satisfies the requirements of this safe harbor is treated as a separate trade or business for purposes of applying Section 199A and the regs thereunder.

8. The Safe Harbor

1. The determination to use this safe harbor must be made annually. Solely for the purposes of Section 199A, each rental real estate enterprise will be treated as a single trade or business if the following requirements are satisfied during the tax year with respect to the rental real estate enterprise:

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

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

iii. 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. If services with respect to the rental real estate enterprise are performed by employees or independent contractors, the taxpayer may provide a description of the rental services performed by such employee or independent contractor, the amount of time such employee or independent contractor generally spends performing such services for the enterprise, and time, wage, or payment records for such employee or independent contractor. Such records are to be made available for inspection at the request of IRS.

b. The taxpayer or RPE attaches a statement to a timely filed original return (or an amended return for the 2018 tax year only) for each tax year in which the taxpayer or RPE relies on the safe harbor. An individual or RPE with more than one rental real estate enterprise relying on this safe harbor may submit a single statement, but the statement must list the required information separately for each rental real estate enterprise.

c. The statement must include the following information:

- A description (including the address and rental category) of all rental real estate properties that are included in each rental real estate enterprise;
- A description (including the address and rental category) of rental real estate properties acquired and disposed of during the tax year; and
- .A representation that the requirements of the Revenue Procedure have been satisfied.

9. Rental Services

a. Rental services for purpose of the Revenue Procedure include, but are not limited to:

- advertising to rent or lease the real estate;
- negotiating and executing leases;
- verifying information contained in prospective tenant applications;
- collection of rent;
- daily operation, maintenance, and repair of the property, including the purchase of materials and supplies;
- management of the real estate; and
- supervision of employees and independent contractors.
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b. Rental services may be performed by owners, including owners of an RPE, or by employees, agents, and/or independent contractors of the owners.

c. The term rental services does not include the following:

- financial or investment management activities, such as arranging financing; procuring property;
- studying and reviewing financial statements or reports on operations;
- improving property under Reg § 1.263(a)-3(d); or hours spent traveling to and from the real estate.
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10. Excluded Real Estate Arrangements

a. The following types of property may not be included in a rental real estate enterprise and are therefore not eligible for the safe harbor:

- Real estate used by the taxpayer (including an owner or beneficiary of an RPE) as a residence under Section 280A(d).

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

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

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

b. The Revenue Procedure applies to tax years ending after December 31, 2017. Alternatively, taxpayers and RPEs may rely on the safe harbor set forth in Notice 2019-7 for the 2018 tax year.

c. **The contemporaneous records requirement will not apply to tax years beginning prior to January 1, 2020**. However, IRS reminds taxpayers that they bear the burden of showing the right to any claimed deductions in all tax years.

11. IRS FAQ Question 17 states that the deduction in association rental is not based on whether the taxpayer qualifies as a real estate professional. Rental real estate may constitute a trade or business for purposes of the QBI deduction if the rental real estate:

- rises to the level of a trade or business under Section 162,
- satisfies the safe harbor requirements under Notice 2019 – 07, or
- meets the self-rental exception (the rental or licensee of property to a commonly controlled trade or business conducted either by the individual or RPE).

Whether rental real estate rises to the level of a trade or business is a facts and circumstance examination.

12. Likewise, IRS FAQ 20 states that material participation of a partner or individual under Section 469 is not required for the QBI deduction. This is regardless of the taxpayer's involvement in the trade or business.

B. Special Rule for Renting Property to a Related Persons

1. The rental or licensing of tangible or intangible property to a related trade or business is treated as a trade or business if the rental or licensing activity and the other trade or business are commonly controlled under proposed regulation 1.199A – 4(b)(1)(i). This rule allows taxpayers to aggregate their trade or businesses with the leasing or licensing of the associated rental or intangible property if the requirements of proposed regulation 1.199A – 4 are met.

2. Proposed Regulation 1.199 – 4 pertains to aggregation and will be discussed in a separate section.

Example

Assume John has a dental practice in a C Corporation. His wife Joan owns the commercial building that she leases to John. The corporation pays all expenses as well as maintenance, taxes, insurance. The lease agreement is a triple net lease. Under the rules, the rental income that Joan receives will not qualify for the deduction under the final regulation. However, some tax planning can change this. The service takes the

position that a single triple net lease is generally not a trade or business. The safe harbor provision will not work because triple net leases are barred. However, if the property were rented to a commonly controlled pass-through trade or business. It could qualify for the deduction. Under the commonly controlled rules, the rental would qualify for the Section 199A deduction if Joan rented it to a trade or business force the same person or persons, directly or by attribution, owned 50% or more of both activities. Since the ownership of one spouse actually to the other spouse, John and Joe will be commonly controlled requirement. Presently, the real arrangement fails because the taxpayers must own the business directly or throw pastor to qualify. The existing rental agreement in a non-pastor does not meet the common control rule. John and Joan can form S corporation from the dental practice and renegotiate the terms of a lease to a traditional commercial property lease arrangement. By operating the dental practice as an S corporation, the rental automatically qualifies for the deduction. This assumes that taxable income of John and Joan either or below or within the threshold amounts based upon their filing status.

C. **Other Rental Issues**

1. The Service provides no bright line rule as to whether a land lease or a lease of unimproved land is a trade or business for purposes of the deduction.

2. As such, the issue as to whether a land lease or lease of unimproved land is a facts and circumstance examination.

X. Forms 8995 and 8995-A

1. Form 8995: Qualified Business Income Deduction.

- This is the simplified computation form will be used if the taxpayer has QBI, qualified REIT dividends and/or qualified PTP income.
- The Taxpayer is not a patron a specified agricultural or horticultural cooperative

a. There is a new worksheet added to provide a reasonable method to track and compute previously disallowed losses or deductions that should be included in the QB I deduction computation for the year allowed. The worksheet is titled *Tracking Losses or Deductions Suspended by Other Provisions*.

2. Form 8995 – A: Qualified Business Income Deduction. This form will be used as follows:

- The taxpayer has QBI, qualified REIT dividends and/or qualified PTP income.
- The Taxpayer is not a patron a specified agricultural or horticultural cooperative

3**. Schedules Associated with Form 8995 – A:** The Schedules associated with the form include the following:

- Schedule A: Specified Service Trades or Businesses
- Schedule B: Aggregation of Business Operations
- Schedule C: Loss Netting and Carryforward

Schedule D: Special Rules for Patrons of Agricultural or Horticultural cooperative.

References:

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION VI:

AMT AND OTHER TAXES

I. AMT and Other Taxes

A. AMT for 2024 (Rev. Proc. 2023 – 34)

1. For 2024, the AMT exemption amount will be as follows:

Married filing joint and surviving spouse	$133,300
Single individuals and HOH	$85,700
Married Filing Separately	$66,650

2. For 2024, the amount used to determine the phase-out of the AMT exemption will be as follows**:**

Married filing joint and surviving spouse	$1,218,700
Single individuals and HOH	$609,350
Married Filing Separately	$609,350

B. AMT for 2025 (Rev. Proc. 2024 – 40)

1. For 2025, the AMT exemption amount will be as follows:

Married filing joint and surviving spouse	$137,000
Single individuals and HOH	$88,100
Married Filing Separately	$68,500

2. For 2025, the amount used to determine the phase-out of the AMT exemption will be as follows**:**

Married filing joint and surviving spouse	$1,252,700
Single individuals and HOH	$626,350
Married Filing Separately	$626,350

C. Excess Taxable Income and AMT

1. For 2024, the excess taxable income above which the 28% tax rate applies will be: (Rev. Proc. 2023 – 34)

Married filing joint and surviving spouse	$ 232,600
Single, HOH and married persons filing separately	$116,300

2. For 2025, the excess taxable income above which the 28% tax rate applies will be: (Rev. Procl. 2024 – 40)

Married filing joint and surviving spouse	$239,100
Single, HOH and married persons filing separately	$119,550

D. Alternative Minimum Tax Exemption for a Child Subject to the Kiddie Tax

1. For 2024, a child for whom the kiddie tax applies the exemption for purposes of the alternative minimum tax may not exceed the sum of the child's earned income for the taxable year plus $9,250.

2. For 2025, a child for whom the kiddie tax applies the exemption for purposes of the alternative minimum tax may not exceed the sum of the child's earned income for the taxable year plus $9,550.

E. AMT Credit Carryforward.

1.The AMT credit carryforward can be used to the extent that the regular tax exceeds AMT. Since many taxpayers will avoid AMT in 2021, the credits may be usable sooner than later. However, the credits are not assignable.

Example

Vichich v. Comm., 146 TC 12. Husband before his marriage to Wife exercised incentive stock options resulting in AMT liability which he reported on his tax return filed jointly with his first wife. The payment of the AMT liability generated an AMT credit carryforward. Husband's first wife died and he remarried (Wife 2). Husband subsequently died. On Wife 2's tax return she reported AMT credits derived from the deceased husband's AMT credit carryforward that she used to offset her income tax liability. The court agreed with the IRS the 2nd wife is not entitled to premarital credit carryforwards.

II. Kiddie Tax

A. General

1. The kiddie tax applies to a child if the child is:

- Under the age of 18, regardless of whether earned income equals more than one half of the child support, or
- That the child turned age 18, or
- If the child was a full-time student between the ages of 19 and 23 before the end of the applicable tax year and the child's earned income for the year does not exceed one half of his or her support.
- The child has at least one living parent at the close of the tax year;
- The child possessed unearned income of more than $2,600; and
- The child did not file a joint return.

2. Unearned income for these purposes is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered. It also includes distributions from qualified disability trusts. In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.

3. **SECURE Act**. The changes under the TCJA created a degree of unfairness causing increase in tax on certain children, including those who are receiving government payments which were characterized under income because they were survivors of deceased military personnel, first responders and emergency workers.

a. As such, the SECURE Act changed the rules under the TCJA on December 20, 2019 by repealing the prior measures. Beginning in 2020, with an option to start retroactively in 2018 and 2019, the income of children is taxed under the pre- TCJA rules. In other words, the old rule now prevails.

