MINI FEDERAL 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.

MINI FEDRAL INCOME TAX UPDATE

By

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I. Filing Status Issues

A. 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))

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

Example

Turner v. Comm., TC Memo 2024 – 20. The taxpayer was not entitled to claim and earned income credit as an eligible individual with a qualifying child. The taxpayer was the grandmother of a minor child who she claimed was her qualifying child. The child did not fit the definition of a qualifying child because the child and the taxpayer did not share the same principal place of abode for more than one half of the year. The taxpayer did not suggest that any individual other than the child was her qualifying child.

B. Head of Household Status

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

Turner v. Comm., TC Memo 2024 – 20. The taxpayer was not entitled to a standard deduction applicable to an individual who qualifies as head of household. The taxpayer did not qualify as the taxpayer's home was not the principal place of abode for more than one half the year of the child or any other person who might qualify as the taxpayer's dependent. The service has the right in this case to reclassify the five status to single.

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

1. Form 8867, the tax preparer due diligence checklist for determining 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.

II. Gross Income Issues

A. Wage Base and Compensation Issues

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.

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

B. Interest Income

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

a. 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. Taxable interest or Nontaxable Interest

a. 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.

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

a. 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).

C. 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.

4.. 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. (See Scott v. Comm., TC Memo 2023 – 141)

D. Virtual Currency and Digital Assets

1. 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.

2. 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.

3. 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.

4. 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.

5. 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.

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

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)

2**. Foreign Earned Income Exclusion Amounts**

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

3. Foreign Housing Exclusion for 2024

a. **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.

4. Waiver for Certain The Taxpayers Electing to Exclude Foreign Earned Income – Rev. Proc. 2024 – 17.

a. The Service has revised the waiver associate with excluding foreign earned income in association with several countries. The service added Ukraine, Belarus, Sudan, Haiti, Niger and Iraq to the list of the waivers for 2023. The prior waiver under Rev Proc 2023 – 19 included China and Ethiopia.

b. The waiver would apply in the event a taxpayer who would've otherwise met the physical presence or residency test had to leave the country due to war, civil unrest or an adverse condition in that country.

5. 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)

a. 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.

G. Foreign Currency and Transaction Reporting

1. Willful Failure to File and Penalty . 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)) 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. Gaynor, 133 AFTR2d 2024 – 716. A Federal District Ct. in Florida concluded that a deceased heiress did not willfully evade F bar 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 F bar 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.

2. **Nonwillful Penalties.** 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. 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. 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.

3. 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 County for the non-willful failure to file an F bar 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.

F. Rental Property Issues

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, D, 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. § 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 taxpayers yacht related activity where the yachts were intended to be chartered was a rental activity under Section 469 court. 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 more importantly the taxpayer was advised cannot 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 include 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 use the property as a primary residence before or after reading 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. Material Participation

a. 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 $3000 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.

13. Real Estate Professionals .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)).

14. Self-Employment Tax Issues Regarding Rentals

a. Generally, rents from rental arrangements are not subject to self-employment tax.
b. 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."*
c. 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)

d. 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.

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

a. 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.

b. 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.

16. 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 Stan shall services provided by a landlord or homeowner to a tenant/occupant involves 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**.

c. 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, the net investment income tax.

d. 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.

e. 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 to be an unclear issue for some time.

J. Other Gross Income Recognition Issues

1. Gambling Income and Losses

a. 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.

b. Payors required to report income. Anyone who pays out gambling winnings must issue the winner a Form W-2G, 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).

c. 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.

d. 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-2G.

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

f. 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.

g. 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.

2. Disability Payments and Section 104

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.

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.

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.

Example

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 warranty 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.

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 arms 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.

3. 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.

III. Adjustments to Gross Income

A. Health Savings Accounts

1. 2024 Figures – Rev. Proc 2023-23.

a. 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.
b. 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
c. 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).
d. 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.

2. 2025 Figures – Rev. Proc 2024-25.

a. 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.
b. 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
c. 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).
d. 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.

B. Medical Savings Accounts -2023– Rev. Proc. 2022 – 38

1. 2024 – Rev. Proc. 2023 – 34; IR 2023 – 208

a. **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 and not more than $8,350.

b. **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.

C. Student Loan Interest Deduction

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.

3. 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)

D. Alimony

1. Audit Risk Item. 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.

2. Current Rules on Alimony. Alimony is generally deductible from gross income by the pay or 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 pay or 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.

E. Retirement and Individual Retirement Accounts

1. Traditional IRA Contributions –2024; IR 2023 – 203; Notice 2023-75, 2023-47 IRB and Rev. Proc. 2023 – 34

a. 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.

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

c. MAGI Phase out Limitation. For 2024, the active participation MAGI limitation phase- out is as follows: (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

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

d. 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. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

3. Roth IRAs – 2024; IR 2023 – 203; Notice 2023-75, 2023-47 IRB and Rev. Proc. 2023 – 34

a. 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.

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

c. 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: (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

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

4. Other Retirement Plan Amounts

a. 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)

b. 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)

c. Annual Contribution Limit

- For 202**4**, the maximum out of compensation that can be taken into account under any qualified plan allocation or benefit formula will be $3**45**,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

d. SIMPLE Plan.

- For 202**4**, the amount of the deferral is $16,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

e. SEP

- The dollar amount will remain the same for 2024. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

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

- For 202**4**, the maximum amount of deferral is $ 23,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

g. 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. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

h. Key employee in top-heavy plan.

- For 2024, the dollar limit is $ 220,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

i. Government, etc. deferred compensation plans.

- For 2024, the limit on deferrals is $ 23,000. (IR 2023 – 203; Notice 2023-75, 2023-47 IRB)

F. SECURE 2.0 Act - Consolidated Appropriations Act of 2023 (PL 117 – 328)

1. Increase in Age for Required Beginning Date for RMDs. The act increases the applicable age at which beneficiaries must begin taking required minimum distributions (RMDs) from qualified retirement plans and annuity contracts as follows:

- For an individual who attains age 72 after December 31, 2022, and age 73 before January 1, 2033, the applicable age is 73.
- For an individual who attains age 74 after December 31, 2032, the applicable age is 75.

2. This increase applies to RMDs required to be made after December 31, 2022, by taxpayers who reach age 72 after that date.

3. This delay in the RBD means that these IRA owners (who, before enactment of the SECURE 2.0 Act, would have had to take RMDs from their IRAs for 2023) will have no RMD due from their IRAs for 2023.

