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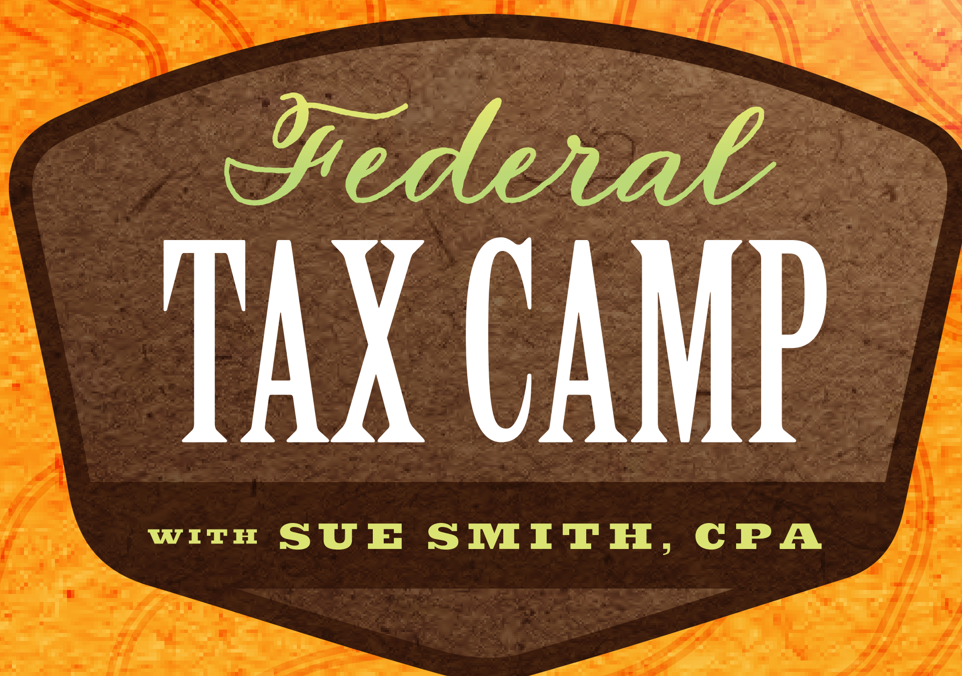

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Agenda

8:00 a.m.
Program Begins

12:00 - 1:00 p.m.
Lunch

4:00 p.m.
Program Ends

Tax practitioners have been hard-pressed to keep up with recent legislation and new IRS guidance. In this course, tax advisors will be fully updated on the most important legislative and regulatory developments of the season as well as major trends and changes in the case law, with a view toward planning considerations. This course is continually updated to reflect enacted legislation.

Highlights

- Comprehensive coverage of the Inflation Reduction Act of 2022 and the SECURE Act 2.0
- Timely coverage of breaking tax legislation
- Employee Retention Tax Credit updates
- Detailed analysis and examples of Sale of Passthrough Entity Interest and Net Investment Income Tax
- Form 1099-K reporting requirements
- The Gig Economy – Tax implications, Independent Contractor vs. Employee Classification, and the 2024 DOL Final Rule
- State of the IRS
- New FinCEN reporting requirements under the Corporate Transparency Act in 2024
- Practice aids, including all the numbers applicable for the current year – inflation-adjusted amounts, mileage rates, retirement contributions, and more
- Advanced practice, reporting, and other issues intertwined with advanced planning and discussion ideas

Questions during the conference?
Contact the CPE team:

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About the Speaker

Susan Smith, CPA

Surgent

Susan Smith, CPA, manages her own firm specializing in tax planning for individuals and business owners and is a frequent speaker at tax conferences. Prior to this, Smith was a senior manager in the tax departments of PwC LLP and Peat Marwick (the predecessor of KPMG LLP). While at PwC LLP she also held the national specialist designation for the real estate and partnership tax practices. During her time at Peat Marwick, Smith led the real estate and tax practices locally. She was also an associate adjunct professor at Widener University in the master's taxation program and received the James L. McCoy Discussion Leader of the Year Award for excellence in teaching in 2008 and 2019.

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2006:		2023:	
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– Tracy Lam
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Susan Smith, CPA
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Revised November 2024

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The SECURE 2.0 Act and The Inflation Reduction Act

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The SECURE 2.0 Act and The Inflation Reduction Act

Learning objective

Upon reviewing this material, the reader will be able to discuss the major provisions of The SECURE 2.0 Act and The Inflation Reduction Act.

I. The SECURE 2.0 Act of 2022

On December 29, 2022, President Biden signed the SECURE Act 2.0 of 2022 ("SECURE 2.0") into law as part of the Consolidated Appropriations Act, 2023. SECURE 2.0 expands on many retirement provisions included in the original Setting Every Community Up for Retirement Enhancement Act (SECURE 1.0), signed into law in 2019. SECURE 1.0 was the most significant retirement legislation passed in over a decade and included 30 provisions primarily aimed at expanding access to retirement savings programs. SECURE 2.0 includes over 100 retirement-related provisions, with major provisions outlined as follows.

A. Major provisions

1. Expanding automatic enrollment in retirement plans

Starting in 2025, SECURE 2.0 requires 401(k) and 403(b) plans to automatically enroll participants in the plans upon becoming eligible at an initial automatic enrollment amount of at least 3%, but not to exceed 10%. For each following year, the automatic enrollment amount is to increase by 1% until it reaches at least 10%, but not more than 15%. Employees may opt out of the plan participation within 90 days. Exceptions apply for small businesses (10 or fewer employees), new businesses (in business less than 3 years), church plans, and governmental plans. Additionally, all 401(k) and 403(b) plans established before December 29, 2022 are grandfathered.

Notice 2024-02 clarifies that a qualified cash or deferred arrangement (CODA) is established on the date plan terms providing for the CODA are adopted initially, even if the plan terms providing for the CODA are effective after the adoption date. For example, if an employer adopted a plan that included a qualified CODA on October 3, 2022, with an effective date of January 1, 2023, then the qualified CODA would have been established on October 3, 2022, even though the qualified CODA was not effective until after December 29, 2022.

Although many exceptions apply to the automatic enrollment requirement, it is important to note that this is a significant change, as prior to SECURE 2.0, 401(k) plans were permitted, but not required, to implement automatic enrollment.

The SECURE 2.0 automatic enrollment provision is effective for plan years beginning after December 31, 2024.

2. Modification of credit for small employer pension plan startup costs (Section 45E)

Prior to SECURE 2.0, the small business startup credit was equal to 50% of administrative costs, with a maximum annual credit limit of $5,000. SECURE 2.0 increased the percentage limitation from 50% to

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100% for employers with up to 50 employees. Employers with 51 to 100 employees are still subject to the 50% percentage limitation. An additional credit equal to a percentage of the amount contributed by the employer on behalf of employees is available, with a maximum limitation of $1,000 on a per-employee basis, provided the plan is not a defined benefit plan and the employer has 100 or fewer employees.

Essentially, under SECURE Act 2.0, the credit has two separate components:

- A qualified startup-cost portion available for the first three years of the plan's existence; and
- An employer-contribution portion, available for the first five years of the plan's existence.

The additional credit is phased out for employers with 51 – 100 employees. The phaseout is equal to 2% multiplied by the number of employees in excess of 50 multiplied by the amount of the credit. The applicable percentage of the additional credit is 100% in years one and two, 75% in year three, 50% in year four, 25% in year five, and no credit for tax years thereafter. The applicable percentage is based on the date the plan was established, not when employees begin to participate in the plan. No contributions with respect to any employee who receives wages from the employer for the taxable year in excess of $100,000 (as adjusted for inflation in multiples of $5,000) may be taken into account for purposes of the credit. The SECURE Act 2.0 modifications to the small business startup credit are applicable for tax years beginning after December 31, 2022.

3. Saver's Match

Under pre-SECURE 2.0 law, a nonrefundable credit is provided for certain individuals who make contributions to IRAs, employer retirement plans such as 401(k) plans, and ABLE accounts. SECURE 2.0 repeals and replaces this credit as it applies to IRAs and employer retirement plan contributions by changing the credit into a federal matching contribution that must be deposited into a taxpayer's IRA or retirement plan. The Saver's Match cannot be withdrawn without incurring penalties, and in certain cases, taxpayers may have to repay the Treasury Department if the Saver's Match is withdrawn prior to retirement. Dependents, full-time students, and nonresident aliens are not eligible for the Saver's Match.

Specifically, the match is equal to 50% of IRA or retirement plan contributions up to $2,000 per individual. A phaseout applies to taxpayers with MAGI as follows:

- Married Filing Jointly: $41,000 to $71,000;
- Head of Household: $30,750 to $53,250; and
- Single or Married Filing Separately: $20,500 to $35,500.

Taxpayers may designate a retirement account to receive the amount of the repaid Saver's Match. The new SECURE 2.0 provisions regarding the Saver's Match are effective for taxable years beginning after December 31, 2026.

4. Pooled Employer Plan modification

A pooled employer plan (PEP) is a 401(k) plan that allows unrelated businesses to participate in one plan managed by a pooled plan provider (PPP). The PPP is the fiduciary of the PEP and has discretion over plan administration and investments, which can reduce the administrative burden and risks for participating companies. SECURE 2.0 clarified that a PEP may designate a named fiduciary other than an employer in the plan to collect contributions to the plan. Such fiduciary would be required to implement written contribution collection procedures that are reasonable, diligent, and systematic. This change is effective for plan years beginning after December 31, 2022.

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5. Multiple Employer 403(b) Plans

A Multiple Employer Plan (MEP) is a retirement plan that is maintained by two or more unrelated employers that are not members of the same controlled group but are treated as part of the same plan. Traditionally, it has proven difficult for small business employers to offer retirement savings programs due to high costs and lack of resources. MEPs provide small businesses with the ability to obtain more favorable retirement plan investments with less expensive management services.

SECURE 1.0 made MEPs more attractive by eliminating outdated barriers to the use of MEPs and improving the quality of MEP service providers. SECURE 2.0 allows 403(b) plans, which are typically sponsored by charities, educational institutions, and non-profits, to participate in MEPs and PEPs. Additionally, SECURE 2.0 provides relief from the “one bad apple rule” so that the violations of one employer do not affect the tax treatment of employees of compliant employers. This change is effective for plan years beginning after December 31, 2022.

6. Increase in age for Required Beginning Date for mandatory distributions

SECURE 1.0 raised the age requirement for required minimum distributions (“RMDs”) from age 70 ½ to 72. This provision allowed individuals to let their retirement savings accumulate for a longer time period if they did not need to rely on retirement savings to cover living expenses. Under SECURE 1.0, the Required Beginning Date (“RBD”) was April 1 following the calendar year in which the IRA owner attained age 72.

SECURE 2.0 further increases the age requirement for RMDs to age 73 starting on January 1, 2023, and to age 75 starting on January 1, 2033. It is important to note that individuals can postpone taking their first RMD as long as they continue to work full or part time for the employer offering the plan.

The new SECURE 2.0 provision applies to distributions required to be made after December 31, 2022 for individuals who attain age 72 after such date.

Tax Year	Birth Date	RMD Age
Through 2019	Before July 1, 1949	70 ½
2020 through 2022	July 1, 1949, through 1950	72
2023 through 2032	1951 – 1959	73
2033 and beyond	1960 and beyond	75

On March 7, 2023, the IRS provided guidance regarding the new SECURE 2.0 changes to RMDs. IRA owners who attained age 72 in 2023 will not have an RMD for 2023. IRA owners who attained age 72 in 2023 will have a required beginning date of April 1, 2025, instead of April 1, 2024. SECURE 2.0 did not change the required beginning date for IRA owners who attained age 72 prior to January 1, 2023. IRA owners who attained age 72 in 2022 were required to take 2022 RMDs by April 1, 2023. [1]

Since financial institutions did not have sufficient time to incorporate SECURE 2.0 updates to their internal systems, Notice 2023-23 stated that the IRS would not consider RMD statements provided to an

[1] Notice 2023-23.

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IRA owner who attained age 72 in 2023 to have been provided incorrectly, provided the owner was notified by April 28, 2023 that no RMD was actually required for 2023.

Financial institutions also expressed concern that certain plan participants and IRA owners who would have been required to begin receiving RMDs for calendar year 2023 but for the new required beginning date provision under SECURE 2.0 (i.e., those who will attain age 72 in 2023) and who received distributions in 2023 could have had those distributions mischaracterized as RMDs (and therefore ineligible for rollover).

Notice 2023-54, released on July 14, 2023, granted relief relating to certain distributions made during 2023 to individuals that were characterized as RMDs but are not actually RMDs as a result of the new SECURE 2.0 provision. This relief applied with respect to any distribution made from a plan between January 1, 2023, and July 31, 2023, to a participant born in 1951 (or that participant's surviving spouse) that would have been an RMD but for the new required beginning date provision under SECURE 2.0. Additionally, Notice 2023-54 extended the 60-day rollover period for such distributions so that the deadline for rolling over such a distribution was September 30, 2023.

> ***Example***: Todd was born in 1951 and received a single-sum distribution in January 2023, part of which was treated as ineligible for rollover because it was mischaracterized as an RMD; Todd had until September 30, 2023, to roll over that mischaracterized part of the distribution.

Similarly, Notice 2023-54 extended the 60-day rollover period for certain IRA distributions made to an IRA owner (or the IRA owner's surviving spouse), so that the deadline for rolling over that portion of the distribution was September 30, 2023. The distributions that were subject to this extension were distributions made from an IRA between January 1, 2023, and July 31, 2023, to an IRA owner born in 1951 (or that individual's surviving spouse) that would have been RMDs but for the new required beginning date provision under SECURE 2.0. This rollover was permitted even if the IRA owner or surviving spouse rolled over a distribution within the last twelve months. It is important to note that making such a rollover of the portion of an IRA distribution mischaracterized as an RMD will preclude the IRA owner or surviving spouse from rolling over a distribution in the next twelve months. However, under this scenario, the individual could still make a direct trustee-to-trustee transfer.

7. Indexing IRA catch-up limit

Under pre-SECURE 2.0 law, the limit on IRA contributions is increased by $1,000 (not indexed for inflation) for individuals who have attained age 50. SECURE 2.0 indexes such limit and is effective for taxable years beginning after December 31, 2023.

8. Higher catch-up limit to apply at age 60, 61, 62, and 63

Under current law, employees who have attained age 50 are permitted to make catch-up contributions under a defined contribution retirement plan. The limit on catch-up contributions for 2024 is $7,500, except in the case of SIMPLE plans for which the limit is $3,500.

SECURE 2.0 increases these limits to the greater of $10,000 or 50 percent more than the regular catch-up amount in 2024 (2025 for SIMPLE plans) for individuals who have attained ages 60, 61, 62 and 63. The increased amounts are indexed for inflation after 2025. When the taxpayer reaches age 64, the catch-up contribution limit reverts to the normal amount. Additionally, SECURE 2.0 requires the catch-up

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contributions to be made as Roth contributions. However, an exception applies to workers with wages of $145,000 or less – they can continue to make traditional contributions.

The Roth catch-up provision applies only to qualified plans, including 401(k), 403(b), and 457(b) plans. Simple IRAs are not subject to this provision. By requiring all catch-up contributions to be Roth contributions for workers with wages in excess of $145,000, it ensures such taxpayers will pay tax on their catch-up contributions during high-earning years. Per SECURE 2.0, if an individual earned more than $145,000 (as indexed) in wages in the previous tax year with the same employer sponsoring the plan, he or she must make all catch-up contributions as Roth contributions. Under current wording, taxpayers that do not receive W-2 wages, such as partners or sole proprietors, may be exempt from this provision.

This new SECURE 2.0 provision was intended to be effective for taxable years beginning after December 31, 2024. On August 25, 2023, the IRS issued Notice 2023-62, providing additional guidance regarding implementation of the new SECURE 2.0 provisions and announcing a 2-year administrative transition period with respect to the requirement that catch-up contributions made on behalf of certain eligible participants be designated as Roth contributions. As a result of Notice 2023-62, the new requirement that any catch-up contributions made by higher income participants in 401(k) and similar retirement plans must be designated as after-tax Roth contributions is delayed until 2026. As such, for 2026, the compensation determination year will be 2025 (the preceding calendar year). Lastly, Notice 2023-62 clarifies that taxpayers with self-employment income do not have Social Security tax wages and thus are not subject to the requirement that catch-up contributions be made as Roth contributions, *regardless of the amount earned.*

It is important to note that some employer 401(k) plans do not allow for Roth contributions. As a result, if employees eligible for catch-up contributions earn over $145,000 in the prior year, they cannot make catch-up contributions if the employer plan does not allow for Roth contributions.

Example: Jody is 60 years old and had $200,000 in W-2 wages from her employer, ABC Corporation, in 2025. If Jody wants to make a catch-up contribution to her retirement account in 2026, she must make those catch-up contributions as Roth contributions since her wages were over the $145,000 threshold in 2025.

9. Treatment of student loan payments as elective deferrals for purposes of matching contributions

To assist employees who may be unable to save for retirement due to obligations to repay student loan debt, SECURE 2.0 permits such employees to receive matching contributions by reason of repaying their student loans. Specifically, SECURE 2.0 allows an employer to make matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA with respect to "qualified student loan payments (QSLPs)," defined as any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee but limited to the limitation applicable under §402(g) for the year (or, if lesser, the employee's compensation), reduced by the elective deferrals made by the employee for such year. The limitation under §402(g) for 2024 is $23,000. Employees must certify annually to the employer making the matching contribution that payment has been made on the loan.

Governmental employers are also permitted to make matching contributions in a §457(b) plan or another plan with respect to such repayments. For purposes of the nondiscrimination test applicable to elective contributions, SECURE 2.0 allows a plan to test separately the employees who receive matching

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contributions on student loan repayments. The new SECURE 2.0 provision is effective for contributions made for plan years beginning after December 31, 2023.

On August 19, 2024, the IRS released Notice 2024-63, providing guidance to assist plan sponsors in implementing QSLP match programs. The notice clarified that for a qualified education loan to be treated as incurred by an employee, the employee who makes a payment on the qualified education loan must have a legal obligation to make the payment under the terms of the loan. In general, a cosigner has a legal obligation to make payments under the terms of a loan, but, unless the primary borrower defaults under a loan, a guarantor does not have a legal obligation to make payments under the loan. For example, if an eligible employee is a cosigner on a qualified education loan for the employee's dependent, both the eligible employee and the dependent may have a legal obligation to make payments under the terms of the loan. However, only the individual who makes payments under the qualified education loan can receive a QSLP match on account of those payments.

To satisfy the §401(m)(4)(D)(ii) certification requirement with respect to a qualified education loan payment, the following items of information must be received by a plan (including a third-party service provider acting on behalf of the plan):

- The amount of the loan payment;
- The date of the loan payment;
- That the payment was made by the employee;
- That the loan being repaid is a qualified education loan and was used to pay for qualified higher education expenses of the employee, the employee's spouse, or the employee's dependent; and
- That the loan was incurred by the employee.

A QSLP match feature may be added to a §401(k) plan, a §403(b) plan, a SIMPLE IRA plan under §408(p), or a governmental §457(b) plan. Further, the notice clarifies that a plan cannot limit QSLP matches to qualified education loan payments for an employee's own education, for a particular degree program, or for attendance at a particular school. Notice 2024-36 applies for plan years beginning after December 31, 2024. For plan years beginning before January 1, 2025, a plan sponsor may rely on a good faith, reasonable interpretation of §110 of the SECURE 2.0 Act.

10. Application of credit for small employer pension plan startup costs to employers that join an existing plan

As discussed, a credit for small employer pension plan startup costs exists for employers joining an MEP. SECURE 2.0 ensures that this tax credit is available for three years for employers joining an MEP, regardless of how long the MEP has been in existence. Prior to SECURE 2.0, the small business may have only been entitled to a partial credit. For example, prior to SECURE 2.0, had an MEP been in existence for two years prior to the small business joining, the small business could only claim the credit for small employer pension plan startup costs for one year. SECURE 2.0 makes such small business employers joining an MEP (including PEPs) eligible for the credit for small employer pension plan startup costs for the full three years. This SECURE 2.0 provision is effective retroactively for taxable years beginning after December 31, 2019.

11. Military spouse retirement plan eligibility credit for small employers

As a result of military spouses often not remaining employed long enough to become eligible for their employer’s retirement plan or vest in employer contributions, SECURE 2.0 provides eligible small

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employers with a tax credit with respect to their defined contribution plans if they meet the following conditions:

- The small employer makes military spouses immediately eligible for plan participation within two months of hire;
- Immediately upon hire, the small employer makes the military spouse eligible for any matching or nonelective contribution that they would have been eligible for otherwise at two years of service; and
- The small employer makes the military spouse 100% vested in all employer contributions immediately.

For purposes of this credit, an eligible small employer is an employer that had no more than 100 employees who received at least $5,000 of compensation from the employer for the preceding year.

The military spouse retirement plan eligibility credit for small employers is equal to the sum of $200 per military spouse and 100% of all employer contributions (up to $300) made on behalf of the military spouse, for a maximum total credit amount of $500. The military spouse retirement plan eligibility credit for small employers can be taken for three years with respect to each military spouse. However, the credit does not apply to highly compensated employees. The military spouse retirement plan eligibility credit for small employers is effective for taxable years beginning after the date of enactment of SECURE 2.0.

12. Small immediate financial incentives for contributing to a plan

SECURE 2.0 permits employers to offer de minimis financial incentives, not paid for with plan assets, to increase employee participation in workplace retirement plans. A likely example of a de minimis financial incentive is a gift card of a low-dollar amount. Prior to SECURE 2.0, employers could provide matching contributions as an employee incentive to contribute to a workplace retirement plan; however, employers were prohibited from providing immediate financial incentives. This new SECURE 2.0 provision is effective for plan years beginning after the date of enactment.

SECURE 2.0 failed to define a "de minimis financial incentive." Notice 2024-02, issued December 20, 2023, provides the following clarifications:

- Legislative history mentions gift cards in small amounts as an example of a de minimis financial incentive an employer might offer to boost employee participation in workplace retirement plans.
- A financial incentive is considered a de minimis financial incentive only if it does not exceed $250 in value.
- A matching contribution cannot be a de minimis financial incentive.
- If an employee receives a de minimis financial incentive, it is considered compensation and must be included in the employee's gross income and wages.

13. Deferral of tax for certain sales of employer stock to employee stock ownership plan sponsored by S corporation

IRC §1042 provides that an individual owner of stock in a non-publicly traded C corporation that sponsors an Employee Stock Ownership Plan (ESOP) may elect to defer the recognition of gain from the sale of such stock to the ESOP if the seller reinvests the sales proceeds into qualified replacement property, such as stock or other securities issued by a U.S. operating corporation. After the sale, the ESOP must own at least 30% of the employer corporation's stock. SECURE 2.0 expands the gain deferral with a 10

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percent limit on the deferral to sales of employer stock to S corporation ESOPs. This new SECURE 2.0 provision is effective for sales made after December 31, 2027.

14. Allows additional nonelective contributions to SIMPLE plans

Employers with SIMPLE plans are required to make employer contributions of either two percent of compensation or three percent of employee elective deferral contributions. SECURE 2.0 permits an employer to make additional contributions to each employee of the plan in a uniform manner, provided that the contribution does not exceed the lesser of up to 10 percent of compensation or $5,000 (as indexed for inflation). This new SECURE 2.0 provision is effective for taxable years beginning after December 31, 2023.

15. Contribution limit for SIMPLE plans

Under pre-SECURE 2.0 law, the annual contribution limit for employee elective deferral contributions to a SIMPLE IRA plan is $16,000 (as indexed for inflation in 2024) and the catch-up contribution limit beginning at age 50 is $3,500 (as indexed for inflation in 2024). Additionally, under pre-SECURE 2.0 law, the small employer (under 100 employees) of a SIMPLE IRA is required to either make matching contributions on the first three percent of compensation deferred or an employer contribution of two percent of compensation (regardless of whether the employee elects to make contributions).

Under SECURE 2.0, the annual deferral limit and the catch-up contribution at age 50 is increased by 10 percent for employers with no more than 25 employees. Under SECURE 2.0, an employer with 26 to 100 employees is permitted to provide higher deferral limits, but only if the employer either provides a four percent matching contribution or a three percent employer contribution. These changes are effective for taxable years beginning after December 31, 2023.

16. Tax treatment of certain nontrade or business SEP contributions

Under SECURE 2.0, employers of domestic employees (such as nannies) are allowed to provide retirement benefits for such employees under a Simplified Employee Pension (“SEP”). This provision is effective for limitation years ending after the date of enactment.

17. Exemption for certain automatic portability transactions

Under pre-SECURE 2.0 law, an employer is permitted to distribute a participant’s account balance without participant consent if the balance is under $5,000 and the balance is immediately distributable, such as after termination of employment. Additionally, employers are required to roll over such distribution into a default IRA if the account balance is at least $1,000 and the participant does not elect otherwise.

SECURE 2.0 allows a retirement plan service provider to provide employer plans with automatic portability services, including the automatic transfer of a participant’s default IRA (established in connection with a distribution from a former employer’s plan) into the participant’s new employer’s retirement plan, unless the participant elects otherwise. This new SECURE 2.0 provision is effective for transactions occurring on or after 12 months after the date of enactment.

18. Starter 401(k) plans for employers with no retirement plan

SECURE 2.0 allows employers that do not sponsor a retirement plan to offer a starter 401(k) plan or safe harbor 403(b) plan. These plans generally require that all employees be default enrolled in the plan at a 3% to 15% of compensation deferral rate, with a maximum limit on annual deferrals of $7,000 (as indexed for inflation in 2024) with an additional $1,000 in catch-up contributions beginning at age 50. Employers

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may not make matching or nonelective contributions to the starter 401(k) plan. This provision intends to help more individuals save for retirement by making it easier for more employers, such as small employers, to offer retirement plans. This new provision is effective for plan years beginning after December 31, 2023.

19. Assist states in locating owners of applicable savings bonds

Sometimes there are owners of matured and unredeemed savings bonds. SECURE 2.0 requires the Treasury Secretary to share certain relevant information with a state that relates to an applicable savings bond registered to an owner with a last known or registered address in that state. In turn, the state may use this information to locate the registered owner in accordance with the state's standards for recovery of abandoned property. This new SECURE 2.0 provision is effective as of the date of enactment.

20. Certain securities treated as publicly traded in case of employee stock ownership plans

SECURE 2.0 permits certain on-exchange traded securities to qualify as "publicly traded employer securities" provided the following conditions are met:

- The security is subject to priced quotations by at least four dealers on a Securities and Exchange Commission-regulated interdealer quotation system;
- The security is not a penny stock and is not issued by a shell company; and
- The security has a public float of at least 10 percent of outstanding shares.

Additionally, if securities are issued by domestic corporations, the issuer must publish annual audited financial statements. Additional depository and reporting requirements apply to securities issued by foreign corporations. As a result of the new SECURE 2.0 provision, highly regulated companies with liquid securities that are quoted on non-exchange markets will be able to treat their stock as "public" for ESOP purposes, thereby making it easier for companies to offer ESOPs to their U.S. employees. This new SECURE 2.0 provision is effective for plan years beginning after December 31, 2027.

21. Modification of age requirement for qualified ABLE programs

ABLE programs are tax-advantaged savings programs for certain individuals with disabilities. SECURE 2.0 increases the age by which blindness or disability must occur for an individual to be an eligible individual by reason of such blindness or disability for an ABLE program. Prior to SECURE 2.0, the individual's disability or blindness had to occur before age 26, but SECURE 2.0 increases the age requirement to age 46. This new SECURE 2.0 provision is effective for taxable years beginning after December 31, 2025.

22. Improving coverage for part-time workers

SECURE 1.0 expanded 401(k) access to part-time employees for plan years beginning after December 31, 2020. Prior to SECURE 1.0, employers could exclude these employees from their defined contribution plans. SECURE 1.0 required qualified plans to include: 1) long-term, part-time employees who have worked at least 500 hours per year in the past three consecutive years (provided employee was at least 21 years of age at end of three-year period); or 2) employees who have completed one year of service with over 1,000 hours of service. Once the employee satisfies the age and service requirements, the employee must be eligible to participate in the employer plan no later than the earlier of: 1) the first day of the first plan year beginning after the date on which the employee satisfied the age and service requirements; or 2) the date six months after the date on which the individual satisfied these requirements.

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SECURE 2.0 reduces the three-year service requirement to two years, effective for plan years beginning after December 31, 2024.

23. Special rules for certain distributions from long-term qualified tuition programs to Roth IRAs

SECURE 2.0 permits beneficiaries of 529 college savings accounts to rollover up to $35,000 over the course of their lifetime from any 529 account in their name to their Roth IRA. Such rollovers are subject to Roth IRA annual contribution limits, and the 529 account must have been open for more than 15 years. Additionally, the rollover cannot exceed the total amount contributed to the account more than five years before the rollover. Roth income limit restrictions are not applicable to the 529 plan Roth conversion.

As a result of this new provision, individuals will have the option to avoid the penalty on a non-qualified withdrawal of leftover 529 plan funds. This new SECURE 2.0 provision applies to distributions after December 31, 2023.

24. Emergency savings accounts linked to individual account plans

SECURE 2.0 allows (but does not require) employers to offer non-highly compensated employees Pension-Linked Emergency Savings Accounts (PLESAs) beginning after Dec. 31, 2023.[2]
This provision was enacted to deter individuals from taking funds from their retirement savings in the event of an emergency. PLESAs are treated as designated Roth accounts. Employers may automatically opt employees into these emergency savings accounts of up to three percent of their salary. Any portion of an account attributable to the employee's contribution is capped at $2,500 (or lower as set by the employer). Once the cap is reached, the additional contributions can either be directed to the employee's Roth defined contribution plan (if they have one) or stopped until the balance attributable to contributions falls below the cap. Participants can withdraw funds held in the PLESA at least once a month, as necessary. If a non-highly compensated employee becomes a highly compensated employee, contributions to the emergency savings account must cease. However, such employees would not be required to immediately distribute the balance of their emergency savings account. Employees that cease employment may take the emergency savings account as cash or roll it into their Roth defined contribution plan or IRA.

25. Enhancement of 403(b) plans

Under pre-SECURE 2.0 law, 403(b) plan investments are generally limited to annuity contracts and publicly traded mutual funds. SECURE 2.0 allows 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs, effective after the date of enactment.