B. Unearned Income of Minor Children Subject to Kiddie Tax Exemption

1. For 2024, the exemption from the kiddie tax for 2024 will be $2,600. A parent will be able to elect to include a child's income on the parent's return for 2024 if the child's income is more than $1,300 and less than $13,000. (Rev. Proc. 2023 – 34)

2. For 2025, the exemption from the kiddie tax for 2025 will be $2,600. A parent will be able to elect to include a child's income on the parent's return for 2025 if the child's income is more than $1,350 and less than $13,500. (Rev. Proc. 2024 – 40)

III. Tax On Net Investment Income

A. Tax for 2024

1. The 3.8% Net Investment Income (NII) Tax Is Imposed On The Lesser Of:

- An Individual's NII For The Tax Year, Or
- MAGI In Excess Of A Floor:
  - $200,000 For Single And Head Of Household;
  - $250,000 For Joint Filers And Surviving Spouses; Or
  - $125,000 For A Married Taxpayer Filing Separately (See Reg. Section 1411(A)(1) & (B); §1.1411- 2(B)(1); §1.1411-2(D)(1)).

2. The Act did not change the threshold requirements for the imposition of the net investment income tax. In other words, the above amounts will be applicable in 2021.

B. Credit Claims Against Net Investment Income

1. The foreign tax credit does not reduce the net investment income tax. (Toulouse v. Comm., 157 TC 49)

2. Application of Tax Treaties

Example

Christensen v. US., 132 AFTR2d 2023 – 5304 (Cr. Fed. Cl). The Court of Federal Claims held that the tax treatment to the US and France does not allow for foreign tax credit against the net investment income tax. The court determined the treaty subjects its allowance of foreign tax credits to the provisions and limitations of the Internal Revenue Code relating to foreign tax credits including restrictions on the application of the credit. The net investment income tax is a restriction against the application of the credit.

IV. Additional Medicare Tax

A. General Rule

1. The 0.9% Additional Medicare Tax applies to your Medicare wages, Railroad Retirement Tax Act (RRTA) compensation, and self-employment income above a threshold amount.

2. Medicare wages and self-employment income are combined to determine if the taxpayer exceeds the thresholds shown below. A self-employment loss cannot be considered for purposes of this tax. RRTA compensation should be separately compared to the thresholds.

3. The employer of the taxpayer is responsible for withholding the .9 additional Medicare tax on the taxpayers Medicare wages or RRTA compensation in excess of the thresholds in a calendar year.

4. The form to file his Form 8959.

B. Threshold Amounts

1. The threshold amounts are as follows:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household	$200,000
Qualifying surviving spouse	$200,000

2. The threshold amounts are not adjusted for inflation.

V. Excess Advance Premium Tax Credit Repayment – Form 8962

A. Advanced Premium Tax Credits required Form 8962 to be attached to the return

Example

Sneed v. Comm., TC Summary 2023 – 11. Taxpayer enrolled in health insurance for herself and to dependents through the marketplace. The taxpayer received advance premium tax credits on the basis of information in the application. Taxpayer did not attach a copy of Form 8962: Premium Tax Credit to her return but later mailed it separately. The notice of deficiency determine the taxpayer was not eligible for the tax credit because her modified AGI exceeds 400% of the federal poverty level line in association with her family size. The form according to the court is required to reconcile the events payments in relation to the eligibility for the credit and income of the taxpayer with respect to the federal poverty level and family size.

B. News Release IR 2024 – 54: Correcting E-file Returns Rejected for Missing Form 8962. The IRS is reminding taxpayers that an e-filed tax return will be rejected if the taxpayer is required to reconcile advance payments of the premium tax credit (APTC) on Form 8962 [Premium Tax Credit (PTC)] but does not complete the form in their tax software and include it with the tax return submission. Taxpayers

must file Form 8962 if any family member was enrolled in Marketplace health insurance and IRS records show that APTC was paid to their Marketplace insurance company. The IRS has seen an increase in the number of taxpayers who are not including the required form when using tax software to file their returns. If a taxpayer's e-filed return is rejected due to a missing Form 8962, they may refile their complete return by completing and attaching Form 8962 or a written explanation of the reason for its absence.

References:

The Inflation Reduction Act of 2022 (IRA 22), PL 117 – 169**.**

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION VII:

PERSONAL TAX CREDITS

I. Child Tax Credit

A. Qualifications

1. To be a qualifying child of the tax year the defendant must be:

- Be under age 17 at the end of the year
- Be your son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of one of these (for example, a grandchild, niece or nephew)
- Provide no more than half of their own financial support during the year
- Have lived with you for more than half the year
- Be properly claimed as your dependent on your tax return
- Not file a joint return with their spouse for the tax year **or** file it only to claim a refund of withheld income tax or estimated tax paid
- Have been a U.S. citizen, U.S. national or U.S. resident alien

B. Amounts

1. 2024. For taxable years beginning in 2024, the amount used to determine the amount of credit that may be refundable is $1,700. (Rev. Proc. 2023-34).

2. 2025. For taxable years beginning in 2025, the amount used to determine the amount of credit that may be refundable is $1,700. (Rev. Proc. 2024-40).

Note: There was no increase in the child tax credit over the prior year.

3. Phase out. The phaseout of the child tax credit is annual income not exceeding $400,000 if married filing joint or $200,000 for all other filers.

C. Denial of Credit

1. No identifying number prior to filing a ritual turn cannot be amended by the taxpayer.

Example

Sowards v. Comm., TC Memo 2023 – 99. The taxpayers filed a joint return for the years at issue. The taxpayers claimed the child tax credit and the additional child tax credit. The IRS notify the taxpayers that the credits were being disallowed as mathematical or clerical errors. At the time of filing, the returns did not have Social Security numbers for the children nor his spouse. After the taxpayer was notified of the disallowance, he received the Social Security numbers. The taxpayer amended his return accordingly. The taxpayer was not allowed to make the amendment as the tax identification numbers had not been issued before the due date for the filing of the return. The dependents were deemed undocumented immigrants and under Section 32 (m) and Section 6428 they were denied. It appears the court left the door open that if the identification numbers were received during the extension. The credits would've been allowed.

II. Adoption Tax Credit

A. Exclusion Amount on Form 1040

1. For 2024, the credit allowed for an adoption of a child with special needs will be $16,810. The maximum credit allowed for other adoptions will be the amount of qualified adoption expenses up to $16,810. (See Rev. Proc. 2023-34)

2. For 2024, the credit will begin to phase out for taxpayers with MAGI in excess of $ 252,150. The phaseout will be complete if MAGI is 292,150. (See Rev. Proc. 2023-34)

3. For 2025, the credit allowed for an adoption of a child with special needs will be $17,280. The maximum credit allowed for other adoptions will be the amount of qualified adoption expenses up to $17,280. (See Rev. Proc. 2024-40)

4. For 2025, the credit will begin to phase out for taxpayers with MAGI in excess of $259,190. The phaseout will be complete if MAGI is $299,190. (See Rev. Proc. 2024-40)

B. Employer Adoption Exclusion Amount

1. For 2024, the amount of employer that can be excluded from an employee's gross income for the adoption of a child will be $16,810. Likewise, the adoption of a child with special needs has the same exclusionary.

2. For 2024, the amount of employer that can be excluded from an employee's gross income for the adoption of a child will be $17,280. Likewise, the adoption of a child with special needs has the same exclusionary.

3. For 2024, for the excludable amount per employee's gross income will begin to phase out for taxpayers with modified AGI in excess of $252,150 and the phaseout will be completed when modified AGI exceeds $292,150.

4. For 2025, for the excludable amount per employee's gross income will begin to phase out for taxpayers with modified AGI in excess of $259,190 and the phaseout will be completed when modified AGI exceeds $299,190.

III. Child and Dependent Tax Credit

A. Current Rule

1. The credit is nonrefundable and families are eligible for the following:

- 35% for taxpayers with adjusted gross income between $0 and $15,000
- 20% to 35% for taxpayers earning between $15,000 and $43,000
- 20% for those earning over $43,000 annually

2. The maximum expense that can be used to calculate the credit is $3,000 for one qualifying person or $6,000 for two or more eligible persons.

IV. Premium Tax Credit

A. Final Regulations Adopting New Definition of "Coverage Month" – TD 10019 (12/17/2024)

1. The IRS issued final regulations amending the definition of a "coverage month" for the purposes of calculating the Premium Tax Credit (PTC) and plans to revise a related form submitted by health care exchanges.

2. The IRS has issued proposed regulations to modify what a coverage month is in certain instances when the full premium balance remains unpaid by the unextended due date of the taxpayer's return for the applicable coverage year, but enough payments were made (including by using APTCs) to avoid coverage termination. In coordination with the Department of Health and Human Services, the IRS issued the regs to promote reporting consistency among exchanges regarding the reporting of enrollment premiums for non-payment months.

3. Under the proposed regs, the modified coverage month definition applies to the first month of a grace period under 45 CFR 156.270(d). The definition also applies to months in which an individual meets the 45 CFR 155.400(g) premium payment threshold. Finally, a coverage month includes months when state insurance departments declare an emergency and prohibit QHP providers from terminating coverage.

4. The final regulations adopt the proposed rules without revision.

5. The IRS intends to revise Form 1095-A, *Health Insurance Marketplace Statement*, to reflect the final regs. The instructions will continue to provide that Exchanges must report $0 in column A for any other months for which the full enrollment premium for the month is not paid, and that the amount reported in column A should be reduced by any enrollment premium refunds or credits.

6. In column B of Form 1095-A, exchanges will be instructed to report the second lowest cost silver plan, or SLCSP, premium that would apply if the enrollment premium had been paid in full.