In essence, an IRA owner who will obtain age 72 in 2023 will have a required beginning date of April 1, 2025 as opposed to April 1, 2024. Therefore such IRA owners will have no RMD due from their IRAs for 2023. (See Notice 2023-23)

4. 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 change 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. But notice also states a defined contribution plan that failed to make a specified RMD will not be treated as having failed to satisfy the plan requirement solely because it did not make that distribution and taxpayers who did not take the specified RMD will not be subject to the excise tax. A specified RMD is any distribution that will be required to be made 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 died in 2020, 21, 22 or 23 on or after the account owners required beginning date and the beneficiary is not using the lifetime or life expectancy payment exceptions or a beneficiary of an eligible designated beneficiary who died during the same timeframe and that designated beneficiary was using the lifetime or life expectancy payment options.

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 $5000 of compensation for the year. These nonelective contributions may not exceed $5000 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 County year 202 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.

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 $6,000 indexed for inflation.

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 withdraw bounty 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.

1**1. Catch-up Contributions of Higher Aid 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.

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

a. The IRS has reminded businesses that starting in tax year 2023 changes under the SECURE 2.0 Act may affect the amounts they need to report on their Forms W-2. 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.

b. 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.

c. 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.

13. Mandatory 401(k) Roth Contributions

a. The SECURE 2.0 Act does require businesses to allow employees (participants) to make up catch-up contributions with regards to FICA Wages exceeding $145,000. This process will begin in 2026 amounts contributed to a designated Roth account are includable in gross income in the year the contribution but eligible distributions are tax-free.

b. The Act provides that if a plan allows participants subject to the mandatory tax treatment to make catch-up contributions, all eligible participants must be permitted to make such contributions as designated Roth contributions even if they are subject to the mandatory Roth Tax Treatment Rule. This means that a plan that currently does not offer participants a chance to elect designated Roth contributions sin may be required to if the catch-up eligible participants will have compensation that exceeds the threshold.

c. As previously indicated this was to take effect in 2024, however due to concerns that plans and service providers could not make the administrative and record-keeping changes the IRS provided a two-year transition period until 2026.

IV. 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.

V. Itemized Deductions

A. Medical Expenses

1. Standard Mileage Rate. The standard mileage rate for medical expenses is set at $0.21 per mile for 2024.

2. 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**

a. Some COLA adjustments are based off of the medical CPI, not the all-consumer CPI. The medical CPI decreased from August 2022 to August 2023, causing the inflation adjusted numbers based off of the medical CPI to decrease from last year.

4. 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

5. 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.

B. Interest Expense

1. 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 husband in fact made said payments.

C. 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)

2. 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.

Examples

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 daunted intent when it made the contribution. The Service argued that the trouble 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 entirely deduction because it failed to satisfy the height 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 deductions. business with a track record of income, expenses, profits and growth rates. A historical track record provided real-world inputs that supply a plausible basis for projecting future revenue. 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.

Oconee Landing Property, LLC v. Comm., TC Memo 2024 – 25. The taxpayer, and 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. There were eight intermediaries between the taxpayer and the appraisers who ensured that all information was passed back and forth across the chain. The appraiser's final appraisal that was included the return was not a qualified appraisal. It appears the taxpayer's partners and associates create dozens of distinct entities to conduct their real estate activities. These include holding companies, development companies, investment companies. Deterring the tax character of the parent tract, it was if material of which these entities ultimately perform the development and construction work. The parent tract which was the subject of the conservation easement and contribution was at all times ordinary income property. Any charitable contribution deduction attributable to the taxpayer's grant of a conservation easement was limited to the taxpayer's basis in the property at the time of the donation. The taxpayer supplied no evidence to establish the starting point for the calculation of basis. In other words, the taxpayer failed to prove its entitlement to deduction in excess of zero because they failed to prove that there was basis in the property exceeding zero.

D. Casualty or Theft Loss

1. An individual may generally deduct losses sustained during the taxable year and not compensated for by insurance or otherwise under Section 165 (a). In addition, a loss of property neither connected with the trade or business or entered into for profit qualifies for a deduction only if it arises from fire, storm, shipwreck, or other casualty, or other theft loss. (See Section 165 (a), (c) (3)

2. An individual claiming a theft loss deduction must show the following:

- A theft has occurred,
- That there is no reasonable chance of recovery,
- That the taxpayer owned the property at the time of the theft or at the time it was stolen

Example

Pascucci v. Comm., TC Memo 2024 – 43. The taxpayers timely file their form 1040 in October 2009. On that return they claimed Madoff related losses totaling $17.3 million consisting of $9.1 million of other miscellaneous deductions and $8.2 million of theft losses derived from variable life insurance policies. With the loss they reported a net operating loss and zero tax liability. The Tax Court denied the theft loss deduction. Specifically, the taxpayers were claiming losses for the declining cash value of several variable life insurance policies in which the taxpayer was not the owner of the assets in the accounts at the time the theft occurred. Notably, the taxpayers were not qualified investors in association with the variable life insurance policies and as such did not have incidents of ownership to be able to claim a theft loss deduction.

3. Texas Relief for Storm Victims – IRS News Release TX 2024 – 13.

a. The IRS has announced relief for individuals and businesses affected by severe storms, straight-line winds, tornadoes, and flooding that began on 4/26/24 in Calhoun, Collin, Cooke, Denton, Eastland, Guadalupe, Hardin, Harris, Jasper, Jones, Lamar, Liberty, Montague, Montgomery, Polk, San Jacinto, Trinity, Walker, and Waller counties.

b. These taxpayers now have until November 1, 2024 to file various federal returns and make payments that were due on or after April 26, 2024 and before November 1, 2024. The November deadline also applies to quarterly estimated tax payments normally due on June 17, 2024 and September 16, 2024, and the quarterly payroll and excise tax returns normally due on April 30, 2024, July 31, 2024 and October 31, 2024.

c. In addition, penalties on payroll and excise tax deposits due on or after April 26, 2024 and before May 13, 2024 will be abated if the deposits were made by May 13, 2024.

VI. Qualified Business Income Deduction

A. Threshold Amounts

1. 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

3. 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.

VII. AMT and Other Taxes

A. **AMT for 2024 (Rev. Proc. 2022 – 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

C. Excess Taxable Income and AMT

1. For 2024, the excess taxable income above which the 28% tax rate applies will be:

Married filing joint and surviving spouse	$ 232,600
Single, HOH and married persons filing separately	$116,300

VIII. Personal Tax Credits

A. Child Tax Credit

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).

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.