26. Reduction in excise tax on certain accumulations in qualified retirement plans

Under pre-SECURE 2.0 law, the excise tax on the failure to take RMDs is 50% of the amount by which the RMD exceeds the actual amount distributed during the calendar year. SECURE 2.0 reduces the excise tax amount from 50% to 25%. Additionally, if the failure to take an RMD is corrected in a "timely manner," defined as within two years, the excise tax is reduced from 25% to 10%. This new provision is effective for taxable years beginning after the date of enactment.

27. Retirement savings lost and found

SECURE 2.0 establishes a national online searchable lost and found database for Americans' retirement plans. The Retirement Savings Lost and Found shall:

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[2] IR 2024-11.

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- Allow an individual to search for information that enables the individual to locate the administrator of any plan in respect to which the individual is or was a participant or beneficiary, and provide contact information for the administrator of any such plan;
- Allow the IRS to assist such an individual in locating any such plan of the individual; and
- Allow the IRS to make any necessary changes to contact information on record for the administrator based on any changes to the plan due to merger or consolidation of the plan with any other plan, division of the plan into two or more plans, bankruptcy, termination, change in name of the plan, change in name or address of the administrator, or other causes.

The creation of the database must occur by December 29, 2024.

On April 15, 2024, the DOL announced that its Employee Benefits Security Administration (EBSA) is proposing to collect information from plan administrators on a voluntary basis to establish this online searchable database. The notice of proposed information collection asks plan administrators to provide the information voluntarily, and it proposes that plan administrators can attach the requested information to their 2023 Form 5500, *Annual Return/Report of Employee Benefit Plan*, once they receive instructions on how to do so.[3]

28. Updating dollar limit for mandatory distributions

Under pre-SECURE 2.0 law, employers could transfer former employees' retirement accounts from a workplace retirement plan into an IRA if their balances were between $1,000 and $5,000. SECURE 2.0 increases the limit from $5,000 to $7,000, effective for distributions made after December 31, 2023.

29. One-time election for qualified charitable distribution to split-interest entity; increase in qualified charitable distribution limitation

SECURE 2.0 allows for a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts, effective for distributions made in taxable years beginning after the date of enactment of this Act. Additionally, SECURE 2.0 indexes for inflation the annual IRA charitable distribution limit of $100,000, effective for distributions made in taxable years ending after the date of enactment.

30. Repayment of qualified birth or adoption distribution limited to three years

Individuals who receive a distribution from their retirement plan in connection with a birth or adoption may recontribute the distribution. SECURE 2.0 limits the recontribution period to three years. This new SECURE 2.0 provision is effective for distributions made after the date of the enactment and retroactively to the three-year period beginning on the day after the date on which such distribution was received.

31. Employer may rely on employee certifying that deemed hardship distribution conditions are met

SECURE 2.0 permits employees to self-certify that deemed hardship distribution conditions are met in the event that they take a hardship withdrawal, provided certain requirements are met. In determining whether a distribution is on account of the hardship of an employee, the administrator of the plan may rely on an employee's written certification that the distribution is:

[3] 89 FR 26932.

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- On account of a financial need of a type that is deemed in regulations prescribed by the Secretary to be an immediate and heavy financial need;
- Not in excess of the amount required to satisfy such financial need; and
- Because the employee has no alternative means reasonably available to satisfy such financial need.

This provision is effective for plan years beginning after the date of enactment.

32. Individual retirement plan statute of limitations for excise tax on excess contributions and certain accumulations

Under pre-SECURE 2.0 law, the statute of limitations for excise taxes imposed on excess contributions or RMD failures started running as of the date Form 5329, *Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts*, was filed for the violation. Sometimes individuals were not aware of the requirement to file Form 5329, leading to an indefinite period of limitations and accumulation of interest and penalties.

SECURE 2.0 institutes a three-year period of limitations beginning when the taxpayer files Form 1040 for the year of violation. An exception applies in the case of excess contributions, which has a six-year period of limitations from the date of filing Form 1040. These changes were implemented by SECURE 2.0 to ensure that there is a reasonable period of limitations, and they are effective as of the date of enactment.

33. Withdrawals for certain emergency expenses

Under IRC §72(t), a 10% early withdrawal penalty typically applies to early distributions from tax-preferred retirement accounts unless an exception exists. SECURE 2.0 provides a new exception for certain distributions used for emergency expenses, defined as unforeseeable or immediate financial needs relating to personal or family emergency expenses. Only one distribution of up to $1,000 is permissible per year, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions may be made during the three-year repayment period unless repayment occurs. The new SECURE 2.0 IRC §72(t) exception applies for distributions made after December 31, 2023.

34. Penalty-free withdrawal from retirement plans for individual case of domestic abuse

SECURE 2.0 provides that individuals self-certifying that they experienced domestic abuse may withdraw the lesser of $10,000 (as indexed for inflation) or 50% of the participant's account. A distribution is treated as an eligible distribution to a domestic abuse victim if such distribution is from an applicable eligible retirement plan and is made to an individual during the one-year period beginning on any date on which the individual is a victim of domestic abuse by a spouse or domestic partner.

The individual may choose to repay such amount over a three-year period and will be refunded income taxes on any amount that is repaid. Additionally, such distribution is not subject to the 10% tax on early distributions. This new SECURE 2.0 provision is effective for distributions made after December 31, 2023.

35. Exception to penalty on early distributions from qualified plans for individuals with a terminal illness

SECURE 2.0 institutes an exception to the 10% penalty on early distributions in the case of distributions made to a terminally ill individual. SECURE 2.0 modifies the definition of a terminally ill individual under §101(g)(4)(A) to be "an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 84 months or less after the date of the

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certification." An employee shall not be considered a terminally ill individual unless such employee furnishes sufficient evidence to the plan administrator in such form and manner as the Secretary may require. Such provision is effective for distributions made after the date of enactment.

36. Special rules for use of retirement funds in connection with qualified federally declared disasters

SECURE 2.0 provides that affected individuals may have up to $22,000 distributed from employer retirement plans or IRAs in the case of a federally declared disaster. Specifically, a "qualified disaster recovery distribution" means any distribution made on or after the first day of the incident period of a qualified disaster and before the date that is 180 days after the applicable date with respect to such disaster and to an individual whose principal place of abode at any time during the incident period of such qualified disaster is located in the qualified disaster area with respect to such qualified disaster and who has sustained an economic loss by reason of such qualified disaster. A "qualified disaster" is any disaster with respect to which a major disaster has been declared by the President of the United States under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Act after December 27, 2020. However, a "qualified disaster area" does not include any area which is a qualified disaster area solely by reason of Section 301 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020. Lastly, the "incident period" refers to the period specified by the Federal Emergency Management Agency as the period during which such disaster occurred.

Distributions in connection with qualified federally declared disasters are not subject to the 10% penalty on early distributions and may be taken into account as gross income over a three-year period. Distributions may be repaid to the tax-preferred retirement account. This SECURE 2.0 provision is effective for disasters occurring on or after January 26, 2021.

37. Elimination of additional tax on corrective distributions of excess contributions

If an individual contributes too much to an IRA, a corrective distribution must be made for the excess contribution amount and any earnings allocable to that contribution. SECURE 2.0 exempts this excess contribution amount and related earnings allocable to the contribution from the 10% penalty on early distributions, effective as of the date of enactment.

38. Long-term care contracts purchased with retirement plan distributions

SECURE 2.0 provides that retirement plans may distribute up to $2,500 annually (as adjusted for inflation) for certain long-term care insurance contract premium payments, and such distributions are exempt from the 10% penalty on early distributions. This new provision is effective three years after the date of enactment.

39. Roth plan distribution rules

Under pre-SECURE 2.0 law, owners of Roth-designated employer retirement plan accounts, such as 401(k) plans, were required to take pre-death distributions. SECURE 2.0 eliminates this requirement, effective for taxable years beginning after December 31, 2023. Prior to SECURE 2.0, individuals with Roth-designated employer retirement plan accounts would have to transfer such accounts to a Roth IRA in order to avoid taking RMDs. In other words, individuals with Roth-designated employer retirement plan accounts are required to take RMDs, just as individuals are not required to take RMDs from Roth IRAs.

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40. Surviving spouse election to be treated as employee

SECURE 2.0 provides that a surviving spouse may elect to be treated as their deceased spouse for purposes of the RMD rules, effective for calendar years beginning after December 31, 2023. As a result, a surviving spouse that is older than the decedent spouse may use the decedent spouse's age to delay the RMD until the start date in which the decedent spouse would have been required to take an RMD.

41. SIMPLE and SEP Roth IRAs

Under pre-SECURE 2.0 law, generally all plans that allow pre-tax employee contributions are permitted to accept Roth contributions except SIMPLE IRAs. Additionally, aside from grandfathered salaried reduction simplified employee pension plans, under pre-SECURE 2.0 law, SEPs can only accept employer money and not on a Roth basis. SECURE 2.0 allows SIMPLE IRAs to accept Roth contributions and allows employers to offer employees the ability to treat employee and employer SEP contributions as Roth in whole or in part. These SECURE 2.0 changes are effective for taxable years beginning after December 31, 2022.

42. Elective deferrals generally limited to regular contribution limit

Under pre-SECURE 2.0 law, catch-up contributions to a qualified retirement plan could be made on a pre-tax or Roth basis if permitted by the plan sponsor. SECURE 2.0 provides that all catch-up contributions to qualified retirement plans are subject to Roth tax treatment, effective for taxable years beginning after December 31, 2023. An exception applies for highly compensated employees.

43. Optional treatment of employer matching or nonelective contributions as Roth contributions

Under pre-SECURE 2.0 law, plan sponsors were not permitted to provide employer matching or nonelective contributions in their 401(k), 403(b), and governmental 457(b) plans on a Roth basis. In other words, matching contributions could only be made on a pre-tax basis. Prior to SECURE 2.0, certain plan participants could elect to convert vested account balances (including any employer matching and non-elective contributions) by utilizing a Roth in-plan conversion. In order to convert any vested account balances, the plan sponsor had to offer the Roth in-plan conversion option. In other words, prior to SECURE 2.0, plan participants could essentially receive employer matching and nonelective contributions on a Roth basis through the Roth in-plan conversion.

SECURE 2.0 permits defined contribution plans to provide participants with the *option* of receiving matching or nonelective contributions on a Roth basis, effective on the date of enactment. However, such employer contributions may only be made on a Roth basis if the contribution is nonforfeitable, meaning the plan sponsor must fully vest such matching or nonelective contributions. Additionally, Notice 2024-02 clarifies that to the extent a plan permits an employee to designate matching contributions or nonelective contributions as Roth contributions, an employee must have an effective opportunity to make (or change) that designation at least once during each plan year. Further, Notice 2024-02 states that a matching contribution may be designated as a Roth contribution only if the employee is fully vested in matching contributions at the time the contribution is allocated to the employee's account.

It is important to note that providing employer contributions to a Roth account could create withholding issues, as employer contributions made on a Roth basis are subject to income tax at the time contributed.

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II. The Inflation Reduction Act -- Background

The Inflation Reduction Act (IRA) signed into law by President Biden on August 16, 2022, includes an estimated $369 billion in expenditures related to clean energy and energy security, the largest investment in the climate in U.S. history. This chapter will discuss major provisions outlined in the IRA.

A. Major provisions

1. Corporate Alternative Minimum Tax - Minimum Tax on Corporate Book Income

The IRA imposes a 15% minimum tax on corporate book income for applicable corporations with profits over $1 billion, effective for tax years beginning after December 31, 2022. For purposes of this minimum tax, book income is the adjusted financial statement income (net income or loss) that corporations report to their investors. The minimum tax will only apply if it exceeds the taxpayer's regular tax (including BEAT) for the year, prior to taking into account general business credits under §38.

The IRA amends §59 to define an applicable corporation as "with respect to any taxable year, any corporation (other than an S corporation, a regulated investment company, or a real estate investment trust) which meets the average annual adjusted financial statement income test for one or more taxable years, which are: i) prior to such taxable year; and ii) end after December 31, 2021. In other words, the tax may be imposed on both public and private C corporations. Additionally, the tax applies to large private equity firms organized as partnerships but excludes portfolio companies owned by these firms.

An applicable financial statement for purposes of the minimum tax is defined under §451(b)(3) as:

1) A financial statement which is certified as being prepared in accordance with generally accepted accounting principles and which is:
    a. A 10–K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the United States Securities and Exchange Commission;
    b. An audited financial statement of the taxpayer which is used for:
        i. Credit purposes;
        ii. Reporting to shareholders, partners, other proprietors, or beneficiaries; or
        iii. Any other substantial nontax purpose; or
    c. Filed by the taxpayer with any other federal agency for purposes other than federal tax purposes, but only if there is no statement of the taxpayer described in a or b above.
2) A financial statement which is made on the basis of international financial reporting standards and is filed by the taxpayer with an agency of a foreign government which is equivalent to the United States Securities and Exchange Commission and which has reporting standards not less stringent than the standards required by such Commission, but only if there is no statement of the taxpayer described in "1" above.
3) A financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary, but only if there is no statement of the taxpayer described in either "1" or "2" above.

Special adjustments to adjusted financial statement income will apply in the following scenarios:

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1) **Consolidated Financial Statements:** Adjustments must be made when an applicable financial statement covers a period other than the taxable year (i.e., a fiscal year applicable financial statement).

2) **Related Entities:** Special adjustments apply to related entities, including:

   a. **Consolidated Returns:** When the taxpayer is part of an affiliated group of corporations filing a consolidated return for any taxable year, the adjusted financial statement income for such taxable year shall take into account items on the group's applicable financial statement which are properly allocable to members of such group.

   b. **Dividends:** If a corporation is not included on a consolidated return with the taxpayer, adjusted financial statement income of the taxpayer with respect to the other corporation is determined by only taking into account the dividends received from the other corporation and other amounts includible in gross income or deductible as a loss, other than amounts required to be included under §§951 and 951A (subpart F or GILTI inclusions).

   c. **Partnerships:** If a corporation is a partner in a partnership, adjusted financial statement income of the taxpayer with respect to the partnership will only take into account the corporation's distributive share of adjusted financial statement income of the partnership.

      i. The adjusted financial statement income of the partnership is the partnership's net income or loss on the partnership's applicable financial statement.

3) **Adjustments to take into account certain items of foreign income**:

   a. If for any taxable year, a taxpayer is a U.S. shareholder of one or more Controlled Foreign Corporations (CFCs), the adjusted financial statement income of such taxpayer with respect to such CFC should be adjusted to take into account the taxpayer's pro rata share of items taken into account in computing the net income or loss set forth on the applicable financial statement of such CFC.

      i. If any of such adjustments made as a result of "a" above would result in a negative adjustment, such adjustment would not be taken into account to reduce the corporation's adjusted financial statement income for the taxable year. Instead, the amount of the adjustment determined for the succeeding taxable year (if positive) would be reduced by an amount equal to the negative adjustment.

4) **Effectively Connected Income:** In the case of a foreign corporation, the principles of §882 apply to determine adjusted financial statement income, meaning only income effectively connected with the conduct of a U.S. trade or business is taken into account on the taxpayer's applicable financial statement.

5) **Adjustments for Certain Taxes:** Adjusted financial statement income should be appropriately adjusted to disregard any federal income taxes, or income, war profits, or excess profits taxes with respect to a foreign country or possession of the United States, which are taken into account on the taxpayer's applicable financial statement, unless taxpayer did not choose to claim the credit on foreign taxes (subpart A of part III of subchapter N) for the taxable year.

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6) **Adjustment with respect to disregarded entities:** Adjusted financial statement income shall be adjusted to take into account any adjusted financial statement income of a disregarded entity owned by the taxpayer.
7) **Cooperatives:** In the case of a cooperative to which §1381 applies the adjusted financial statement income shall be reduced by amounts referred to in §1382(b) relating to patronage dividends and per-unit retain allocations, to the extent such amounts were not otherwise taken into account in determining adjusted financial statement income.
8) **Alaska Native Corporations:** Certain adjustments are made to adjusted financial statement income for Alaska Native Corporations.
9) **Tax-exempt entities:** In the case of a tax-exempt corporation, adjusted financial statement income shall be appropriately adjusted to take into account any adjusted financial statement income of an unrelated trade or business, or derived from debt-financed property to the extent income from such property is treated as unrelated business taxable income.
10) **Depreciation:** With respect to depreciation, adjusted financial statement income shall be:
    a. Reduced by depreciation allowed under §167 to property to which §168 applies, to the extent of the amount allowed as deductions in computing taxable income for the tax year; and
    b. Adjusted to disregard any amount of depreciation expense that is taken into account on the taxpayer's applicable financial statement with respect to such property.

If after applying the adjustments above, the corporation's adjusted financial statement income is negative for taxable years ending after December 31, 2019, the corporation may carry forward the financial statement NOL indefinitely to reduce future adjusted financial statement income. Financial statement NOL carryovers are not taken into account for purposes of the Average Annual Adjusted Financial Statement Income Test.

Adjusted financial statement income shall be reduced by an amount equal to the lesser of:

- The aggregate amount of financial statement NOL carryovers to the taxable year; or
- 80% of adjusted financial statement income computed without regard to the deduction for financial statement NOL.

Specifically, the tentative minimum tax under the IRA is equal to the excess of:

- 15% of the adjusted financial statement income for the taxable year as determined under §56A, over
- The corporate AMT foreign tax credit for the taxable year.

Per the IRA, the corporation will be able to offset the amount of book minimum tax paid against its regular tax liability in a future year. However, the credit cannot reduce a future year's tax liability below the computed corporate alternative minimum tax for that year.

As discussed, the IRA outlines an "Average Annual Adjusted Financial Statement Income Test," stating that a corporation meets the Average Annual Adjusted Financial Statement Income Test for a taxable year if:

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- **In the case of a U.S. corporation,** the average annual adjusted financial statement income of such corporation, determined without regard to §56A(d) for the three-taxable-year period ending with such taxable year exceeds $1 billion; and
- **In the case of a foreign-parented multinational group**, such corporation meets the average annual adjusted financial statement income test for a taxable year if:
  - The corporation meets the average annual adjusted financial statement income of such corporation, determined without regard to §56A(d) for the three-taxable-year period ending with such taxable year exceeds $1 billion; and
  - The average annual adjusted financial statement income of such corporation determined without regard to §56A(d) for the three-taxable-year period ending with such taxable year exceeds $100 million.

The IRA states that a foreign-parented multinational group is, with respect to any taxable year, two or more entities if:

- At least one entity is a domestic corporation and another entity is a foreign corporation;
- Such entities are included in the same applicable financial statement with respect to such year; and
- Either:
  - The common parent of such entities is a foreign corporation; or
  - If there is no common parent, the entities are treated as having a common parent which is a foreign corporation.

A late-breaking amendment to the bill revised the application of the $1 billion income threshold to ensure that the provision does not apply to unrelated companies that are otherwise below the threshold but that are under common ownership of an investment fund, where the aggregation of their earnings might have put them above the threshold. There was discussion of changing the $10,000 SALT limitation; however, the $10,000 limitation on the deduction for state and local taxes remains in place through 2025, as under current law. Instead, this amendment was paid for by extending the excess business loss limitation provision under §461(l) for two additional years. The TCJA excess business loss limitation provision was originally set to sunset as of December 31, 2025. However, ARPA extended the excess business loss provision for an additional year, through December 31, 2026. As such, under the IRA, §461(l) applies for tax years beginning after December 31, 2020, and before January 1, 2029.

If a corporation meets the Average Annual Adjusted Income Test in any year, the minimum tax on corporate book income continues to apply unless:

- The corporation experiences a change in ownership;
- Such corporation does not satisfy the Average Annual Adjusted Financial Statement Income Test for a specified number of consecutive years (to be determined by the Treasury); or
- The Treasury Department determines that it is no longer appropriate to apply such minimum tax to the corporation.

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Practice note: Impact of the Minimum Tax

> Corporations may be subject to the new alternative minimum tax if they have significant permanent or temporary tax differences that result in a higher financial statement income than taxable income.

2. Tax on stock buybacks

The IRA imposes a one-percent excise tax on a publicly traded U.S. corporation on the fair market value of any of its stock that is repurchased by the corporation during the taxable year, subject to certain exceptions. Under the netting rule, the amount of these repurchases is reduced by the FMV of any issuances of the covered corporation's stock during the covered corporation's taxable year, including the FMV of any stock issued or provided to employees of the covered corporation or employees of a specified affiliate of the covered corporation during the taxable year. "Repurchase" refers to corporate redemptions under §317(b) and can include "economically similar" transactions as determined by the Secretary. The repurchases subject to this excise tax are reduced by the value of any new issuance to the public and stock issued to the employees of the corporation.

Repurchases facilitated through a subsidiary of publicly traded companies would also result in excise tax treatment; a subsidiary is any corporation or partnership which is owned more than 50% directly or indirectly by the covered corporation. For purposes of the excise tax, the acquisition of stock of a covered corporation by a specified affiliate of the covered corporation, from a person who is not the covered corporation or a specified affiliate of the covered corporation, is treated as a repurchase of the stock of the covered corporation by the covered corporation. A specified affiliate is defined as, with regard to any corporation:

- Any corporation more than 50 percent of the stock of which is owned (by vote or by value), directly or indirectly, by the corporation; and
- Any partnership more than 50 percent of the capital interests or profits interests of which is held, directly or indirectly, by the corporation.

The following transactions are specifically excluded from excise tax:

- Tax-free reorganizations (§368(a));
- Aggregate annual repurchases that do not exceed $1 million;
- Repurchases treated as stock dividends;
- Repurchases contributed to ESOPs or similar plans;
- Repurchases by dealers in securities; and
- Repurchases by RICs/REITs.

The excise tax on repurchase of corporate stock does not apply to purchases by a dealer in securities in the ordinary course of business. The excise tax is not deductible for income tax purposes. The excise tax applies to repurchases of stock after December 31, 2022.

On June 29, 2023, the IRS issued Announcement 2023-18, which specified that until specific deadlines were outlined in future regulations, taxpayers were exempt from both reporting and paying the new excise tax, as well as from penalties related to the failure to file or pay this excise tax. On January 17, 2023, the Treasury Department and the IRS published Notice 2023-2 to provide initial guidance on the application of the stock repurchase excise tax. The notice described certain operating rules for purposes of the stock repurchase excise tax, along with anticipated rules for reporting and paying any liability for the stock repurchase excise tax. On April 9, 2024, the IRS and Department of the Treasury issued proposed regulations (REG-115710-22), offering guidance on the recently implemented 1% excise tax on corporate

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stock buybacks. The IRS and Department of the Treasury simultaneously introduced proposed regulations (REG-118499-23) intended to offer guidance on the reporting and payment procedures associated with this new excise tax.

The proposed regulations clarify that the stock repurchase excise tax applies to preferred stock in the same manner as to common stock. Additionally, stock is treated as issued or provided by a covered corporation at the time at which, for federal income tax purposes, ownership of the stock transfers to the recipient. The FMV of stock of a covered corporation that is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation is the market price of the stock on the date the stock is repurchased or acquired. In other words, if the price at which the repurchased or acquired stock is purchased differs from the market price of the stock on the date the stock is repurchased or acquired, the FMV of the stock is the market price on the date the stock is repurchased or acquired.

The following are acceptable methods for determining the market price of repurchased or acquired stock of a covered corporation traded on an established securities market:

- The daily volume-weighted average price as determined on the date the stock is repurchased by the covered corporation or acquired by a specified affiliate of the covered corporation;
- The closing price on the date the stock is repurchased by the covered corporation;
- The average of the high and low prices on the applicable date the stock is repurchased by the covered corporation; or
- The trading price at the time of the issuance or repurchase by the covered corporation.

Generally, the covered corporation must consistently apply one of these methods to all stock repurchased by the covered corporation or acquired by a specified affiliate throughout the taxable year.

Per the proposed regs, which largely substantiated guidance from Notice 2023-2, any covered corporation engaging in a stock repurchase after December 31, 2022 must submit the following forms as part of the stock repurchase excise tax return:

- Form 720, *Quarterly Federal Excise Tax Return*, on which the stock repurchase excise tax liability is reported; and
- Form 7208, *Excise Tax on Repurchase of Corporate Stock*, which details the excise tax calculation.

The obligation to submit these forms extends to all covered corporations who made a repurchase during the taxable year (i.e., there is no de minimis filing threshold).

With respect to a covered corporation that has a taxable year ending after December 31, 2022, and on or before the date of publication of final regulations in the Federal Register, the stock repurchase excise tax return for such taxable year would be required to be filed by the due date of the Form 720 for the first full calendar quarter after the date of publication of final regulations in the Federal Register. In other words, reporting and payment of the excise tax liability will only be required by the due date of Form 720 for the first full calendar quarter after the date of publication of final regulations in the Federal Register.

Example: Covered corporation ABC had a taxable year ending December 31, 2023. If the date of publication of final regulations in the Federal Register was September 16, 2024, the corporation ABC would be required to file the stock repurchase excise

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tax return for its 2023 taxable year by January 31, 2025 (the due date of the Form 720 for the calendar quarter ending December 31, 2024).

With respect to a covered corporation that has a taxable year ending **after** the date of publication of final regulations in the Federal Register, the stock repurchase excise tax return for such taxable year would be required to be filed by the due date of the Form 720 for the first full calendar quarter of the taxable year of the covered corporation.

Example: Covered corporation ABC had a taxable year ending December 31, 2024. If the date of publication of final regulations in the Federal Register was September 16, 2024, the corporation ABC would be required to file the stock repurchase excise tax return for its 2024 taxable year by April 30, 2025 (the due date of the Form 720 for the calendar quarter ending March 31, 2025).

On September 13, 2024, the IRS issued additional proposed regulations (REG-112129-23). These proposed regulations are largely consistent with many provisions outlined in prior guidance. Most taxpayers generally do not need to revisit their 2023 tax return positions and may continue relying on the statute and/or notice guidance for their 2023 tax returns. Fiscal year taxpayers with tax years ending after September 13, 2024, may need to consider specific provisions for their 2023-2024 tax years.

The IRS simultaneously released Notice 2024-66, providing relief through a waiver of penalties under §6655 for corporate taxpayers that struggled with determining their CAMT liability and whether they qualified as an Applicable Corporation. Such taxpayers that underpaid estimated income tax in 2024 due to miscalculating their CAMT liability will not be penalized. While corporations will not face penalties under §6655 for failing to make estimated payments related to CAMT, they could still face other penalties if they fail to pay CAMT on time. With the proposed regulations now issued and penalty relief extended for 2024 installments, corporations should focus on reviewing the regulations and assessing their impact on CAMT liabilities.

Below is a copy of Form 7208.

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Form **7208** (June 2024)

Department of the Treasury
Internal Revenue Service

Excise Tax on Repurchase of Corporate Stock

For calendar year 20______ , or other tax year beginning ________________________ , 20______ ,
and ending ________________________ , 20______ .

Attach to Form 720.

Go to *www.irs.gov/Form7208* for instructions and the latest information.

OMB No. 1545-2323

Name | **Employer identification number (EIN)**

Part I Total Stock Repurchases (see instructions)

1 **(a)** If repurchasing or acquiring entity is one other than the entity listed above, enter its name	**(b)** If repurchasing or acquiring entity is one other than the entity listed above, enter its EIN	**(c)** Type of transaction	**(d)** Stock symbol	**(e)** Class of stock	**(f)** Trading exchange	**(g)** Number of shares	**(h)** Total fair market value (FMV) of repurchased shares
							$
							$
							$
							$
							$
							$
							$
							$
							$
							$
							$

2	Total from attachment, if necessary	2	$
3	Add amounts in column (h) and enter here. If filer is an applicable specified affiliate, see instructions	3	$

4 Were any of the repurchases shown on line 1 or line 2 with respect to stock of an applicable foreign corporation or a covered surrogate foreign corporation? . . . . ☐ Yes ☐ No

All filers reporting more than $1 million on line 3 must go to Part II. If you're an applicable specified affiliate reporting $1 million or less on line 3, see instructions. If you're NOT an applicable specified affiliate and reporting $1 million or less on line 3, stop here, and attach this form to Form 720.

Part II Exceptions

5a	Stock repurchases as part of a reorganization in which no gain or loss is recognized	5a	$
b	Stock repurchases treated as dividends	5b	$
c	Reserved for future use	5c	
d	Stock repurchases by a dealer in securities in the ordinary course of business	5d	$
e	**Total exceptions.** Add lines 5a through 5d	5e	$

For Paperwork Reduction Act Notice, see the instructions. Cat. No. 56401D Form **7208** (6-2024)

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Part III **Contributions to Employer-Sponsored Retirement Plans** (see instructions)

6 Repurchases				Contributions				
				Repurchased Class		Different Class		
(a) Class of stock repurchased	**(b)** Number of shares repurchased	**(c)** Aggregate FMV	**(d)** Average price per share (divide (c) by (b))	**(e)** Number of shares	**(f)** Aggregate FMV of shares contributed (multiply (d) by (e))	**(g)** Number of shares contributed	**(h)** Aggregate FMV of shares contributed	**(i)** Aggregate value of contributions
								$
								$
								$
								$
								$
								$
								$
								$
								$
								$
								$
								$
								$

7	Total from attachment, if necessary	7	$
8	Add amounts in column (i) and enter here	8	$

Part IV **Stock Issued or Provided**

9a	Stock issued or provided to employees	9a	$
b	Stock issued or provided to employees of a specified affiliate	9b	$
c	Stock issued but not entered on line 9a or line 9b	9c	$
d	**Total issuances.** Add lines 9a through 9c	9d	$

Part V **Tax and Payments**

10	**Stock repurchases subject to tax.** Subtract lines 5e, 8, and 9d from line 3. If zero or less, enter -0- and see instructions. If more than zero, continue to line 11	10	$
11	**Excise tax on stock repurchases.** Multiply line 10 by 1% (0.01). Enter here and on Form 720 on the line for **IRS No. 150**	11	$

Form **7208** (6-2024)

3. Increase in §41(h) research credit against payroll tax for small business

Prior to the IRA, a qualified small business with qualifying research activities could elect to claim up to $250,000 of its credit for increasing research activities as a payroll tax credit against the employer's share of OASDI taxes (6.2%). This is due to the fact that some small businesses may not have a large enough income tax liability to take advantage of their research credit.

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A qualifying small business is a business with less than $5 million in gross receipts and is less than five years old. The credit is generally equal to:

- 20% of the excess (if any) of the qualified research expenses of the taxable year over the base amount;
- 20% of the basic research payments; and
- 20% of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

The IRA allows qualified small businesses to claim an additional $250,000 in qualifying research expenses as a payroll tax credit ($500,000 maximum credit amount), first taken against the employer's share of OASDI tax (6.2%), and then against the employer’s share of Medicare tax (1.45%). Any credit amount in excess of the payroll tax carries forward to the next quarter.