B. Update – FS – 2024 – 04

1. The IRS also updated its FAQ regarding eligibility.

2. Eligibility. The eligibility requirements have been revised. A taxpayers eligible for the credit if they meet the following requirements:

- Have household income that meets certain requirements or for 2024, you, or your spouse (if filing a joint return), received, or were approved to receive, unemployment compensation for any week beginning during 2024.
    - Do not file a Married Filing Separately tax return ((unless you qualify for a special rule that allows certain victims of domestic abuse and spousal abandonment to claim the Premium Tax Credit using the Married Filing Separately filing status;
    - Cannot be claimed as a dependent by another person; and

• In the same month, you, or a family member:
  o Enroll in coverage (excluding "catastrophic" coverage) through a Marketplace
  o Are not able to get affordable coverage through an eligible employer-sponsored plan that provides minimum value

o Are not eligible for coverage through a government program, like Medicaid, Medicare, CHIP or TRICARE

o Pay the share of premiums not covered by advance credit payments

2. Income Limits

a. In general, individuals and families may be eligible for the Premium Tax Credit if their household income for the year is at least 100 percent but no more than 400 percent of the federal poverty line for their family size.

b. For tax years 2021 through 2025, Congress temporarily expanded eligibility for the Premium Tax Credit by eliminating the requirement that a taxpayer's household income may not be more than 400 percent of the federal poverty line. Under this rule, taxpayers with household income of more than 400 percent of the federal poverty line for their family size may be allowed to claim a Premium Tax Credit, if otherwise eligible (see Q5)

3. Changing Definition of Household Income

a. For purposes of the Premium Tax Credit, your household income is your modified adjusted gross income for the year plus that of every other member of your family (see Q6) who is required to file a federal income tax return. Modified adjusted gross income is the adjusted gross income on your federal income tax return plus any excluded foreign income, nontaxable Social Security benefits (including tier 1 railroad retirement benefits), and tax-exempt interest received or accrued during the taxable year. It does not include Supplemental Security Income (SSI).

4. Filing Status. If the taxpayer was married and filed their return as married filing separately, the taxpayer is still eligible for the credit. This is particular the case under Section 1.36 B – 2 (b) (2) in association with certain victims of domestic abuse and spousal abandonment whereby filing as married filing separately they can claim the credit. In addition, the taxpayer must be living apart from the spouse at the time of filing return, the taxpayer is unable to file a joint return because they are a victim of domestic abuse or spousal abuse and a certified such on the return. The certification is at the top of Form 8962 which is attached to the return.

5. Affordability of Employer Coverage for Employees and Family Members. If the taxpayer is an employee and the employer offers coverage which is known as an employer-sponsored plan in such plan is deemed affordable it refers to and satisfies coverage in association with the minimum value that does not exceed 8.39% of household income for 2024.

V. Education Credits

A. American Opportunity Tax Credit

1. The amount of the credit available is capped at $2,500 associate with the cost of tuition and related expenses paid during the tax year. The taxpayer can receive a tax credit based on 100% of the first $2,000 of tuition and related expenses. This does include course material paid during the tax year and 25% of the next $2,000 of tuition and related expenses paid during the tax year. 40% of the credit is refundable.

2. Taxpayers will not be allowed to claim the credit or the lifetime learning credit or the tuition deduction unless the taxpayer receives a Form 1098 – T from the educational institution. No American opportunity tax credit will be allowed unless the taxpayer includes the employer identification number of any educational institution to which the qualified tuition and related expenses were paid for education furnished in academic education.

3. Verification similar to the earned income credit will be required each year that taxpayers must include in the return prior to taking the credit.

4. The taxpayer has the burden to show that the dependent student was enrolled at least half-time and eligible education institution in order to receive the education credit. The fact that the student receives a Form 1098 – T is not enough evidence that they are entitled to the deduction. (Lee and Martin v Comm. TCM 2017 – 73).

5. If this credit was denied or reduced for any reason other than a math or clerical error, Form 8862: Information to Claim Certain Credits at the Disallowance is still required to be attached to the return.

6. No credit will be allowed if the identifying number of the tax periods issued after the due date of the tax return. (Section 32 (m), Section 24 (e), Section 25A (I))

7. The credit includes tuition and related expenses and only applies to the first four years of college. Related expenses are those expenses required for the enrollment or attendance and eligible education institution.

Example

Bravo v. Comm., Tax Court Docket No. 26566 – 22 (January 14, 2024). The taxpayer claimed the American Opportunity Tax Credit for her and her dependent son. The qualified related expenses for purposes of this credit included books, two computers, an office chair, a laptop messenger bag and ink cartridge for a printer. The book was viewed as the only qualified related expense eligible to be included in the computation of the credit. The rest fell outside the definition of qualified intuition related as they were not a requirement for attendance or coursework.

B. Lifetime Learning Credit

1. The Credit Is Nonrefundable. The Maximum Benefit Is $2,000 (20% Of First $10,000 In Qualified Expenses) Per Return. The student must be enrolled particular class is an eligible educational institution, take higher education courses to get the degree or other recognized educational credit or to get or improve job skills and be enrolled for at least one academic timeframe beginning in the tax year.

2. The academic timeframe can be a trimester, semester or quarterly basis and can include summer school.

C. Income Limitations for both Credits

1. For both credits an, there is a phaseout or reduction in the amount of the credit. Based upon the taxpayer's modified AGI. That is between $80,000 and $90,000 or $160,000 and $180,000 if the taxpayer is married filing jointly.

2. Both credits remain to be claimed on Form 8863.

D. Unreported Income and Estimated Income can Impact on the Credit

1. Unreported income can impact if not eliminate the education credit.

Example

Trice v. Comm., TC Memo 2023 – 15. Taxpayer had failed to report Social Security disability benefits of which the IRS showed the taxpayer had received. Taxpayer admitted she did receive said benefits and should have reported any 5% of payments as gross income less deductions for work or other adjustments and for Medicare premium. The taxpayer claimed the Lifetime Learning credit in the full amount such amount is reduced to the extent disability payments cost her modified AGI to trigger the limits on personal tax credit.

VI. Earned Income Credit

A. Eligibility Requirements

1. The taxpayers investment income must be less than $11,600 in 2024. (Rev Proc. 2023 – 34)

a. For 2025, the investment income must be less than $11,950. (Rev. Proc. 2024 – 40)

2. The taxpayer must not have filed a Form 2555: Foreign Earned Income or claim any foreign earned income exclusion.

3. The taxpayer claiming the credit without any qualifying children must be between the ages of 25 and 65. If the taxpayer is claiming jointly without a child, only one spouse needs to meet the age requirement.

4. The taxpayer can still qualify for the credit if they are separated but still married. The taxpayers must not file a joint return and the child must meet the definition of a qualifying child including living with the taxpayer for more than half the year and the taxpayer and your spouse must not have live together during the last 6 months of the year or are subject to a written separation agreement or decree.

B. 2024 EIC Credit

1. For the 2024 tax year (taxes filed in 2025), the earned income credit will range from $632 to $7,830, depending on your filing status and how many children you have. Below are the maximum 2024 earned income tax credit amounts, plus the most you can earn before losing the benefit altogether.

Number of children	Maximum earned income tax credit	Max AGI, single or head of household filers	Max AGI, married joint filers
0	$632	$18,591	$25,511
1	$4,213	$49,084	$56,004
2	$6,960	$55,768	$62,688
3 or more	$7,830	$59,899	$66,819

C. 2025 EIC Credit

1. For the 2025 tax year (taxes filed in 2065), the earned income credit will range from $649 to $8,046, depending on your filing status and how many children you have. Below are the maximum 2025 earned income tax credit amounts, plus the most you can earn before losing the benefit altogether.

Number of children	Maximum earned income tax credit	Max AGI, single or head of household filers	Max AGI, married joint filers
0	$648	$19,104	$26,2141
1	$4,328	$50,434	$57,554
2	$7,152	$57,310	$64,430
3 or more	$8,490	$61,555	$68,675

VII. Energy Efficient Home Improvement Credit

A. General Rule

1. The Inflation Reduction Act of 2022 amended the credits for energy efficient home improvements under Section 25C of the Internal Revenue Code and the residential energy property under Section 25D of the Code.

2. As amended, the energy efficient home improvement credit is increased for years after 2022, with an annual credit of generally up to $1,200. There will be no lifetime limit.

3. Beginning January 1, 2023, the amount of the credit is equal to 30% of the sum of amounts paid by the taxpayer for certain qualified expenditures, including

- o qualified energy efficiency improvements installed during the year,
- o residential energy property expenditures during the year, and
- o home energy audits during the year.

4.There are limits on the allowable annual credit and on the amount of credit for certain types of qualified expenditures.

5. The maximum credit you can claim each year is:

- $1,200 for energy property costs and certain energy efficient home improvements, with limits on doors ($250 per door and $500 total), windows ($600) and home energy audits ($150)
- $2,000 per year for qualified heat pumps, biomass stoves or biomass boilers.

Note: In essence the maximum could be $3,200 per tax year.

6.The credit has no lifetime dollar limit. You can claim the maximum annual credit every year that you make eligible improvements until 2033.

7.The credit is nonrefundable, so you can't get back more on the credit than you owe in taxes. You can't apply any excess credit to future tax years.

8. The credit is allowed for qualifying property placed in service on or after January 1, 2023, and before January 1, 2033.

9. In order to qualify for the credit the improvements must be the taxpayer’s main home which is the home generally where the taxpayer resides most of the time. In addition, the energy efficient home improvement credit is assessed to the home located United States it must be also an existing home that the taxpayer either improves or adds onto. It cannot be a new home.