4. No identifying number prior to filing original return cannot be amended.

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.

B. Adoption Tax Credit

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)

5. Adoption Exclusion

a. **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
b. The exclusion is allowed regardless of expenses.

6. Phaseout of the Exclusion

a. 2024. The amount excludable from an employee's gross income will begin to phase out for taxpayers with modified AGI in excess of $252,150 and the phaseout will be complete if modified $ 292,150.

C. Premium Tax Credit Update – FS – 2024 – 04

1. The IRS has made some updates to its FAQ regarding the Premium Tax Credit.

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 (see Q7) or for 2021, you, or your spouse (if filing a joint return), received, or were approved to receive, unemployment compensation for any week beginning during 2021.
    - 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 (see Q9 and Q10);
    - 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
(see Q11-15)
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. For tax year 2021, if a taxpayer or the taxpayer's spouse (if filing a joint return), received, or was approved to receive, unemployment compensation for any week beginning during 2021, the amount of the taxpayer's household income is considered to be no greater than 133 percent of the federal poverty line for his or her family size and the taxpayer is considered to have met the household income requirements for
being allowed a Premium Tax Credit.

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).

b. Regarding unemployment compensation, previously an eligible taxpayer was allowed to exclude from income up to $10,200 of unemployment compensation for the 2020 tax year. That exclusion also should have been excluded from modified AGI in doing the computation of the credit. Beginning in July 2021, the IRS review tax returns filed prior to the exclusion to identify taxpayers on which both the excludable unemployment compensation and access repayments were reported by the taxpayer. Taxpayer should have received letters from the IRS within 30 days of the adjustment informing them of what kind of adjustment was made. The adjustments could either be a refund, payment of IRS debt payment or an offset. If the cause of the excluded unemployment compensation, taxpayers are now eligible for deductions or credit not claimed on the original return an amended return for such should be filed for the year 2020.

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.

6. 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 89 16: 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.

7. 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.

D. Energy Efficient Home Improvement Credit

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. Rebates – IR 2024 – 113; Announcement 2024 – 19. 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. 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.

a. 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.

b. If a taxpayer purchases an item or items eligible for both rebates and the Sec. 25C credit, to determine the amounts paid for the items, the taxpayer may allocate the rebates pro rata to individually itemized expenditures as a share of total project cost.

E. Residential Clean Energy Property Credits

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.

6. Qualifications. The credit can be **claimed for qualifying expenditures incurred for either an existing home or a newly constructed home**.

a. 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.

b. The taxpayer cannot claim the credit if they are the landlord.

c. 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.

d. There is no overall dollar limit for the Residential Clean Energy Property Credit.

e. The credit is generally limited to 30% of qualified expenditures made for property placed in service beginning in 2022 through 2032.

f. 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.

g. 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.

h. 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.

i. 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.

7. The issue on rebates discussed previously under Rebates – IR 2024 – 113; Announcement 2024 – 19 applies here as well.

F. Clean Vehicle Credits – TD 9995; IR 2014 – 131

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 Rev. Proc. 2022-42 for more detailed guidance.)
- 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 identification number to the IRS for you 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.

12. Amount of Credit

a. 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.

b. 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

c. 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.

d. 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

e. 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.

f. 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

G. 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.

Note: In my opinion, this will minimize exposure to CPAs involving the claiming of the credit.

IX. Estate, Gift and Trust Update

A. Estate Tax Exclusion Amount

1. For 2024, the estate exclusion will be $13,610,000. (Rev. Proc. 2023 – 34)

B. Interest on Certain Portion of the Estate Tax Payable in Installments

2. For 2024, the dollar amount used to determine the portion will be $1,850,000. (Rev. Proc. 2023 – 34)

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.

D. Gift Tax Update

1. Exclusions

a. For 2024, the gift tax exclusion will be $18,000. (See Rev. Proc. 2022 – 38)

b. For gifts made in 2024, exclusion for gifts to non-citizen spouses will be $185,000. (See Rev. Proc. 2022 – 38)

2. Foreign Gift Reporting – Section 6039 F

a. 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.

b. 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.

c. For gifts from foreign corporations and foreign partnerships made in 2024, the reporting threshold amount will be $19,570. (See Rev. Proc. 2023 – 38)

3. Rights and Restrictions Disregarded

a. Under Section 2703 (a), he value of any property shall 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), or
- any restriction on the right to sell or use such property.

b. However, under section 2703 (b), the exceptions under 2703 (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:

- 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.
- Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.

Example

Huffman v. Comm., TC Memo 2024-12. A married couple was liable for gift tax arising from the sale of shares in a corporation to their son when he exercised options granted to him in right to purchase agreements. The agreements were between the son and the corporation and a trust, which held stock in the company. Pursuant to the agreements, the son paid $5 million for the shares. The agreements were not a testamentary device to transfer shares to the son from the couple for less than full and adequate consideration. The court held that the agreements were not comparable to similar arm's-length arrangements. As a result, the agreements were disregarded under Section 2703(b) for purposes of valuing the shares that the son purchased. The government's valuation was largely accepted, with an adjustment to the value of revenues associated with a licensing agreement. After that adjustment was made, the parties were directed to subtract the $5 million paid by the son to arrive at the value of the gift subject to tax.

X. Sole Proprietorship Issues

A. Hobby Losses

1. With respect to Section 183 the general rule is outlined in Section 183(a), which states the following: *"In the case of any activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this section."*

2. Section 183(c) states that the definition of an "Activity Not Engaged in For Profit" *"means any activity other than one with respect to which deductions are allowable under Section 162 or under paragraph (1) or (2) of section 212."*

3. Section 183(e) states the following pertaining to postponement of a presumption of non-profit. Specifically, the language indicates the following:

"A determination as to whether the presumption provided by subsection (d) applies with respect to any activity shall, if the taxpayer so elects, not be made before the close of the fourth taxable year... following the taxable year in which the taxpayer first engages in the activity."

4. Reg. Section 1.183-2(b) states that all facts and circumstances that bear on the activity are to be taken into account in determining whether the activity was engaged in for profit. Included are the following factors:

a. The manner in which the taxpayer carried on the activity;
b. The expertise of the taxpayer or her advisers;
c. The time and effort spent by the taxpayer in carrying on the activity;
d. The expectation that the assets used in the activity may appreciate in value;
e. The success of the taxpayer in carrying on other similar or dissimilar activities;

f. The taxpayer's history of income or losses with respect to the activity;
g. The amount of occasional profits, if any, which are earned;
h. The financial status of the taxpayer;
i. The presence of elements of personal pleasure or recreation;
j. No single factor is controlling in the determination. (See Barnes v. Commissioner, TC Memo 1992-72 (1992); Dunn v. Commissioner 70 TC 715 (1978) affd. 615 F. 2d 578 (2nd Cir, 1980))

5. The IRS released an updated audit guide relating to hobby losses: Publication 5558, IRS Audit Technique Guide: Activities Not Engaged in for Profit — Internal Revenue Code Section 183.