For purposes of the Research Credit Against Payroll Tax for Small Business, a Qualified Small Business is a corporation, S corporation, or partnership with:

- Gross receipts of less than $5,000,000 during the taxable year; and
- No gross receipts for any taxable year preceding the five-taxable-year period ending with such taxable year.

Any other person is considered a Qualified Small business for purposes of the credit if they meet the requirements above, taking into account the aggregate gross receipts received in carrying on all trades or businesses.

The new IRA provisions are effective for tax years beginning after December 31, 2022.

Per §41(h)(4)(B)(ii), a qualified small business is limited to making the payroll election for five tax years. A qualified small business may apply the payroll tax credit for increasing research activities against their payroll tax liability by:

- Completing Form 6765, *Credit for Increasing Research Activities*, making the election to claim the payroll tax credit, and attaching the completed form to their timely filed business income tax return; and
- Claiming the payroll tax credit by completing Form 8974, *Qualified Small Business Payroll Tax Credit for Increasing Research Activities*, and attaching this form to Form 941, *Employer’s Quarterly Federal Tax Return*.

4. Drug Price Negotiation Program

The IRA directs the Health & Human Services Secretary to establish a Drug Price Negotiation Program, in which the Secretary shall:

- Publish a list of selected drugs:
    - 10 Part D drugs in 2026;
    - 15 Part D drugs in 2027;
    - 15 Part B or D drugs in 2028; and
    - 20 Part B or D drugs in 2029 and any subsequent year.
- Enter into agreements with manufacturers of the selected drugs.
- Negotiate, and, if applicable, renegotiate maximum fair prices for such selected drugs.
- Carry out the publication and administrative duties and compliance monitoring.

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Essentially, the IRA will enable Medicare to negotiate pricing for negotiation-eligible drugs under Medicare Parts B and D. The maximum fair price ceiling for a drug is based on the lesser of:

- The price of the drug or biological paid under Part B or D; or
- A percentage of the nonfederal average manufacturer price, which is used to help calculate a maximum price for drugs bought by the "big four" federal purchasers:
    - The Department of Veterans Affairs;
    - The Department of Defense;
    - The Public Health Service; and
    - The Coast Guard.

This provision will take effect beginning in 2026. The selection of negotiation-eligible drugs will be determined on different criteria, including how expensive they are. The negotiated maximum fair prices would generally be in effect until the first year beginning at least nine months after the date the Secretary determines there is a marketed generic or biological substitute for a drug. If drug manufacturers do not offer the specified drugs at or less than the maximum fair price, they will be subject to a civil monetary penalty equal to ten times the difference between the maximum fair price and the offered price, multiplied by all applicable units.

Under the IRA, an excise tax is imposed on drug manufacturers, producers, and importers that fail to enter into pricing agreements. This excise tax rate will range from 185.71% to 1,900% of the selected drug's price depending on the duration of noncompliance. The excise tax would not apply to drugs sold for export.

5. Manufacturer Rebate for Certain Drugs with Prices Increasing Faster than Inflation

The IRA requires drug manufacturers to pay inflation rebates to Medicare if they increase prices on Medicare Part D drugs faster than inflation. The inflation-adjusted payment amount is the benchmark-period manufacturer price with respect to a drug for such period, increased by the percentage by which the rebate-period CPI-U exceeds the applicable benchmark-period CPI-U. It is important to note that this provision applies to drug prices for individuals with Medicare, not private insurance. The inflation rebate provision was implemented in 2023, using 2021 as the base period to determine inflation changes.

6. Health insurance premium subsidies

The premium tax credit ("PTC") is a refundable credit available to eligible taxpayers who purchase health insurance on the Health Insurance Marketplace. In order to qualify for the credit, the taxpayer generally must meet certain criteria, including:

- The taxpayer must have household income within a certain range;
- The taxpayer, if married, must file a joint return (limited exceptions apply);
- The taxpayer cannot be claimed as a dependent by another individual; and
- The taxpayer or a family member must have health insurance coverage through the Health Insurance Marketplace, be unable to get affordable coverage through an employer-sponsored plan, be ineligible for coverage through a government program (Medicare, Medicaid, etc.), and pay the share of premiums not covered by advance credit payments.

Essentially, the PTC is calculated by computing the difference between the benchmark premium for health insurance for the individual or family and a specified maximum contribution (a percentage of MAGI). The benchmark premium is the premium for the second-lowest-cost silver plan available in a

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region. It is a function of age, geographic location, and number of enrollees. For example, the PTC is significantly larger for older individuals than younger individuals.

Generally, the PTC is available to taxpayers with household income between 100% and 400% of the federal poverty line (FPL). The PTC is limited to the excess of the premiums for the applicable benchmark plan covering the taxpayer's family over the taxpayer's contribution amount. This contribution amount is equal to the taxpayer's household income multiplied by an applicable percentage based on the taxpayer's income in relation to the federal poverty line.

ARPA temporarily changed the affordability percentages used for premium tax credits for 2021 and 2022 to increase credits for individuals eligible for assistance and provide credits for taxpayers with income over 400% of the FPL. All individuals with premiums in excess of 8.5% of their household income were eligible for the PTC in 2021 and 2022. In addition to these changes, for tax year 2020, ARPA suspended the repayment obligations for taxpayers receiving excess advance premium tax credits so such payments were not subject to recapture.

The IRA extended the temporary ARPA rules from 2023 through 2025, meaning taxpayers with income over 400% of the FPL remain eligible for the PTC. All individuals with premiums in excess of 8.5% of their household income will be eligible for the PTC through 2025. This provision under the IRA allows more individuals to claim the PTC than under pre-IRA law. The IRA did not extend the suspension of repayment obligations for taxpayers receiving excess advance premium tax credits.

The CBO provided the following projections under the IRA:

- A 64-year-old would receive a premium tax credit if his or her income did not exceed $163,700 in that year.
- A 21-year-old would receive a premium tax credit if his or her income did not exceed $54,600.
- A family of four consisting of individuals ages 50, 50, 21, and 21 would receive a premium tax credit if their household income was no greater than $304,100.
- A younger family of four, consisting of people ages 24, 24, 5, and 5 would receive a premium tax credit if the household's income was no more than $192,700.

On October 11, 2022, the IRS issued final regs (T.D. 9968), providing a "family glitch" fix and increasing access to the PTC. Prior to the final regs, a taxpayer who was offered employer-sponsored insurance coverage was only eligible for the PTC for the employee's share of cost covering the employee, not the family. If the cost of self-only coverage was determined to be affordable, even if the cost of family coverage was determined to be unaffordable, the taxpayer would be ineligible for the PTC, hence the "family glitch."

The final regs provide that the affordability of an employer-provided healthcare plan is determined based on the employee's share of the cost of covering the employee and those family members, not the cost of covering only the employee. The final regulations regarding the PTC apply for taxable years beginning after December 12, 2022.

For purposes of the PTC, the taxpayer's family includes the taxpayer, the taxpayer's spouse if filing jointly, and any dependents of the taxpayer. The cost of covering individuals who are offered the

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coverage but are non-family members is not considered in determining whether the employee's family members have an offer of affordable employer coverage.

The final regulations provide that an individual who has offers of employer coverage from multiple employers has an offer of affordable coverage if at least one of the offers of coverage is affordable.

Example: Joe has an offer of employer coverage from his employer and also from the employer of his spouse, Jen, for a year for which they file a joint return. Joe has an offer of affordable coverage if either Joe's required contribution for self-only coverage under his employer's plan does not exceed 8.5 percent of his and Jen's household income, or if Jen's required contribution for family coverage under Jen's employer's plan does not exceed 8.5 percent of their household income.

The final regulations also provide a minimum value rule for related individuals that is separate from the minimum value rule for employees, which requires a plan's share of the total allowed costs of benefits provided to related individuals to be at least 60 percent. Per the final regulations, the intent of the rule is to ensure that employers continue to provide a plan that has the same benefit design for employees and related individuals, and not to burden employers with having to offer different benefit packages for employees and related individuals.

As a result, the final regulations include a rule providing that an employer plan that provides minimum value to an employee also provides minimum value to related individuals if the scope of benefits and cost sharing (including deductibles, co-payments, coinsurance, and out-of-pocket maximums) under the plan are the same for employees and family members. If cost sharing varies based on whether related individuals are enrolled and/or the number of related individuals enrolled (i.e., the tier of coverage), the minimum value for related individuals is based on the tier of coverage that would, if elected, cover the employee and all related individuals (disregarding any differences in deductibles or out-of-pocket maximums that are attributable to a different tier of coverage).

Notice 2022-41, released the same day as the PTC final regulations, permits a non-calendar year cafeteria plan to allow an employee, during a period of coverage, to revoke prospectively an election of family coverage under a group health plan that is not a health FSA and that provides minimal essential coverage, provided the following conditions are met:

- One or more related individuals are eligible for a special enrollment period to enroll in a Qualified Health Plan (QHP) through an Exchange pursuant to guidance issued by the Department of Health and Human Services and any other applicable guidance, or one or more already-covered related individuals seeks to enroll in a QHP during the Exchange's annual open enrollment period; and
- The revocation of the election of coverage under the group health plan corresponds to the intended enrollment of the related individual or related individuals in a QHP through an Exchange for new coverage that is effective beginning no later than the day immediately following the last day of the original coverage that is revoked.

The guidance provided in Notice 2022-41 is effective for elections effective on or after January 1, 2023.

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7. Maximum out-of-pocket cap for Medicare beneficiaries

Prior to the IRA, Part D catastrophic coverage applied once an individual spent $7,050 out-of-pocket (2022). Once catastrophic coverage applied, the individual would pay 5% of any subsequent drug costs, with no annual cap or limitation.

The IRA eliminates the 5% cost sharing under catastrophic coverage starting in 2024. The IRA also limits out-of-pocket costs for prescription drugs for Medicare Part D beneficiaries to $2,000 per year beginning in 2025 (to be indexed to Part D drug inflation in subsequent years). Once an individual spends $2,000 out-of-pocket for covered drugs, co-insurance is eliminated, with Medicare Part D paying 20% of the cost of brand name drugs and 40% of the cost of generic drugs. The remaining costs will be borne by insurers and drug manufacturers.

Additionally, the IRA caps out-of-pocket co-pay costs for insulin at $35 per month under Medicare Part D plans, starting plan years 2023 through 2025. Lastly, the IRA limits Medicare prescription drug premium increases to no more than 6% annually from 2024 through 2029.

8. Credit for electricity produced from certain renewable sources

Prior to the IRA, §45(a) provided a renewable electricity production credit for any taxable year in an amount equal to the product of 1.5 cents (indexed for inflation), multiplied by the kilowatt hours of electricity produced by the taxpayer from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service, and sold by the taxpayer to an unrelated person during the taxable year. This credit was reduced by grants, tax-exempt bonds, subsidized energy financing, and other credits.

Prior to the IRA, the qualified facility construction was generally required to begin prior to January 1, 2022. The IRA extends the deadline for the beginning of construction projects to before January 1, 2025. Additionally, the IRA imposes two requirements for taxpayers to obtain the full 1.5 cent base amount: a precluding wage requirement and apprenticeship requirement.

9. Extension and modification of Energy Credit

The IRA amends the §48 energy credit to include energy storage technology, qualified biogas property, and microgrid controllers as qualifying property for purposes of the energy credit. The construction of these types of property must begin before January 1, 2025. The IRA also expanded the types of property that qualify as type 2 solar property and qualified fuel cell property.

10. Energy Efficient Home Improvement Credit (Formerly Known as the Nonbusiness Energy Property Credit)

Prior to the IRA, a credit was available to individual taxpayers for nonbusiness energy property placed in service prior to January 1, 2022. The property that qualified for the credit included Qualified Energy Efficiency Improvements and Residential Energy Property Expenditures. The credit was equal to 10% of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during the taxable year and the amount of the residential energy property expenditures paid or incurred by the taxpayer during such taxable year. Additionally, there was a lifetime limitation on the amount of the credit ($500 nonrefundable credit during the taxpayer’s lifetime). Pre-IRA rules regarding the energy-efficient home improvement credit applied for 2022.

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Per §25C(c), "qualified energy efficiency improvements" are any energy efficient building envelope component, if:

- The component is installed in or on a dwelling unit located in the United States and owned and used by the taxpayer as his or her personal residence;
- The original use of the component commenced with the taxpayer; and
- The component could reasonably be expected to remain in use for at least 5 years.

Per §25C(d), "residential energy property expenditures" are expenditures made by the taxpayer for qualified energy property which is:

- Installed on or in connection with a dwelling unit located in the United States and owned and used by the taxpayer as the taxpayer's principal residence; and
- Originally placed in service by the taxpayer.

The IRA renamed the nonbusiness energy property credit to the "Energy Efficient Home Improvement Credit" and made the following changes:

- It expanded the credit for energy-efficient components placed in service before January 1, 2033.
- It increased the nonbusiness energy property credit from 10% to 30% of the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during the taxable year and the amount of the residential energy property expenditures paid or incurred by the taxpayer during such taxable year.
- It repealed the requirement that residential energy property expenditures must be made with respect to the taxpayer's principal residence.
- It repealed the $500 lifetime credit limitation and replaced it with an annual credit limitation of $1,200 per taxpayer per year, including annual sub-limits of:
  - $600 for credits related to qualified residential energy property expenditures (including central air conditioners, electric panels, natural gas, propane, or oil water heaters, oil furnaces, and water boilers);
  - $600 for windows, and skylights that meet Energy Star most efficient certification requirements; and
  - $250 for any exterior door ($500 aggregate limit for all exterior doors) that meet applicable Energy Star requirements.
- It increases the $1,200 annual limit to $2,000 for amounts paid for specified heat pumps, heat pump water heaters, and biomass stoves and boilers.
  - The maximum total yearly energy efficient home improvement credit amount may be up to $3,200.
- It increased the credit to $150 for amounts spent for a home energy audit, defined as an inspection and written report with respect to a dwelling unit located in the United States and owned or used by the taxpayer as the taxpayer's principal residence that:
  - Identifies the most significant and cost-effective energy efficiency improvements with respect to such dwelling unit, including an estimate of the energy and cost savings with respect to each such improvement; and
  - Is conducted and prepared by a home energy auditor that meets the certification or other requirements specified by the Secretary in regulations or other guidance.

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The credit percentage rate phases down to 26% for property placed in service in 2033 and 22% for property placed in service in 2034. For qualified property placed in service after December 31, 2024, no credit shall be allowed unless:

- Such item is produced by a qualified manufacturer; and
- The taxpayer includes the qualified product identification number of such item on his or her tax return.

Additionally, the credit may not be claimed until the year it is installed. The IRA did not make changes to refundability (i.e., the credit remains nonrefundable), and the taxpayer may not carry the credit forward to future tax years.

The Energy Efficient Home Improvement Credit is only available for primary homes and certain improvements made to second homes. The credit cannot be taken for improvements made to homes not used as a residence by the taxpayer (i.e., landlords can never take the Energy Efficient Home Improvement Credit for a home they rent out but do not use as a residence for themselves). Renters may be eligible for the credit, provided the home they are renting is their principal residence and additional requirements are met.

If a taxpayer has a residence in which they also conduct business, they may be eligible for the Energy Efficient Home Improvement Credit as follows:

Percentage Business Use of Residence	Credit Eligibility
Not more than 20%	Full credit can be claimed
More than 20% but under 100%	The credit is reduced to include only the portion of expenditures for the property that is allocable to use for nonbusiness purposes
100%	The credit cannot be claimed

A taxpayer can claim the Energy Efficient Home Improvement Credit only for qualifying expenditures incurred for an existing home or for an addition to or renovation of an existing home, not for a newly constructed home. Certain labor costs related to the installation of eligible types of property may qualify for the credit. However, used property is not eligible for the Energy Efficient Home Improvement Credit.

The credit may be adjusted if the taxpayer receives any of the following incentives:

- **Subsidies**: If a public utility provides a subsidy to the taxpayer for the purchase or installation of an energy conservation measure, the taxpayer cannot claim a credit for the amount of the subsidy used to purchase or install the qualifying property.
- **Rebates**: The taxpayer must reduce the amount of the expenditure on which credit is calculated by the amount of the rebate.
- **State Energy-Efficiency Incentives**: Generally, a taxpayer is not required to reduce the purchase price or cost of property acquired with a governmental energy-efficiency incentive unless that incentive qualifies as a rebate under federal income tax law.

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11. Residential Clean Energy Credit (Formerly Known as the Residential Energy Efficient Property (REEP) Credit)

The residential energy efficient property credit (REEP) allows taxpayers to take an individual tax credit for solar electric, solar hot water, small wind energy, full cell, biomass fuel property, and geothermal heat pumps installed in homes before January 1, 2024. Labor costs related to the installation of these types of property are eligible for the credit. The IRA renames the Residential Energy Efficient Property Credit to the Residential Clean Energy Credit. For property placed in service after December 31, 2019, and before January 1, 2023, the credit applicable percentage was equal to 26% of the taxpayer's qualified expenditures. For property placed in service after December 31, 2022, and before January 1, 2024, the applicable percentage was planned to equal 22% of the taxpayer's qualified expenditures. There is no annual limit on eligible costs.

The IRA extends the Residential Clean Energy Credit through 2035 and increases the applicable percentage to:

- 26% for property placed in service before January 1, 2022;
- 30% for property placed in service after December 31, 2021, and before January 1, 2033;
- 26% for property placed in service after December 31, 2032, and before January 1, 2034;
- 22% for property placed in service after December 31, 2033, and before January 1, 2035.

Lastly, the IRA expands the Residential Clean Energy Credit for qualified battery storage technology expenditures.

Specifically, the Residential Clean Energy Credit allows taxpayers to take an individual tax credit of a percentage of the cost of:

- Solar electric property expenditures (solar panels);
    - (IRS FAQs clarify that solar roofing tiles and solar roofing shingles serving as solar electric collectors while also performing the function of traditional roofing qualify for the credit) [4]
- 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.

The credit may not be claimed until the year it is installed. Certain labor costs related to the installation of eligible types of property may qualify for the credit. There is no overall dollar limit for the Residential Clean Energy Property Credit; however, 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.

In the case of a residence or dwelling unit that is jointly occupied by two or more individuals, the maximum amount of such fuel cell property expenditures used to calculate the total Residential Clean Energy Property Credit amount for all individuals living in that dwelling unit during a calendar year is limited to $1,667 for each half kilowatt of capacity of qualified fuel cell property.

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[4] Fact Sheet 2022-40.

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The Residential Clean Energy Credit is nonrefundable, but a taxpayer may carry forward the unused amount of the credit to reduce tax liability in future tax years. The Residential Clean Energy Credit is only available for primary homes and certain improvements made to second homes.

- The credit cannot be taken for improvements made to homes not used as a residence by the taxpayer (i.e., landlords can never take the Residential Clean Energy Credit for a home they rent out but do not use as a residence for themselves).
- Renters may be eligible for the credit, provided the home they are renting is their principal residence and additional requirements are met.

If a taxpayer has a residence in which they also conduct business, they may be eligible for the Residential Clean Energy Credit as follows:

Percentage Business Use of Residence	Credit Eligibility
Not more than 20%	Full credit can be claimed
More than 20% but under 100%	The credit is reduced to include only the portion of expenditures for the property that is allocable to use for nonbusiness purposes
100%	The credit cannot be claimed

A taxpayer can claim the Residential Clean Energy Credit for qualifying expenditures incurred for either an existing home or a newly constructed home. However, used property is not eligible for the Residential Clean Energy Credit.

The credit may be adjusted if the taxpayer receives any of the following incentives:

- **Subsidies**: If a public utility provides a subsidy to the taxpayer for the purchase or installation of an energy conservation measure, the taxpayer cannot claim a credit for the amount of the subsidy used to purchase or install the qualifying property.
- **Rebates**: The taxpayer must reduce the amount of the expenditure on which credit is calculated by the amount of the rebate.
- **State Energy-Efficiency Incentives**: Generally, a taxpayer is not required to reduce the purchase price or cost of property acquired with a governmental energy-efficiency incentive unless that incentive qualifies as a rebate under federal income tax law.

12. Accelerated Cost Recovery Deduction for Energy Efficient Commercial Building Property

Taxpayers may take an accelerated cost recovery deduction for energy efficient commercial building property (EECB property) for the year placed in service. Prior to the IRA, the §179D deduction limit was the statutory dollar amount ($1.88 in 2022), multiplied by the square footage of the building, over the aggregate amount of the deductions with respect to the building for all prior taxable years. Prior to the IRA, to be considered eligible EECB property, it was required to have been installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 50 percent or more in comparison

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to a reference building. New construction, renovations, and additions to commercial or high-rise residential buildings most often qualify for the §179D deduction.

The IRA made the following changes to the accelerated cost recovery deduction for energy efficient commercial building property:

- Lowers the minimum 50% efficacy requirement in reducing total annual energy and power costs to 25%; and
- Replaces the statutory dollar amount ($1.88 in 2022) with an applicable dollar value multiplication factor, set at $0.50 and increased by $0.02 for each percentage point cost reduction over 25%. The multiplication factor is capped at $1 under the IRA.
    - For projects that meet prevailing wage and registered apprenticeship requirements, the base amount is $2.50 and increased by $0.10 for each percentage point increase in energy efficiency, capped at a maximum amount of $5 per square foot (when 50% or greater energy savings is achieved).

The maximum deduction amount is the total deduction a building can claim, less deductions claimed with respect to the building in the preceding three years.

13. New Energy Efficient Home Credit

The new §45L energy efficient home credit is available to eligible contractors for each qualified new energy efficient home that was constructed by the eligible contractor and acquired by a person from such eligible contractor to use as a residence during the tax year. Prior to the IRA, the new energy efficient home credit was only available for new energy efficient homes acquired by a homeowner before January 1, 2022, and the maximum credit amount was $1,000 or $2,000 per dwelling unit (based on certain criteria).

The IRA extends the new energy efficient home credit to new energy efficient homes acquired prior to January 1, 2033. Additionally, beginning in 2023, the IRA modified and increased the maximum credit amount per dwelling unit to $500, $1,000, $2,500, or $5,000 depending on certain criteria. Generally, the $500 or $1,000 credit will apply to multifamily homes and the $2,500 credit will apply to single family and manufactured homes, The maximum $5,000 credit applies to single family and manufactured homes certified as DOE Zero Energy Ready Homes (ZERHs). Generally, homes meeting this qualification use a renewable energy system to offset all or most of the annual energy consumption.

14. Clean Vehicle Credit

Prior to the IRA, taxpayers could claim a credit for a new qualified plug-in electric drive motor vehicle placed in service by the taxpayer during the taxable year. The base amount of the credit was $2,500. In the case of a vehicle which draws propulsion energy from a battery with not less than 5 kilowatt hours of capacity, the amount of the credit is $2,500, plus $417 for each kilowatt hour of capacity in excess of 5 kilowatt hours (not to exceed $5,000), for a total maximum credit amount of $7,500. Heavier fuel cell vehicles qualified for up to a $40,000 credit. The credit phased out after the manufacturer sold its 200,000th electric drive motor vehicle, and for certain vehicles manufactured by Tesla and GM.

The IRA removed the limitation on the number of vehicles eligible for the credit, applicable for all vehicles sold after December 31, 2022. The IRA also changed the dollar amount of the credit, allowing taxpayers to receive a $3,750 credit for meeting a “critical minerals requirement” and $3,750 for meeting a “battery component requirement”. The maximum credit per vehicle is $7,500.

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The credit may only be claimed to the extent of the taxpayer's tax due and is not refundable. The credit cannot be carried forward to the extent it is claimed for personal use; however, the credit may be carried forward to the extent it is claimed for business use. Only one taxpayer may claim the Clean Vehicle Credit per vehicle placed in service (i.e., the credit cannot be allocated or prorated between multiple taxpayers). In the case of married filing jointly taxpayers, either spouse may be identified as the owner claiming the new vehicle credit. For vehicles placed in service January 1, 2024 or later, buyers will only be able to claim the clean vehicle credit if the seller has registered with the IRS and successfully submits a seller report through the IRS Energy Credits Online Portal. The Clean Vehicle Credit is claimed on Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit*, in the year that the vehicle is placed in service, and the VIN of the new vehicle must be reported on this form.

Per IRS FAQs, a new clean vehicle for purposes of the Clean Vehicle Credit is a vehicle that: [5]

- Is placed in service on or after January 1, 2023 and acquired by a taxpayer for original use;
    - Note: Original use is defined as "the first use to which the vehicle is put after it is sold, registered, or titled"
- Is not acquired for resale;
- Is manufactured by a qualified manufacturer;
- Is manufactured primarily for use on public streets, roads, and highways, with at least four wheels;
- Has a gross vehicle weight of less than 14,000 pounds;
- Is powered to a significant extent by an electric motor with a battery capacity of 7 kilowatt hours or more and must be capable of being recharged from an external source of electricity; and
- Has final assembly in North America.

Fuel Cell Vehicles are also considered new clean vehicles for purposes of the Clean Vehicle Credit if:

- Original use begins with the taxpayer;
- Final Assembly occurs in North America; and
- The seller of the vehicle provides a report to the IRS.

Under the IRA, the $7,500 clean vehicle credit consists of a $3,750 credit for meeting a "critical minerals requirement" and $3,750 for meeting a "battery component requirement" as follows:

- Vehicles meeting neither requirement will not be eligible for the Clean Vehicle Credit.
- Vehicles meeting only one requirement may be eligible for a $3,750 credit.
- Vehicles meeting both requirements may be eligible for the full $7,500 credit.

The critical mineral and battery component requirements of the Clean Vehicle Credit apply to vehicles placed in service on or after April 18, 2023, including vehicles ordered or purchased prior to but placed in service on or after April 18, 2023.

The amount of the Clean Vehicle Credit depends on when the taxpayer placed the vehicle in service, regardless of purchase date. For vehicles placed in service January 1, 2023 through April 17, 2023 the credit is calculated as follows:

- $2,500 base amount
- Plus $417 for a vehicle with at least 7 kilowatt hours of battery capacity

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[5] FS-2023-22

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- Plus $417 for each kilowatt hour of battery capacity beyond 5 kilowatt hours
- Up to $7,500 total.

For vehicles placed in service January 1, 2023 through April 17, 2023, the minimum credit will generally be $3,751 ($2,500 + (3 x $417)), the credit amount for a vehicle with the minimum 7 kilowatt hours of battery capacity.

For vehicles placed in service April 18, 2023 and after, the credit is calculated as follows:

- $3,750 if the vehicle meets the critical minerals requirement only;
- $3,750 if the vehicle meets the battery components requirement only; and
- $7,500 if the vehicle meets both requirements.

A vehicle that does not meet either requirement will not be eligible for the Clean Vehicle Credit.

The critical minerals requirement essentially states that critical minerals contained in the battery must be:

- Extracted or processed in the United States, in any country with which the United States has a free trade agreement in effect, or recycled in North America; and
- Equal to or greater than the applicable percentage:
    - 40% for a vehicle placed in service after December 31, 2022 (and after April 18, 2023), and before January 1, 2024;
    - 50% for a vehicle placed in service during calendar year 2024;
    - 60% for a vehicle placed in service during calendar year 2025;
    - 70% for a vehicle placed in service during calendar year 2026; and
    - 80% for a vehicle placed in service after December 31, 2026.

The battery components requirement essentially states that the battery's components must be:

- Manufactured or assembled in North America; and
- Equal to or greater than the applicable percentage:
    - 50% for a vehicle placed in service after December 31, 2022 (and after April 18, 2023), and before January 1, 2024;
    - 60% for a vehicle placed in service during calendar year 2024;
    - 60% for a vehicle placed in service during calendar year 2025;
    - 70% for a vehicle placed in service during calendar year 2026;
    - 80% for a vehicle placed in service during calendar year 2027;
    - 90% for a vehicle placed in service during calendar year 2028; and
    - 100% for a vehicle placed in service during calendar year 2029 and thereafter.

A list of eligible clean vehicles that qualified manufacturers have indicated meet the IRS requirements is located at www.fueleconomy.gov/newtaxcredit. This list will be updated as manufacturers continue to provide information about eligible clean vehicles. Individuals can typically find the vehicle's weight, battery capacity, final assembly location, and VIN on the vehicle's window sticker. If the VIN is known, it can confirm final assembly information. Final confirmation of whether a vehicle qualifies for the credit should be done at the time of purchase, and the seller must provide the buyer with a report about a vehicle's eligibility at the time of sale. Buyers are advised to obtain a copy of the IRS's confirmation that a "time-of-sale" report was submitted successfully by the dealer.

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To qualify for the credit, the final assembly of the vehicle must occur in North America. The clean vehicle credit is not allowed if the manufacturer's suggested retail price (MSRP) is in excess of:

- $80,000 for vans, SUVs, and pickups; and
- $55,000 for all other vehicles.

A vehicle's MSRP is the vehicle's base retail price as suggested by the manufacturer, plus the retail price suggested by the manufacturer for each accessory item or optional equipment attached to the vehicle at the time of delivery to the dealer. MSRP does not include destination charges, optional items added by the dealer, or taxes and fees. The Clean Vehicle Credit limitations are based on MSRP, not the actual price paid for the vehicle (i.e., if the purchase price drops below the MSRP due to manufacturer/dealer incentives).

Final Assembly is defined as "the process by which a manufacturer produces a new clean vehicle at, or through the use of, a plant, factory, or other place from which the vehicle is delivered to a dealer or importer with all component parts necessary for the mechanical operation of the vehicle included with the vehicle, whether or not the component parts are permanently installed in or on the vehicle."

The clean vehicle credit is disallowed if the lesser of the MAGI of the taxpayer for the current or preceding tax year exceeds the following threshold amounts:

- $300,000 for taxpayers filing joint returns or surviving spouses;
- $225,000 for head of household taxpayers; and
- $150,000 for all other taxpayers.

Per IRS FAQs, if a partnership or an S corporation places a new clean vehicle in service and the new clean vehicle credit is claimed by individuals who are direct or indirect partners of that partnership or shareholders of that S corporation, the modified AGI thresholds apply to those partners or shareholders. [6]

For purposes of the Clean Vehicle Credit, the seller must provide the following information to the taxpayer and IRS:

- Name and taxpayer identification number of the seller;
- Name and taxpayer identification number of the taxpayer (only one taxpayer may be listed on the seller report – in the event of multiple owners, only the taxpayer that intends to claim the credit should be listed);
- Vehicle identification number (VIN) of the new clean vehicle;
- Battery capacity of the new clean vehicle;
- Verification that the taxpayer is the original user of the new clean vehicle;
- The date of the sale and the sale price of the vehicle;
- Maximum credit allowable for the new clean vehicle being sold;
- For sales after December 31, 2023, the amount of any transfer credit applied to the purchase; and
- A declaration under penalties of perjury from the seller.