10. The following energy efficient home improvements are eligible for the Energy Efficient Home Improvement Credit:

- Building envelope components satisfying the energy efficiency requirements
    - exterior doors (30% of costs up to $250 per door, up to a total of $500);
    - exterior windows and skylights (30% of costs up to $600); and
    - insulation materials or systems and air sealing materials or systems (30% of costs).
- Home energy audits (30% of costs up to $150)
- Residential energy property (30% of costs, including labor, up to $600 for each item) satisfying the energy efficiency requirements
    - central air conditioners;
    - natural gas, propane, or oil water heaters;
    - natural gas, propane, or oil furnaces and hot water boilers; and
    - improvements to or replacements of panelboards, sub-panelboards, branch circuits, or feeders that are installed along with building envelope components or other energy property enabled its installation and use.
- Heat pumps and biomass stoves and biomass boilers (30% of costs, including labor) satisfying the energy efficiency requirements
    - electric or natural gas heat pump water heaters;
    - electric or natural gas heat pumps; and
    - biomass stoves and biomass boilers.

11. Home Energy Audit. Beginning in 2024, taxpayers will need to substantiate that a "qualified auditor" conducted their home audit. To satisfy this requirement, the written audit should state that the auditor is certified by one of the certification programs listed on the Department of Energy certification programs for the Energy Efficient Home Improvement Credit page to conduct the home energy auditor.

B. Rebates – IR 2024 – 113; Announcement 2024 – 19

1. Taxpayers who receive rebates for the purchase of energy efficient homes will not include the value of the rebates as income on their tax returns. However, the taxpayers will need to reduce the basis of the property when they sell it by the amount of the rebate.

2. Specifically, the following is noteworthy:

- A rebate paid at the time of sale is not included in a purchaser's cost basis under Sec. 1012, the announcement said. For example, if the purchaser receives a $500 rebate at the time of sale of

eligible property with a sales price of $600, then the purchaser's cost basis in the property is $100, not $600.

- The amount of a rebate provided later constitutes an adjustment to basis under Sec. 1016. For example, if a purchaser spends $600 to buy eligible property in 2023 but later receives a $500 rebate, then the purchaser's cost basis is reduced to $100 from $600 when the rebate is provided.
- The payer of a rebate is not required to file an information return with the IRS or provide a statement to the purchaser to report the payments of rebate amounts to the purchaser, per Sec. 6041.
- Rebate payments made directly to a business taxpayer in connection with the business taxpayer's sale of goods or provision of services to a purchaser are not excluded from that taxpayer's gross income under Sec. 61.

3. Taxpayers who receive rebates under the DOE home energy rebate programs and who are also eligible for the Sec. 25C credit must reduce the amount of the amount of qualified expenditures used to calculate credit by the amount of the rebate. For example, if a taxpayer receives a $100 rebate for a $400 product, then the 30% credit applies to the remaining $300, for a credit of $90.

C. Revenue Procedure 2024 – 31 Qualified Manufacturers Required Registration

1. The Revenue Procedure provides guidance on qualified manufacturers registering in the agreement process with respect to certifying that materials provided in association with the energy efficient home improvement credit meet the requirements for taxpayer to obtain the credit. The registration will be conducted via the IRS energy credits online portal.

2. Manufacturers will have until April 30, 2025 to complete the registration process and they would be deemed to be qualified for the 2020 for tax filing season.

3. The Revenue Procedure also details for qualified manufacturers to obtain product identification numbers (pin) numbers in association with their registration.

VIII. Residential Clean Energy Property Credits

A. General Rule

1. The residential clean energy property credit is a 30-percent credit for certain qualified expenditures made by a taxpayer for residential energy efficient property.

2. The Act extended the residential clean energy property credit through 2034.

3. The following residential clean energy expenditures are eligible for a Residential Clean Energy Property Credit of 30% of the cost:

- solar electric property expenditures (solar panels);
- solar water heating property expenditures (solar water heaters);
- fuel cell property expenditures;
- small wind energy property expenditures (wind turbines);
- geothermal heat pump property expenditures; and
- battery storage technology expenditures.

4. Roofing Expenditure. Some solar roofing tiles and solar roofing shingles serve as solar electric collectors while also performing the function of traditional roofing, serving both the functions of solar electric generation and structural support MAY qualify for the credit.

5. A taxpayer may include the labor costs properly allocable to the onsite preparation, assembly, or original installation of the qualified property and for piping or wiring to interconnect the qualifying property to the home.

B. Qualifications. The credit can be **claimed for qualifying expenditures incurred for either an existing home or a newly constructed home**.

1. The taxpayer may claim the credit for a purpose to the main home and whether they own it or rent it. Again, the main home is determine where the taxpayer lives for the mower majority of the time and it must in the property must be located in the United States.

2. The taxpayer cannot claim the credit if they are the landlord.

3. If the taxpayer uses the property solely for business purposes, the credit cannot be claimed. However if the taxpayer used the home partly for business the maximum amount of the credit available if the business use is less than 20% would be the full amount of the credit. However if the business use of the property is more than 20% is based on the shared expenses allocable to non-business use.

4. There is no overall dollar limit for the Residential Clean Energy Property Credit.

5. The credit is generally limited to 30% of qualified expenditures made for property placed in service beginning in 2022 through 2032.

6. Qualified expenses include the costs of new clean energy property including:

- Solar electric panels
- Solar water heaters
- Wind turbines
- Geothermal heat pumps
- Fuel cells
- Battery storage technology (beginning in 2023)

Note: Used clean energy property is not eligible for the credit.

7. Qualified expenses may include labor costs for onsite preparation, assembly or original installation of the property and for piping or wiring to connect it to the home.

8. Traditional building components that primarily serve a roofing or structural function generally don't qualify. For example, roof trusses and traditional shingles that support solar panels don't qualify, but solar roofing tiles and solar shingles do because they generate clean energy.

9. The credit allowed for fuel cell property expenditures is 30% of the expenditures up to a maximum credit of $500 for each half kilowatt of capacity of the qualified fuel cell property.

10. The issue on rebates discussed previously under Rebates – IR 2024 – 113; Announcement 2024 – 19 applies here as well.

IX. Clean Vehicle Credits – TD 9995; IR 2014 – 131

A. General Rule

1. The IRS has issued final regulations for the new and previously on clean vehicle credit. If a taxpayer purchases and places in service a new plug-in electric vehicle or fuel-cell vehicle in 2023 or after the taxpayer may qualify for a clean vehicle credit. At the time of sale, the seller must give the taxpayer information about the vehicles qualifications and the seller must register online and report the same to the IRS. If this does not occur the vehicle will not be eligible for the credit.

2. A taxpayer may qualify for a credit up to $7,500 under Section 30D if you buy a new, qualified plug-in EV or fuel cell electric vehicle (FCV). The Inflation Reduction Act of 2022 changed the rules for this credit for vehicles purchased from 2023 to 2032. In some instances, the maximum credit is reduced to $3750.

3. To qualify, you must:

- Buy it for your own use, not for resale
- Use it primarily in the U.S.

4. To qualify for the credit a vehicle must :

- Have a battery capacity of at least 7 kilowatt hours
- Have a gross vehicle weight rating of less than 14,000 pounds
- Be made by a qualified manufacturer.
    - FCVs do not need to be made by a qualified manufacturer to be eligible. (See Revenue Procedure 2022 – 42)
- Undergo final assembly in North America
- Meet critical mineral and battery component requirements (as of April 18, 2023).

5. The sale qualifies only if:

- You buy the vehicle new
- The seller reports required information to you at the time of sale and to the IRS.
    - Sellers are required to report your name and taxpayer ID number to the IRS for the taxpayer to be eligible to claim the credit.

6. The vehicle's manufacturer suggested retail price (MSRP) can't exceed:

- $80,000 for vans, sport utility vehicles and pickup trucks
- $55,000 for other vehicles

7. The MSRP is the retail price of the automobile suggested by the manufacturer, including manufacturer installed options, accessories and trim but excluding destination fees. It is not necessarily the price paid.

8. The taxpayer can find your vehicle's weight, battery capacity, final assembly location (listed as “final assembly point”) and VIN on the vehicle's window sticker.

9. In addition, an eligible vehicle can be ascertained by going to www.fueleconomy.gov. The link is also on the IRS website.

10. In addition, your modified adjusted gross income (AGI) may not exceed:

- $300,000 for married couples filing jointly
- $225,000 for heads of households
- $150,000 for all other filers

Note: The taxpayer can use their modified AGI from the year you take delivery of the vehicle or the year before, whichever is less. If your modified AGI is below the threshold in 1 of the two years, you can claim the credit.

11. The credit is nonrefundable, so you can't get back more on the credit than you owe in taxes. You can't apply any excess credit to future tax years.

B. Amount of Credit

1. The amount of the credit depends upon when the taxpayer placed the vehicle in service regardless of the purchase date. Placed in service refers to the date the taxpayer took delivery of the vehicle.

2. For vehicles placed in service January 1 to April 17, 2023:

- $2,500 base amount
- Plus $417 for a vehicle with at least 7 kilowatt hours of battery capacity
- Plus $417 for each kilowatt hour of battery capacity beyond 5 kilowatt hours
- Up to $7,500 total

3. In general, the minimum credit will be $3,750 ($2,500 + 3 times $417), the credit amount for a vehicle with the minimum 7 kilowatt hours of battery capacity.

4. For vehicles placed in service April 18, 2023 and after: Vehicles will have to meet all of the same criteria listed above, plus meet new critical mineral and battery component requirements for a credit up to:

- $3,750 if the vehicle meets the critical minerals requirement only
- $3,750 if the vehicle meets the battery components requirement only
- $7,500 if the vehicle meets both

5. A vehicle that doesn't meet either requirement will not be eligible for a credit. Specifically, the final assembly of the vehicle must occur in north America. Also to clarify, no credit will be allowed unless the taxpayer includes the vehicle identification number on the tax return for the tax year that they are claiming the credit.