Examples

Schwarz v. Comm., TC Memo 2024 – 55. In a recent 117 page Tax Court decision, the Tax Court determined the taxpayers, through various entities, conducted real estate ecotourism operations involving ranchland in South Texas. The activities are primarily aimed at hunting, fishing and hosting events. They reported significant losses through a partnership which flow to the personal return. The personal return was the subject of the audit and they backed storage into the partnership. The Tax Court determined that the taxpayer schedule F activities on their 1040 and real estate operations were separate and that the partnership schedule F activity was not engaged in a profit-making function. The court focused on the expectation of profit and the businesslike manner of the operations. It also concluded that there was a significant amount of recreational activity. The revenue over six year timeframe was $14 million with losses of the same time of 3 million. The court concluded the scale the losses of the timeline combined with the nature of the activities, specifically hunting and fishing were viewed as personal recreational and indicated a lack of a profit motive. The record-keeping was also a problem in the sense that the records were not reliable. The taxpayer amazingly was not assessed accuracy penalties because they were able to demonstrate a reasonable cause defense based upon the reliance of the tax preparers.

Kraske v. Comm., TC Memo 2023-128. Taxpayer working over 50 hours per week as a cloud computing engineer consultant was not engaged in activity for profit. The activity was not operating a businesslike manner s shown by facts that taxpayer didn't keep separate business records, that he didn't adjust system or methods to improve profitability, and that only ostensible business plan was comprised largely of buzzwords and general aspirations but didn't include budgets or provide roadmap for completing projects. Also, other factors indicating not-for-profit nature of activity included that taxpayer didn't show how much time he spent on activity; admitted that expert allegedly hired as part of activity was personal friend with whom taxpayer spent time attending movies and other entertainment events; didn't show expectation that activity assets/computer servers and networking components would appreciate in value; used activity losses to offset other income; and appeared to derive personal pleasure from activity.

B. Excess Business Loss Limitation

1. The CARES Act temporarily suspended the Sec. 461(l) limitation on excess business losses for pass-through businesses and sole proprietorships for the 2018, 2019, and 2020 tax years.

2. For taxable years beginning in 2024, the threshold amount will be $305,000 ($610,000 for joint returns). (See Rev. Proc 2023-34)

3. The determination of the excess business loss limitation is made at the taxpayer level aggregating all business activities. Gains or losses attributable to trade or businesses of performing services as an employee are not considered.

4. Wages are no longer considered business income, and business capital losses are not taken into account in the calculation, whereas net business capital gains are taken into account.

C. Self-Employment Tax Matters

1. For 2024, the first $168,600 of your combined wages, tips, and net earnings is subject to any combination of the Social Security part of self-employment tax, Social Security tax, or railroad retirement (tier 1) tax.

Example

Bibeau v. Comm., TC Memo 2023 – 66. An individual's self-employment income from his law practice was not exempt from federal taxation. The taxpayer was an enrolled member of the Minnesota Chippewa Tribe. The taxpayer argued that the Indian Citizenship Act (the Act) lacked clear and precise language authorizing Congress to tax Indians. Further, the taxpayer argued that Congress must expressly authorize the federal taxation of Indians before income taxes can be levied. However, Indians, as citizens of the United States, are generally subject to taxation. Since the Act took effect in 1924, all native-born Indians have been U.S. citizens, and the Code does not grant tax exemptions solely because a taxpayer is an Indian. Accordingly, since no treaty or statute expressly or implicitly exempted the taxpayer's income from taxation, his self-employment income was taxable

D. Section 274 Substantiation Rules

1. Section 274 (d) impose a strict substantiation requirements for certain expenses such as automobiles. (See Reg. Sec. 1.274 – 5 T (a)). To substantiate by adequate records, the taxpayer must provide:

- An account book, log or similar record and
- Documentary evidence, which together are sufficient to establish each element with respect to an expenditure
-

2. Section 274 (d) indicates that no deduction or credit shall be allowed on the basis of mere approximations or guesstimates. Generally it requires a contemporaneous writing. However, if it is not contemporaneous then other sufficient credible evidence is required to support a taxpayer's deduction. Other sufficient corroborating evidence can include the taxpayer's own statements, written or oral, containing specific information in detail as to such elements and other evidence sufficient to establish the deduction. Such evidence must be direct evidence, written or oral, to demonstrate elements of cost, amount, time, place or date of the expenditure or use thereof.

3. If the taxpayer's records are destroyed due to fire, flood, earthquake or other casualty, the taxpayer may reconstruct the expenses using a reasonable method. (See Reg. Sec. 1.274 – 5T (c) (5))

Examples

PM Anderson c. Comm., TC Memo 2024 – 95. A married couple was not entitled to claim various Schedules C, Profit or Loss From Business, and Schedules E, Supplemental Income and Loss, expenses due to lack of substantiation. The IRS had no record of returns for those years and prepared substitutes for returns for the taxpayers. The taxpayers principally relied on accounting documents (cash disbursements journals and account registers) to substantiate reported business expenses. Further, the taxpayers explained the absence of additional evidence of actual payments on the grounds that the boxes containing that evidence were too voluminous to produce or the evidence was tied up in other litigation. Since the taxpayers did not convince the Tax Court that evidence of payment that existed was unavailable to them due to circumstances beyond their control, the Tax Court did not accept the taxpayers' journals and

registers as evidence of actual payment. Additionally, because proper record keeping was feasible and, apparently, proper records were maintained, the Tax Court declined to exercise its authority to estimate the taxpayers' expenditures. Moreover, the taxpayers were not entitled to net operating loss (NOL) carryovers for similar reasons.

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Additionally, because proper record keeping was feasible and, apparently, proper records were maintained, the Tax Court declined to exercise its authority to estimate the taxpayers' expenditures. Moreover, the taxpayers were not entitled to net operating loss (NOL) carryovers for similar reasons.