The seller must provide such report to the taxpayer no later than the date of purchase. Taxpayers that did not receive a report from the seller because their vehicle was previously ineligible, but their vehicle is now eligible (i.e., due to a change in the vehicle's classification and MSRP limitation) may request and receive a report from the seller after the vehicle's purchase date.

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[6] FS-2023-08.

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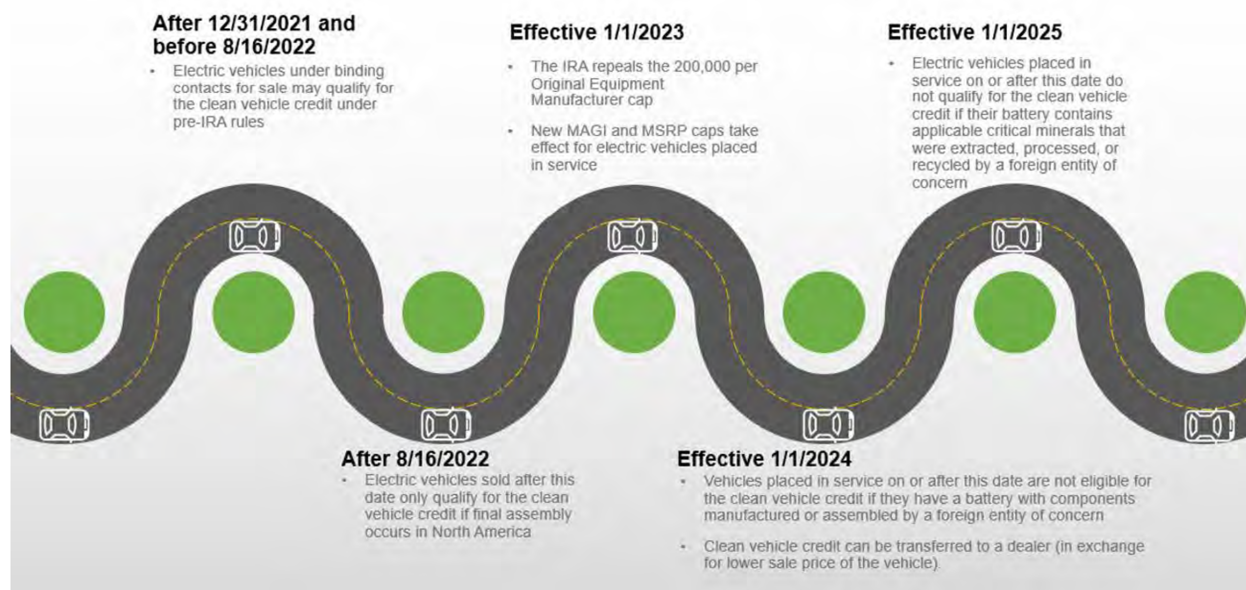
The clean vehicle credit will cease to apply to vehicles placed in service after December 31, 2032. For vehicles placed in service after 2023, qualifying vehicles will not include any vehicle with battery components that were manufactured or assembled by a foreign entity of concern (Iran, China, Russia, North Korea, and Iran). Taxpayers are required to include the vehicle identification number (VIN) on their tax return to claim a clean vehicle tax credit.



15. Credit for Previously Owned Clean Vehicles

The IRA created a clean vehicle credit for used vehicles, effective for sales through December 31, 2032. This credit is only available to individual taxpayers; business entities such as corporations or partnerships are not eligible for the credit.

New IRC §25E provides that a qualified buyer who places in service a previously owned clean vehicle during the taxable year may take a credit equal to the lesser of:

- $4,000; or
- The amount equal to 30% of the sale price with respect to such vehicle.

The credit is not refundable and cannot be carried forward.

Per IRS FAQs, a previously owned clean vehicle is a motor vehicle that meets the following requirements:

- The model year of the vehicle is at least two years earlier than the calendar year in which a taxpayer acquires the vehicle;
- The purchasing taxpayer is not the original user of the vehicle;
- The vehicle was acquired for a sales price of $25,000 or less from a dealer and the purchasing taxpayer is the first qualified buyer to claim the credit since August 16, 2022, other than its original user; and
- Such motor vehicle is a:
  - Qualified fuel cell motor vehicle with a gross vehicle weight rating of less than 14,000 pounds, or
  - A vehicle made by a qualified manufacturer that meets the definition of a motor vehicle under Title II of the Clean Air Act, has a gross vehicle weight rating of

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less than 14,000 pounds, is powered to a significant extent by an electric motor with a battery capacity of seven kilowatt hours or more, and is capable of being recharged from an external source of electricity.

Note: The dealer selling the previously owned clean vehicle must provide a report containing purchaser and vehicle information to the purchaser and to the IRS, containing the following information:

- Name and taxpayer identification number of the dealer;
- Name and taxpayer identification number of the taxpayer;
- Vehicle identification number of the vehicle;
- Battery capacity of the vehicle;
- The date of the sale and the sales price of the vehicle;
- Maximum credit allowable for the vehicle being sold;
- For sales after December 31, 2023, the amount of any transfer credit applied to the purchase; and
- A declaration under penalties of perjury from the dealer.[7]

This credit is disallowed if the taxpayer's MAGI for the year of purchase or preceding year exceeds:

- $150,000 for married filing jointly taxpayers;
- $112,500 for head of household taxpayers; and
- $75,000 for all other taxpayers.

The taxpayer's MAGI would be the lesser of MAGI in the taxable year or the prior tax year.

The IRA defines a previously owned clean vehicle as a motor vehicle:

- In which the model year is a least two years earlier than the calendar year in which the taxpayer acquires such vehicle;
- In which the original use commenced with a person other than the taxpayer; and
- That is acquired by the taxpayer in a qualified sale, defined as the sale of a motor vehicle by a dealer for a price of $25,000 or less.

The §25E credit for previously owned clean vehicles only applies to the first resale for a used vehicle, and the buyer must purchase the used vehicle from a dealership. For vehicles placed in service January 1, 2024 or later, buyers will only be able to claim the credit for previously owned clean vehicles if the seller has registered with the IRS and successfully submits a seller report through the IRS Energy Credits Online Portal. Buyers can only claim the §25E credit for previously owned clean vehicles once every three years. The credit for previously owned clean vehicles applies to vehicles acquired after December 31, 2022, and before January 1, 2033.

16. Transfer of New Clean Vehicle Credit and Previously Owned Clean Vehicles Credit

After December 31, 2023, and before December 31, 2032, taxpayers purchasing eligible new clean vehicles or previously owned clean vehicles can elect to transfer the clean vehicle tax credit or previously owned clean vehicle credit to an eligible entity, in exchange for a financial benefit from the eligible entity equal to the amount of the credit. The financial benefit that reduces the purchase price of the eligible vehicle can be in the form of cash, a partial payment, or a down payment for the purchase of such vehicle. By making the transfer election, buyers receive an immediate financial benefit rather than waiting to file their tax return to claim the credit. An eligible entity, also referred to as a "registered dealer," is

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[7] FS-2023-22.

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generally a dealer that sells a new clean vehicle or previously owned clean vehicle to a taxpayer and registers with the IRS.

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 the buyer as a condition of the buyer making the transfer election;
- The modified AGI limitations, as applicable; and
- 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 August 16, 2022, to a person other than the person with whom the original use of such vehicle commenced.

The registered dealer must also provide the buyer with a copy of the seller report submitted for the vehicle, and confirmation of the successful submission of the report through the IRS Energy Credits Online Portal.[8]

All dealers and sellers must submit seller reports through the IRS Energy Credits Online Portal for vehicles placed in service beginning January 1, 2024. The seller report submission is done at the time of the sale through the IRS Energy Credits Online Portal. Registered dealers that provide all required information through the IRS Energy Credits Online Portal and are in tax compliance may become eligible to participate in the advance payment program once their registration information is verified by the IRS. The initial registration of the dealer/seller can be completed by an individual representative of the dealer/seller who is currently authorized to legally bind the dealer or seller in these matters. Information collected during the initial registration includes the registered dealer's business EIN, address, phone number, and email. Additional information is required for dealers registering for advance payments. Qualified manufacturers who are also direct sellers of vehicles must complete dealer registration in order to submit seller reports and receive an advance payment when a credit is transferred. Dealer registration expires after ten years.

Per IRS FAQs, in order to submit seller reports for previously owned clean vehicles or register to receive advance payments, a dealer must be licensed by a state, the District of Columbia, an Indian tribal government, or any Alaska Native Corporation to engage in the sale of vehicles. Non-licensed dealers and sellers must still be registered through the IRS Energy Credits Online Portal to submit seller reports.[9]

Rev. Proc. 2023-33 outlines the specific information that manufacturers, sellers, and dealers must provide through the IRS Energy Credits Online Portal at the time of registration:

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[8] FS-2023-22.
[9] FS-2023-22.

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- **Qualified Manufacturer Registration:** An individual representative of the manufacturer must register through the IRS Energy Credits Portal and provide required information to request to become a qualified manufacturer.
  - The individual representative of the manufacturer must be currently authorized to legally bind the manufacturer in such matters.
  - Beginning January 1, 2024, to be considered a qualified manufacturer, manufacturers must have entered into a written agreement through the IRS Energy Credits Online Portal.
  - Beginning January 1, 2024, qualified manufacturers must file monthly written reports through the IRS Energy Credits Online Portal by the fifteenth of the month following the month to which each monthly written report relates.
- **Seller Registration:** An individual representative of the seller must register through the IRS Energy Credits Portal and provide the required information:
  - Seller name, business address, phone number, and email address;
  - Seller Taxpayer Identification Number (TIN) or Employer Identification Number (EIN);
  - Proof of a state, District of Columbia, Indian tribal government, or Alaska Native Corporation issued license to sell vehicles (for §25E sellers);
  - Certification that, in the event a buyer returns a vehicle within 30 days of the time of sale, the seller will update the seller report;
  - In the case of a previously owned clean vehicle, certification that the seller will provide each taxpayer with the following information:
    - 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 August 16, 2022, to a person other than the person with whom the original use of such vehicle commenced, excluding transfers to or between dealers; and
  - Such other information as may be required by the IRS Energy Credits Online Portal.
  - Note: The individual representative of the seller must be currently authorized to legally bind the seller in such matter.
- **Dealer Registration:** An individual representative of the dealer must register through the IRS Energy Credits Portal.
  - The individual representative of the dealer must be currently authorized to legally bind the dealer in such matter.
  - A dealer must register at least 15 days prior to being able to receive any advance payments.
  - A dealer may register at any time after October 6, 2023, but will not become an eligible entity until January 1, 2024.
  - At the time of registration, the dealer must provide the same information as sellers (detailed above), as well as the following information:
    - Bank account information of the dealer, for purposes of receiving electronic payments.
    - Certification that the dealer will provide each taxpayer with the following information:

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        - For purposes of the clean vehicle credit, the MSRP of the new clean vehicle, or for purposes of the previously owned vehicle credit, 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 such taxpayer as a condition of the taxpayer making the transfer election. This amount must equal the amount of the credit potentially allowable as to the purchase of the vehicle and such amount may be provided in the form of cash or a down payment or partial payment for the purchase of the vehicle; and
        - The MAGI limitations.
    - Certification that, no later than the time of sale of the vehicle, the dealer will make the payment to the taxpayer (whether in cash or in the form of a partial payment or down payment for the purchase of such vehicle) in an amount equal to the credit otherwise allowable to such taxpayer.
    - Certification that the dealer, with respect to any incentive otherwise available for the purchase of a vehicle for which a clean vehicle credit or previously owned clean vehicle credit is allowed, ensured that:
        - The availability or use of such incentive does not limit the ability of a taxpayer to make a transfer election, and
        - Such election does not limit the value or use of such incentive; and
    - Certification that, in the event a buyer returns a vehicle within 30 days of the time of sale, and the dealer fails to report such return through the IRS Energy Credits Online Portal, the dealer will have an excessive payment of any advance payment amount received for the sale of such vehicle.

The IRS may revoke a dealer's registration to receive transferred credits and be eligible for advance payments for any of the following reasons: [10]

- The registered dealer fails to comply with any of the registration requirements;
- The registered dealer fails to satisfy the dealer tax compliance requirement;
- The registered dealer loses its license to sell vehicles;
- The IRS determines that the registered dealer provided inaccurate information to the taxpayer regarding the vehicle eligibility or the taxpayer's eligibility for the advance payment program;
- The IRS determines that the registered dealer provided inaccurate information to the IRS regarding vehicle eligibility or taxpayer eligibility for the advance payment program;
- The registered dealer fails to retain records for each taxpayer who makes a transfer election for a period of three years; or
- The registered dealer's registration has been suspended three times in the preceding year.

Not later than the time of sale, the buyer must provide the registered dealer with the following information: [11]

- The date of the transfer election;

[10] Rev. Proc. 2023-33.
[11] FS-2023-22.

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- The buyer's taxpayer identification number/SSN;
- A photocopy of the buyer's valid, government-issued photo identification document;
- An attestation, that either:
    - The buyer's prior year modified AGI did not exceed the modified AGI limitation, or, if not known, to the best of the buyer's knowledge and belief, the buyer's prior year modified AGI did not exceed such limitation, or
    - To the best of the buyer's knowledge and belief, the buyer's current year modified AGI will not exceed the modified AGI limitation;
- For new clean vehicles, an attestation that the vehicle will be used predominantly for personal use;
- For previously owned clean vehicles, an attestation (or declaration) that the buyer is a qualified buyer;
- An attestation that the buyer will file an income tax return for the taxable year in which the vehicle is placed in service, reporting eligibility for the applicable credit, the vehicle's VIN, and the buyer's election to transfer the credit to the dealer and repaying any credit amounts subject to recapture (if applicable);
- An attestation that the buyer is making this election prior to placing the vehicle in service and this is the first or second transfer election the buyer made during the taxable year;
- An attestation that in the event the buyer exceeds the applicable modified AGI limitations, the buyer will repay the amount received as an addition to tax for the tax year the vehicle was placed in service; and
- An attestation that the buyer has voluntarily elected to transfer the credit.

A taxpayer can make no more than two elections to transfer a clean vehicle credit each tax year, and buyers must transfer the entire amount of the credit allowable to the registered dealer. Such elections could be for two clean vehicle credits or one clean vehicle credit and one previously owned clean vehicle credit. The elections cannot be for two previously owned clean vehicle credits. Spouses may each transfer no more than two clean vehicle credits each tax year. As such, in the case of a joint return, each individual taxpayer may make no more than two transfer elections per taxable year. Lastly, the transfer election is final.

Dealers who are eligible to receive advance payments should receive advanced payments via direct deposit within 48-72 hours of a successfully submitted time of sale report and advance payment request. As discussed, only licensed dealers may register to receive advance payments. The IRS may suspend a registered dealer's eligibility to participate in the advance payment program for any of the following reasons: [12]

- The IRS determines that the registered dealer provided inaccurate information to the taxpayer regarding the vehicle's eligibility or the taxpayer's eligibility for the advance payment program;
- The IRS determines that the registered dealer provided inaccurate information to the IRS regarding the vehicle's eligibility or taxpayer's eligibility for the advance payment program;
- The IRS determines that the registered dealer provided inaccurate information to the IRS regarding its eligibility for the advance payment program;
- The registered dealer fails to satisfy the dealer tax compliance requirement;

[12] Rev. Proc. 2023-33.

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- The IRS determines that the bank account information that the dealer provided through the IRS Energy Credits Online Portal is not valid;
- The dealer fails to report the return of a vehicle through the IRS Energy Credits Online Portal as required; or
- The IRS determines it is necessary to suspend the registered dealer's registration to prevent abuse of the advance payment program.

The IRS will accept or reject submissions of the seller report and advance payment request in real time. Dealers who are eligible to receive advance payments may initiate an advance payment request, beginning January 1, 2024. Dealers are required to disclose information about the applicable income limits to buyers; however, dealers are not required to verify a buyer's income for a credit transfer or advance payment. If the buyer's income exceeds the limits, dealers are not required to repay the advance payment. Dealers cannot require buyers to transfer the clean vehicle credit or previously owned vehicle credit.

Certain scenarios apply if a vehicle is returned or a sale is cancelled, after a credit is transferred: [13]

- If a sale of an eligible vehicle for the clean vehicle credit is cancelled before the taxpayer places the vehicle in service, the vehicle will still be eligible for a clean vehicle credit upon a subsequent qualifying sale to another taxpayer.
- If an eligible vehicle for the clean vehicle credit is returned within 30 days of being placed in service, the purchaser cannot claim a clean vehicle credit with respect to the vehicle, as it was already placed in service.
- If a previously owned clean vehicle is returned, it is not eligible for a subsequent sale if the vehicle history reflects that such subsequent sale is not a qualified sale.
- If the vehicle history does not reflect the prior sale and return, the vehicle remains eligible for the previously owned clean vehicle credit.
- If the taxpayer made an election to transfer the clean vehicle credit, that vehicle transfer election is nullified, and any advance payment made pursuant to the clean vehicle transfer rules will be recaptured from the registered dealer as an excessive payment.

The tax treatment of the transferred tax credits is as follows: [14]

- **Registered Dealers:**
  - Advance payments received by the registered dealer are not treated as a tax credit to the dealer and may exceed the dealer's regular tax liability.
  - Advance payments received by the registered dealer are not included in the gross income of the dealer.
  - The payment made by the registered dealer to the buyer in exchange for the transferred credit is not deductible by the dealer. This payment is treated as repaid by the buyer to the registered dealer as part of the purchase price of the vehicle, and as a result is treated as part of the total amount received from the sale transaction.
  - Registered dealers do not claim transferred tax credits when filing their tax return. Registered dealers claim transferred tax credits via the advance payment program through the IRS Energy Credits Online Portal.

[13] FS-2023-22

[14] FS-2023-22.

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- **Buyers:**
  - The financial benefit payment made by the registered dealer to the buyer in the form of a cash payment, down payment, or partial down payment is not includible in the gross income of the buyer. This payment made by the registered dealer is treated as an advance payment of the credit to the buyer on behalf of the Secretary and the basis of the applicable eligible vehicle is reduced by the amount of the credit.
  - A buyer who makes the transfer election must file an income tax return for the taxable year in which the vehicle transfer election is made that notes this election, and the buyer must attach Form 8936, *Clean Vehicle Credits*, its successor form, or any additional forms, schedules, or statements as prescribed by the Commissioner.
  - Buyers who transfer a credit to a registered dealer but exceed the income limitations must repay the IRS when filing their tax return.

17. Credit for Qualified Commercial Clean Vehicles

The IRA creates a new IRC §45W credit for qualified commercial clean vehicles, part of the §38 general business credit. This credit is available to businesses and tax-exempt organizations. A qualified commercial clean vehicle generally is any vehicle made by a qualified manufacturer, acquired for use or lease by the taxpayer, not available for resale, and either:

- Is manufactured primarily for use on public streets, roads, and highways (not including a vehicle operated exclusively on a rail or rails); or
- Is mobile machinery, including vehicles that are not designed to perform a function of transporting a load over public highways.

Additionally, the qualified commercial clean vehicle generally must be propelled to a significant extent by an electric motor which draws electricity from a battery that has a capacity of not less than 15 kilowatt hours (or, in the case of a vehicle which has a gross vehicle weight rating of less than 14,000 pounds, 7 kilowatt hours) and is capable of being recharged from an external source of electricity.

The vehicle must also meet certain efficient vehicle requirements. The credit is equal to the lesser of:

- 15% of the basis of such vehicle (30% in the case of a vehicle not powered by gasoline or diesel internal combustion engine); or
- The incremental cost of such vehicle (the excess of the purchase price for such vehicle over the price of a comparable vehicle, meaning a vehicle powered solely by gasoline or diesel internal combustion engine and comparable in size and use).

The §45W Credit for Qualified Commercial Clean Vehicles is limited to:

- $7,500 for light-duty vehicles (weighing less than 14,000 pounds); and
- $40,000 for all other vehicles (i.e., heavy-duty vehicles).

Certain federal, state, and local governments as well as certain tax-exempt entities may elect to treat the Credit for Qualified Commercial Clean Vehicles as a refundable credit. To be eligible for the Credit for Qualified Commercial Clean Vehicles, the vehicle must not have been allowed a credit under §§20D or 45W. The §45W Credit for Qualified Commercial Clean Vehicles is effective for sales on or after January 1, 2023, and before January 1, 2033.

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Unlike the §30D Clean Vehicle Credit, the Credit for Qualified Commercial Clean Vehicles does not have the critical minerals requirement, battery component requirement, North American assembly requirement, or MAGI or MSRP restrictions.

Whether a taxpayer can claim the qualified commercial clean vehicle credit in its business depends on who is the owner of the vehicle for federal income tax purposes. If the vehicle is leased, the owner of the vehicle is determined based on whether the lease is considered a lease or recharacterized as a sale for federal income tax purposes.

Per IRS FAQs, a vehicle lease agreement would make a vehicle more likely to be recharacterized as a sale for tax purposes if: [15]

- The lease term covers more than 80% to 90% of the economic useful life of the vehicle;
- There is a bargain purchase option at the end of the lease or other terms/provisions that would economically compel the lessee to acquire the vehicle at the end of the lease term; or
- There are terms that result in the lessor transferring ownership risk to the lessee.
    - Example: There is a terminal rental adjustment clause that requires the lessee to pay the difference between the actual and expected value of the vehicle at the end of the lease.

If the clean vehicle lease is recharacterized as a sale, the lessee would need to determine if they are eligible to claim either a clean vehicle credit or a qualified commercial vehicle credit. The lessor would not be eligible for either the clean vehicle credit or qualified commercial vehicle credit since they engaged in a resale of the vehicle.

18. Alternative Fuel Refueling Property Credit

Prior to the IRA, a credit was available for the cost of any qualified alternative fuel vehicle refueling property placed in service by a business or at a taxpayer's principal residence before January 1, 2022. The credit was equal to 30% of the cost of property placed in service, limited to $30,000 annually for depreciable property or $1,000 annually for personal use.

The IRA extends the alternative fuel refueling property credit to property placed in service before January 1, 2033. Under the IRA, the credit cap remains at $1,000 for personal property. For business property, the IRA decreases the credit amount percentage from 30% to 6%, with a maximum limitation of $100,000 for depreciable property (increased from $30,000). If prevailing wage and registered apprentice requirements apply, the credit percentage increases to 30%, with a maximum limitation of $100,000 for depreciable property. The IRA changes are effective for property acquired after December 31, 2022.

Under the IRA, in order for property to be treated as qualified alternative fuel vehicle refueling property, property placed in service must be located in an eligible census tract. An eligible census tract is either:

- A low-income community as described in §45D(e); or
- Not in an urban area, defined as a census tract (as defined by the Bureau of the Census), which, according to the most recent decennial census, has been designated as an urban area by the Secretary of Commerce.

[15] FS-2023-08.

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19. Advanced Manufacturing Production Credit

The IRA creates an advanced manufacturing production credit equal to the sum of the credit amounts determined for each eligible component produced by the taxpayer and sold to an unrelated person during the tax year.

The IRA defines an eligible component as:

- Any solar energy component;
- Any wind energy component;
- Certain inverters;
- Any qualifying battery component; and
- Any applicable critical mineral.

Different formulas are used based on the type of component to calculate the credit.

20. Clean Energy Production Credit and Clean Energy Investment Credit

The IRA established the new clean energy production credit and the new clean energy investment credit. The new credit for clean energy production is equal to 0.3 center per kWh of clean energy produced and sold or stored at qualified facilities placed in service after December 31, 2024. The new credit for clean energy investment is available for property placed in service after December 31, 2024 and is equal to 6% of the taxpayer's investment in qualified property for the year the property is placed in service. Taxpayers can choose between either the clean energy production credit or clean energy investment credit, but not both.

21. Prevailing Wage/Apprenticeship Requirements

As a result of the IRA, taxpayers may qualify for increased credit amounts for certain credits if they meet the prevailing wage and apprenticeship requirements. The **prevailing wage requirement** generally provides that laborers and mechanics employed by the taxpayer, or any contractors, or subcontractors are paid wages at rates not less than the prevailing wage rates for construction, alteration, or repair of a similar character. For purposes of showing compliance with the prevailing wage provisions, the taxpayer must maintain records that are sufficient to establish that the taxpayer and the taxpayer's contractor and subcontractor paid wages not less than such prevailing wage rates. Examples of records may include, but are not limited to, documentation identifying the applicable wage determination, the laborers and mechanics who performed construction work on the facility, the classifications of work they performed, their hours worked in each classification, and the wage rates paid for the work. The requirement to pay prevailing wages applies to work performed at the location of the facility as well as any secondary work site that is established specifically for or dedicated exclusively for a specific period of time to, the construction, alteration, or repair of the facility. The prevailing wage rate for work performed at any secondary work site is determined based on the geographic area in which the secondary site is located. Additionally, proposed regulations clarify that a laborer or mechanic would be considered "employed" by the taxpayer (or contractor or subcontractor) if the individual performs the duties of a laborer or mechanic for the taxpayer (or contractor or subcontractor) regardless of whether the individual would be characterized as an employee or an independent contractor for other federal tax purposes.[16]

[16] REG-100908-23.

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Per proposed regulations, the term “construction, alteration, or repair” generally means all types of work performed at the location of the facility.[17] Construction, alteration or repair also includes, but is not limited to:

- Constructing, altering, remodeling, or installing of items fabricated offsite; and
- Painting and decorating; and
- Manufacturing or furnishing of materials, articles, and supplies or equipment at the location of the facility.

Construction, alteration, or repair does not include maintenance work that occurs on the facility. Maintenance is work that is ordinary and regular in nature and designed to maintain existing functionality of a facility as opposed to an isolated or infrequent repair of a facility to restore specific functionality or adapt it for a different or improved use.

Prevailing wage rates are determined by the Department of Labor (DOL) for each classification of laborers and mechanics in a predetermined geographic area for a particular type of construction. In the absence of an applicable general wage determination, taxpayers may request a supplemental wage determination from the DOL. If a taxpayer fails to meet the prevailing wage requirements, the taxpayer is required to make correction payments for any underpaid or missing wages, plus interest, to the affected laborers and mechanics. Taxpayers failing to meet the prevailing wage requirements may also owe a penalty payment to the IRS. Even if the prevailing wage or apprenticeship requirements were not met during any period of the construction, alteration, or repair of a facility, a taxpayer may still be eligible to get the increased credit or deduction amounts by making certain correction and penalty payments. A taxpayer will be deemed to satisfy the prevailing wage requirements if the taxpayer:

- Pays the affected laborers or mechanics the difference between what they were paid and the amount they were required to have been paid, plus interest at the federal short-term rate (as defined in §6621) plus 6 percentage points; and
- Pays a penalty to the IRS of $5,000 for each laborer or mechanic who was not paid at the prevailing wage rate in the year.
    - Under the proposed regulations, the penalty may not apply if the taxpayer quickly corrects certain limited errors or has a qualifying project labor agreement in place and timely corrects any failures to pay prevailing wages, as detailed in the proposed regulations. The amount a taxpayer must pay to the laborer or mechanic as well as the penalty to the IRS is increased if the failure is determined to be the result of intentional disregard.

The apprenticeship requirement generally provides that a certain amount of total labor hours must be performed by qualified apprentices. A worker is considered an apprentice who can be paid a rate less than the applicable prevailing wage rate if the worker is employed pursuant to and individually registered in a bona fide apprenticeship program registered by the Department of Labor's Employment Training Administration, Office of Apprenticeship, or a State Apprenticeship Agency recognized by the Department of Labor's Office of Apprenticeship, and the employer adheres to the requirements of that registered apprenticeship program. By meeting prevailing wage and apprenticeship requirements, taxpayers can increase the base amounts of these incentives by 5 times.

Each taxpayer (or contractor or subcontractor) who employs four or more workers to perform construction, alteration, or repair work on a facility must employ one or more qualified apprentices when

[17] REG-100908-23.

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the apprenticeship requirements apply. Additionally, a minimum percentage of the total labor hours of the construction, alteration, or repair work must be performed by qualified apprentices from a registered apprenticeship program. The percentage is 12.5 percent for facilities beginning construction in 2023, increasing to 15 percent for facilities beginning construction in 2024 or after.

To cure a failure to meet the apprenticeship requirements, a taxpayer must pay a penalty of $50 multiplied by the total labor hours for which the apprenticeship requirements were not met. The amount of the penalty with respect to the apprenticeship requirements is also increased to $500 per labor hour if the IRS determines the failure was due to intentional disregard.

Under the good faith effort exception, taxpayers are deemed to satisfy the apprenticeship requirements if they have requested qualified apprentices from a registered apprenticeship program and either:

- The request was denied for reasons other than the taxpayer, contractor, or subcontractor's refusal to comply with the program's standards and requirements; or
- The program failed to respond within five business days of receiving a request.

To satisfy the good faith effort exception, the taxpayer (or contractor or subcontractor) must make a written request to at least one registered apprenticeship program that:

- Has a geographic area of operation that includes the location of the facility, or that can reasonably be expected to provide apprentices to the location of the facility;
- Trains apprentices in the occupation(s) needed by the taxpayer (or contractor or subcontractor) performing construction, alteration, or repair with respect to the facility; and
- Has a usual and customary business practice of entering into agreements with employers for the placement of apprentices in the occupation for which they are training, pursuant to its standards and requirements.

The prevailing wage and apprenticeship requirements apply to the following credits:

- Alternative Fuel Refueling Property Credit;
- Renewable Electricity Production Credit;
- Clean Electricity Production Credit;
- Credit for Carbon Oxide Sequestration;
- Credit for Production of Clean Hydrogen;
- Clean Fuel Production Credit;
- Energy Credit;
- Clean Electricity Investment Credit;
- Qualifying Advanced Energy Project Credit; and
- Energy Efficient Commercial Buildings Deduction.

Only the prevailing wage requirement applies to the following credits:

- New Energy Efficient Home Credit; and
- Zero-Emission Nuclear Power Production Credit.