6. To claim the credit the taxpayer will file Form 8936: Qualified Plug-in Electronic Drive Motor Vehicle Credit (including Qualified 2 Wheeled Plug-in Electronic Vehicles) Tuesday

C. Updates to n New, Previously Owned Clean Vehicle and Commercial Clean vehicle Credit Updates – FS – 2024 – 14; IR 2024 – 111

1. As part of the eligibility for the credit the VIN of a new clean vehicle is required to be included on Form 8936: Clean Vehicle all Credits when the tax return is filed.

2. For vehicle sales occurring in 2023 caller sellers must file reports that the vehicle is eligible for the credit by February 15, 2024. For sales occurring in 2024 in later years, sellers must file the report within three days of the date of the sale or the IRS Energy Credit Online vehicle. (See Rev. Proc. 2024 – 12)

3. Not later than the time of sale, the registered dealer must provide the buyer with a written disclosure containing the following information under penalty of perjury:

• The MSRP of the new clean vehicle or the sale price of the previously owned clean vehicle.
• The maximum amount of the credit allowable and any other incentive available for the purchase of such vehicle.
• The amount provided by the dealer to you as a condition of you making the transfer election.
• The modified AGI limitations provided in section 30D(f)(10) (in the case of a new clean vehicle) or section 25E(b)(2) (in the case of a previously owned clean vehicle), as applicable.

4. For previously owned clean vehicles, certification that:

- The model year of the vehicle is at least two years prior to the calendar year of sale; and
- That the transfer is the first transfer of the vehicle since Aug. 16, 2022, to a person other than the person with whom the original use of such vehicle commenced.

5. Not later than the time of sale, the registered dealer must also provide you a copy of the seller report submitted for the vehicle (See Topic B FAQ 9 and Topic D FAQ 2) and confirmation of the successful submission of the report through IRS Energy Credits Online.

6. Dealers are not required to verify purchase income for a credit transfer or advance payments. They are also not required to repay the advance payment if the purchaser exceeds the income limitations. However, dealers are required to disclose information about the applicable income limits to the purchaser who must attest that he or she expects to qualify for the credit.

D. Qualifying Cars for 2024

1. For 2024 the following cars qualify for the Clean Vehicle Credit

- 2024 All-Electric Vehicles That Can Qualify for the $7,500 Credit
- 2024 Cadillac Lyriq 2024 Tesla Model 3
- 2024 Chevrolet Blazer EV 2024 Tesla Model X
- 2024 Chrysler Pacifica Hybrid (PHEV) 2024 Tesla Model Y
- 2024 Ford 150 Lightning 2024 Volkswagen ID.4
- 2024 Honda Prologue

2. Plug-in Hybrid Cars

a. Plug-in hybrids can qualify for the credit as long as they have a battery of 7kWh capacity or greater.

IRS maintains a list of qualified vehicles. Plug-in hybrids that can qualify for a partial $3,750 credit. 2024 Audi Q5 2024 Ford Escape Plug-in.

b. For vehicles placed in service on or after January 1, 2024, sellers will submit seller reports electronically to the IRS. The IRS's acceptance of this seller report means a Qualified Manufacturer has submitted the VIN listed in the seller report to the IRS as an eligible vehicle. For previously owned clean vehicles, sellers will also provide the sale price (which must be $25,000 or less) and review vehicle history reports in making attestations regarding the vehicle's eligibility.

X. Foreign Tax Credit

A. Qualifying Foreign Taxes

1. A taxpayer can claim a foreign tax credit in association with foreign taxes imposed by a foreign country or US possession. Generally only income, war profits and excess profits qualify for the credit.

2. Taken as a deduction, for income taxes reduces US taxable income. Foreign taxes that are deducted or on Schedule A.

3. Any foreign earned income or foreign housing cost exclusion does not allow the taxpayer to take a foreign tax credit on the income so excluded.

4. The credit is claimed on Form 1116: Foreign Tax Credit. Likewise, corporations can claim the credit on Form 1118.

5. There is a special 10 year statute of limitations that applies to foreign taxes paid or accrued to any country or any possession of the US in which the credit is allowed against the tax. The 10 year timeframe begins from the date for the filing of the return for the year in which the taxes were actually paid or accrued. (Section 6511 (a)). The 10 year statute of limitations also applies to refund claims.

Example

Polk v US , US Fed Court of Claims No. 1:22 – CB – 00896 (8/18/2023). The taxpayers had not filed their 2008 tax return. In 2010 the IRS filed a substituted return resulting in an assessment of taxes in the amount of $156,796. The IRS took payments from refunds to the taxpayer subsequently filed returns. The taxpayers filed a claim for refund but the claim was made more than three years after the due date of the return and more than two years after the payment of taxes. Part of the amount due was from a foreign tax credit that was previously disallowed by the IRS under the general statute of limitations. The IRS erred in because there is a special period of limitation regarding foreign taxes paid or accrued. If the claim for credit or refund relates to an overpayment attributable to foreign taxes paid or accrued the statute of limitations is 10 years from the due date for the filing of the return for the tax year in which the four taxes were in fact paid or accrued.

References:

The Inflation Reduction Act of 2022 (IRA 22), PL 117 – 169**.**

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.

SECTION VIII:

ESTATES, GIFTS AND TRUSTS

I. Estate Tax Update

A. Estate Tax Exclusion Amount

1. For 2024, the estate exclusion will be $13,610,000. (Rev. Proc. 2023 – 34)

2. For 2025, the estate exclusion will be $13,990,000. (Rev. Proc. 2024 – 40)

B. Interest on Certain Portion of the Estate Tax Payable in Installments

1. For 2024, the dollar amount used to determine the portion will be $1,850,000. (Rev. Proc. 2023 – 34)

1. For 2025, the dollar amount used to determine the portion will be $1,900,000. (Rev. Proc. 2024-40)

C. Valuation of Qualified Real Property in Decedent's Gross Estate – Section 2032 A

1. For an estate of a decedent dying in 2024, the executor can elect to use special use valuation method under Section 2032A for qualified real property. The aggregate decrease in the value of said real property resulting from the election cannot exceed $1,390,000. (Rev. Proc. 2023 – 34)

2. For an estate of a decedent dying in 2025, the executor can elect to use special use valuation method under Section 2032A for qualified real property. The aggregate decrease in the value of said real property resulting from the election cannot exceed $1,420,000. (Rev. Proc. 2024-40)

II. Deceased Spouse Unused Exemption (DSUE)

A. Overview

1. The surviving spouse may utilize the DSUE in addition to their own exemption amount. The deceased spouse's estate must make an election to have the portability provisions apply. Executors intending to make the election must timely file a complete and properly prepared Form 706, including extensions, irrespective of whether or not the gross estate has a value in excess of the exclusion amount or is otherwise not obligated to file Form 706.

a. A complete and properly prepared Form 706 includes filling out the section designated to determine whether or not the portability feature has been elected as well as the calculation of the DSUE.

b. For purposes of electing the portability, Form 706 is considered complete and properly prepared if the return is prepared in accordance with the instructions for the Estate Tax Return.

c. It should be noted the value of the marital deduction property and show reduction property is not required to be reported. However, executors must include the description, ownership, and the beneficiary of marital or charitable deduction property along with all other information necessary to establish the right of the state to such deductions.

d. The value of marital deduction property or charitable deduction property is required if:

- The value of such property relates to, is affected by, or is needed to determine the value passing from the decedent to another recipient;
- The value of such property is needed to determine the estate's eligibility for the provisions of Sections 2032,2032A or another provision;
- Less than the entire value of an interest in property includible in the decedent's gross estate is marital deduction property charitable deduction property; or
- A partial disclaimer or partial qualified terminable interest property election is made with respect to a bequest, devise, or transfer of property includible in the gross estate, part of which is marital
- deduction property or charitable deduction property.

2. Computation of DSUE. The DSUE of a decedent is the lesser of the following:

- The basic exclusion amount in effect or the year in which the decedent died or
- The decedent's applicable exclusion amount less the sum of the amount of the taxable state and the amount of any adjusted taxable gifts of the decedent which together is the amount on which the tentative tax on the estate is determined.

a. The determination of the DSUE is based last deceased spouse of the surviving spouse if a surviving spouse remarries and then divorces the subsequent death divorced spouse does not end the status of a privacy spouse as the last deceased spouse of a surviving spouse.

B. IRS Provides Simplified Method for Extending Portability Election - Rev Proc 2022-32, 2022-30 IRB

1. The IRS has released a procedure that provides a new, simplified method for obtaining an extension of time to make a "portability" election. A portability election allows a surviving spouse to apply a deceased spouse's unused exclusion (DSUE) amount to their own transfers during life or at death.

2. The new procedure provides a new simplified method for certain estates to use to obtain an extension of time to elect portability of a DSUE amount. The procedure applies to estates that are not normally required to file an estate tax return because the value of the gross estate and adjusted taxable gifts is under the filing threshold and the decedent has a surviving spouse.

3. Under the new procedure, an extension request must be made on or before the fifth anniversary of the decedent's death. This simplified method, which doesn't require a user fee, should be used in lieu of the letter ruling process.

4. In 2017, the IRS published Rev Proc 2017-34, 2017-26 IRB 1282, which provided a simplified method for obtaining an extension of time to make a portability election for an estate wasn't required to file an estate tax return and the decedent had a surviving spouse. This procedure was to be used in lieu of the letter ruling process and was available up to the second anniversary of the decedent's date of death.

5. Since the publication of Rev Proc 2017-34, the IRS issued numerous letter rulings granting an extension of time to elect portability in situations in which the decedent's estate was not required to file an estate tax return and the time for obtaining relief under the simplified method had expired. According to the IRS, these requests place a significant burden on the IRS's resources. Therefore, the new procedure supersedes Rev Proc 2017-34.

6. Rev Proc 2022-32 is effective July 8, 2022, and it is the exclusive method for obtaining an extension of time for estates.