RM Ottuso v. Comm., TC Memo 2024 – 91. An individual was not entitled to deduct gasoline expenses due to lack of substantiation. The taxpayer operated a store. However, the taxpayer did not offer any contemporaneous records of how the store's three vehicles. The taxpayer did not provide any corroborative evidence to support his assertion that the vehicles were used exclusively for business purposes. Moreover, the record contained no detailed descriptions or photographs of the vehicles. Consequently, the taxpayer failed to satisfy the strict substantiation requirements.

Midwest Medical Aesthetics Center, TC Memo 2024 – 32. The taxpayer a corporation was not entitled to deduct automobile expenses due to a lack of substantiation. Specifically, the taxpayer failed to substantiate the business purpose of the vehicles. The directors had listed the vehicles as personal assets on two separate loan applications but the expenses were reported on Form 1120. The taxpayers were also denied deductions for a laser it acquired under a long-term lease agreement. Service disallow the depreciation on it the taxpayers claimed it had purchased a second laser however, they did not provide any documentation as to the purchase. Also, the taxpayer was not allowed to take a depreciation deduction for furniture it purchased because the furniture did not have the business purpose new furniture was installed in the directors home.

CR Pangelina v. Comm., TC Memo 2024 – 5. The taxpayer was not entitled to various business deductions on Schedule C due to lack of substantiation. The taxpayer failed to meet the strict requirements of substantiation under Section 274. The bank records submitted by the taxpayer to substantiate various business deductions for the taxpayer's business as a contractor did not meet the rules of substantiation. The profit loss statements provided by the taxpayer were insufficient and unreliable.

Steward v. Comm., TC Summary Opinion 2024 – 3. The taxpayer, a musician, had his contemporaneous automobile log destroyed by a fire but was able to deduct automobile expenses based on reconstruction.

Chappell v. Comm., TC Summary Opinion 2024 – 2. The Tax Court disallowed automobile expenses of the taxpayer because the taxpayer failed to meet the strict substantiation rules but in the alternative, the taxpayer was allowed the standard mileage rate based on mileage logs but only to the extent that the business purpose was self-evident.

4. Cohan Rule. If the taxpayers able to establish that he or she paid or incurred deductible expense but is unable to substantiate the precise amount, the Courts generally may approximate the deductible amount

only if the taxpayer present sufficient evidence to establish a rational basis for the estimate. (See Cohan v. Comm., 39F2d 540, 543 – 544 (2nd CIR, 1930))

a. To qualify under the rule for the estimation treatment, the taxpayer must establish that they were entitled to the deduction. This rule does not apply to listed property or section 274 substantiation requirements.

Examples

Kalk v. Comm., TC Memo 2024 – 82. Taxpayer was not entitled to cost of goods sold deduction due to the lack of substantiation. The taxpayers testimony regarding the cost of goods sold incurred in the business was not credible as she felt provide evidence to corroborate her testimony. The taxpayer failed to provide any receipts, credit card statements, bank statements or other evidence to support the expenditures. Likewise, taxpayer is not entitled to business deductions including expenses for office deductions, utilities, rent expense, commissions and fees due to lack of substantiation. The court did indicate that the: rule does apply that the taxpayer has to have some sort of corroboration.

Thompson v. Comm., TC Memo 2024 – 14. The taxpayers who had earned income from both farming and a tax preparation business had unreported income from both businesses but more importantly had deductions that they could not prove such as insurance, chicken feed and contract labor. There was not enough information to even apply the Cohan rule for an estimate.

Frazier v. Comm., TC Memo 2024 – 3. A C corporation and its shareholders, a married couple, were entitled to salary-and-wage deductions. The Tax Court found that the professional-fee ledger in conjunction with the taxpayers' accountant's testimony established that the C corporation actually paid for the professional-fee expenditures. Further, the Tax Court determined that the C corporation, not the taxpayer-husband, was the other member of another LLC (the LLC).

Alvarado v Comm., TC Memo 2024 – 1. The Tax Court found that a tax professional who also operate a used car business as a sole proprietor understated gross income but use the Cohan rule to determine cost of goods sold at 55% of sales while the tax return claim 82% in the iris adjustment was based on a 36% rate. The court allowed the rule to prevail based upon the methodology used in determining the estimate and did not apply the strict requirements standard under Section 274.

E. Farmers and Ranchers – IR 2024 – 248; Notice 2024 – 70.

1. The IRS is extended. For farmers and ranchers forced the seller exchange livestock because of drought conditions to replace their livestock entity for taxes and any gain from for sales or exchanges. The notice provides a list of designated regions eligible for federal assistance. There are 41 states listed in bobbing various regions.

2. The notice provides a replacement extension timeframe for eligible farmers and ranchers that is four years from the end of the first year after the first drought free year to replace the sold or exchange livestock.

3. As a result, eligible farmers and ranchers who drought sale replacement timeframe was scheduled to expire at the end of 2024 will have until the end of the next tax year to replace said livestock.

XI. General. Business Matters

A. Section 179 Expense

1. ***2024.*** For 2024, the aggregate cost of any Section 179 property that a taxpayer elects to treat as an expense cannot exceed $1,220,000. The expensing limit will be reduced when more than and under § 179(b)(5)(A), the cost of $3.050,000 of expensing-eligible property is placed in service. (Rev. Proc. 2023-34)

B. Bonus Depreciation

1. The increase to bonus depreciation to 100% pertains to qualified property in the applicable percentages are subject to a revised phasedown schedule that is shown below:

- 100% for property placed in service after September 27, 2017 and before January 1, 2023;
- 80% for property placed in service during calendar year 2023;
- 60% for property placed in service during calendar year 2024;
- 40% for property placed in service during calendar year 2025;
- 20% for property placed in service during calendar year 2026.

Note: The language in the statute with respect to place in service means both acquired and placed in service. This is particularly important with respect to the 100% in the first year. In addition, the phasedown also applies to long-term production property and aircraft.

C. **Automobile Expense**

1. Standard Mileage Rate. For 2024, the standard mileage rate for deductible business expenses is $0.67 per mile. (Notice 2024 – 8)

2. Luxury Auto Depreciation Caps – Rev. Proc. 2024 – 13. The luxury car depreciation caps for a passenger car, sports utility vehicle, truck or van placed in service in 2024 limit the annual depreciation deduction as follows:

- 12,400 for the first year without bonus depreciation
- $20,400 for the first year with bonus depreciation
- $19,800 for the second year
- $11,900 for the third year
- $7,160 for the fourth through sixth year

3. Access Depreciation on Luxury Vehicles. If depreciation exceeds the annual cap, the excess depreciation is deducted beginning in the year after the vehicle's regular depreciation period ends. The annual cap for this excess depreciation is:

- $7,160 for passenger cars and
- $7,160 for SUVS, trucks, and vans.