As discussed, taxpayers claiming an increased amount for a tax credit by meeting the prevailing wage and apprenticeship requirements must adhere to specific recordkeeping requirements related to the employment of laborers, mechanics, and apprentices, including the records of any contractor or subcontractor. Examples for recordkeeping requirements for the prevailing wage requirement include

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each laborer or mechanic's hourly rates, hours worked, and deductions from wages, and actual wages paid, including payroll records that reflect the hours worked in each classification and the actual wages and fringe benefits paid to each laborer and mechanic. Examples for recordkeeping requirements for the apprenticeship include copies of any written requests for apprentices by the taxpayer (or contractor or subcontractor), any agreement entered by the taxpayer (or contractor or subcontractor) with a registered apprenticeship program, documents reflecting any registered apprenticeship program sponsored by the taxpayer (or contractor or subcontractor), documents verifying participation in a registered apprenticeship program by each apprentice, records reflecting the required ratio of apprentices to journeyworkers prescribed by each registered apprenticeship program from which qualified apprentices are employed, records reflecting the daily ratio of apprentices to journeyworkers, and the payroll records for any work performed by apprentices. If a taxpayer fails to meet the prevailing wage requirements, the taxpayer is required to make correction payments for any underpaid or missing wages, plus interest, to the affected laborers and mechanics. Taxpayers failing to meet the prevailing wage requirements may also owe a penalty payment to the IRS.

22. Elective pay

As mentioned, certain federal, state, and local governments as well as certain tax-exempt entities may have otherwise been unable to claim certain energy credits because they do not owe federal income tax. Elective payment, also referred to as an "elective pay" or "direct pay" allows applicable entities to benefit from some energy credits by treating the amount of the credit as a payment of tax and receiving a refund of any resulting overpayment. Specifically, applicable entities may elect to be treated as having made a tax payment against federal income taxes for the taxable year with respect to which an applicable credit was determined, in the amount of such credit.

Applicable entities include tax-exempt organizations (including all organizations described in §501(c) and religious or apostolic organizations under §501(d)), states, and political subdivisions such as local governments, Indian tribal governments and their subdivisions, Alaska Native Corporations, the Tennessee Valley Authority, rural electric cooperatives, U.S. territories and their political subdivisions, and agencies and instrumentalities of state, local, tribal, and U.S. territorial governments. An applicable entity can use elective pay with respect to 12 credits as long as it meets the tax credit's underlying requirements.

On June 21, 2023, the IRS issued proposed regulations concerning the election under the IRA to treat the amount of certain tax credits as a payment of federal income tax. [18] On March 5, 2024, the IRS issued final regulations. If an applicable entity has any remaining federal income tax liability, then the amount of the credit first offsets that tax liability and the rest is refunded to the applicable entity. If the applicable entity has no federal income tax liability, the applicable entity's refund will be equal to the full amount of the applicable credit.

The following credits are eligible for elective pay:

- Energy Credit (48), (Form 3468, Part VI);
- Clean Electricity Investment Credit (48E), (Form 3468, Part V);
- Renewable Electricity Production Credit (45), (Form 8835, Part II);
- Clean Electricity Production Credit (45Y);
- Commercial Clean Vehicle Credit (45W), (Form 8936, Part V);
- Zero-emission Nuclear Power Production Credit (45U), (Form 7213, Part II);

[18] REG-101607-23.

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- Advanced Manufacturing Production Credit (45X), (Form 7207);
- Clean Hydrogen Production Credit (45V), (Form 7210);
- Clean Fuel Production Credit (45Z);
- Carbon Oxide Sequestration Credit (45Q), (Form 8933);
- Credit for Alternative Fuel Vehicle Refueling / Recharging Property (30C), (Form 8911, Part II); and
- Qualifying Advanced Energy Project Credit (48C), (Form 3468, Part III).

The following steps should be taken to make a successful payment election and receive an elective payment:

1) The taxpayer must identify the applicable credit for which they intend to earn and use elective pay.
2) The taxpayer must determine their tax year, if not already known.
3) The taxpayer must satisfy all eligibility requirements for the tax credit and any applicable bonus credits, if applicable, for a given tax year,
    - The taxpayer must keep necessary documentation to substantiate the underlying tax credit and any bonus amounts, if applicable.
4) The taxpayer should complete pre-filing registration with the IRS, including providing information about themselves, the credit(s) they intend to earn, and each eligible project/property that will contribute to the applicable credit.
5) The taxpayer should file the required annual tax return by the due date or extended due date and make a valid elective payment election.

Pre-filing registration is a required electronic process for all entities that intend to make an elective payment election (or those that intend to make a credit transfer). Completing the pre-filing process and receiving a registration number is a requirement to making an elective payment election, as an elective payment election is not valid unless it contains the registration number assigned to the taxpayer. As a result, it is important to complete pre-filing registration in sufficient time to have all of the valid registration number(s) needed at the time the tax return is filed.

The applicable credit property should be placed in service prior to submitting a pre-filing registration. Once the taxpayer successfully completes the pre-filing registration process, they will receive registration numbers(s) necessary for making the elective payment election or transfer election on their tax return. Generally, the taxpayer must register and obtain a separate registration number for each applicable credit property that contributes to an applicable credit and for which they intend to make an elective payment election. It is important to note that a registration number does not guarantee credit eligibility. Pre-filing registration only provides the IRS with information that helps ensure the prompt processing of the election and payment after a tax return is filed. Additionally, a registration number is only valid for the taxable year for which it is obtained. If the election for a particular applicable credit property lasts more than one year, its registration number must be renewed each year during the election period.

Generally, elective payments occur after the tax return is processed, assuming requirements are met. The taxpayer is not entitled to receive the elective payment until the due date of the return, even if the taxpayer files the return before the due date. Typically, entities that file by the due date of their return and appropriately elect elective pay can anticipate elective payment issuance within approximately 45 days of the due date of their annual return. A taxpayer cannot make an elective payment election for credits that they purchased or that were transferred to them.

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Applicable entities are prohibited from obtaining an excess benefit. Per IRS FAQs, if an applicable entity receives a grant, forgivable loan, or other income exempt from taxation under subtitle A or otherwise excluded from taxation (tax-exempt amount) for the specific purpose of purchasing, constructing, reconstructing, erecting, or otherwise acquiring an investment-related credit property (restricted tax-exempt amount), and the sum of any restricted tax-exempt amounts plus the applicable credit otherwise determined with respect to that investment-related credit property exceeds the cost of the investment-related credit property, then the amount of the applicable credit is reduced so that the total amount of applicable credit plus the amount of any restricted tax-exempt amounts equals the cost of investment-related credit property.[19]

IRS FAQs clarify the following:[20]

- The determination of whether a tax-exempt grant is made for the specific purpose of purchasing, constructing, reconstructing, erecting, or otherwise acquiring an investment-related credit property is made at the time the grant is awarded to the applicable entity.
- A tax-exempt grant awarded after the investment-related credit property is purchased, constructed, reconstructed, erected, or otherwise acquired is generally not a restricted tax-exempt amount unless approval of the grant was perfunctory, and the amount of the grant was virtually assured at the time of application.
- The excess benefit rule does not apply if a tax-exempt amount is not received for the specific purpose of purchasing, constructing, reconstructing, erecting, or otherwise acquiring a property eligible for an investment-related credit.

The FAQs provide the following example:

- School district A receives a tax-exempt grant in the amount of $400,000 from a federal agency to purchase electric school bus B. A purchases B for $400,000. A's basis in B is $400,000. B qualifies for the maximum §45W credit, $40,000. However, because the amount of the restricted tax-exempt grant plus the amount of the §45W credit exceeds the cost of B, A's §45W credit is reduced by the amount necessary so that the total amount of the §45W credit plus the restricted tax-exempt amount equals the cost of B. A's §45W credit is therefore reduced by $40,000 to zero.
- Now assume that the grant above is in the amount of $300,000. A purchases B using the grant and $100,000 of A's unrestricted funds. A's basis in B is $400,000 and A's §45W credit is $40,000. Since the amount of the restricted tax-exempt grant plus the amount of the §45W credit ($340,000) is less than the cost of B, A's 45W credit is not reduced.

The FAQs provide another example:

- Public charity B receives a $60,000 grant from a private foundation to build energy property, P, a qualified investment credit property that costs $80,000. B uses $20,000 of its own funds plus the $60,000 grant to build P. B's basis in P is $80,000. Based upon acquisition cost, B can earn a §48 investment credit (with bonus credit amounts) of $40,000 (50% of basis). However, because the amount of the restricted tax-exempt grant ($60,000) plus the §48 credit ($40,000) exceeds P's cost by $20,000, B's §48 applicable credit is reduced by $20,000 so that the total amount of the §48 investment credit plus the restricted tax-exempt amount equals the cost of P.

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[19] Elective pay and transferability frequently asked questions: Elective pay.

[20] Elective pay and transferability frequently asked questions: Elective pay.

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23. Transferability

Proposed regulations also address the transferability of certain credits. Transferability allows entities that qualify for a tax credit but are not eligible to use elective pay to transfer all or a portion of the credit to a third-party buyer in exchange for cash. The buyer and seller must negotiate and agree to the terms and pricing. Applicable entities are not eligible to transfer credits. A transferee taxpayer may not make any additional transfers of a transferred eligible credit. An eligible taxpayer must make an election to transfer any portion of an eligible credit on its original tax return for the taxable year for which the credit is determined by the due date of such return (including extensions of time), but such an election cannot be made earlier than February 13, 2023. This election is an irrevocable election.

Any amount of consideration paid by the transferee taxpayer to the eligible taxpayer for the transfer of such credit (or such portion thereof) is:

- Required to be paid in cash;
- Not included in the eligible taxpayer's gross income; and
- Not allowed as a deduction to the transferee taxpayer under any provision of the Code.

An excessive transfer, defined as a transfer of credit in excess of what the transferee could properly claim, may result in a penalty.

In the case of a partnership or an S corporation that directly holds a facility or property for which an eligible credit is determined, the election to transfer an eligible credit is made at the entity level and no election by any partner or shareholder is allowed with respect to such facility or property. Any amount received as consideration for a transferred eligible credit is treated as tax-exempt income, and a partner's distributive share of the tax-exempt income is based on the partner's distributive share of the transferred eligible credit.

In June 2023, the IRS released proposed regulations regarding taxpayers that elect to transfer eligible credits in a taxable year and the transferee taxpayers to which eligible credits are transferred. These proposed regulations provide general rules related to transfers of eligible credits by transferor partnerships and transferor S corporations and purchases of eligible credits by transferee partnerships and transferee S corporations.[21] The proposed regulations clarify that any tax-exempt income resulting from the receipt of consideration for the transfer of a specified credit portion by a transferor partnership or transferor S corporation is treated as arising from an investment activity and not from the conduct of a trade or business. As such, this tax-exempt income is not treated as passive income to any partners or shareholders who do not materially participate.

The proposed regulations include special rules applicable to transferor and transferee partnerships and their direct and indirect partners.

For transferor partnerships:

- Under the proposed regulations, a partner's distributive share of tax-exempt income resulting from the receipt of cash by a transferor partnership for a transferred specified credit portion is generally based on the partner's proportionate distributive share of the otherwise eligible credit.
- Additionally, tax-exempt income resulting from the receipt of cash by a transferor partnership in exchange for a transferred specified credit portion should be allocated to

[21] REG-101610-23.

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the same partners and in the same proportionate amount, as the specified credit portion would have been allocated if not transferred.

The IRA permits taxpayers to transfer all or any portion of the following credits:

- Energy Credit (48), (Form 3468, Part VI);
- Clean Electricity Investment Credit (48E), (Form 3468, Part V);
- Renewable Electricity Production Credit (45), (Form 8835, Part II);
- Clean Electricity Production Credit (45Y);
- Zero-emission Nuclear Power Production Credit (45U), (Form 7213, Part II);
- Advanced Manufacturing Production Credit (45X), (Form 7207);
- Clean Hydrogen Production Credit (45V), (Form 7210);
- Clean Fuel Production Credit (45Z);
- Carbon Oxide Sequestration Credit (45Q), (Form 8933);
- Credit for Alternative Fuel Vehicle Refueling/Recharging Property (30C), (Form 8911, Part II); and
- Qualified Advanced Energy Project Credit (48C), (Form 3468, Part III).

24. Three-Year Carryback for Certain General Business Credits

Prior to the IRA, general business credits could be carried back one year and carried forward 20 years. New credits were unable to be carried back to a year prior to the effective date for the applicable credit.

The IRA creates a three-year carryback period for certain general business credits related to clean energy and allows them to be carried back to a year prior to the effective date. Additionally, it extends the carryforward period to 22 years. The new three-year carryback for certain general business credits applies to the following credits for tax years beginning after 2022:

- §30C Alternative Fuel Vehicle Refueling Property Credit
- §45 Renewable Electricity Production Credit
- §45Q Credit for Carbon Oxide Sequestration
- §45U Zero-Emission Nuclear Power Production Credit
- §45V Credit for Production of Clean Hydrogen
- §45W Credit for Qualified Commercial Clean Vehicles (for tax-exempt entities)
- §45X Advanced Manufacturing Production Tax Credit
- §45Z Clean Fuel Production Credit
- §48 Energy Credit
- §48C Qualifying Advanced Energy Project Credit
- §48E Clean Electricity Investment Credit

25. Enhancement of IRS Services

The IRA allocates nearly $80 billion in additional funding to the IRS to enhance services provided by the IRS. These funds are available through September 30, 2031.

Approximately $3.2 billion is provided to the IRS for taxpayer services, including:

- Taxpayer services;
- Pre-filing assistance and education services;
- Filing and account services; and
- Taxpayer advocacy services.

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Approximately $45 billion is provided to the IRS for tax enforcement activities, including:

- Determining and collecting owed taxes;
- Providing legal and litigation support;
- Conducting criminal investigations;
- Providing digital asset monitoring and compliance activities;
- Enforcing criminal statutes related to violations of internal revenue laws and other financial crimes; and
- Hiring and purchasing passenger motor vehicles.

Approximately $25 billion is provided to the IRS for operations support, including:

- Supporting taxpayer services and enforcement programs;
- Rent payments;
- Facilities services;
- Printing and postage;
- Physical security;
- Headquarters and other IRS-wide administration activities;
- Research and statistics of income;
- Telecommunications and information technology development; and
- Enhancement, operations, and maintenance.

Approximately $5 billion is provided for IRS business systems modernization, including:

- Development of callback technology and other technology to provide a more personalized customer service; and
- The operation and maintenance of legacy systems.

On August 7, 2024, the IRS issued statistics on the Inflation Reduction Act clean energy tax credits for tax year 2023. Taxpayers have claimed over $6 billion in credits for residential clean energy investments, such as solar electricity generation, solar water heating, and battery storage, and more than $2 billion for energy-efficient home improvements, including heat pumps, high-efficiency air conditioners, insulation, windows, and doors, on 2023 tax returns filed and processed as of May 23, 2024.

Detailed statistics from the IRS (IR-2024-202) are as follows:

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Residential and Energy Efficient Home Improvement Credit

Credit	Number of returns	Credit value
Residential Clean Energy Credit	1,246,440	Total: $6.3 billion, Average per return: $5,084
Rooftop solar	752,300	Up to 30% of cost
Batteries	48,840	Up to 30% of cost
Energy Efficient Home Improvement Credit	2,338,430	Total: $2.1 billion, Average per return: $882
Home insulation	669,440	Up to 30% of cost
Windows and skylights	694,450	Up to 30% of cost or $600
Central air conditioners	488,050	Up to 30% of cost or $600
Doors	400,070	Up to 30% of cost, $250 per door, or $500 total
Heat pumps	267,780	Up to 30% of cost or $2,000
Heat pump water heaters	104,180	Up to 30% of cost or $2,000

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Sale of Passthrough Entity Interest and Net Investment Income Tax

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Sale of Passthrough Entity Interest and Net Investment Income Tax

Learning objective

Upon reviewing this material, the reader will be able to understand the effects of the sale of a passthrough entity's interest on Net Investment Income Tax.

I. Background

Enacted by the Healthcare and Education Reconciliation Act of 2010 and applying to tax years beginning in 2013, §1411(a)(1) imposes on individuals the Net Investment Income Tax (NIIT) of 3.8%, a tax in addition to income tax, for the lesser of:

- The individual's **net investment income** for a taxable year; or
- The excess, if any, of the individual's
  - **Modified adjusted gross income** for such taxable year, over
  - The **threshold amount**.

Section 1411(c) refers to Net Investment Income (NII) as any excess of net investment income over net investment deductions, with **investment income** being:

(i) Gross income of interest, dividends, annuities, royalties, and rent not derived from the ordinary course of business;

(ii) Gross income derived from a trade or business that is either: (1) a passive activity within the meaning of §469 or (2) a financial instruments/commodities trading business under §475(e)(2); AND

(iii) The net gain (to the extent accounted for in computing taxable income) attributable to the disposition of property described in (ii).

Practice note: Common investment expenses deductible in computing NII

Examples of properly allocable deductions include investment interest expense, investment advisory and brokerage fees, expenses related to rental and royalty income, and state and local income taxes properly allocable to items included in NII.

The **threshold amount** is defined under §1411(b) as the following:

- $250,000 for MFJ, Surviving Spouse;
- $125,000 for MFS; or
- $200,000 for other individuals.

Note: Line and code references apply to 2024 forms

Within this manual, references to line numbers of forms, including Form 8960 are made. All references apply to the 2024 draft version of the respective forms. Filled-in draft forms have had the draft watermarks removed for readability and illustrative purposes.

The IRS generally releases an early draft version of forms in the late summer of each year. The final versions of tax forms are generally released in December or early January.

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Practice point: Not Inflation Adjusted

The threshold amounts of §1411(b) are not indexed for inflation.

The **Modified Adjusted Gross Income (MAGI)** is outlined under §1411(d) as adjusted gross income (AGI) increased by the excess of: (1) the foreign earned income exclusion under §911(a)(1) over (2) deductions/exclusions disallowed by the double-benefit prohibitions of §911(d)(6) with the amount of foreign earned income excluded.

Taxpayers subject to the NIIT must determine their tax by completing Form 8960, *Net Investment Income Tax—Individuals, Estates, and Trusts*.

Example 1: Rachel Green is a single taxpayer with wages of $180,000 and $15,000 of dividends and capital gains.

Rachel's modified adjusted gross income is $195,000, which is less than the $200,000 statutory threshold. She is not subject to the Net Investment Income Tax.

Example 2: Fox Mulder is a single taxpayer with wages of $180,000 and $90,000 of passive partnership interest, which is considered Net Investment Income.

Fox's modified adjusted gross income is $270,000, which exceeds the threshold of $200,000 for single taxpayers by $70,000.

Fox's Net Investment Income is $90,000; however, the Net Investment Income Tax is based on the lesser of $70,000 (the amount modified adjusted gross income exceeds the $200,000 threshold) or $90,000 (Net Investment Income).

Fox owes NIIT of $2,660 ($70,000 x 3.8 percent).

Example 3: Homer and Marge are married and file a joint return. For the current year they report AGI of $300,000 consisting of the following: $175,000 in wages, jointly owned interest and dividend income of $12,500 each ($25,000 total), and $100,000 in long-term capital gains.

Within their portfolio account, Homer and Marge pay interest of $4,000 on debt incurred to purchase stock. This interest is allocable to the stock and is investment interest. They also pay their broker $8,000 in investment advisory fees. (Note: these are excluded from Schedule A due to the suspension of miscellaneous itemized deductions).

Since Homer and Marge's modified adjusted gross income exceeds the threshold of $250,000 (married filing jointly) by $50,000, they must complete Form 8960.

Homer and Marge's Net Investment Income is $121,000; however, the NII Tax is based on the lesser of $50,000 (the amount modified adjusted gross income exceeds the $250,000 threshold) or $121,000 (Net Investment Income).
Homer and Marge owe NIIT of $1,900 ($50,000 x 3.8 percent).

Any Net Investment Income Tax calculated on Form 8960 is transferred as an Additional Tax on Schedule 2 (Form 1040), Line 12.

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Form **8960**

Department of the Treasury
Internal Revenue Service

Net Investment Income Tax— Individuals, Estates, and Trusts

Attach to your tax return.
Go to *www.irs.gov/Form8960* for instructions and the latest information.

OMB No. 1545-2227
2024
Attachment Sequence No. 72

Name(s) shown on your tax return: HOMER AND MARGE
Your social security number or EIN:

Part I Investment Income

☐ Section 6013(g) election (see instructions)
☐ Section 6013(h) election (see instructions)
☐ Regulations section 1.1411-10(g) election (see instructions)

Line	Description	Sub-line	Sub-amount	Line	Amount
1	Taxable interest (see instructions)			1	12,500
2	Ordinary dividends (see instructions)			2	12,500
3	Annuities (see instructions)			3	
4a	Rental real estate, royalties, partnerships, S corporations, trusts, trades or businesses, etc. (see instructions)	4a			
b	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	4b			
c	Combine lines 4a and 4b			4c	
5a	Net gain or loss from disposition of property (see instructions)	5a	100,000		
b	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	5b			
c	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	5c			
d	Combine lines 5a through 5c			5d	100,000
6	Adjustments to investment income for certain CFCs and PFICs (see instructions)			6	
7	Other modifications to investment income (see instructions)			7	
8	Total investment income. Combine lines 1, 2, 3, 4c, 5d, 6, and 7			8	125,000

Part II Investment Expenses Allocable to Investment Income and Modifications

Line	Description	Sub-line	Sub-amount	Line	Amount
9a	Investment interest expenses (see instructions)	9a	4,000		
b	State, local, and foreign income tax (see instructions)	9b			
c	Miscellaneous investment expenses (see instructions)	9c			
d	Add lines 9a, 9b, and 9c			9d	4,000
10	Additional modifications (see instructions)			10	
11	Total deductions and modifications. Add lines 9d and 10			11	4,000

Part III Tax Computation

Line	Description	Sub-line	Sub-amount	Line	Amount
12	Net investment income. Subtract Part II, line 11, from Part I, line 8. Individuals, complete lines 13–17. Estates and trusts, complete lines 18a–21. If zero or less, enter -0-			12	121,000
	Individuals:				
13	Modified adjusted gross income (see instructions)	13	300,000		
14	Threshold based on filing status (see instructions)	14	250,000		
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	50,000		
16	Enter the smaller of line 12 or line 15			16	50,000
17	Net investment income tax for individuals. Multiply line 16 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			17	1,900
	Estates and Trusts:				
18a	Net investment income (line 12 above)	18a			
b	Deductions for distributions of net investment income and charitable deductions (see instructions)	18b			
c	Undistributed net investment income. Subtract line 18b from line 18a (see instructions). If zero or less, enter -0-	18c			
19a	Adjusted gross income (see instructions)	19a			
b	Highest tax bracket for estates and trusts for the year (see instructions)	19b			
c	Subtract line 19b from line 19a. If zero or less, enter -0-	19c			
20	Enter the smaller of line 18c or line 19c			20	
21	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (0.038). **Enter here and include on your tax return** (see instructions)			21	

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 59474M Form **8960** (2024)

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II. NIIT Excepted dispositions under §1411(c)(4)

The purpose of §1411(c)(4) is to allow gain attributable to non-passive activities to be excluded from the calculation of §1411 tax upon the disposition of an interest in a Passthrough Entity ("PTE"). For a §1411(c)(4) disposition, the gain from the sale of the interest is includible in NII to the extent that: (1) if the PTE's individual assets were sold at FMV and (2) such allocable share of the gain/loss would be includible in the partner/shareholder's NII. Thus, these gains are includible to the extent they are derived from PTEs treated as a passive activity under §469 or are a financial instruments/commodities trading business under §475(e)(2).

A §1411(c)(4) disposition is the disposition of an interest in a Passthrough Entity (either partnership or S corp; "PTE") by an individual, estate, or trust if:

- PTE is engaged in one or more trades or businesses, or owns an interest (directly or indirectly) in another PTE that is engaged in one or more trades or businesses, other than the business of trading in financial instruments or commodities (within the meaning of §1.1411-5(a)(2); §475(e)(2)); and
- One or more of the trades or businesses of the PTE is not a passive activity (within the meaning of §1.1411-5(a)(1); §469) of the transferor.[1]

For PTEs disposing of an interest in a subsidiary PTE, that disposition qualifies for an NIIT exception with respect to a partner/shareholder of the PTE if the partner/shareholder would satisfy §1411(c)(4) disposition requirements having held the subsidiary PTE interest directly (i.e., the subsidiary PTE conducts at least one trade or business AND the trade or business is not a passive activity). Thus, the partner/shareholder shall be treated as owning a proportionate share of any subsidiary PTE which is held indirectly through one or more tiers of PTEs (i.e., a look through rule). [2]

A. Special rules

If part of a single liquidation plan, a PTE's assets are disposed in a fully taxable transaction followed by a complete liquidation of the PTE, the disposition will be treated as a single asset sale subject to NIIT if a passive activity, with no additional gain or loss subject to NIIT on the subsequent liquidation of the PTE. [3]

In the case of S corporation shareholders, should a disposition of S corporation stock terminate the S election, the corporation will continue to be treated as an S corporation for purposes of determining whether or not a stock disposition will be treated as an excepted disposition under §1411(c)(4). [4]

Further, an S corporation's allocation of built-in gains ("BIG") tax under §1374 does not impact the gain determined for NIIT purposes. [5]

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1 *Prop. Reg. §1.1411-7(a)(3)(i).*
2 *Prop. Reg. §1.1411-7(a)(3)(ii).*
3 *Prop. Reg. §1.1411-7(a)(4)(i).*
4 *Prop. Reg. §1.1411-7(a)(4)(iii)(A).*
5 *Prop. Reg. §1.1411-7(a)(4)(iii)(C).*

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B. Section 469 passive activities

Section 469 restricts certain taxpayers' use of deductions and credits derived from passive activities. Passive activities exist (§469(c)) in the following scenarios:

- Businesses in which the taxpayer does not **materially participate** (includes activities on Schedules C or F and from partnerships, LLCs, and S Corporations); AND
- All rentals, including real estate and equipment leasing.

Generally, **all rental activity**[6] is treated as a passive activity, regardless of whether the individual materially participates.[7] As it relates to loss limitations, there are exceptions for those with "active participation" or individuals meeting an exception as a "real estate professional".

Though all rentals are categorically passive, an activity is not a "rental activity" for a taxable year if any of the following six conditions exist:[8]

1. The average period of customer use is seven days or less.[9]
2. The average period of customer use is 30 days or less and significant personal services are provided by or on behalf of the owner of the property in connection with making it available for customer use. What constitutes "significant personal services" is not clearly defined in the regulations and depends on all relevant facts and circumstances, including the frequency of services, the type and amount of labor required to provide services, and the value of the services relative to the amount charged for the use of the property.[10]
3. Extraordinary personal services are provided in connection with making the property available for use by customers. For services to be deemed extraordinary, the use of the property must be incidental to the receipt of the services. For example, student use of a school's dormitory facilities generally is incidental to receipt of the personal services provided by the school's teaching staff.[11]
4. The rental is incidental to a nonrental activity. Specifically, the application of this rule is limited to: (i) investment property (property held primarily to realize gain from appreciation); (ii) property used in a trade or business where the gross income from rentals is less than two percent of the lesser of the property's unadjusted basis or fair market value; and (iii) property used for employee lodging.[12]
5. The property is customarily made available during defined business hours for the nonexclusive use by various customers. For example, a golf course that is made available during prescribed hours for nonexclusive use by various customers would not be considered a rental activity.[13]
6. The property is self-rented. Specifically, if property is rented for use in an activity conducted by a partnership, S corporation, or joint venture in which the taxpayer-property-owner owns an interest, it is not a rental activity.[14]

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6 *I.R.C. §469(j)(8) defines this as an activity where the payments are principally for the use of tangible property.*

7 *I.R.C. §469(c)(2).*

8 *Temp. Regs. §1.469-1T(e)(3). However, the material participation standard does not apply to taxpayers engaged in rental real estate activities. A rental real estate activity is one involving the receipt of compensation for the use of realty and is characterized by low turnover among tenants, long lease terms, and the performance of insubstantial services by the lessor to the lessee. Consequently, operation of a hotel or a condominium hotel would not be a rental real estate activity, but operation of an apartment house should be.*

9 *Temp. Regs. §1.469-1T(e)(3)(ii)(A).*

10 *Temp. Regs. §1.469-1T(e)(3)(ii)(B).*

11 *Temp. Regs. §1.469-1T(e)(3)(ii)(C).*

12 *Temp. Regs. §1.469-1T(e)(3)(ii)(D).*

13 *Temp. Regs. §1.469-1T(e)(3)(ii)(E).*

14 *Temp. Regs. §1.469-1T(e)(3)(ii)(F).*

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Note:

> However, a non-rental activity may nonetheless be passive if the property owner does not materially participate.

1. Activities and groups of activities

Since material participation is defined in terms of participation in an activity, the definition of what constitutes an activity is extremely important, as shown in the following simple example. Assume Mr. Cook owns 10 different real estate properties in 10 different Philadelphia suburbs, and he participates in the real estate properties for 800 hours per year, working an equal number of hours (80) in each property. Each property also has a full-time staff. If each property was defined as a separate activity, Mr. Cook would not materially participate in any of the real estate properties, since he would not reach the applicable requirement of more than 100 hours of participation (SPA test number four). **In contrast, if all 10 real estate properties constitute a single activity, Mr. Cook would satisfy the 500-hour test for material participation (test number one).**

One or more trades, businesses, or rental activities are treated as a single activity if the activities constitute an appropriate economic unit for the purposes of determining a gain or loss.[15] Generally, whether activities are treated as a single activity depends on all the relevant facts and circumstances.[16] Under proposed regulations, the taxpayer has great flexibility in determining what constitutes a single activity. The taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities. To treat more than one activity as a single activity the following factors, not all of which are necessary for such treatment, are given the greatest weight in determining whether activities constitute an appropriate economic unit:

- The extent of common control between the activities (for example, the extent to which the activities to purchase or sell goods are under common control);
- The extent of common ownership;
- Similarities in types of businesses;[17]
- Geographical location; and
- Interdependencies among themselves (i.e., involve products or services that are normally provided together, have the same customers, have the same employees, or are accounted for with a single set of books and records).