C. Final Regs. Eliminate Clawback – TD 9884

1. The IRS has released final regs that adopt the special rule provided in the proposed regs issued in November 2018 in cases where the portion of the credit against the estate tax that is based on the BEA is less than the sum of the credit amount attributable to the BEA allowable in computing gift tax payable.

2. Under Section 2001(b), to determine the amount of federal estate tax to be paid at death, the gift and estate tax provisions apply a unified rate schedule to the taxpayer's cumulative taxable gifts and taxable estate on death to arrive at a net tentative tax. The net tentative tax then is reduced by a credit based on the applicable exclusion amount (AEA), which is the sum of the basic exclusion amount (BEA) and, if applicable, the deceased spousal unused exclusion (DSUE) amount.

3. Section 11061 of the Tax Cuts and Jobs Act, amended Section 2010 to provide that for decedents dying and gifts made after December 31, 2017, and before January 1, 2026, the BEA is increased from $5 million, adjusted for inflation, to $10 million adjusted for inflation (Increased BEA). On January 1, 2026, the BEA will revert to $5 million as adjusted for inflation.

4. On November 23, 2018, the IRS issued proposed regs (Preamble to Prop Reg REG-106706-18), which provided a "special rule," that ensured that a decedent's estate would not be inappropriately taxed with respect to gifts that were sheltered from gift tax by the increased BEA when made.

5. The final regs adopt the proposed regs but provide additional examples illustrating how the rules will operate.

6. The final regs provide that in computing the estate tax, the increased BEA is applied first against the decedent's taxable gifts. To the extent any BEA remains at death, it is applied against the decedent's estate. Therefore, in the case of a decedent who had made enough gifts to cause the total BEA allowable in the computation of gift tax payable to equal or exceed the date of death BEA (as adjusted for inflation), there is no remaining BEA available to be applied to reduce the estate tax.

III. Basis and Step Up

A. Rev. Rul. 2023 – 2

1. If the assets of an irrevocable grantor trust are not included in the grantor's gross estate then upon the decedent's death, those assets do not get a Section 1014 basis step-up even though the grantor trust's owner is liable for federal income tax on the trust's income.

2. The assets of the grantor trust are not considered as acquired or passed from a decedent by bequest, devise, inheritance, or otherwise within the meaning of Section 1014(b), and are not considered to have been acquired from or to have passed from the decedent under Section 1014(a).

3. This means that the step-up basis which generally applies the fair market value at the time someone dies to property that a taxpayer receives from the decedent, does not apply.

B. Consistent Basis Reporting Final Regulations Issued -TD 9991

1. The final regulations adopt most of the provisions from the proposed regulations, with two important

changes. First, the proposed regulations provided that if no estate tax return is filed, or if a decedent's property is not reported on a filed return before the period of limitations on assessment expires, the final value of that property is zero, the so-called "zero basis rule".

2. The IRS recognized that such a rule primarily impacts the recipients of unreported property, who may have had no knowledge of or involvement in the failure to report the property for Federal estate tax purposes, but, nevertheless, have an increased tax burden under the rule. As such, the final regulations do not include the zero basis rule. Instead, the final regulations clarify that the consistent basis requirement applies only to included property, a term that is defined to refer to property, the value of which is included in the value of the decedent's gross estate.

3. The second change from the proposed regulations is the removal of the obligation of most transferees of property subject to the consistent basis rule to file additional Forms 8971 if they, in turn, transfer the property subject to this rule. This subsequent filing rule will now apply only to trustees who transfer property subject to the consistent basis rule.

4. The final regulations clarify the definition of "Final Value." "Final value" is defined as:

- the value reported on the federal estate tax return once the period of limitations on assessment has expired without that value being adjusted by the IRS;
- the value determined by the IRS once that value can no longer be contested by the estate;
- the value determined in an agreement binding on all parties; or
- the value determined by a court once the court's determination is final.

4. An executor is required to file Form 8971 (the Information Return) and all required Statements. In general, the Information Return and Statements are due to the IRS and beneficiaries on or before the earlier of 30 days after the due date of the estate tax return or the date that is 30 days after the date on which the estate tax return is filed with the IRS.

5. If a beneficiary acquires property after the due date of the estate tax return, the Statement must be furnished to the beneficiary by January 31 of the year following the acquisition of that property. Also, by January 31, the executor must attach a copy of the Statement to a supplement to the Information Return. An executor has the option of furnishing a Statement before the acquisition of property by a beneficiary.

6. Executors have a duty to supplement the Information Return or Statements upon the receipt, discovery, or acquisition of information that causes the information to be incorrect or incomplete. Reg. §1.6035-1(d)(2) provides a nonexhaustive list of changes that require supplemental reporting.

7. Penalties may be imposed under Reg. §301.6721-1(h)(2)(xii) for filing an incorrect Information Return, and Reg. §301.6722-1(e)(2)(xxxv) for filing incorrect Statements. In addition, an accuracy-related penalty can be imposed under Reg. §1.6662-9 on the portion of the underpayment of tax relating to property subject to the consistent basis requirement that is attributable to an inconsistent basis.

8. Reg. §1.1014-10 applies to property described in Reg. §1.1014-10(c)(1) that is acquired from a decedent or by reason of the death of a decedent if the decedent's estate tax return is filed after September 17, 2024. Reg. §1.6035-1 applies to executors of the estate of a decedent who are required to file a federal estate tax return under Code Sec. 6018 if that return is filed after September 17, 2024, and to trustees receiving certain property included in the gross estate of such a decedent. Reg. §1.6662-9 applies to property described in

Reg. §1.1014-10(c)(1) that is reported on an estate tax return required under Code Sec. 6018 if that return is filed after September 17, 2024.

IV. Final Regulations on GST Exemption

A. Rule

1. The service has issued final regulations provide guidance on when and how taxpayers contain an extension of time to make certain GST exempt allocations and elections under Section 2642 (g) (1).

2. As a result of the final regulations relief under this code section will no longer be granted on or after May 6, 2024. However, private letter ruling relief will still be granted.

3. The final regulation removed a proposal that would prohibit relief to revoke a prior GST election.. The final regulation would allow relief to revoke a GST election if it was erroneous in nature.

4. The final relations provide additional details relate to affidavits when requesting Private Letter Ruling for GST purposes.

5. To receive relief the taxpayer must show that acted reasonably and in good faith and that they are not attempting to benefit from hindsight and that it would not prejudice the interest the government if relief were granted.

V. Income Included In Estate

A. Death Benefit Proceeds from Life Insurance

1. The gross estate of a decedent does not include death benefit proceeds from life insurance policies that were acquired by an irrevocable trust that the decedent created and for which premiums were funded with valid loans. Specifically, in order to be includable there has got to be a retention of incidents of ownership. (See Becker v. Comm., TC Memo 2024 – 89)

B. Uncashed Check Includable in Estate

1. Gift checks to family members that remained uncashed at the time of death were not completed gifts. As a result, the checks' value should have been included in his gross estate, according to the Third Circuit.

Example

Estate of DeMuth, Jr. (CA 3) 132 AFTR2d 2023 – 5122. Prior to the death of their father, his agent wrote out 11 checks to family members totaling $464,000 and either had them mailed or personally delivered to said family members. 10 of the 11 checks were paid from the decedent's investment account after his death. The executor filed an estate return that excluded the value of the 11 checks. The IRS determined the taxpayer should've included 10 of the 11 checks that did not clear before his death and issued a notice of deficiency accordingly. The estate appealed previously to the Tax Court. The Service in that case agreed to exclude three of the checks as they had been deposited on the date the taxpayer died. The estate argued remaining seven checks were completed gifts when they were mailed or delivered to the recipients. The Tax Court found that under local state law, the remaining checks were part of the estate because the checks were not completed gifts apply to the taxpayers death. The Tax Court noted that the mere delivery of a

check does not complete a gift. A gift is not completed until the donor has parted with dominion and control over the check. This happens with the account on which the check is drawn accepts certifies or makes the final payment of the checks. The checks were not completed lifetime gifts according to the Tax Court. The state appealed to the Third Circuit Court of Appeals which agreed with the Tax Court stating that the remaining checks at issue were all deposited and paid after the taxpayer's death there was no actual or constructive delivery sufficient to divest the taxpayer of dominion so the checks were still revocable when the taxpayer died. The checks were not distributed in contemplation of death no evidence to support that allegation.

C. Life Insurance Valuation Issues

1. Proceeds from Life insurance policy used to fund redemption of deceased owner shares in a private company or includable for purposes of determining estate tax value without a reduction for the redemption obligation.

Example

Connelly v. US,NO. 23 – 146 (US 6/6/24). The US Supreme Court affirmed and 8th Circuit Ct. decision involving a company's obligation to redeem a deceased shareholders shares of stock in a corporation. Brothers Michael and Thomas Connelly were co-owners of Crown C Supply (Crown), a building supply store in St. Louis. The brothers were the sole owners of the corporation, with Michael owning 77.18% and Thomas owning the remaining 22.82%. Michael and Thomas desired a "smooth transition of ownership" if one of them should die. In order to ensure that transition, they entered into an agreement whereby, upon the death of one of the siblings, the other would have the right to purchase the deceased brother's shares. Under the agreement, if the surviving brother declined to purchase the shares, Crown would be required to redeem the shares. Michael died in 2013, and Thomas declined to purchase his brother's shares. Therefore, Crown redeemed Michael's shares. Thomas, along with Michael's son, estimated that Michael's share value at the time of his death was $3 million, and Crown redeemed those shares using $3 million of life insurance proceeds.