4. Least Inclusion Amounts for cars, SUVs, Trucks and Vans. If a vehicle is first leased in 2024, a taxpayer must add a lease inclusion amount to gross income in each year of the lease if its fair market value at the time of the lease is more than:

- $62,000 for a passenger car, or

- $64,000 for an SUV, truck or van.

D. Accounting Method

1. The Tax Cuts and Jobs Act expands the universe of taxpayers that can use the cash method of accounting for C Corporations (and partnerships with the C corporation as a partner) and as well as the provision specific to forming businesses of C Corporations and provisions concerning the use of inventory.

2. The Act amends Section 448 (b)(3) to require that a C corporation (or partnership with a C corporation as a partner), or any predecessor to meet the gross receipts test for the tax year rather than all prior tax years beginning after December 31, 1985 and amends Section 448(c)(1), which provides the gross receipts test to refer to the tax year rather than prior tax years.
a. In other words, the gross receipts test must be satisfied only for the tax year for which the taxpayer seeks to use the cash method and not all earlier tax years that begin after 1985.

3. Under the Act the gross-receipts test is satisfied for the tax year if the average annual gross receipts are under the prescribed dollar limit for the three tax-year period ending with the tax year that precedes the tax year for which the taxpayer is being tested.
4. For 2024, the gross receipts exception will be $ 30 million, (See Rev. Proc. 2023-.34)

5. Taxpayers that qualify as small businesses under Section 448 (c) are eligible for exceptions to the number of rules. The exceptions to the limitations include the following:

- The business interest expense limitation.
- The unit Requirement that direct and certain indirect costs allocable to real or tangible personal property produced by the taxpayer be capitalized into the basis of the property.
- The prohibition of the use of the cash method of accounting for C Corporations.
- The requirement that taxable income from a long-term contract be determined under the percentage of completion method.
- The requirement to maintain inventory under Section 471.

6. The small business exception qualification is satisfied if the above gross receipts test is met.

7. Rev. Proc. 2024-34: Updated List of Automatic Changes in Tax Accounting Methods. The revenue procedure detailed 21 changes to the list of automatic changes in accounting methods used on Form 3115. The changes included matters associated with:

- Upfront payments for network upgrades received by utilities
- Commodity Credit Loans treatment
- Attorney advances on behalf of clients
- Materials and Supplies, Repair and maintenance costs
- Change from Reserve Method to Specific Charge-off method
- Amortization and Interest Expense of Bond Premiums
- Depreciation and Amortization – impermissible to permissible methods
- Deduction for Energy Efficient Commercial Building
- Software Expenditures
- Change in Method of Accounting for SRE expenditures
- Startup Expenditures and organizational fees
- Capital Expenditures and various items
- Losses Expenses and Interest with regards to Related Party Transactions
- Deferred Compensation Matters

- Methods of Accounting – Cash to Accrual, Nonaccrual Method, film producers treatment, warranty costs, Hybrid Methods for banks, farmers,
- Taxable Year of Inclusion Items
- Obligations Issued at Discount
- Prepaid Subscription Income
- Long term contract matters
- Inventory Issues – capturing huge
- LIFO Issues
- Mark to Market Accounting
- Discounted Unpaid Losses
- Functional Currency
- REMIC Fees
- Market Discount Bonds

The changes are effective for Forms 3115 filed on or after April 30, 2024 of a year of change ending on or after September 30, 2023.

XII. S Corporation's

A. Guidance on Perfecting S Elections and QSubs Elections – Rev. Proc 2022 – 19

1. The IRS released Rev. Proc. 2022-19, which expands Rev. Proc. 2013-30 providing a simplified method for taxpayers to request relief for late elections by S corporations, qualified Subchapter S subsidiaries (QSubs), electing small business trusts (ESBTs), and qualified Subchapter S trusts (QSSTs).

2. Rev. Proc. 2022-19 also amplifies Rev. Proc. 2004-35 providing automatic relief for certain taxpayers requesting relief for late shareholder consents for S elections in community property states.

3. In addition, Rev. Proc. 2022-19 adds certain no-rule areas with respect to IRS letter ruling requests, consistent with the guidance provided in the revenue procedure. The guidance focuses on six issues:

- nonidentical governing provisions;
- principal-purpose determinations regarding the one-class-of-stock requirement;
- disproportionate distributions;
- certain inadvertent errors or omissions on Form 2553, *Election by a Small Business Corporation,* or Form 8869, Qualified Subchapter S Subsidiary Election;
- missing administrative or acceptance letters for an S or QSub election; and
- the requirement to file returns consistent with an S election.
-

4. The governing provisions of an S corporation cannot provide for disproportionate distribution or liquidation rights among any shares of stock, or else the S corporation will have two classes of stock and will be ineligible to have an S election (See Regs. Sec. 1.1361-1(l)). This most often applies in the context of a limited liability company with an S election that has governing provisions more common to those of a partnership. These are known as non-identical governing provisions.

5. Rev. Proc. 2022-19 provides a new method for relief for nonidentical governing provisions. To qualify for relief, the S corporation and its shareholders must satisfy the following requirements:

- The corporation has or had one or more nonidentical governing provisions;
- The corporation has not made, and for federal income tax purposes is not deemed to have made, a disproportionate distribution to an applicable shareholder;

- The corporation timely filed (defined as filed within six months after its original due date, excluding extensions) a return on Form 1120-S, U.S. Income Tax Return for an S Corporation, for each tax year of the corporation, beginning with the tax year in which the first nonidentical governing provision was adopted and through the tax year immediately preceding the tax year in which the corporation made a request for corrective relief; and
- Before any nonidentical governing provision is discovered by the IRS, all of the requirements of the revenue procedure are satisfied.

6. To request relief, the corporation must prepare a statement of all the relevant facts, signed by a corporate officer, and each applicable shareholder must consent to the election. The corporation will prepare an explanation of how each nonidentical governing provision was discovered and each action taken to correct or remove it. To demonstrate reasonable cause for relief, the description must include each action taken by the corporation and each applicable shareholder to establish that the corporation and shareholder acted reasonably and in good faith in correcting or removing each nonidentical governing provision upon discovery.

7. Applicable shareholders include the corporation's current or former shareholders who own or owned stock of the corporation at any time during the period beginning on the date on which the nonidentical governing provision was adopted and ending on the date on which the nonidentical governing provision was removed or modified to comply with the one-class of- stock requirement.