One of the criteria identified in aggregating activities is the extent to which the activities are commonly controlled. Based upon IRS guidance, two or more activities are considered commonly controlled if, under all facts and circumstances, separate activities are controlled by the same interests.[18] In general, control includes direct and indirect control, whether or not legally enforceable and however exercised. The determination is made on the basis of fact, not form. If there are no compelling arguments to the contrary, activities are presumed to be commonly controlled if they are part of the same common-ownership

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15 *Treas. Regs. §1.469-4(c)(1).*

16 *Treas. Regs. §1.469-4(c)(2).*

17 *There are two tests for similarity. First, two activities are similar if their predominant operations are in the same line of business. Predominance is present when more than 50 percent of an undertaking's gross income is attributable to a single line of business. Temp. Regs. §1.469-4T(f)(4)(ii). Operations are in the same line of business if they share the same Standard Industry Classification Code (SIC), as described in Rev. Proc. 89-38. In the case of real estate, every conceivable type of business related to real estate ownership, operation, management, or construction is treated as the same line of business. However, hotel management is generally treated as a separate line of business from other real estate businesses. The second test of similarity is the vertical-integration test. Two activities are treated as similar if one activity provides more than 50 percent of its property or services to another activity that is commonly controlled. That is, the activities are essentially vertically integrated. Temp. Regs. §1.469-4T(f)(4)(iii).*

18 *Temp. Regs. §1.469-4T(j)(1).*

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group.[19] A common-ownership group exists when the common-ownership percentages of any five or fewer persons (other than passthrough entities such as partnerships or S corporations) exceed 50 percent. For purposes of this criterion, the common-ownership percentage of a person is the person's smallest ownership percentage in any such activity.[20] In determining a person's ownership percentage, direct as well as indirect ownership through passthrough entities such as partnerships and S corporations is counted.[21]

A few other principles exist regarding grouping of activities as listed below:

- A rental activity may not be grouped with a trade or business activity unless either the rental activity is insubstantial in relation to the trade or business activity or the trade or business is insubstantial in relation to the rental activity.[22] The meaning of the word "**insubstantial**" is undefined. Under prior IRS guidance, the ability to aggregate was determined by the so-called "80-20 rule," whereby the taxpayer had to treat all rental and business undertakings at a single location as a single activity if the gross income from either constituted more than 80 percent of the gross income.
- **Once the activities have been grouped by the taxpayer, the taxpayer may not regroup the activities** unless the original grouping was clearly inappropriate or if a material change occurs that makes the original grouping clearly inappropriate. When a taxpayer regroups activities, the taxpayer must comply with disclosure requirements as determined by the Commissioner.[23]
- A partnership or S corporation determines its activities as an entity, and once these activities are grouped, the partner or shareholder groups those activities with activities conducted directly by the partner and shareholder or activities conducted through other partnerships or S corporations in accordance with the foregoing rules.[24]

2. Material participation for business activities

Participation is broken down into distinct types:

- Material Participation relating business activities; AND
- Active Participation relating to rental activities.

Generally, a taxpayer will be treated as **materially participating in an activity** only **if the taxpayer is involved in the operations of the activity on a regular, continuous, and substantial basis**.[25] In general, taxpayers who own limited partnership interests will be treated as not materially participating in the activities of the partnership.[26] The regulations provide seven tests to determine material participation. An individual materially participates in a trade or business activity in any taxable year if any one of the following seven tests is met:

1. The individual participates in the activity for **more than 500 hours** during the taxable year;[27]

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19 *Temp. Regs. §1.469-4T(j)(2)(i).*
20 *Temp. Regs. §1.469-4T(j)(2)(ii).*
21 *Temp. Regs. §1.469-4T(j)(3).*
22 *Treas. Regs. §1.469-4(d)(1).*
23 *Treas. Regs. §1.469-4(e).*
24 *Treas. Regs. §1.469-4(d)(5)(i).*
25 *I.R.C. §469(h)(1).*
26 *Temp. Regs. §1.469-5T(e)(1). Such limited partners may be treated as materially participating only if they meet the 500-hour test, the material-participation-in-five-of-the-preceding-10-taxable-years test, or the material-participation-in-any-three-preceding-taxable-years test. Temp. Regs. §1.469-5T(e)(2).*
27 *Temp. Regs. §1.469-5T(a)(1).*

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2. The individual's participation in the activity for the taxable year constitutes **substantially all of the participation** in such activity by all individuals (including nonowners) for that year;[28]
3. The individual participates in the activity for **more than 100 hours during the taxable year and such individual's participation is not less** than the participation in the activity of any other individual (including nonowners);[29]
4. The activity is a significant-participation activity (SPA -- defined below) and the individual's aggregate participation in all SPAs during the year exceeds 500 hours;[30]
5. The individual materially participated in the activity for any five taxable years during the 10 preceding taxable years;[31]
6. The activity is a personal-service activity (PSA) in which the individual materially participated during any three preceding taxable years;[32] or
7. The individual participates in the activity for at least 100 hours during the taxable year and on the basis of all facts and circumstances the participation is material.[33] This "facts-and-circumstances" test is limited to cases where: (i) no person other than the taxpayer in question is compensated for management services; and (ii) no other individual, whether or not an owner of the business, provides more hours of management service than the taxpayer.[34]

A **significant-participation activity (SPA)** is a trade or business activity in which the taxpayer participates from 100 to 500 hours during the taxable year, but in which the taxpayer does not materially participate. Taxpayers must be wary of passive activities that are classified as SPAs. SPAs are essentially a "heads the IRS wins, tails you lose" proposition. SPA losses are treated as passive losses, but SPA income is treated as nonpassive income. Therefore, SPA losses may not be used to shelter other nonpassive income or even other SPA income, and SPA income cannot be used to absorb other passive-activity losses or even other SPA losses.

A **personal-service activity (PSA)** is an activity that derives more than 50 percent of its gross income from the provision of services in the health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting professions. A taxpayer's interests in two or more personal-service activities controlled by the same interests are treated as the same activity. This rule applies even if the interests are in diverse professions, such as accounting and the performing arts.

3. Real estate professional

Beginning in 1994, income and deductions from a rental real estate activity in which the real estate professional materially participates may no longer be classified as passive-activity income and related deductions.

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28 *Temp. Regs. §1.469-5T(a)(2).*
29 *Temp. Regs. §1.469-5T(a)(3).*
30 *Temp. Regs. §1.469-5T(a)(4).*
31 *Temp. Regs. §1.469-5T(a)(5).*
32 *Temp. Regs. §1.469-5T(a)(6).*
33 *Temp. Regs. §1.469-5T(a)(7).*
34 *Temp. Regs. §1.469-5T(b)(2)(ii).*

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To qualify as a real estate professional, a taxpayer must meet the following requirements:

a. **More than one-half of the personal services** performed in trades or businesses by the taxpayer during the taxable year **are performed in real property trades or businesses** in which the taxpayer materially participates.[35]

b. **The services performed by the taxpayer in real property trades or businesses** in which the taxpayer materially participates **exceed 750 hours.**[36]

c. In the case of a joint return, at least one of the spouses must separately, with respect to all trades or businesses in which the spouse performs services, render a majority of such personal services in real property trades or businesses in which the spouse materially participates, and must perform more than 750 hours of services in real property trades or businesses in which the spouse materially participates.[37] In determining whether a taxpayer materially participates in a real property trade or business, however, the participation of both spouses is taken into account.[38]

d. The statute makes it clear that the provision for real estate professional status does not affect the determination of whether the taxpayer materially participates with respect to any interest in a limited partnership as a limited partner.[39]

e. Personal services performed as an employee are not treated as performed in a real property trade or business unless the taxpayer is a five-percent owner of the business.[40]

If you're a real estate professional for purposes of §469(c)(7), your rental income or loss won't be passive if you materially participated in the rental real estate activity.

III. Calculation of gain (loss) attributable to passthrough entity interest dispositions – Primary Method

For dispositions where §1411(c)(4) exceptions do not apply entirely, such gains and losses are determined as following:

- For dispositions resulting in gain for income tax purposes, the taxpayer's NII gain equals the lesser of:
  - (i) The amount of gain the taxpayer recognizes for income tax purposes; or
  - (ii) The taxpayer's allocable share of net gain from a deemed sale of the PTE's 1411 property (i.e., gain from sale of passive/financial commodity property).
- For dispositions resulting in loss for income tax purposes, the taxpayer's NII loss equals the lesser of:
  - (i) The amount of loss the taxpayer recognizes for income tax purposes; or
  - (ii) The taxpayer's allocable share of net loss from a deemed sale of the PTE's 1411 property (i.e., loss from sale of passive/financial commodity property).

Example 1: ***Facts (Primary Method)***
A owns a one-half interest in AP, LLC, a calendar year partnership. In Year 1, A sells its interest for $200,000. A's adjusted basis for the interest sold is $120,000. Thus, A recognizes $80,000 ($200,000 - $120,000) of gain from the sale. AP, LLC is engaged in three trade or business activities, X, Y, and Z, none of which trade in financial instruments or commodities. AP, LLC also owns marketable

[35] *I.R.C. §469(c)(7)(B)(i).*
[36] *I.R.C. §469(c)(7)(B)(ii).*
[37] *I.R.C. §469(c)(7)(B) (flush language).*
[38] *I.R.C. §469(h)(5).*
[39] *I.R.C. §469(c)(7)(A) (flush language).*
[40] *I.R.C. §469(c)(7)(D)(ii).*

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securities. For Year 1, A materially participates in activity Z; thus, it is not a passive activity subject to NIIT. A, however, does not materially participate in activities X and Y, so these activities are passive activities subject to NIIT. Because AP, LLC is engaged in at least one trade or business and at least one of those trades or businesses is not passive to the transferor A, A determines its amount of gain or loss attributable to NIIT given the fair market value and adjusted basis of the gross assets used in AP, LLC's activities as follows:

Activity	Classification to A	Adj. Basis	FMV	Total Gain (Loss)	A's Share of Gain (Loss)
X	Passive	136,000	96,000	(40,000)	(20,000)
Y	Passive	60,000	124,000	64,000	32,000
Z	Non-Passive	40,000	160,000	120,000	60,000
Marketable Securities	Portfolio	4,000	20,000	16,000	8,000
Total		240,000	400,000	160,000	80,000

Total Gain	80,000
Portfolio/Passive Gain [($20,000) + $32,000 + $8,000]	20,000
Gain subject to NIIT *	**20,000**
**** Lesser of Total Gain and Portfolio/Passive Gain but not less than zero***	

Analysis
A must determine the portion of gain or loss from the sale of AP's Section NII property allocable to A. A's allocable share of gain from AP's NII property is $20,000 (($20,000) from X + $32,000 from Y + $8,000 from the marketable securities). Because the $20,000 allocable to A from a deemed sale of AP's NII property is less than A's $80,000 gain, A will include $20,000 for NIIT purposes.

Example 2: ***Facts (Primary Method)***
Assume the same facts as Example 1, but A materially participates in activities Y and Z and does not materially participate in activity X. Because AP, LLC is engaged in at least one trade or business and at least one of those trades or businesses is not passive to the transferor A, A determines its amount of gain or loss attributable to NIIT given the fair market value and adjusted basis of the gross assets used in AP, LLC's activities as follows:

Activity	Classification to A	Adj. Basis	FMV	Total Gain (Loss)	A's Share of Gain (Loss)
X	Passive	136,000	96,000	(40,000)	(20,000)
Y	Non-Passive	60,000	124,000	64,000	32,000
Z	Non-Passive	40,000	160,000	120,000	60,000
Marketable Securities	Portfolio	4,000	20,000	16,000	8,000
Total		240,000	400,000	160,000	80,000

Total Gain	80,000
Portfolio/Passive Gain (Loss) [($20,000) + $8,000]	(12,000)
Gain subject to NIIT *	- *
**** Lesser of Total Gain and Portfolio/Passive Gain but not less than zero***	

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Analysis
A's allocable share of AP's NII property is ($12,000) (($20,000) from X + $8,000 from the marketable securities). Because A sold its interest for a gain for income tax purposes, the amount allocable to A from a deemed sale of AP's NII property cannot be less than zero. Accordingly, A includes no gain or loss for NIIT purposes.

A. Optional simplified reporting method

Under the optional method, the IRS permits a simplified method for gains associated with PTEs where the passive assets are likely to be relatively small. The simplified reporting method is intended to limit the information sharing burden on PTEs by allowing transferors to rely on readily available information to calculate the amount of gain or loss included in NII under §1411(c)(4). For this purpose, the optional simplified method relies on historic distributive share amounts received by the transferor from the PTE to extrapolate a percentage of the assets within the PTE that are passive with respect to the transferor for purposes of §1411(c)(4). For example, if ten percent of the income reported on the applicable Schedules K-1 is of a type that would be included in net investment income, then the simplified reporting method presumes that ten percent of the income tax gain on the disposition of the transferor's interest relates to NII property of the PTE for purposes of the disposition.

1. Qualifications and exceptions

The optional simplified reporting method applies to a §1411(c)(4) disposition **if either requirement is met:** [41]

- **Five-Percent Threshold:** If the absolute value of all NII income, gain, loss, and deduction items allocated to a partner/shareholder is 5% or less of the absolute value of all income, gain, loss, and deduction allocated to a partner/shareholder during the §1411 holding period, and the total PTE gain included for income tax purposes does not exceed $5,000,000.
- **$250,000 Gain/Loss Threshold:** The total gain/loss recognized by the selling partner/shareholder does not exceed $250,000 (including gains/losses from multiple dispositions as part of a plan; all dispositions in a single tax year are presumed to be part of a plan).

Section 1411 holding period is defined to mean the year of disposition and the transferor's two taxable years preceding the disposition or the time period the transferor held the interest, whichever is less.

- Where the transferor acquires its interest from another PTE in a nonrecognition transaction during the year of disposition or the prior two taxable years, the transferor must include in its §1411 holding period the period that the previous owner or owners held the interest.
- Also, where the transferor transferred an interest in a subsidiary PTE to a PTE in a nonrecognition transaction during the year of the disposition or the prior two taxable years, the transferor must include in its §1411 holding period that period that it held the interest in the subsidiary PTE.
- Finally, the §1411 holding period also includes the period that a previous owner or owners held the interest transferred if the transferor acquired its interest by gift.

[41] *Prop. Reg. §1.1411-7(c)(2)*

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Though the above qualifications may be met, Prop. Reg. 1.1411-7(c)(3) provides **five exceptions where the optional simplified reporting method is disallowed:**

1. Partners/shareholders that have held the interest for less than 12 months;
2. Contributions of NII property to a PTE followed distributions of non-NII property during the §1411 holding period [i.e., mixing-bowl transactions] (contributions of NII property within 120 days of the disposition of a PTE interest will be presumed to not qualify for the optional reporting method);
3. PTEs have increased or decreased NII property by 25% or more during the partner/shareholder's §1411 holding period (i.e., significant change in composition of the assets);
4. S election was made during the shareholder's §1411 holding period; OR
5. Partial dispositions of interests not representing proportionate share of the economic rights in a PTE (e.g., partner sells preferred interest in partnership while retaining common interest would disallow the optional simplified reporting method).

2. Calculation details

The calculation under the optional simplified reporting method is as follows:

(1) Determine the NIIT holding period (i.e., §1411 holding period) and test the optional simplified reporting method requirements are met.
   - **Section 1411 holding period:** generally, the year of disposition and the transferor's two taxable years preceding the disposition or the time period the transferor held the interest, whichever is less.

(2) Determine the NII disposition fraction:
   (i) Numerator is the sum of all income, gain, loss, and deduction items (including separately stated items included in NIIT during the NIIT holding period (the aggregate across multiple tax years); if the numerator is a negative amount in connection with a computation of overall gain, then the fraction shall be zero.
   (ii) Denominator is the sum of all income, gain, loss, and deduction allocated to the taxpayer during the NIIT holding period.

(3) Multiply the total income tax gain included for income tax purposes by the fraction determined in step 2.

Example 1: ***Facts (Optional Simplified Reporting Method)***
B owns a one-half interest in BC, a partnership. In Year 2, B sells the interest for $2,000,000. B's adjusted basis for the interest sold is $1,100,000, resulting in a total gain of $900,000 ($2 mil - $1.1 mil). Because BC is engaged in at least one trade or business and at least one of those trades or businesses is not passive to the transferor B, B determines its amount of gain or loss from NII using the optional simplified reporting method. None of the disqualifying provisions of Prop. Reg. §1.1411-7(c)(3) apply. The $900,000 gain exceeds the $250,000 threshold test for the optional simplified reporting method; and thus, the 5% test must be evaluated as the gain is less than the $5 million requirement of the 5% test. The aggregate net income from BC's activities allocable to B for the year of disposition and the two preceding tax years is as follows:

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Activity	Classification to A	Aggregate Income (Loss) §1411 Holding Period	Absolute Income/Loss
X	Non-Passive	1,800,000	1,800,000
Y	Passive	(10,000)	10,000
Marketable Securities	Portfolio	20,000	20,000
Total		1,810,000	1,830,000
NII Items ($10,000 activity Y + $20,000 marketable securities)			30,000
Total Items			1,830,000
Threshold % - 5% Threshold test is met!			**1.64%**
NII Items [(10,000) activity Y + $20,000 mktbl secs.]		10,000	
Total Allocable Share		1,810,000	
NII Disposition Fraction		**0.55%**	
Total Gain ($2.2 mil - $1.1 mil)		900,000	
NII Disposition Fraction		0.55%	
Gain subject to NIIT		**4,972**	

Analysis

During B's §1411 holding period, B was allocated $30,000 of gross items of a type taken into account in the calculation of NII ($10,000 of loss from activity Y and $20,000 of income from marketable securities). The total amount/absolute value of B's allocated net items during the §1411 holding period equals $1,830,000 ($1,800,000 income from activity X, $10,000 loss from activity Y, and $20,000 income from marketable securities). Thus, 1.64% ($30,000/1,830,000) of B's allocations, which is less than the 5% threshold, during the §1411 holding period are of a type that is taken into account in the computation of NII, and because B's chapter 1 gain recognized of $900,000 ($2 mil - $1.1 mil) is less than $5,000,000, B qualifies under §1.1411-7(c)(2)(ii) to use the optional simplified method.

B's percentage of NII property is determined by dividing B's allocable shares of income and loss of a type that is taken into account in the calculation of NII that is allocated to B by the PTE during the §1411 holding period, $10,000 ($10,000 loss from Y + $20,000 income from marketable securities) by $1,810,000, which is the sum of B's share of income and loss from all of BC's activities ($1,800,000 + ($10,000) + 20,000). Thus, B's gain for purposes of NII is $4,972 ($900,000 income tax gain multiplied by the fraction 10,000/1,810,000).

Example 2: ***Facts***

Assume the same facts as Example 1, but B sells the interest in BC for $900,000. B's percentage of NII property is determined by dividing B's allocable shares of income and loss of a type that is taken into account in the calculation of NII that is allocated to B by the PTE, during the §1411 holding period, $10,000 ($10,000 loss from Y + $20,000 income from marketable securities) by $1,810,000, which is the sum of B's share of income and loss from all of BC's activities ($1,800,000 + ($10,000) + 20,000). Because B's allocable share during the §1411 holding period of income and loss is a type that is taken into account in calculating NII and is a positive amount, and B sells its interest for an overall income tax loss of $200,000 ($900,000 - $1,100,000), B uses a fraction of 0 to compute its NII gain under paragraph (c)(4) of this section. Thus, B has no gain or loss for NII purposes ($200,000 income tax loss multiplied by a fraction of 0).

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3. Deferred recognition transactions

In the case of deferred recognition transactions (e.g., installment sales), the calculation of gain/loss for NIIT purposes is performed in the year of disposition as though the entire gain was recognized and taken into account in such year. For this purpose, it is assumed that any contingencies potentially affecting consideration to the seller/transferor that are reasonably expected to occur will occur, and in the case of annuities based on the life expectancy of one or more individuals, the present value of the annuity (using existing federal tax valuation methods) is used to determine the estimated gain. This approach allows the transferor to determine its NII inclusion for each future installment. If under this approach no gain or loss from the disposition would be included in NII, then the transferor excludes each payment received from the deferred recognition transaction from NII. If under this approach only a portion of the chapter 1 gain on the disposition would be included in NII, then the difference between the gain recognized for chapter 1 purposes and the gain recognized for NII purposes is considered an addition to basis, and after taking those basis adjustments into account, gain amounts are included in NII as payments are received in accordance with the existing rules for installment sales or private annuities.

4. Information reporting and other considerations [42]

Any seller/transferor applying the calculations previously described, including in reliance on the proposed regulations, must attach a statement to the seller/transferor's income tax return for the year of disposition. That statement must include:

- The taxpayer's name and taxpayer identification number;
- The name and taxpayer identification number of the PTE in which the interest was transferred;
- The amount of the transferor's gain or loss on the disposition of the interest for income tax purposes; and
- The amount of adjustment to gain or loss by reason of basis differences for income tax and NIIT purposes. The transferor must also attach a copy of any information provided by the PTE to the transferor relating to the transferor's allocable share of gain or loss from the deemed sale of the PTE's NII property.

PTEs must provide the seller/transferor the transferor's allocable share of the net gain or loss from the deemed sale of the PTE's NII property. However, the proposed regulations only require PTEs to provide this information to sellers/transferors that are ineligible for the optional simplified reporting method. If a seller/transferor qualifies to use the optional simplified reporting method in proposed §1.1411-7(c) but prefers to determine net gain or loss under the primary method of proposed §1.1411-7(b), then the transferor must negotiate with the PTE the terms under which the information will be supplied.

As a final note, should the basis used for determining income tax gain and NIIT gain be different (relating to certain income from CFCs and PFICs where no applicable elections have been made), these adjustments are made after the calculations outlined above and operate independently from these rules provided in the proposed regulations.[43]

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[42] *Prop. Reg. §1.1411-7(g).*
[43] *Prop. Reg. §1.1411-7(f).*

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The Gig Economy

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The Gig Economy

Learning objectives

Upon reviewing this material, the reader will be able to:

- Understand the fundamentals of the gig economy, including its definition and key characteristics;
- Analyze the complexities of worker classification within the gig economy, distinguishing between independent contractors and employees, and evaluating the factors that influence classification status; and
- Evaluate the tax implications of the gig economy for both gig economy workers and platforms.

I. The gig economy

A. Introduction

The gig economy represents a labor market characterized by short-term, flexible, and freelance work arrangements. Within the gig economy, jobs are typically temporary or project-based, with individuals offering services or completing tasks for various clients or companies. Digital platforms and apps play a crucial role in facilitating work in the gig economy, connecting gig workers with potential clients or employers. Common examples of gig economy labor encompass roles such as ridesharing drivers, food delivery drivers, grocery shoppers, freelance writers, graphic designers, and other independent contractors. It is common for individuals to utilize multiple platforms to offer their services, contributing to the dynamic and ever-evolving nature of the gig economy.

The gig economy has grown significantly in recent years for several reasons, such as:

- **Technological Advancements**: The growth of digital technology and apps has made it easier for workers to connect with popular gig economy platforms.
- **Flexibility**: Gig work provides individuals with the flexibility of when and where they work, easily adapting to changing lifestyles and preferences.
- **Economic Circumstances**: For some individuals, gig work is a response to economic circumstances, providing a source of income in a challenging job market or an additional source of income to another job.

Common examples of gig economy work include:

- Driving a vehicle for scheduled rides;
- Driving a vehicle for scheduled deliveries of food or goods;
- Renting out property or a portion thereof;
- Completing errands or tasks for an individual;
- Renting equipment;
- Selling merchandise or other goods online;
- Providing professional or creative services; and
- Engaging in other temporary, on-demand, or freelance assignments.

The 2022 “Freelance Forward" report by Upwork reported that the freelance / gig economy workforce represented 39% of the total workforce, increased from 36% of the workforce in 2021. The same report highlighted that freelance/gig economy workers contributed $1.35 trillion to the U.S. economy in annual

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earnings in 2022, a substantial increase from $50 billion in 2021. According to the Statista Research Department, as of December 18, 2023, there were 57.3 million freelancers working in the U.S., with an average weekly workload ranging from 11 to 30 hours. These statistics underscore the rising prominence of gig work, reflecting its popularity as a flexible and accessible form of employment.

Gig Economy Platforms provide a digital marketplace where individuals can offer their services (such as driving, delivering food, or grocery shopping), to users seeking those services. Examples of popular Gig Economy Platforms include Uber, Lyft, DoorDash, Instacart, AirBnB, and TaskRabbit. Acting as intermediaries, these platforms connect gig economy workers with consumers seeking specific services. Gig Economy Platforms typically do not directly employ gig workers but rather act as facilitators of transactions between the gig workers and consumers. As a result, individuals who work for these platforms are generally classified as independent contractors rather than traditional employees. This means they are not employees of the Gig Economy Platform provider, but instead work independently and have greater autonomy over their work schedules and operations.

With the expansion of the gig economy, it has become increasingly important for all small businesses to understand and correctly apply the rules related to classifying workers as either employees or independent contractors. Misclassifying an employee as an independent contractor can result in significant tax consequences, including penalties and interest, as well as legal liability for the employer. Workers who are misclassified may incur liability for self-employment taxes or denial of business-related deductions. As a result, understanding and accurately applying worker classification rules is crucial for both businesses and workers alike.

B. Rev. Rul. 87-41

The determination of whether an individual is an independent contractor or employee is based on the facts and circumstances of his or her specific situation. In 1987, the IRS issued Rev. Rul. 87-41, providing guidance on the classification of workers as employees or independent contractors for federal employment tax purposes. This ruling outlines 20 factors that may be considered in determining worker classification. It is important to note that no single factor is determinative, and the entire working relationship must be considered.

The 20 factors outlined in Rev. Rul. 87-41 are as follows:

1. **Instructions**: A worker who is required to comply with instructions on when, where, and how to work is often considered an employee rather than an independent contractor.
2. **Training**: If the business provides training to the worker on how to perform a service in a particular method or manner, this suggests an employment relationship.
3. **Integration**: If the worker's services are integrated into the business's operations (i.e., the success of the business is dependent upon the performance of the worker’s services), this generally indicates an employment relationship.
4. **Services Rendered Personally**: If the services must be rendered personally and the business has the right to control the details of the work, the worker is typically classified as an employee.
5. **Hiring, Supervising, and Paying Assistants**: If the business hires, supervises, and pays the worker's assistants, it indicates control over workers on the job, suggesting an employment relationship.
6. **Continuing Relationship**: A continuous or ongoing relationship generally indicates an employment relationship.

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7. **Set Hours of Work**: If the worker has set hours of work established by the business, this generally suggests employee status. Independent contractors typically choose their own hours of work.
8. **Full-Time Required**: If the worker is required to work full-time for the business, this indicates a stronger likelihood of employee status as they are restricted from completing other gainful work.
9. **Work Performed on Employer's Premises**: If the work is performed on the employer's premises, it is generally indicative of an employment relationship.
10. **Order or Sequence Set**: If the worker must perform services in the order or sequence set by the business or follow the established routines or schedules of the business, this suggests an employment relationship, since the worker is not free to follow his or her own pattern of work.
11. **Oral or Written Reports**: If the worker must submit regular reports to the business, it may indicate an employment relationship.
12. **Payment by Hour, Week, Month**: Payment on an hourly, weekly, or monthly basis is more characteristic of an employment relationship than an independent contractor relationship.
13. **Payment of Business or Travel Expenses**: If the business pays the worker's business or travel expenses, it typically suggests employee status.
14. **Furnishing of Tools and Materials**: If the business provides tools and materials to the worker, this suggests an employment relationship.
15. **Significant Investment**: If the worker has a significant investment in facilities used to perform services, this suggests independent contractor status. Lack of investment in facilities indicates dependence on the individual(s) for whom the services are performed, indicating an employee-employer relationship.
16. **Realization of Profit or Loss**: The worker's potential for profit or loss based on managerial skill suggests an independent contractor relationship.
17. **Working for More Than One Firm at a Time**: Working for multiple businesses at the same time typically indicates independent contractor status.
18. **Making Services Available to the General Public**: If the worker makes their services available to the general public, this suggests independent contractor status.
19. **Right to Discharge**: The right to discharge the worker suggests an employer-employee relationship.
20. **Right to Terminate**: The right to terminate the worker at will suggests an employer-employee relationship.

Many of the factors outlined in Rev. Rul. 87-41 center around the degree of control a business has over its workers. The classification of gig workers as independent contractors or employees has been an ongoing subject of legal and regulatory scrutiny. Both companies operating in the gig economy and gig workers alike should be aware of the factors delineated in Rev. Rul. 87-41 when evaluating worker classification for tax compliance.

C. Three-factor test

In addition to the 20 factors outlined in Rev. Rul. 87-41, the IRS utilizes a three-factor test to determine whether a worker is an independent contractor or an employee:

1. Behavioral control;
2. Financial control; and

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3. The relationship between the parties.

Behavioral Control is the extent to which the individual receiving services has the right to direct or control what the worker does and how the worker performs his or her services. Factors to consider when determining behavioral control include:

- Type of instructions given;
- Degree of instruction;
- Evaluation systems; and
- Training.

Financial Control is the extent to which the individual receiving services has the right to control the economic aspects of the worker's job. Factors to consider when determining financial control include:

- Significant investment;
- Unreimbursed expenses;
- Opportunity for profit or loss;
- Services available to the market; and
- Method of payment.

The relationship between the parties refers to the extent to which the worker and individual for whom the services are provided see their relationship with each other. Factors to consider when determining the relationship between the parties include:

- Written contracts;
- Employee benefits (pension plan, insurance, vacation pay, etc.);
- Permanency of the relationship; and
- Services provided as key activity of the business.

If after analyzing all factors a business is unable to determine a worker's classification, they may file Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to request a determination of the status of a worker. A Form SS-8 determination may be requested only in order to resolve federal tax matters. The IRS will not issue a determination letter for a tax year for which the statute of limitations on the tax return has expired. Additionally, the IRS will not issue a determination letter for proposed transactions, hypothetical situations, cases involving current worker classification litigation, cases involving state or local government workers who may be performing services under an agreement entered into pursuant to Section 218 of the Social Security Act, or business-to-business transactions, or for other reasons not in the best interests of tax administration.

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Form **SS-8**

(Rev. December 2023)

Department of the Treasury
Internal Revenue Service

Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding

Go to *www.irs.gov/FormSS8* for instructions and the latest information.