Upon filing the estate tax return for Michael's estate as his executor, Thomas valued Michael's shares at $3 million, and an IRS examination ensued. During the examination, Thomas obtained a valuation from an outisde accounting firm that relied on *Estate of Blount,* 428 F.3d 1338 (11th Cir. 2005), in which the Eleventh Circuit held that when determining the fair market value of a corporation, insurance proceeds should be excluded when those proceeds are "offset by an obligation to pay those proceeds to the estate in a stock buyout." The IRS disagreed with this position and, taking into account the insurance proceeds, determined that Michael's shares should have been valued at $5.3 million, which resulted in an additional $889,914 estate tax liability. The estate paid the additional liability, and Thomas, as the estate's executor, sued for a refund in district court. The district court held that the estate was not entitled to a refund because a "redemption obligation is not an ordinary corporate liability," and that the "life-insurance proceeds used to redeem Michael's shares must be included in the fair market value of Crown C and of Michael's shares" (*Connelly,* No. 4:19-cv-01410-SRC (E.D. Mo. 9/21/21)). The Eighth Circuit affirmed the decision on the same basis (*Connelly,* 70 F.4th 412 (8th Cir. 2023)).

The Supreme Court agreed to hear the case to address the dispute of whether life-insurance proceeds that will be used to redeem a decedent's shares must be included when calculating the value of those shares for purposes of the federal estate tax. In a unanimous decision, the Court affirmed the Eighth Circuit's judgment and held that Michael's shares were not diminished in value based on Crown's contractual redemption obligation because redemption obligations are not necessarily liabilities that reduce a corporation's value for purposes of the federal estate tax. Thomas argued before the Court that Crown's redemption obligation

to redeem Michael's shares offset the life insurance proceeds, contending that a potential purchaser of the company's shares would treat the two as canceling each other out.

The IRS countered that no real-world buyer or seller would have viewed the redemption obligation as an offsetting liability. The Court agreed with the IRS, finding that an obligation to redeem shares at fair market value does not offset the value of life-insurance proceeds set aside for the redemption because a share redemption at fair market value does not affect any shareholder's economic interest. The Court explained that under the general rules of the estate tax, a decedent's taxable estate includes the value of "all property" owned by a decedent "at the time of his death," that the "lodestar" of calculating property value in a decedent's estate is FMV, and a corporation's FMV determination must include a company's net worth including proceeds of life insurance policies payable to the company. The Court found that Crown's promise to redeem Michael's shares at fair market value did not reduce the value of those shares and that Crown's value at the time of Michael's death consisted of the $3 million in life-insurance proceeds earmarked for the redemption plus $3.86 million in other assets and income-generating potential, for a total value of $6.86 million. A potential buyer of Michael's shares and 77.18% ownership would be willing to pay up to $5.3 million ($6.86 million × 0.7718), according to the Court, as that represented the value the buyer could expect to receive in exchange for Michael's shares when Crown redeemed them at fair market value. According to the Court, Thomas's argument that Crown's redemption obligation represented an offsetting liability against the company's value because the life insurance proceeds would leave the company as soon as they arrived to complete the redemption could not be reconciled with the basic mechanics of a stock redemption, and his understanding of stock redemptions would turn this ordinary process upside down.

D. Buy – Sell Agreement and Valuation Issues

1. Section 2703 describes certain rights and restrictions that are disregarded when valuing property. Section 2703(a)(1) provides that the value of any property must be determined without regard to any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right).

2. Section 2703(a)(2) includes any restriction on the right to sell or use such property. Section 2703(b) provides an exception for any option, agreement, right, or restriction if:

- it is a bona fide business arrangement;
- it is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth; and
- its terms are comparable to similar arrangements entered into by persons in an arm's-length transaction.

Example

Huffman v. Comm., TC Memo 2024 – 12. A son exercised a stock option with his parents at a low value. Fair market value was not used. The court rejected the family's claim that the option agreements controlled the valuation of the stock purchased, finding that the terms of the agreements were not comparable with those that would be entered into in an agreement negotiated at arm's length. This case provides another illustration of the difficulty taxpayers have in establishing a valuation in a family buy-sell agreement when challenged by the IRS. The IRS cites Section 2703, which allows the government to demand greater scrutiny of the valuation in an intra-family agreement and requires the taxpayer to show comparable sales to affirm

its valuation. Here, the court found the taxpayer failed to meet this requirement of § this code section and found, found an undervaluation and imposed a substantial gift tax liability.

E. The Revocable Trust and an Split Dollar Insurance Arrangement

1. Section 2038- Revocable Transfers

a. The value the gross estate shall include value of all property to the extent of any interest of which the decedent has at any time of transfer, by trust or otherwise, where the enjoyment was subject at the date of death to an exercise of a power by the decedent alone or by the decedent in conjunction with others to alter, amend, revoke or terminate or were such powers relinquished during the three-year timeframe ending on the date of the decedent's death.

Examples

Estate of Levine v. Comm., 158 TC 2. To provide for her grandchildren, before she died Marion Levine created an estate plan that would shelter some of her estate from estate tax. This plan included a revocable grantor trust and an irrevocable insurance trust that purchased split-dollar life insurance on the lives of her daughter and son-in-law with money borrowed from Levine. The insurance trust gave Levine a receivable for the cash.

What was the value of the split-dollar receivable in Levine's estate on the alternative valuation date? Was it the value of the grantor trust's right to be repaid in the future or the cash-surrender value of the life-insurance policies on the alternate valuation date?

The Tax Court held that only the value of the split-dollar receivable Levine was holding at the time of her death was includible in her estate and the estate correctly calculated that value. The court found that the life insurance policies weren't included in Levine's estate because they were always owned by the insurance trust. The insurance trust bought the policies and held them. Therefore, the insurance policies weren't includible in Levine's estate. Levine gave money to the insurance trust in exchange for the split-dollar receivable. Thus, the receivable wasn't transferred property but property retained by Levine and, after Levine's death, belonged to her estate.

Levine did voluntarily transfer the $6.5 million to the insurance trust. But Levine didn't retain an interest in that cash. Instead, she received the split-dollar receivable, which gave her the right to the greater of $6.5 million or the cash-surrender value of the policies. Levine didn't have any immediate contractual right to the policies cash-surrender value, she had to wait until her daughter or son-in-law died (theirs were the lives insured) or the policies were terminated and only the insurance trust had the right to terminate the policies.

The Tax Court rejected the IRS's argument that Levine could have unwound the split-dollar transaction at will because her attorneys-in-fact stood on both sides of the transaction. The Court found Levine's attorneys-in-fact, who were also the trustees of her grantor trust, stood in her shoes for this split-dollar arrangement. However, the attorneys-in-fact weren't on both sides of the transaction. The insurance trust owned the life-insurance policies, and it had a separate unrelated trustee. The one attorney-in-fact (Larson) who had a role in the insurance trust could only direct its investments. Moreover, the insurance trust was irrevocable, so neither Levine nor her attorneys-in-fact had any right to change, modify, amend or revoke its terms.

Since Larson, in his role as an attorney-in-fact, could not take any action which Levine could not take herself, he could not surrender the policies in his capacity as attorney-in-fact because Levine did not retain any right to possession or enjoyment of the cash she transferred. Larson, in his role as the single member of the insurance trust's investment committee, was acting in a fiduciary capacity and Levine's children (the other attorneys-in-fact) were not the only beneficiaries of the insurance trust; so were Levine's grandchildren. According to the insurance trust's terms, Levine's grandchildren wouldn't receive anything if the life-insurance policies were surrendered while Levine's children were living. Thus, if Larson surrendered the policies before Levine's children died he would breach his fiduciary duties to those beneficiaries.

The court determined that the property to be valued for estate tax purposes was the split-dollar receivable. This was included in Levine's estate because she held the receivable at the time of her death and there were no restrictions on what she could do with that property. The IRS and the estate agreed on the value of the split-dollar receivable.

F. Transfers with Retained Life Estate – Section 2036

1. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death:

- the possession or enjoyment of, or the right to the income from, the property, or
- the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Example

Milner Fields v. Comm., TC Memo 2024 – 90. Section 2036 (a) required inclusion in gross estate of value of underlying assets exceeding value of partnership interest to which decedent's great-nephew/POA transferred assets on decedent's behalf shortly before her death. Notably, until her death, decedent retained enjoyment of transferred assets, right to income from same, and right to designate who should possess or enjoy that income. And estate failed to prove that transfers were bona fide. Although estate put forth number of plausible non-tax reasons for transfers, including allegedly to avoid elder abuse, to allow for appointment of successor manager, to resolve issues with banks not honoring POA, and to allow for consolidated asset management, those claims ultimately weren't credible when considering surrounding circumstances and timeline of transfers; instead, it appeared transfers weren't for any reason other than reducing estate tax.

VI. Estate Deductions

A. Charitable Deduction – Section 2055

1. Charitable Deduction for an estate will be denied in association with the trust where the trust does not qualify as a charitable remainder annuity trust. In creating a charitable remainder annuity trust, the trust must possess either a specified dollar amount for a fixed percentage. This did not occur in there was no reformation of the trust to make and qualified. (See Estate of Block, TC Memo., 2023 – 30)

2. CCA 202233014. The service has indicated that a decedent's estate was not entitled to an estate tax deduction for a portion of the unitrust interest that could be distributed either to a charity or the decedent's spouse at the discretion of the trustee. Section 2055 (a) allows an estate a taxable charter reduction transfers to a charity. The code section does allow a deduction for the interest is a partial interest in interest in the same property passes to a non-charity. However, no deduction will be allowed unless the interest is in the form of a guaranteed annuity or unitrust interest. The unitrust portion or unitrust interest did not qualify for channel reduction it was not in the form of a fixed amount or an amount that was ascertainable nor severable from the non-charitable interest.

B. Claims Against the Estate – Section 2053

1. Payments a decedent makes to relatives where the payments are required also to be made under a prenuptial agreement are not deductible claims against the estate.