8. The corporation will retain the corporate governing provision statement, the shareholder statement(s), and the revised governing provisions in its corporate records. There is no need to notify the IRS of the corporation's identification of the nonidentical governing provisions, the change in governing provisions, or the qualification for relief under Rev. Proc. 2022-19. Rather, if the IRS examines the corporation, then the corporation will provide the documentation to support meeting the requirements for relief under the revenue procedure.

9. To perfect the Form 2553 or Form 8869, the taxpayer must write to an IRS service center explaining the error(s) or omission(s) and the necessary correction(s). Note that Rev. Proc. 2022-19 provides specific addresses where the request should be mailed, which differ from where a Form 2553 or Form 8869 is currently filed.

10. When a taxpayer files Form 2553 for an S election or Form 8869 for a Qsub election, the IRS will provide a written acknowledgment of its acceptance (CP261 for an S election; for a Qsub election, CP279 to the parent and CP279A to the subsidiary). The written acknowledgment is an administrative item that does not affect the election. A new letter can be requested by calling the IRS. A letter ruling is not available with regard to any missing administrative acceptance letter.

11. Rev. Proc. 2022-19 verifies that filing an incorrect income tax return (e.g., Form 1065, *U.S. Return of Partnership Income, or Form 1120, U.S. Corporation Income Tax Return*) inconsistent with an S or Qsub election does not by itself terminate the validity of the S or Qsub election. The revenue procedure provides that the taxpayer must file a federal income tax return for open tax years consistent with its status. (Note that, depending upon the type or return filed and the facts and circumstances surrounding the filing, the statute of limitation may not have started.) The IRS will not issue a letter ruling to address any inconsistent return filing.

B. Digital Access Question

1. For 2023 and beyond the digital asset question will be added to all pass-throughs, including estates and trusts.

C. **Revoking S Election**

1. Section 1362 describes the procedures for electing or revoking S corporation status. It also states some rules for terminating S corporation status if the corporation fails to meet one or more of the eligibility requirements of Sec. 1361.
2. Section 1362(g) restricts S corporations for which the S election has been terminated from reelecting S corporation status before the fifth tax year after the year of termination, unless the IRS consents to a new election.

3. Certain relief under this section requires a taxpayer to submit a request for a Private Letter Ruling. However, taxpayers considering a letter ruling for inadvertent termination will need to now follow Revenue Procedure 2022 – 19.

4. Does a bankruptcy have an impact on the revocation of an S election?

a. In Re Vital Pharmaceuticals (Bktcy Ct FL) 132AFTR2d 2023 – 5268, a bankruptcy court rejected a sole shareholders request for leave from automatic stay in his S corporations Chapter 11 bankruptcy case where the shareholder was attempting to revoke the S election and thus ultimately shifting back to the Corporation the tax liability on a $370 million asset sale. The bankruptcy court determines the S election was property of the bankruptcy estate and as such the S election was protected by the automatic stay. The shareholder received tax benefits from the S election for a number of years prior to the filing of the bankruptcy could not show cause for lifting the stay or even if the shareholder taxpayer could the relief would be null and void because it was the corporation that made the S election or it's the corporation that will determine if it will be revoked. The court went on to note that although the shareholder did have a role of consenting to the election or revoking the election this did not mean that there is no distinction between a corporation and shareholders particularly whereas here the shareholder wasn't not in fact an officer or director and their interest in duties were not aligned.

D. Pass-through of S Corp. Income to Individuals

1. An un-even distribution does not mean that the S Corporation has more than one class of stock – Regulation 1.361 – 1 (1) (2)

Maggard v. Comm., TC Memo 2024 – 77. The S Corporations income flow to a married couple who were it shareholders and the S corporation was not subject to taxation as a C Corporation. The taxpayers contended that other shareholders of the S Corporation made unauthorized distributions to themselves in excess of their ownership shares. As such these actions terminated the S Corporation Status. The IRS argued that the other shareholders actions did not matter the regulations indicate that shareholders rights focus on governing documents and not what shareholders actions do. The disproportionate distributions are not enough to change the S Corporation status. The entity continue to have one class of stock the S Corporations entity neither authorized nor created a second class of shares by way of a formal corporate governance action. The taxpayers were required to include in their income allocable share of income from the K-1 despite any disproportionate distributions.

2. Taxpayer shareholder still required to recognize her share of S Corporation Income even though taxpayer was excluded from the benefits of owning stock.

Veeraswamy v. Comm TC Memo 2024 – 83. The taxpayer owned more than 50% of an S corporation that she began with her ex-husband. She had to recognize her share of the net income even though she was excluded from the benefits of owning stock by her former husband. She was still deemed to be a

shareholder. A poor relationship between shareholders does not grant evasion of the recognition of pastor items or ownership treatment. Evidence indicated the taxpayer owned 50% interest corporate documents demonstrate such.

XIII. Partnership Update

A. IR 2023 – 162. IRS Issues FAQ for Passthrough Entities to Report Negative Amounts electronically to IRS on Part II of Schedules K – 2 and K – 3

1. A pass-through entity receives information that certain gross income amounts to be reported on Schedules K – 2 and K – 3 are negative. The current schema for electronic filing of the Schedules K – 2 and K – 3 do not permit negative values for certain line items in Part II, Section 1 of the schedules. Since the schema does not allow for the negative amounts to be reported electronically, the taxpayer should enter zero on the line items in Schedules K – 2 and K – 3, Part II, section 1 and then attach a General Dependency (XML) schema to Schedule K – 2 identify the line items and the negative values for which the pass-through entity reported zero. Also, the pass-through entity should attach a list of the impacted line items and the negative numbers.

B. IRS Releases Information on MeF Error Message, Form 1065 Changes

1. The IRS released two new answers to frequently asked questions (FAQs) on e-filing Form 1065. These FAQs address an e-file error message and how to identify a foreign partner now that the designation "FOREIGNUS" has been removed as an option.

2. The first FAQ addresses how to correct an error message a filer received when using code ZZ on line 20 of Schedule K-1.

a. According to the answer there was a programming error impacting 2023 Form 1065 e-filers that blocks e-filed partnership returns from using code ZZ. The IRS recommends that e-filers get an extension to file their 2023 Form 1065 returns and defer trying to e-file those returns until June 16, 2024, when the IRS estimates that the code ZZ problem will be fixed.