OMB. No. 1545-0004

For IRS Use Only:
Case Number:

Earliest Receipt Date:

Disclosure of Information

The information provided on Form SS-8 may be disclosed to the firm, worker, or payer named below to assist the IRS in the determination process. For example, if you are a worker, we may disclose the information you provide on Form SS-8 to the firm or payer named below. The information can only be disclosed to assist with the determination process. See *Privacy Act and Paperwork Reduction Act Notice* in the separate instructions for more information. **If you do not want this information disclosed to other parties, do not file Form SS-8.**

IMPORTANT THINGS YOU SHOULD KNOW

- **The Form SS-8 must be fully completed. If you provide incomplete information, we may not be able to process your request.**
- All questions in Parts I through IV must be explained with clear concise answers.
- Part V must be completed if the worker provides a service directly to customers or is a salesperson.
- If you cannot answer a question, enter "Unknown" or "Does not apply."
- If you need more space for a question, attach another sheet with the part and question number clearly identified. Write your firm's name (or worker's name) and employer identification number (or social security number) at the top of each additional sheet attached to this form.
- You MUST include copies of the Forms W-2, 1099-MISC, and/or 1099-NEC for each year you are contesting. See instructions.

Name of firm (or person) for whom the worker performed services		Worker's name	
Firm's mailing address (include street address, apt. or suite no., city, state, and ZIP code)		Worker's mailing address (include street address, apt. or suite no., city, state, and ZIP code)	
Trade name		Worker's daytime telephone number	Worker's alternate telephone number
Firm's fax number	Firm's website	Worker's fax number	Worker's social security number
Firm's telephone number (include area code)	Firm's employer identification number	Worker's employer identification number (if any)	

Note: If the worker is paid for services performed for a business or individual not listed above, enter the name, address, and taxpayer identification number of that business/individual who paid the worker, if known. Explain the relationship between the firm and the business/individual who paid the worker.

Part I General Information

1 This form is being completed by: ☐ Firm ☐ Worker
for services performed from beginning date ________ (MM/YYYY) to ending date ________ (MM/YYYY).

Caution: Filing Form SS-8 does not prevent the expiration of the time in which a claim for refund must be filed.

2 Explain your reason(s) for filing this form.

☐ You received a bill from the IRS
☐ You believe you erroneously received a Form 1099 or Form W-2
☐ You are unable to get workers' compensation benefits
☐ You were audited or are being audited by the IRS
☐ Other (specify) ________

Don't complete this form if payment was received for reasons unrelated to Form SS-8. See instructions.

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at *www.irs.gov/pub/irs-pdf/iss8.pdf*?

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 16106T Form **SS-8** (Rev. 12-2023)

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Part I General Information *(continued)*

3 Total number of workers who performed or are performing the same or similar services: ____________ .

4 How did the worker obtain the job? Attach any advertisement.

☐ Application ☐ Bid ☐ Employment agency ☐ Other (specify) ____________

5 **Attach copies of all supporting documentation (for example, contracts; invoices; memos; Forms W-2, Forms 1099-MISC, or Forms 1099-NEC issued or received; IRS closing agreements; or IRS rulings).**

a Inform us of any current or past litigation concerning the worker's status. ____________

b If no income reporting forms (Form 1099-MISC, 1099-NEC, or W-2) were furnished to the worker, enter the amount of income earned for the year(s) at issue $ ____________ .

c If both Form W-2 and Form 1099-MISC, or both Form W-2 and Form 1099-NEC, were issued or received, explain why. ____________

6 Describe the firm's business. ____________

7 Did the worker receive pay from more than one entity (for example, two or more entities with different taxpayer identification numbers) because of a business sale, merger, acquisition, or reorganization? ☐ No. Skip to line 8. ☐ Yes. Complete the rest of line 7.

Name of the firm's previous owner: ____________

Previous owner's taxpayer identification number: ____________ Change was a: ☐ Sale ☐ Merger ☐ Acquisition ☐ Reorganization

☐ Other (specify) ____________

Description of above change: ____________

Date of change (MM/DD/YY): ____________

8 What is the worker's job title? ____________

Describe the worker's duties. ____________

9 Which do you believe the worker is? Check only one. ☐ Employee ☐ Independent contractor

Explain. ____________

10 Did the worker perform any services for the firm before or after the dates entered on line 1 on page 1 of this form? . . . ☐ **Yes** ☐ **No**

If "Yes," what were the dates of service? ____________

If "Yes," explain any differences between the services provided. ____________

11a Is the work done under a written agreement between the firm and the worker? . . . . ☐ **Yes** ☐ **No**

If "Yes," attach a copy (preferably signed by both parties).

If "Yes," describe the terms and conditions of the work arrangement. ____________

b Is the work done under an oral agreement? . . . . ☐ **Yes** ☐ **No**

If "Yes," describe the details of the agreement. ____________

Part II Behavioral Control (Provide names and titles of specific individuals, if applicable.)

1 What specific training and/or instruction is the worker given by the firm? ____________

2 Who gives the worker work assignments? ____________

How are the assignments received? ☐ In person ☐ Phone ☐ Email ☐ Text message

☐ Other (specify) ____________

3 Who determines the methods by which the assignments are performed? ____________

4 If problems or complaints arise, who is contacted? ____________

Who is responsible for their resolution? ____________

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at *www.irs.gov/pub/irs-pdf/iss8.pdf*?

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Part II **Behavioral Control** (Provide names and titles of specific individuals, if applicable.) *(continued)*

5 Is the worker required to complete reports? ☐ **Yes** ☐ **No**
If "Yes," attach examples.

6a How frequently does the worker perform services? ☐ As scheduled ☐ As needed ☐ As available
☐ Other (specify) ____________

b Describe the worker's primary services. ☐ Sales ☐ Timesheets ☐ Patient logs
☐ Other (specify) ____________

7 Where are the services performed? If more than one location, what percentage of the worker's time is spent at each location?
☐ Firm premises ________ %
☐ Worker's office or shop ________ %
☐ Customer's location ________ %
☐ Other (specify) ____________ ________ %

8a Is the worker required to attend meetings? ☐ **Yes** ☐ **No**
If "Yes," what type of meetings? ☐ Sales ☐ Staff ☐ Other (specify) ____________

b Is the worker penalized if unable to attend a meeting? ☐ **Yes** ☐ **No**
If "Yes," what is the penalty? ____________

9 Is the worker required to provide the services personally? ☐ **Yes** ☐ **No**

10 Can the worker hire substitutes or helpers? ☐ **Yes** ☐ **No**

11 If the worker hires the substitutes or helpers, is approval required? ☐ **Yes** ☐ **No**
If "Yes," who approves the hiring? ☐ Firm ☐ Other (specify) ____________

12 Does the worker pay substitutes or helpers? ☐ **Yes** ☐ **No**
If "Yes," is the worker reimbursed? ☐ **Yes** ☐ **No**
If the worker is reimbursed, explain who reimburses them.

Part III **Financial Control** (Provide names and titles of specific individuals, if applicable.)

1a List the supplies, equipment, materials, and property provided by
The firm: ____________
The worker: ____________

b Are supplies, equipment, materials, or property provided by another party? ☐ **Yes** ☐ **No**
If "Yes," explain. ____________

2 Does the worker lease equipment, space, or a facility? ☐ **Yes** ☐ **No**
If "Yes," what are the terms of the lease? (Attach a copy or explanatory statement.) ____________

3 Are expenses incurred by the worker in the performance of services for the firm? ☐ **Yes** ☐ **No**
If "Yes," explain. ____________

4a Are expenses reimbursed by the firm? ☐ **Yes** ☐ **No**
If "Yes," provide the frequency and amount. ____________

b Are expenses reimbursed by another party? ☐ **Yes** ☐ **No**
If "Yes," explain. ____________

5a What type of pay does the worker receive? ☐ Salary ☐ Commission ☐ Hourly wage ☐ Piece work ☐ Lump sum
☐ Other (specify) ____________

b If paid commission, does the firm guarantee a minimum amount of pay? ☐ **Yes** ☐ **No**
If "Yes," explain. ____________

6 Can the worker request advance pay? ☐ **Yes** ☐ **No**
If "Yes," how often? ☐ Daily ☐ Weekly ☐ Monthly ☐ Other (specify) ____________

7 Whom does the customer pay? ☐ Firm ☐ Worker
If worker, does the worker pay the total amount to the firm? ☐ **Yes** ☐ **No** If "No," explain. ____________

8 Does the firm carry workers' compensation insurance on the worker? ☐ **Yes** ☐ **No**

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at *www.irs.gov/pub/irs-pdf/iss8.pdf*?

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Part III Financial Control (Provide names and titles of specific individuals, if applicable.) (*continued*)

9a Does the worker take a financial risk by performing services? ☐ **Yes** ☐ **No**

If "Yes," explain. ____________________

b Can the worker suffer a financial loss by performing services? ☐ **Yes** ☐ **No**

If "Yes," explain. ____________________

10a Who sets the rate of pay for the services performed? ☐ Firm ☐ Worker ☐ Other (specify) ____________________

b If products are sold, who sets the product price? ☐ Firm ☐ Worker ☐ Other (specify) ____________________

Part IV Relationship of the Worker and Firm

1 Are benefits made available to the worker? ☐ **Yes** ☐ **No**

If "Yes," which benefits are available? ☐ Paid vacations ☐ Sick pay ☐ Paid holidays ☐ Personal days ☐ Pensions ☐ Insurance benefits ☐ Bonuses ☐ Other (specify) ____________________

2 Can the firm or worker end the work relationship without penalty? ☐ **Yes** ☐ **No**

If "No," explain. ____________________

3 Did the worker perform similar services for others during the time period entered in Part I, line 1? ☐ **Yes** ☐ **No**

If "Yes," is the worker required to get approval from the firm? ☐ **Yes** ☐ **No**

4 Is there an agreement prohibiting competition between the firm and the worker? ☐ **Yes** ☐ **No**

If "Yes," explain or attach available documentation. ____________________

5 Reserved for future use.

6 Does the worker advertise? ☐ **Yes** ☐ **No**

If "Yes," what type of advertising does the worker do? Provide copies, if available. ____________________

7 Does the worker assemble or process a product at home? ☐ **Yes** ☐ **No**

If "Yes," who provides the materials and instructions or patterns? ____________________

If "Yes," what does the worker do with the finished product? ☐ Return to the firm ☐ Provide to another party ☐ Sell it ☐ Other (specify) ____________________

8a Does the firm introduce the worker to its customers? ☐ **Yes** ☐ **No**

If "Yes," how is the worker introduced? ☐ Employee ☐ Partner ☐ Representative ☐ Contractor ☐ Other (specify) ____________________

b Under whose name are services performed? ☐ Firm ☐ Worker ☐ Other (specify) ____________________

9 Does the worker still perform services for the firm? ☐ **Yes** ☐ **No**

If "No," how did the work relationship end? ☐ Firm ended the work relationship ☐ Worker ended the work relationship ☐ Job completed ☐ Contract ended ☐ Firm or worker went out of business ☐ Other (specify)

Part V For Service Providers or Salespersons. You **must** complete this part if the worker provided a service directly to customers or is a salesperson.

1 Is the worker responsible for contacting potential new customers? ☐ **Yes** ☐ **No**

If "Yes," what are the worker's specific responsibilities? ____________________

2 Is the worker provided leads (names and contact information) for potential new customers? ☐ **Yes** ☐ **No**

If "Yes," who provides the leads? ____________________

3 Is the worker required to report on potential new customers contacted? ☐ **Yes** ☐ **No**

If "Yes," what are the reporting requirements? ____________________

4 Does the firm set terms and conditions of sale? ☐ **Yes** ☐ **No**

If "Yes," explain. ____________________

5 Are orders submitted and subject to the firm's approval? ☐ **Yes** ☐ **No**

6 Who determines the worker's sales territory? ☐ Firm ☐ Worker ☐ Other (specify) ____________________

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at *www.irs.gov/pub/irs-pdf/iss8.pdf*?

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Part V **For Service Providers or Salespersons.** You **must** complete this part if the worker provided a service directly to customers or is a salesperson. *(continued)*

7 Did the worker pay for the privilege of serving customers on the route or in the territory? ☐ **Yes** ☐ **No**

If "Yes," whom did the worker pay? ______

If "Yes," how much did the worker pay? $ ______

8 Where does the worker sell the product? ☐ Home ☐ Retail establishment ☐ Online

☐ Other (specify) ______

9 List the product and/or services distributed by the worker (for example, meat, vegetables, fruit, bakery products, beverages, or laundry or dry cleaning services). If more than one type of product and/or service is distributed, specify the principal one. ______

10 Does the worker sell life insurance full time? ☐ **Yes** ☐ **No**

11 Does the worker sell other types of insurance for the firm? ☐ **Yes** ☐ **No**

If "Yes," enter the percentage of the worker's total working time spent in selling other types of insurance ______ %

12 Does the worker solicit orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments? ☐ **Yes** ☐ **No**

If "Yes," what percentage of the worker's time is spent in solicitation? ______ %

13 Is the merchandise purchased by the customers for resale or use in their business operations? ☐ **Yes** ☐ **No**

Describe the merchandise and state whether it is equipment installed on the customers' premises. ______

Sign Here Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented are true, correct, and complete.

Print your name ______ Signature ______ Date ______

Did you remember to answer all questions and refer to the Instructions for Form SS-8 at *www.irs.gov/pub/irs-pdf/iss8.pdf*?

Did you sign Form SS-8?
Did you attach copies of your Form W-2 or Form 1099 for each year contested?

Form **SS-8** (Rev. 12-2023)

When Form SS-8 is filed, the IRS generally tries to get information from all parties involved (typically two or more), by sending those parties blank Forms SS-8 to complete. An IRS technician will review the facts, potentially request additional information from the requestor or other parties and render a decision on the matter. Then, the IRS will typically issue a formal determination to the firm and send a copy to the worker. Any Form SS-8 determination only applies to the worker or class of workers requesting it, and the decision is binding on the IRS if there is no change in the facts or law that formed the basis for the ruling.

D. DOL worker classification

It is important to acknowledge that while the IRS primarily utilizes Rev. Rul. 87-41 and the three-factor test to determine whether a worker is an employee or independent contractor, the Department of Labor (DOL) utilizes different criteria to determine worker classification. Additionally, state laws governing worker classification may vary.

The Fair Labor Standards Act (FLSA), enacted in 1938, was enacted to safeguard workers' rights by establishing minimum wage, overtime pay eligibility, and protection against exploitation in the workplace. Notably, these protections do not apply to independent contractors. Since the 1940s, both the Department of Labor (DOL) and courts have utilized an economic reality test to discern a worker's classification under the FLSA, whether as an employee or an independent contractor. The economic reality test is a framework used to determine whether a worker is considered an employee or an independent contractor. It assesses various factors to determine the extent of economic dependence between the worker and the employer. When assessing economic dependence, the DOL and courts have historically conducted a totality-of-the-circumstances analysis, considering multiple factors to determine whether a worker is an employee or an independent contractor, with no factor or factors carrying predetermined weight.

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On January 7, 2021, the DOL introduced a final rule known as the "2021 IC Rule," marking a departure from the historical approach utilized by both courts and the DOL in applying the economic reality test to determine a worker's status under the FLSA. The 2021 IC Rule outlined two "core" factors for assessing worker classification:

1) The nature and degree of the worker's control over the work; and
2) The worker's opportunity for profit or loss.

Additionally, the 2021 IC rule introduced three additional factors that were given less weight in the analysis of determining worker status:

3) Amount of skill required for the work;
4) Permanence of the working relationship; and
5) Whether the work is part of an integrated unit of production.

Per the 2021 IC Rule, if the two "core" factors aligned in their classification of the worker, their combined weight would typically outweigh the significance of the remaining three factors of lesser importance. However, if the core factors produced differing classification outcomes, the remaining factors could assist in determining the appropriate worker classification.

The 2021 IC Rule was originally scheduled to take effect on March 8, 2021. However, on March 4, 2021, the DOL issued a rule postponing the effective date of the 2021 IC Rule, followed shortly by another rule on May 6, 2021, withdrawing the 2021 IC Rule entirely. On October 13, 2022, the DOL introduced a Notice of Proposed Rulemaking (NPRM), proposing the rescission and replacement of the 2021 IC Rule. The DOL cited concerns that maintaining the 2021 IC Rule would create confusion and disruption for both workers and businesses, as it departed from established case law applying the multifactor economic reality test as a totality-of-the-circumstances test.

On January 10, 2024, the Department of Labor (DOL) issued a final rule, which further revises the definition of employee under the Fair Labor Standards Act (FLSA) as it relates to independent contractors. This 2024 final rule rescinds and replaces the 2021 final rule and provides an analysis for determining employee or independent contractor status that aligns more closely with the FLSA as interpreted by longstanding judicial precedent. The DOL highlighted concerns with the 2021 final rule, stating it placed undue weight on "core factors" and was problematic due to limited and narrow consideration of other factors. According to the DOL, "leaving the 2021 Independent Contractor Rule in place would have a confusing and disruptive effect on workers and businesses alike due to its departure from decades of case law describing and applying the multifactor economic reality test as a totality-of-the-circumstances test." [1] The 2024 final rule relies on the longstanding multifactor "economic reality" test used by courts to determine worker classification status. This test relies on the totality of the circumstances where no one factor is determinative. Effective March 11, 2024, the 2024 final rule aims to address these issues and provide clearer guidelines for worker classification.

Consistent with the DOL and judicial precedent, the 2024 final rule applies the following six factors to analyze employee or independent contractor status under the FLSA:

- **Factor 1 - Opportunity for profit or loss depending on managerial skill:** This factor evaluates whether the worker exercises managerial skill, such as initiative, business acumen, or judgment, that impacts the worker's economic success or failure in

[1] DOL Frequently Asked Questions - Final Rule: Employee or Independent Contractor Classification Under the FLSA

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performing the work. Relevant considerations when analyzing this factor include, but are not limited to:

- Whether the worker determines or negotiates the pay for the work provided;
- Whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed;
- Whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and
- Whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space.

If a worker lacks the opportunity for profit or loss, it indicates that they are likely an employee rather than an independent contractor.

Example 1: A worker for a landscaping company performs assignments only as determined by the company for its corporate clientele. The worker does not independently select assignments, solicit additional work from other clients, advertise the landscaping services, or attempt to minimize costs. Additionally, the worker regularly agrees to work additional hours in order to increase their earnings.

In this scenario, the worker does not exercise managerial skill that affects their profit or loss. Rather, their earnings depend primarily on the availability of work and their willingness to work additional hours.

The absence of managerial skill affecting opportunity for profit or loss suggests that the worker is more likely to be classified as an employee rather than an independent contractor under the opportunity for profit or loss factor.

Example 2: A worker provides landscaping services directly to corporate clients, taking charge of various aspects of the business operations.

The worker produces their own advertising, negotiates contracts, decides which jobs to undertake and schedules when to perform them, and makes decisions regarding whether to hire additional assistance.

By exercising such managerial autonomy, this worker significantly influences their potential for profit or loss.

Based on these circumstances, the worker's exercise of managerial skill points towards their classification as an independent contractor under the opportunity for profit or loss factor.

- **Factor 2 - Investments by the worker and the potential employer:** This factor evaluates whether a worker's investments are of a capital or entrepreneurial nature.
  - The DOL emphasizes that costs unilaterally imposed by an employer on a worker are not capital or entrepreneurial in nature.
  - The DOL notes that a capital or entrepreneurial investment signifies that the worker is operating as an independent business.
  - Additionally, the DOL highlights that capital or entrepreneurial investments tend to enhance a worker’s ability to work for multiple companies, further reflecting the characteristics of an independent business.
  - Finally, the DOL affirms that the worker's investments need not be equal to the potential employer's investments and should not be compared only in terms of the dollar values of investments or the sizes of the worker and the potential

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employer. Instead, the focus should be on comparing the investments to determine whether the worker is making similar types of investments as the potential employer. Even if on a smaller scale, similarities in the nature of investments suggest that the worker is operating independently, thus supporting their classification as an independent contractor.

Example 1: A graphic designer provides design services for a commercial design firm.

The firm provides essential resources such as software, a computer, office space, and all necessary equipment and supplies for the worker.

The company invests in marketing efforts and client acquisition, maintaining a central office from which to manage services.

The worker occasionally uses their own preferred drafting tools for certain jobs.

These circumstances suggest that the worker's relatively minor investment in supplies is not capital in nature and does little to further a business beyond completing specific jobs. As a result, these facts indicate employee status under the investment factor.

Example 2: A graphic designer occasionally completes specialty design projects for the same commercial design firm.

The graphic designer purchases their own design software, computer, drafting tools, and rents an office in a shared workspace. Additionally, the graphic designer spends money on marketing their services.

These types of investments are indicative of an independent business and are capital in nature, enabling the worker to complete more work and extend their market reach.

Consequently, these facts suggest independent contractor status under the investment factor.

- **Factor 3 - Degree of permanence of the work relationship:** This factor states that the degree of permanence of the work relationship would weigh in favor of the worker being an employee when the work relationship is indefinite in duration or continuous, but would weigh in favor of the worker being an independent contractor when the work relationship is definite in duration, non-exclusive, project-based, or sporadic based on the worker being in business for themself and marketing their services or labor to multiple entities.
  - The DOL clarifies that independent contractors may have regularly occurring fixed periods of work, but the seasonal or temporary nature of work alone does not necessarily indicate independent contractor classification.
  - Further, the DOL acknowledges that independent contractors often rely on repeat business and long-term clients or customers in order to sustain the economic viability and success of their business.

Example 1: A cook has been consistently preparing meals for an entertainment venue over the course of several years.

The cook prepares meals as directed by the venue, depending on the size and specifics of the event. The cook only prepares food for the entertainment venue, which has regularly scheduled events each week.

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The relationship between the cook and the venue is characterized by a high degree of permanence and exclusivity.

These facts indicate employee status under the permanence factor.

Example 2: A cook has prepared specialty meals intermittently for an entertainment venue over the past 3 years for certain events.

The cook promotes their meal preparation services to multiple venues and private individuals, exercising discretion in accepting or declining work based on availability, including instances where they are occupied with other meal preparation assignments.

The cook has a sporadic or project-based nonexclusive relationship with the entertainment venue.

These facts indicate independent contractor status under the permanence factor.

- **Factor 4 – Nature and degree of control:** This factor evaluates the worker's substantial control over key aspects of the performance and supervision of the work, including scheduling, price or rate determination for goods or services, project selection, workload management, and limitations on the worker's ability to work for others. The DOL also states that an employer's compliance with legal obligations, safety or health standards, or requirements to meet contractual or quality control obligations, for example, may indicate that the employer is exerting control, suggesting that the worker is economically dependent on the employer.

Example 1: A registered nurse provides nursing care for Alpha House, a nursing home. The nursing home sets the work schedule with input from staff regarding their preferences and determines where each nurse will work in the nursing home.

Alpha House's internal policies prohibit nurses from working for other nursing homes while employed with Alpha House in order to protect its residents. In addition, the nursing staff are supervised by regular check-ins with managers, although nurses typically carry out their duties without direct supervision.

Despite nurses having some autonomy in their work and schedule preferences, Alpha House retains control over the timing and location of nurse assignments, as well as their ability to work elsewhere.

These facts indicate employee status under the control factor.

Example 2: A registered nurse provides specialty movement therapy to residents at Beta House.

The nurse maintains a website and was contacted by Beta House to assist its residents.

The nurse provides the movement therapy for residents on a schedule agreed upon between the nurse and the resident, without direction or supervision from Beta House, and sets the price for services on the website. In addition, the nurse simultaneously provides therapy sessions to residents at Beta House as well as other nursing homes in the community.

The facts—that the nurse markets their specialized services to obtain work for multiple clients, is not supervised by Beta House, sets their own prices, and has

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the flexibility to select a work schedule–indicate independent contractor status under the control factor.

- **Factor 5 – Extent to which the work performed is an integral part of the potential employer's business:** This factor analyzes whether the work performed is an integral part of the employer's business. The DOL emphasizes that this factor must consider whether the work is critical, necessary, or central to the employer's principal business in order to better reflect the economic reality case law and to be more consistent with the totality-of-the-circumstances approach when determining whether a worker is an employee or an independent contractor.

Example 1: A large farm grows tomatoes that it sells to distributors. During the harvest season, the farm hires workers to pick the tomatoes.

Since picking tomatoes is an integral part of farming tomatoes, and the company is in the business of farming tomatoes, the role of tomato pickers is integral to the farm's operations.

These circumstances indicate employee status under the integral factor.

Example 2: The same farm pays an accountant to provide non-payroll accounting support, including filing its annual tax return. His accounting support, while important, does not constitute a critical, necessary, or central function of the farm's principal business of tomato farming.

As the accountant's work is not integral to the business, these facts indicate independent contractor status under the integral factor.

- **Factor 6 – Skill and Initiative:** This factor considers whether the worker uses specialized skills when performing their work and whether those skills contribute to business-like initiative. According to the DOL, employee status is indicated when the worker does not use specialized skills in performing their work or when the worker is dependent upon training from the employer to perform the work. Conversely, when the worker brings specialized skills to the work relationship, it is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

Example 1: A highly skilled welder provides welding services for a construction firm.

The welder does not make any independent judgments at the job site beyond the decisions necessary to do the work assigned. The welder does not determine the sequence of work, order additional materials, think about bidding the next job, or use those skills to obtain additional jobs, and is told what work to perform and where to do it.

In this example, the welder, despite possessing considerable technical proficiency, is not using those skills in a manner that evidences business-like initiative.

These facts indicate employee status under the skill and initiative factor.

Example 2: A highly skilled welder provides a specialty welding service, such as custom aluminum welding, for a variety of area construction companies.

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Leveraging these specialized skills, the welder actively markets their services to attract new clients and secure work from multiple companies. Their approach not only demonstrates technical proficiency but also exhibits a proactive business-like initiative in utilizing and promoting their skills.

These facts indicate independent contractor status under the skill and initiative factor.

Below summarizes key similarities between the 2021 IC Rule and 2024 Final Rule:

- Both rules define independent contractors as workers who are in business for themselves, while FLSA-covered employees are those who are, as a matter of economic reality, economically dependent on their employer.
- Economic dependence is considered the "ultimate inquiry" in both rules' analyses.
- Each rule provides a non-exhaustive list of factors to evaluate economic dependence, emphasizing that no single factor is determinative in the analysis.
- Both rules stress that economic dependence does not hinge on the amount of income earned by the worker or whether the worker has other income sources.

Below summarizes key differences between the 2021 IC Rule and 2024 Final Rule:

- The 2024 final rule returns to a totality-of-the-circumstances economic reality test, where no single factor or group of factors is assigned any predetermined weight;
- The 2024 final rule considers six factors (instead of five), including the investments made by the worker and the potential employer;
- The 2024 final rule provides additional analysis of the control factor, including a detailed discussion of how scheduling, supervision, price-setting, and the ability to work for others should be considered when analyzing the nature and degree of control over a worker;
- The 2024 final rule returns to the DOL's historical consideration of whether the work is integral to the employer's business, rather than whether it is exclusively part of an "integrated unit of production";
- The 2024 final rule provides additional context to some factors, such as the permanence and skill factors; and
- The 2024 final rule omits a provision from the 2021 IC Rule which minimized the relevance of an employer's reserved but unexercised rights to control a worker.

Again, the 2024 final rule emphasizes that no factor or set of factors among the list of six factors has a predetermined weight, and additional factors may be relevant if such factors in some way indicate whether the worker is in business for themself (i.e., an independent contractor), as opposed to being economically dependent on the employer for work (i.e., an employee under the FLSA). Under the economic reality test, no single factor singlehandedly determines a worker's status; rather, the economic reality factors are all weighed to assess whether a worker is economically dependent on a potential employer for work, according to the totality of the circumstances. Lastly, the 2024 final rule provides that different factors may be more or less important in different circumstances depending on the facts of each individual case. It is important for businesses and individuals alike to familiarize themselves with the new DOL 2024 final rule when determining worker classification.

E. Tax implications

The tax implications for gig economy work vary for both the platform and the independent contractor providing services through the platform.

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Tax considerations for gig economy platforms include:

- Information reporting:
  - Gig economy platforms are required to report payments made to independent contractors to the IRS, typically using Form 1099-NEC, if they issued payments totaling $600 or more.
- Compliance:
  - Gig economy platforms need to ensure compliance with regulations, including accurately reporting payments, providing necessary forms to contractors, and adhering to any applicable state or federal laws.
- State and local taxes:
  - Platforms should consider state and local tax implications, as tax rules can vary by jurisdiction.

Tax considerations for gig economy independent contractors include reporting income, self-employment taxes, quarterly estimated taxes, and deductions.

1. Reporting income

Gig economy workers must report income earned from any gig work on their tax return, including:

- Income from part-time or temporary work;
- Income not reported on an information return such as Form 1099-K, Form 1099-MISC, Form 1099-NEC, etc.;
  - Note: Generally, gig economy workers receive Form 1099-NEC if they received payments of more than $600 per year. Gig economy workers earning less than $600 from a platform must still report their earnings on their tax return.
- Income paid in forms other than cash, such as property, goods, or virtual currency/digital assets; and
- Income derived from gig economy work outside of a platform.

Failure to report income on a tax return can result in penalties, such as:

- A **negligence or disregard of the rules or regulations penalty** applies when a taxpayer does not make reasonable attempts to follow the tax laws when preparing their tax return (negligence) or when they carelessly, recklessly, or intentionally ignore tax rules or regulations (disregard).
  - In the case of negligence or disregard of the rules or regulations, an accuracy-related penalty of 20% is applied to the portion of the underpayment of tax that happened because of negligence or disregard.
  - In the case of substantial understatement, an accuracy-related penalty of 20% of the portion of the underpayment of tax that was understated on the return applies.
  - **A substantial understatement of income tax penalty** applies if a taxpayer understates their tax liability by 10% of the tax required to be shown on their tax return or $5,000, whichever is greater.
- Additional penalties may exist, and interest is charged on such penalties.

2. Self-employment taxes

Employers are not required to withhold taxes or pay Social Security and Medicare tax on independent contractors. Consequently, independent contractors are responsible for the full 15.3% Social Security and

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Medicare taxes, referred to as the self-employment tax, comprised of 12.4% for Social Security (old-age, survivors, and disability insurance) and 2.9% for Medicare (hospital insurance). Conversely, employers are required to withhold income taxes and pay Social Security, Medicare, and unemployment tax on wages paid to employees. Employers generally withhold 6.2% for Social Security tax and 1.45% for Medicare tax (for a total of 7.65%) from wages paid to an employee. Employers are also required to pay the employer share of Social Security and Medicare taxes, which is also 7.65% of wages paid to an employee.

Misclassifying workers as independent contractors negatively impacts employees because the employer's share of taxes is not paid, and the employee's share is not withheld. If a business misclassifies an employee, the business can be held liable for employment taxes for that worker.