Example

Estate of Spizzirri, TC Memo., 2023-25. The decedent had been married 4 times. He had 4 children from his first marriage and 3 stepchildren from his last marriage. Before the last marriage he entered into a prenuptial agreement. Among the provisions was a provision in his will which would include payments to the surviving spouse and a one million-dollar gift to each of the stepchildren. The last wife filed a claim in the probate seeking enforcement of the prenuptial agreement. The surviving spouse's children also filed a claim. The estate paid the bequests and sent 1099s. The estate subsequently filed an estate tax return and reported no adjusted taxable gifts even though the payments were made and exceeded the gift tax exclusion. The return also reported payments the surviving spouse children as claims against the estate reducing the taxable estate. The IRS disagreed and assessed additional taxes they disallowed the claims against the estate. The Tax Court determined that the state failed to meet its burden of the transfers were not gifts. The state are the transfers payments for care and companionship during the decedent's life. The court noted decedent make transfers by check and there was no indication that they were meant as compensation. In addition, the decedent failed to issue any 1099s related to the payments nor report them on his personal return. Witnesses failed to establish the transfers or anything other than a gift. The court determined that there was amounts were of a donative nature and not an agreement associated with services.

2. Claims Against the Estate must arise out of the Decedent's personal obligations existing at the time of Death.

Example

MacElhenny v. Comm., TC Memo 2023 – 33. The Tax Court held that an estate could not deduct the value of two consent judgments against the decedent which arose in a commercial lending arrangement because the debts were satisfied before the decedent died and therefore were not the decedent's personal obligations at the time of his death as required by Section 2053. The court also held that the decedent's children received taxable gifts by purchasing property from the estate at a discount.

VII. Estate Liability

A. General Rule

1. Section 6324 (a) (2) imposes personal liability for unpaid estate taxes on the category of persons listed in the statute. This is generally the recipients of nonprobate property overseas property included in the gross estate or have possession of such property on the date of the decedent's death.

2. Under this code section the service has taken the position that decedent successor executors and trustees and beneficiaries fall within the category of listed persons under Section 6324.

3. The Ninth Circuit in Paulson (68F4th 528, 9th Cir. 2023) held that Sec. 6324(a)(2) imposes personal liability for unpaid estate taxes on the categories of persons listed in the statute (generally, recipients of nonprobate property) who receive property included in the gross estate or have possession of such property on the date of death. The court also held that the defendant successor trustees and trust beneficiaries in the case were within the categories of persons listed in Sec. 6324(a) and were personally liable for unpaid estate taxes, a holding that extended transferee liability further than in prior cases.

4. Prior to this decision, courts historically had concluded that the statute applied only to persons in actual possession of assets on the date of death or those with an immediate right to such assets (for example, the beneficiary of a life insurance policy), and not those who took possession at some time in the future. This interpretation was rejected by the Ninth Circuit, and although the decision was appealed to the U.S. Supreme Court, *certiorari* was denied.

VIII. Gift Tax Update

A. Exclusions

1. For 2024, the gift tax exclusion will be $18,000. (See Rev. Proc. 2023 – 34)

2. For gifts made in 2024, exclusion for gifts to non-citizen spouses will be $185,000. (See Rev. Proc. 2023 – 34)

3. For 2025, the gift tax exclusion will be $19,000. (See Rev. Proc. 2024 – 40)

4. For gifts made in 2025, exclusion for gifts to non-citizen spouses will be $190,000. (See Rev. Proc. 2024 – 40)

B. Foreign Gift Reporting – Section 6039 F

1. If the value of the aggregate foreign gifts received by a U.S. person exceeds a threshold amount, the U.S. person must report each foreign gift to IRS. The reporting thresholds apply for gifts received from nonresident alien individuals or foreign estates, and foreign partnerships or foreign corporations.

2. For gifts from a nonresident alien individual or foreign estate, reporting is required only if the aggregate amount of gifts from that person exceeds $100,000 during the tax year.

3. For gifts from foreign corporations and foreign partnerships made in 2024, the reporting threshold amount will be $19,570. (See Rev. Proc. 2023 – 38)

4. New Proposed Regulations on Reporting of Transactions with Foreign Trusts and Large Foreign Gifts – Reg – 124850 – 08

a. The Service has released proposed regulations to provide guidance regarding information reporting on transactions with foreign trusts and the receipt of large foreign gifts as well as loans from and uses of property involving foreign trusts. The proposed regulations provide special rules for a dual resident taxpayer.

b. A dual resident taxpayer is a foreign national who is considered a resident of the United States pursuant to its domestic laws and also a resident of a treaty country pursuant to the treaty partner's domestic laws, but invokes the "tie-breaker" provision of the treaty so as to be treated as a nonresident alien for U.S. income tax purposes. Although dual resident taxpayers are generally treated as nonresident aliens for purposes of computing their U.S. income tax liability, they may be treated as U.S. persons for certain international information reporting requirements (such as Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts and Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner).

c . Under the proposed regulations, dual resident taxpayers are generally not treated as U.S. persons for any portion of the year in which they are treated as nonresident aliens for purposes of computing their U.S. income tax liability.

C. Remainder Interest

1. An agreement to terminate a qualified terminable interest property (QTIP) trust and the distribution of the assets to a surviving spouse did not result in a taxable gift by the surviving spouse. However, the agreement did result in taxable gifts by the children to the surviving spouse of their remainder interests. The surviving spouse, as personal representative, made a QTIP election with respect to the property that funded a residuary trust. The estate claimed a marital deduction for the value of the trust. The surviving spouse and the children entered into a nonjudicial agreement to commute the QTIP trust and distribute the balance to the surviving spouse. The surviving spouse transferred the assets he received from the trust to establish trusts for the benefit of the children and their descendants in exchange for promissory notes. The distribution of the trust assets were soon to be a disposition that was not gratuitous by the surviving spouse. However, prior to the agreement, the children had rights in the trusts in the form of remainder interests. The children gave up the remainder interest rights by agreeing to transfer all the trust assets to the surviving spouse. There is no reciprocal gift between the parties because there was not a deemed gift from the surviving spouse to the children to offset the actual gift from the children to the surviving spouse. As such the children surrendering their remainder interest constituted a gift. (McDougall v. Comm., 162 TC-No. 9)

IX. Trust Update

A. Grantor Trust Issues

1. CCA 202352018. The IRS concluded that modifying a grantor trust to add a tax reimbursement clause constituted a taxable gift by the consenting trust beneficiaries to the grantor, because the addition of a discretionary power to distribute income and principal to the grantor was a relinquishment of a portion of the beneficiaries' interest in the trust. This new position contradicts a previous IRS letter ruling from 2016 that allowed such modifications without triggering gift tax.23 The IRS acknowledged this inconsistency and clarified in the CCA that the letter ruling no longer reflects its official position. The CCA offers limited guidance on valuing the deemed gift, suggesting that the value could be equal to the entire value of the trust.

B. Q-tip Trust Termination

1. The Termination of a qualified terminal interest property trust by the surviving spouse and distribution of assets to the surviving spouse does not trigger a gift tax liability under Section 2501.

Example

Estate of Annenberg v. Comm.,162 TC No. 9. The Tax Court held that even if the transfer was property under Section 2519 the estate is not liable for the gift tax because the surviving spouse received back the interest in the property that she was treated as holding and transferring and made no gratuitous transfer under Section 2501. The service in a prior CCA 202118008 advise the termination of a Q-tip trust were assets were distributed surviving spouse would result in a state exclusion and separate gift transfers. The service in this court case focused on whether the surviving spouse had made a gift and did not address whether any remaining or remainder beneficiaries consented to the termination that would constitute a gift. The court said so long as there is no evidence of a gratuitous transfer no gift tax can occur.

C. Charitable Contribution Deduction – IRS Letter Ruling 20243002

1. A trust was entitled to deduction for a charitable contribution where it was the sole shareholder of a corporation that intended to make a non-liquidating distribution of all of its real property to a trust.

2. The trust can acknowledge that the distribution would result in the Corporation recognizing gain equal to the excess of the real property's fair market value over the corporation's adjusted basis in the year of the distribution.

3. When this occurs the trust being the sole shareholder of the corporation is entitled to deduct those amounts from Gross income to the extent they would otherwise be includable in the gross income of the trust for the tax year as a result of the distribution of the real property from the Corporation.

X. Greenbook Update Estate and Gift Tax Provisions

A. Introduction

1. The Greenbook is issued annually by Treasury and is designed to provide a detailed account of the current administration's revenue proposals and legislative initiatives.

2. The current green but has the following proposals included:

- Impose a 25% minimum income tax on taxpayers with greater than $100 million in wealth;
- Require reporting of estimated total value of trust assets and other information about the trust, including the inclusion ratio in certain circumstances;
- Require that a defined value formula clause be based on a variable that does not require IRS involvement;
- Cap the gift tax annual exclusion at $50,000 per donor, indexed for inflation after 2025, and remove the present-interest requirement;
- Modify tax rules for grantor retained annuity trusts to require the remainder interest to have a minimum value for gift tax purposes equal to the greater of 25% of the value of the assets transferred or $500,000, but not more than the value of the assets transferred;
- Treat transactions between grantors and their grantor trust as regarded for income tax purposes;
- Provide that the payment of income tax on the income of a grantor trust is a gift;
- Redetermine a trust's GST inclusion ratio on certain transactions, including decanting and sales between a GST-nonexempt and a GST-exempt trust;
- Treat loans made by a trust to a trust beneficiary as a distribution for income tax purposes;
- Revise rules for valuation of promissory notes and fractional interests; and

- Revise the definition of a “guaranteed annuity” from a charitable lead annuity trust to require that the value of the remainder interest be at least 10% of the value of the property transferred.

References:

Consolidated Appropriations Act, 2023, HR 2617

The Coronavirus Preparedness and Response Supplemental Appropriations Act, PL 116 – 123, March 6, 2020

The Coronavirus Aid Relief, And Economic Security (CARES) Act, PL 116 – 123, Sections 1106 et al, March 27, 2020

H.R. 1, The "Tax Cuts and Jobs Act", P.L. 115-97.