3. The second FAQ addresses partnerships e-filing Form 1065 that use Part II, Item E, on Schedule K-1 and Item C, on Schedule K-3.

a. According to the IRS' answer, a partnership must enter a partner's SSN or Taxpayer Identification Number (TIN) on Schedule K-1, Part II, Item E. In past years, when a foreign partner didn't have an SSN or a TIN, many partnerships entered "FOREIGNUS" instead. However, for partnerships that e-file, the "FOREIGNUS" designation has been removed.

4. The IRS wants e-filing partnerships to enter 000-00-0000 in Item E if the partner is an individual or 00-0000000 if the partner is an entity. Partnerships should use this procedure only for foreign partners who are not required to obtain an SSN or TIN.

5. This same procedure should be used to complete Item C on Schedule K-3.

6. The IRS notes that this "change in e-file policy at the IRS should not be interpreted by partners, partnerships, and their tax preparers as a policy that partners who were not previously required to obtain an SSN or TIN are now required to do so."

C. Form 1065 – X

a. For tax years beginning on or after January 1, 2023, the practitioner should use the August 2 023 revision of Form 1065 – X.

b. Under the 2023 revision, Part 1, Section 2 – BBA AAR. Item C 2 has been added to indicate when adjustments do not result in the imputed underpayment. Likewise, Part II, Line 13 is changed from Contributions to Cash Contributions and Line 13 B is added for Non-cash contributions.

c. Remember, partnerships under the BBA must file an Administrative Adjustment Request (AAR) instead of an amended return.

D. **Section 754 Election**

1. When a partnership distributes property or a partner transfers his or her interest, the partnership can elect under Section 754 to adjust the basis of partnership property.
2. A Section 754 election allows a step-up or step-down in basis under either Section 734(b) or Section 743(b) to reflect the FMV at the time of the exchange.

3. This election has the advantage of not taxing the new partner on gains or losses already reflected in the purchase price of his or her partnership interest.

4. Regulations Streamline Partnership Basis Elections – TD 9963

a. Under final regulations issued by the IRS and Treasury, partnerships electing to adjust the basis of partnership property under Section 754 will not have to include a partner's signature on their election statement.

b. Partnerships generally may make the election in the case of a distribution of property in the manner provided in Section 734 or a transfer of a partnership interest under Section 743.

c. The election applies to all distributions of property and all transfers of a partnership interest in the partnership during the tax year with respect to which it is filed and for all subsequent tax years.

d. The final regulations are effective beginning Aug. 5, 2022, although taxpayers have been able to rely on the proposed regulations previously.

5. Revoking a Section 754 Election

a. A partnership that wants to revoke its Sec. 754 election should file its revocation request using Form 15254, *Request for Section 754 Revocation*, which must be filed no later than 30 days after the close of the partnership's tax year and must state the reason(s) for requesting a revocation.

b. A revocation application will not be approved when the revocation's purpose is primarily to avoid a reduction in the basis of partnership assets upon a transfer or distribution of partnership property.

c. Before a Section 754 election is finalized, it must be reviewed and approved by a manager and the Chief Counsel's office. This guidance applies to any partnership, whether subject to TEFRA, the BBA, or separate deficiency proceedings.

6. Foreign Issues -Form 8832: Entity Classification Election

a. Foreign entities formed as LLCs that want to be taxed as a partnership in the United States must make an election on Form 8832.
b. Without this election, this type of entity defaults to a corporation.

c. The Service does allow a late election not exceeding 120 days after the ruling to file the election.(See 202113004, 202130010, 202136001, and 202138005)

E. Limited Partners and Self Employment Tax – Functional Test Determination for Limited Partners

1. The Tax Court has recently indicated that in determining whether a distributive share of partnership profits under a state law limited partner qualifies for the exception for self-employment tax, the limited partners function and role in the partnership must be examined and determined.

2. Section 1401(a) imposes a tax on the self-employment income of individuals. Self-employment income is defined as "the net earnings from self-employment derived by an individual … during any taxable year."[4] Sec. 1402(a) in turn defines net earnings from self-employment as:
the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in section 702(a)(8) from any trade or business carried on by a partnership of which he is a member.
3. In essence, the sections require partners to include the distribution of partnership income profits and net

earnings from self-employment. However, section 1402 (a) (12) contains an exception to the imposition of self-employment tax for the distributive share of any item of income or loss of a limited partner, as such, other than guaranteed payments described under Section 707 (c) to that partner for services actually rendered to or on behalf of the partnership to the extent those payments are established to be in the nature of renumeration for such services.

4. The legislative history of this provision reveals that Congress intended to exclude distributive shares of partnership net income of limited partners from the Social Security system exempting them from self-employment taxes but also precluding it from generating any future retirement benefits, the value of which at the time was considered to exceed the incurrence of self-employment tax. This change under a recent tax case

Example

Soroeban Capital Partners, LP, 161 TC No. 12. The limited partnership made guarantee payments and distribute ordinary income to its limited partners. On its tax returns for the years at issue, the partnership reported as net earnings from self-employment it's guaranteed payments to limited partners plus the general partner's share of ordinary income. The partnership excluded from his computation of net earnings from self-employment the ordinary income distributed to the limited partners. The IRS increased the limited partnership's net earnings from self-employment to include the share of order income allocated to the limited partners. The services position is that they were limited partners in name only. The partnership argued first that the ordinary income allocated to the limited partners is excluded from its e net earnings from self-employment because those partners are under state law limited partners. In addition, the partnership indicated the Tax Court could not inquire into the functional roles of the limited partners in a partnership level proceeding. The Tax Court noted that partnerships are required to include in their computation of net earnings from self-employment the distributive share of their partner's income.

However, Section 1402 (a) (13) excludes from the net income from self-employment computation a limited partner's distributive share of income. The Tax Court determined that the congressional intent for the limited partner exception was earnings associated with an investment nature with the limited partner is functioning as a limited partner. To ascertain whether the earnings allocated to limited partners were of an investment nature, the court must inquire as to the function and roles of the limited partners. Since the partnership was recorded Catholic net earnings from self-employment at the partnership level, any adjustment to the calculation would be made in a partnership level proceeding. In essence, the court has jurisdiction to determine whether ordinary income allocated to limited partners is to be excluded from net earnings from self-employment in the current partnership level proceeding. The Court rejected the partnership's argument that since it is a state law limited partnership and slimmer partners are characterized as such under state law that there distributive shares of income are excluded from an earnings is subject to self-employment tax. The court found that before the partners distribute shares to be excluded the court must ascertain whether the limited partners are functioning in that capacity as limited partners.

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.