Individuals generally must pay self-employment tax and file Schedule SE if their net earnings from self-employment were $400 or more. Generally, net earnings from self-employment are subject to the self-employment tax. Schedule C is typically used to figure net earnings from self-employment.

For 2024, the first $168,800 of a taxpayer’s combined wages, tips, and net earnings is subject to any combination of the Social Security part of self-employment tax. All of a taxpayer’s combined wages, tips, and net earnings in the current year are subject to the 2.9% Medicare part of the self-employment tax. Taxpayers are liable for an additional 0.9% Medicare Tax if their wages, compensation, or self-employment income (together with that of their spouse if filing a joint return) exceed the threshold amount for their filing status:

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separate	$125,000
Single	$200,000
Head of Household	$200,000
Qualifying Surviving Spouse	$200,000

Taxpayers may use Form 8919, *Uncollected Social Security and Medicare Tax on Wages*, to figure and report their share of the uncollected Social Security and Medicare taxes due on their compensation if they were an employee but were treated as an independent contractor by their employer. By utilizing this form, the taxpayer’s Social Security earnings will be credited to their Social Security record.

Practice Note - Voluntary Classification Settlement Program

- The Voluntary Classification Settlement Program is an optional program that provides businesses with an opportunity to reclassify their workers as employees for future employment tax purposes.
- This program offers partial relief from federal employment taxes for eligible businesses who agree to prospectively treat their workers as employees.
- Businesses must meet certain eligibility requirements and apply by filing Form 8952, *Application for Voluntary Classification Settlement Program (VCSP)*, and enter into a closing agreement with the IRS.

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3. Quarterly estimated taxes

If a taxpayer does not pay enough tax during the year either through withholding or by making estimated tax payments, they may have to pay a penalty. Since gig workers do not have taxes withheld from their paychecks, they are often required to make quarterly estimated tax payments to cover their tax liabilities throughout the year. Taxpayers who work as an employee and do gig economy work on the side may be able to avoid making estimated tax payments on their gig income by withholding more tax from their employee paycheck.

Estimated tax payments are generally due four times a year:

- April 15 for payment period January 1–March 31.
- June 15 for payment period April 1–May 31.
- September 15 for payment period June 1–August 31.
- January 15 for payment period September 1–December 31.

If a due date falls on a Saturday, Sunday or legal holiday, payment is due the next business day.

4. Deductions

Unlike employees, independent contractors may qualify for various tax deductions related to their business expenditures, including mileage, phone bills, tools/equipment, or other costs directly associated with their work. Generally, taxpayers may deduct ordinary and necessary expenses incurred in conducting a trade or business. Ordinary expenses are expenses that are common and accepted in the taxpayer's trade or business, while necessary expenses are expenses that are appropriate for the business. Additionally, independent contractors also may deduct the employer-equivalent portion of their self-employment tax when calculating their adjusted gross income.

It is pivotal for gig economy workers to maintain meticulous and accurate records in order to keep track of deductible expenses. By keeping accurate records, gig economy workers can ensure they do not miss out on any eligible deductions, thereby maximizing their tax savings. Certain expenses, such as those associated with mixed-use assets like vehicles used in ridesharing, may need to be allocated between business and personal use, adding a layer of complexity. The IRS requires taxpayers to maintain adequate records to substantiate the deductions claimed on their tax returns. Keeping detailed records demonstrates compliance with tax laws and can help substantiate deductions in the event of an audit.

5. Other considerations

To summarize, gig workers who are independent contractors share many of the filing obligations of small business owners, even if they earn relatively modest amounts:

- Gig workers who are independent contractors generally must report their income and expenses on Schedule C;
- Gig workers who are independent contractors must file Schedule SE if their net earnings from self-employment are $400 or more;
- Gig workers who are independent contractors may be required to make estimated payments and file Form 1040-ES; and
- Gig workers who are independent contractors may have additional state and local tax obligations.

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It is essential to understand worker classification rules within the gig economy. Adhering to classification rules ensures compliance with labor laws and tax regulations, mitigating the risk of legal issues. Lastly, being aware of the classification rules helps prevent misclassification errors that could lead to penalties.

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Numbers Applicable to Rulings

Learning objectives

Upon reviewing this chapter, the reader will be able to:

- Describe the structure of the tax brackets for 2024;
- Quantify the standard deduction, the personal exemption, and the phase out of personal exemptions and itemized deductions;
- Identify the factors that determine the amount of earned income tax credit;
- Explain how and to what extent interest from certain bonds may be excluded from gross income;
- Define a dependent for purposes of, and calculate, the dependent-care credit;
- Discuss the various education credits;
- Describe what other education-related expenditures may be deductible;
- Quantify the mileage rates for automobiles owned or used in a trade or business, the SIFL rates for aircraft usage, and the per-diem rates that may be applicable to employee business expenses;
- Discuss the Social Security benefits applicable to retirees and their spouses;
- Explain the limitations that apply to long-term care insurance and health savings accounts; and
- Discuss other limitations applicable to taxpayers in 2024.

I. Tax rates and other information for 2024

A. Tax rates for the individual

The tax rate brackets for 2024 are as follows.[1]

Single:

If taxable income is:	The tax is:
Not over $11,600	10% of taxable income.
Over $11,600 but not over $47,150	$1,160 plus 12% of the excess over $11,600.
Over $47,150 but not over $100,525	$5,426 plus 22% of the excess over $47,150.
Over $100,525 but not over $191,950	$17,168.50 plus 24% of the excess over $100,525.
Over $191,950 but not over $243,725	$39,110.50 plus 32% of the excess over $191,950.
Over $243,725 but not over $609,350	$55,678.50 plus 35% of the excess over $243,725.
Over $609,350	$183,647.25 plus 37% of the excess over $609,350.

Head of Household:

If taxable income is:	The tax is:
Not over $16,550	10% of taxable income.
Over $16,550 but not over $63,100	$1,655 plus 12% of the excess over $16,550.
Over $63,100 but not over $100,500	$7,241 plus 22% of the excess over $63,100.
Over $100,500 but not over $191,950	$15,469 plus 24% of the excess over $100,500.
Over $191,950 but not over $243,700	$37,417 plus 32% of the excess over $191,150.
Over $243,700 but not over $609,350	$53,977 plus 35% of the excess over $243,700.
Over $609,350	$181,954.50 plus 37% of the excess over $609,350.

[1] Rev. Proc. 2023-34.

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Married Filing Jointly and Surviving Spouse:

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

Married Filing Separately:

If taxable income is:	The tax is:
Not over $11,600	10% of taxable income.
Over $11,600 but not over $47,150	$1,160 plus 12% of the excess over $11,600.
Over $47,150 but not over $100,525	$5,426 plus 22% of the excess over $47,150.
Over $100,525 but not over $191,950	$17,168.50 plus 24% of the excess over $100,525.
Over $191,950 but not over $243,725	$39,110.50 plus 32% of the excess over $191,950.
Over $243,725 but not over $365,600	$55,678.50 plus 35% of the excess over $243,725.
Over $365,600	$98,334.75 plus 37% of the excess over $365,600.

Estates and Trusts:

If taxable income is:	The tax is:
Not over $3,100	**10% of taxable income.**
Over $3,100 but not over $11,150	**$310 plus 24% of the excess over $3,100.**
Over $11,150 but not over $15,200	**$2,242 plus 35% of the excess over $11,150.**
Over $15,200	**$3,659.50 plus 37% of the excess over $15,200.**

Capital Gains Rate:

For 2024, the tax rate on capital gain and/or qualifying dividend income is available to individuals only with ordinary taxable income of the following:

2024 Capital Gains Rates

Filing Status	0%	15%	20%
Single	$0-$47,025	$47,026-$518,900	Over $518,900
Married Filing Jointly and Surviving Spouses	$0-$94,050	$94,051-$583,750	Over $583,750
Married Filing Separately	$0-$47,025	$47,026-$291,850	Over $291,850
Head of Household	$0-$63,000	$63,001-$551,350	Over $551,350
Estates, Trusts & Kiddie Tax	$0-$ 3,150	$ 3,151-$15,450	Over $15,450
Unrecaptured Section 1250 gain			25%
Collectibles Eligible gain on qualified small business stock less the 1202 exclusion			28%

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B. Standard deduction[2]

The standard deduction in 2024 is as follows:

Filing status:	2024
Married filing jointly and Surviving spouses (§1(a))	$29,200
Heads of Households (§1(b))	$21,900
Unmarried (§1(c))	$14,600
Married filing separately (§1(d))	$14,600

For 2024, the standard deduction for a dependent is the lesser of: (i) the deduction for a single taxpayer; and (ii) the greater of (x) $1,300, or (y) the sum of $450 and the dependent's earned income.

Additional standard deductions for the elderly and blind in 2024:[3]

Taxpayer	Either	Both
Unmarried	$1,950	$3,900
Married	$1,550	$3,100

C. Qualified Business Income deduction

For taxable years beginning in 2024, the threshold amounts under §199A(e)(2) and phase-in range amounts under §199A(b)(3)(B) and §199A(d)(3)(A) are:

Filing Status	Threshold Amount	Phase-in Range Amount
Married Filing Jointly	$383,900	$483,900
Married Filing Separately	$191,950	$241,950
All Other Returns	$191,950	$241,950

D. Personal exemptions

The personal exemption amount under §151(d) is $5,050.[4] However, the personal exemption and dependency exemption deductions are reduced to $0 for years 2018 through 2025 by the Tax Cuts and Jobs Act of 2017 (TCJA).

The amount of the personal exemption still matters. The way TCJA suspends the deduction is to reduce the amount of the deduction for an exemption to "zero." However, the reduction to zero is only for the tax deduction. The amount still applies for other purposes, such as the income limit for a qualified relative.[5]

Example: Bob and Mary are married and file a joint return for 2024. Their son, Jay, is 20 years old. Jay graduated from college in 2023 but cannot find a job that utilizes his education. The family decided it would be better for Jay to live at home and not seek other full-time employment so that he can continue to seek employment in his chosen field. Jay worked at a local store part-time and earned $4,000.

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2 Rev. Proc. 2023-34.
3 Rev. Proc. 2023-34.
4 Rev. Proc. 2023-34.
5 I.R.C. §151(d), created by the TCJA.

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> Jay is not a qualifying child because he is over 18 years old and is not a student. However, he is a qualifying relative to Bob and Mary because he lived with them all year, they provided over half of Jay's support, and Jay's gross income is less than the exemption amount for 2024 of $5,050. If they are not subject to the child and family credit income limitation, Bob and Mary can take a family credit of $500 for 2024.

On September 16, 2020, the IRS and Department of Treasury released final regulations, confirming that the definition of a qualifying relative is based on the inflation-adjusted personal exemption threshold, even though personal exemptions are suspended under the TCJA. Additionally, the final regulations clarify that the definition of a qualifying relative for purposes other than determining the deduction under §151(a) is based on the inflation-adjusted personal exemption threshold.[6]

E. Gift/Estate Exemptions

Tax year 2024 allows for a $18,000 annual exclusion for gifts to any person (other than gifts in future interests in property). If spouses splitting gifts, the annual exemption is doubled to $36,000. For tax year 2024, the first $185,000 of gifts to a non-US citizen spouse (other than gifts of future interests in property) are not considered taxable gifts. The lifetime gift exemption in 2024 increases to $13.61 million from $12.92 million in 2023.

On April 26, 2022, the IRS issued proposed regulations regarding the increased estate and gift tax exclusion amount provided by the TCJA.[7] The proposed regulations provide an exception to the special rule for includible transfers, or transfers treated as includible, in a grantor's gross estate. This exception would apply to transfers that allow a donor to retain sufficient interest or income from the gifted property. The proposed regulations state that "the purpose of the special rule is to ensure that bona fide inter vivos transfers of property are consistently treated as a transfer of property by gift for both gift and estate tax purposes."

Without the proposed regulations, the application of the special rule to includible gifts results in securing the benefit of the increased BEA even when the donor continues to have title, possession, use, benefit, control, or enjoyment of the transferred property during life. In such circumstances, the proposed regulations provide an exception to the special rule that the amount includible or treated as includible as part of the gross estate is subject to estate tax with the benefit of only the BEA available at the date of death. The proposed regulations would also apply the exception to the transfer, elimination, or relinquishment within 18 months of the donor's date of death of the interest or power that would have caused inclusion in the gross estate, effectively allowing the donor to retain the enjoyment of the property for life. In other words, even if the donor gives up all rights or powers, if it is within 18 months of his or her death, the property is still subject to the exception to the special rule.

The proposed regulations outline the exception to the special rule in the following example:

> *Assume that when the BEA was $11.4 million, a donor gratuitously transferred the donor's enforceable $9 million promissory note to the donor's child. The transfer constituted a completed gift of $9 million. On the donor's death, the assets that are to be used to satisfy the note are part of the donor's gross estate, with the result that the note is treated as includible in the gross estate for purposes of section 2001(b). Thus, the $9 million gift is excluded from adjusted taxable gifts in computing the tentative estate tax under section 2001(b)(1). Nonetheless, if the donor dies after a*

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6 T.D. 9913.

7 REG-118913-21.

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statutory reduction in the BEA to $6.8 million, the credit to be applied in computing the estate tax is the credit based upon the $6.8 million of the BEA allowable as of the date of death.

The proposed regulations specify that the special rule will continue to apply to transfers includible in the gross estate when the taxable amount of the gift is not material. The taxable amount of the gift is not considered material when it is 5% or less of the total amount of the transfer, valued as of the date of the transfer. The proposed regulations are applicable to the estates of decedents dying on or after April 27, 2022. It is important to note that the special rule will not be necessary until the BEA has been decreased by statute (currently January 1, 2026, but could potentially be sooner if legislation is enacted prior to this date).

F. Alternative Minimum Tax Exemption

For 2024, the AMT exemption is:

- $133,300 for joint filers and surviving spouses;
- $85,700 for single filers (other than surviving spouses);
- $66,650 for married individuals filing separately; and
- $29,900 for estates and trusts.

Filing status	2024 Threshold Phaseout Amount	2024 Complete Phaseout Amount
Married filing joint	$1,218,700	$1,751,900
Surviving Spouses	$1,218,700	$1,751,900
Single	$609,350	$952,150
Married filing separate	$609,350	$875,950
Estates and trusts	$99,700	$219,300

G. Reduction of itemized deductions

The overall limitation on itemized deductions does not apply for 2024. The limitation is suspended for years 2018 through 2025 by TCJA.

H. Earned income tax credit (EITC)[8]

1. Earned income and AGI limits

The American Rescue Plan Act (ARPA) temporarily expanded the EITC for taxpayers, allowing more individuals to meet eligibility requirements for the credit in 2021. The temporary changes to the EITC for the 2021 tax year have since expired and are no longer applicable.

ARPA permanently modified the EITC as follows:

a. **Qualifying Child Requirement** -- In prior years, to qualify for the EITC with qualifying children, taxpayers typically had to provide information about the qualifying child, including name, age, and TIN/SSN. ARPA removed this requirement, essentially allowing individuals who have qualifying children to claim the EITC, despite not being able to provide proper documentation.

b. **Joint Return Requirement** – Prior to ARPA, individuals who were married were required to file a joint return in order to be eligible to claim the EITC. ARPA modified this requirement and provides that certain separated married individuals are not required to

8 All numbers from section E. are from Rev. Proc. 2023-34.

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file jointly in order to claim the EITC. For EITC purposes, an individual will not be treated as “married” if the individual:

- Is considered married per §7703(a).
- Lives with his or her qualifying child for more than half of the tax year.
- Does not file a joint return for the tax year.
- Does not have the same principal place of abode as his or her spouse during the last six months of the tax year or has a decree, instrument, or agreement with regard to his or her spouse and is not a member of the same household with his or her spouse by the end of the tax year.

This provision applies to the tax years beginning after December 31, 2020.

c. **Investment Income Requirement** – Prior to ARPA, individuals with certain types of investment over $3,650 were unable to claim the EITC. ARPA increased the threshold amount to $10,000 for tax years beginning after December 31, 2020. The $10,000 threshold will be indexed for inflation for tax years beginning after 2021.

d. **Identification Requirement** -- Prior to ARPA, a taxpayer was required to provide a qualifying child’s name, age, and taxpayer identification number in order to claim the qualifying child when determining the amount of the EITC. If the taxpayer was unable to provide the qualifying child’s name, age, and taxpayer identification number, he or she was ineligible to claim the EITC as an eligible individual with no qualifying children. ARPA removed this requirement and allows an eligible individual who has qualifying children, but cannot provide the necessary identification for such children, to claim the EITC as an eligible individual with no qualifying children. This provision is effective for tax years beginning after December 31, 2020.

2. Investment income limit

Investment income must be $11,600 or less for 2024.

3. Maximum credit amounts

Below are the following figures applicable to the 2024 tax year:[9]

If filing...	Qualifying Children Claimed			
	Zero	**One**	**Two**	**Three or more**
Earned Income Amount	$8,260	$12,390	$17,400	$17,400
Maximum Credit Amount	$632	$4,213	$6,960	$7,830
Threshold Phaseout - Single, Head of Household or Surviving Spouse	$10,330	$22,720	$22,720	$22,720
Completed Phaseout - Single, Head of Household or Surviving Spouse	$18,591	$49,084	$55,768	$59,899
Threshold Phaseout - Married Filing Jointly	$17,250	$29,640	$29,640	$29,640
Completed Phaseout - Married Filing Jointly	$25,511	$56,004	$62,688	$66,819

[9] Rev. Proc. 2023-34.

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Note:

> The Welfare Reform Act of 1996 changed the definition of "adjusted gross income" for purposes of the phase out of the earned income credit. Adjusted gross income is now determined by disregarding net capital losses, net losses from trusts and estates, net losses from nonbusiness rents and royalties, and 50 percent of net losses from businesses.

I. Exclusion from income for certain redemptions of bonds

An exclusion is available for income from the redemption of United States savings bonds for taxpayers who pay qualified higher-education expenses (as defined in §135). This exclusion, however, is phased out by reducing the exclusion by the amount otherwise excludable income multiplied by a fraction. The numerator of the fraction is the excess of the taxpayer's modified adjusted gross income over the threshold amount, and the denominator of the fraction is $30,000 for joint returns or $15,000 for all others. For tax years beginning in 2024, taxpayers with modified adjusted gross income above the "threshold phase-out amount" are subject to this phaseout, up to a "completed phase-out amount," the point at which the benefit is no longer available.

The Service has announced that for 2024:[10]

Filing status	2024 threshold phaseout amount
Married filing jointly	$145,200
Others	$96,800

Example: In 2024, Mr. and Mrs. Smith redeem $15,000 in U.S. savings bonds in order to help pay for their daughter's college tuition. Mr. and Mrs. Smith file a joint income tax return for the 2024 taxable year. Their combined adjusted gross income for 2024 is $155,200. The amount of the exclusion is $10,000 ($15,000 - ($15,000 x $10,000/$30,000)).

J. Dependent-care credit

1. In general

For purposes of the dependent-care credit, a taxpayer who maintains a household that includes one or more qualifying individuals may claim a nonrefundable credit against income-tax liability for up to a certain percent of a limited amount of employment-related expenses.

ARPA made several temporary changes to the dependent-care credit for the 2021 tax year only that have since expired.

In tax year 2024, eligible employment-related expenses are limited to $3,000 if there is one qualifying individual or $6,000 if there are two or more qualifying individuals. The applicable credit percentage is 35% in 2024. The 35-percent credit rate is reduced, but not below 20 percent, by one percentage point for each $2,000 (or a fraction thereof) of adjusted gross income above $15,000 until it reaches $43,001. Thus, the maximum credit is $1,050 if there is one qualifying individual and $2,100 if there are two or more qualifying individuals. The credit is not available to married taxpayers unless they file a joint return. The applicable dollar limit of otherwise eligible employment-related expenses is reduced by any amount excluded from income under an employer-provided dependent-care-assistance program.

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10 Rev. Proc. 2023-34.

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2. Exclusion

Amounts paid or incurred by an employer for dependent-care assistance provided to an employee generally are excluded from the employee's gross income and wages if the assistance is furnished under a program meeting certain requirements. These requirements stipulate that the program be described in writing, satisfy certain nondiscrimination rules, and provide for notification to all eligible employees. Dependent-care assistance expenses eligible for the exclusion are defined the same as employment-related expenses with respect to a qualifying individual under the dependent-care tax credit. Prior to ARPA, the dependent-care exclusion was limited to $5,000 per year, except that a married taxpayer filing a separate return could exclude only $2,500. ARPA temporarily increased the exclusion amount for employer-provided dependent care assistance to $10,500 for 2021. However, the exclusion amount for employer-provided dependent care assistance returned to $5,000 per year ($2,500 MFS) in tax year 2022 and beyond. Dependent-care expenses excluded from income are not eligible for the dependent-care tax credit.

3. Planning notes

a. In 2024, the dependent-care credit is nonrefundable.

b. Many taxpayers and accountants wrongly assume that the $6,000 must be prorated between the two qualifying individuals. This is untrue. If $5,900 is paid on behalf of one qualifying individual and $100 on the other, the full $6,000 is taken into account in computing the credit.

c. Another often overlooked area is a non-child individual can be a qualifying individual. An individual who is incapable of self-care, such as one of the parents following certain surgical procedures after returning home for a few days, can be a qualifying individual.

d. Payments to a non-dependent parent of the taxpayer for the care of the taxpayer's child qualify as payments for dependent care.

e. Carryovers of unused dependent care assistance program amounts are generally not permitted (other than a 2 ½ month grace period). However, in 2021 and 2022, the CAA 2021 temporarily provided that employers could amend their plans to permit the carryover of unused dependent care assistance program amounts to plan years ending in 2021 and 2022, or to extend the permissible period for incurring claims to plan years over the same period.

K. Dependent Care FSA

Dependent Care FSAs allow individuals to make pretax contributions to pay qualified childcare expenses. Single or Married filing jointly taxpayers can contribute up to $5,000 to an FSA in 2024. Married Filing Separately taxpayers can contribute up to $2,500 to an FSA in 2024.

L. Adoption expenses

A tax credit is allowed for **qualified adoption expenses** paid or incurred by a taxpayer. In 2024 the maximum credit is $16,810[11] per eligible child, including special-needs children. A $16,810 credit is provided in the year a special-needs adoption is finalized, regardless of whether the taxpayer has qualified adoption expenses.

a. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses that are: (i) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (ii) not

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[11] Rev. Proc. 2023-34.

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incurred in violation of state or federal law, or in carrying out any surrogate parenting arrangement; (iii) not for the adoption of the child of the taxpayer's spouse; and (iv) not reimbursed (e.g., by an employer).

b. A taxpayer may exclude up to $16,810 in 2024 per eligible child, including special-needs children, for employer-provided adoption assistance to reimburse qualified adoption expenses. In the case of a special-needs adoption, the exclusion is provided regardless of whether the taxpayer has qualified adoption expenses. The exclusion does not apply for purposes of payroll taxes.

Note:

Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit. A taxpayer may be eligible for the adoption credit (with respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

The dollar limitation applies separately to both the credit and the exclusion of employer-reimbursements for adoption related expenses. Taxpayers can claim both the credit and the exclusion, but the exclusion must be claimed before any allowable credit. Expenses used for the exclusion will reduce the amount of qualified adoption expenses available for credit. Thus, taxpayers may not claim both an exclusion and credit for the same expenses.

Example 1: Leslie, a single taxpayer, paid $12,000 of qualified adoption expenses in 2024. Her employer reimbursed her for $5,000 of those expenses in 2024 when the adoption became final. Her 2024 modified adjusted gross income is $165,000. Leslie will exclude the $5,000 of employer-reimbursed expenses from income. The expenses for the adoption credit will be limited to $7,000 ($12,000 expenses paid less $5,000 of employer reimbursement).

Example 2: Patricia, a single taxpayer, paid $20,950 of qualified adoption expenses in 2024. Her employer reimbursed her for $5,000 of those expenses in 2024 when the adoption became final. Her 2024 modified adjusted gross income is $125,000. Patricia will exclude the $5,000 of employer-reimbursed expenses from income. The expenses for adoption credit will be limited to $15,950 ($20,950 expenses paid less $5,000 of employer reimbursement).

Example 3: Margorie, a single taxpayer, paid $35,000 of qualified adoption expenses in 2024. Her employer reimbursed her for $16,810 of those expenses in 2024 when the adoption became final. Her 2024 modified adjusted gross income is $225,000.

Margorie will exclude the $16,810 of employer-reimbursed expenses from income. Margorie's expenses available for credit total $18,190 ($35,000 expenses paid less $16,810 reimbursed by her employer).

However, the expenses for the adoption credit will be limited to $16,810.
Thus, $1,380 ($18,190 creditable expenses - $16,810 credit limitation) will go unused for either an exclusion or credit.

c. The adoption credit (and the employer-provided adoption assistance exclusion) is phased out ratably for taxpayers with modified adjusted gross income between $252,150 and $292,150 in 2024.[12] The dollar/credit limitation must be reduced for a particular year for credits claimed in a prior year for the same adoption effort.

Example: A $3,000 adoption credit was claimed in 2023 with an additional $15,000 of qualified expenses paid in 2024 for the same adoption. The maximum credit that can be claimed in 2024 is $13,810 ($16,810 credit limitation less $3,000 of qualified expenses claimed in 2023).

[12] Adoption credit amounts and limitations updated by Rev. Proc. 2023-34.

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d. Qualified adoption expenses related to unsuccessful adoption attempts must be combined with those expenses related to subsequent attempts, whether or not those attempts are successful.

Example: Jennifer claimed $8,000 of qualified adoption expenses credit in 2022 related to an unsuccessful adoption. In 2023 and 2024, she spent an additional $10,000 for qualified adoption expenses in connection with successful adoptions finalized in 2024. The maximum allowable credit in 2024 is $8,810 ($16,810 credit limitation less $8,000 previously claimed).

Note:

For S corporation employers, adoption expenses provided to a more-than-2% shareholder are not excludable from income. A more-than-2% shareholder is any shareholder with greater than 2% of the value of stock, the percentage of stock, or the voting power of the stock.

e. An eligible child is an individual who: (i) has not attained age 18; or (ii) is physically or mentally incapable of caring for himself or herself. A special-needs child is an eligible child who is a citizen or resident of the United States who a state has determined: (i) cannot or should not be returned to the home of the birth parents; and (ii) will not be adopted unless special assistance is provided to the adoptive parents. Factors include whether the child has a specific factor or condition (such as the child's ethnic background, age, or membership in a minority or sibling group), and whether the child has a medical condition, or a physical, mental, or emotional handicap.

f. Generally, both domestic and foreign adoptions qualify for the credit, however, there are differing timing rules for when the credit can be claimed based on the type of adoption.
- Qualified expenses related to a domestic adoption become creditable in the tax year following the payment. This is the case even if the adoption is never finalized or the eligible child is yet to be identified.
- Qualified expenses related to a foreign adoption become creditable in the tax year the adoption is finalized. Once the adoption is finalized, all qualified expenses from prior years and the year the adoption becomes final are available for the credit.
- Whether domestic or foreign, adoption expenses paid after the year the adoption becomes final are available for credit in the year of payment.

Example 1: Mark and Julie paid qualified adoption expenses of $3,000 in 2022, $4,000 in 2023, and $5,000 in 2024. This domestic adoption became final in 2024. The timing analysis is as follows:
- The $3,000 paid in 2022 is creditable on the 2023 tax return (i.e., the year following the payment).
- The $4,000 paid in 2023 is creditable on the 2024 tax return (i.e., the year following the payment).
- The $5,000 paid in 2024 is creditable on the 2024 tax return (i.e., the year of finalization).
- Accordingly, no credit is allowed on the 2022 tax return.
- The 2023 tax return would have $3,000 of available expenses for credit to offset the 2023 tax liability, with any excess credits available to be carried forward for up to 5 years.
- The 2024 tax return would have $9,000 ($4,000 from 2023 and $5,000 from 2024) of available expenses for credit to offset the 2024 tax liability,

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with any excess credit from either 2023 or 2024, being carried forward to later years.

Example 2: Mark and Julie paid qualified adoption expenses of $3,000 in 2022, $4,000 in 2023, and $5,000 in 2024. This foreign adoption became final in 2024. The timing analysis is as follows:

- The $12,000 ($3,000 from 2022 + $4,000 from 2023 + $5,000 from 2024) becomes creditable on the 2024 tax return as this is the year the adoption becomes final.
- Any excess credits would be available for a carryforward of up to five years.
- Whether domestic or foreign, any additional expenses paid in 2025 would be creditable in 2025 as the adoption has been finalized.

g. The adoption credit is generally available to all filing statuses except married filing separately. Married taxpayers filing separately may still be able to claim the credit if the filer is considered unmarried because of legal separation or living apart from spouse.

If taxpayers filed married filing separately in the year qualified adoption expenses are first allowable, the taxpayer generally can't claim the credit or exclusion for those particular expenses. Additionally, changes in filing status can impact the availability of the credit.

Example: John and Patty paid qualifying adoption expenses of $2,000 in 2022, $5,000 in 2023, and $4,000 in 2024. The domestic adoption became final in 2024. For tax year 2024, the taxpayers will file jointly, but all prior year tax filings were filed using the married filing separately filing status.

- When claiming the qualified adoption expenses in 2024, only $9,000 ($5,000 from 2023 and $4,000 from 2024) will be creditable in 2024.
- Because the taxpayers filed separately in 2023 when the first $2,000 of expenses became creditable, those adoption expenses may not be claimed in 2024.
- If claiming the credit is a priority, amended returns could be filed for 2023 within the appropriate period of limitations to change the filing status and claim $2,000 qualified expenses for purposes of the adoption credit.

h. The adoption credit and exclusion are both claimed on Form 8839, *Qualified Adoption Expenses*, which is attached to a filed individual income tax return. Creditable expenses should be tracked and provided by the taxpayer, and employer-provided adoption assistance should be reported on the employee's Form W-2, box 12, code T. Adoption documentation is no longer required to be attached to the filed return, though documentation should be retained as part of accurate record keeping.

i. The SECURE Act contains favorable updates for both **qualified adoption expenses** and **qualified births.** The SECURE Act allows for penalty-free withdrawals from retirement plans of up to $5,000 per individual in the event of a qualified birth of a child or adoption for distributions made after December 31, 2019. This provision is a new exemption from the 10% penalty tax of §72(t) for early withdrawals from qualified plans and IRAs.

Married couples may separately take a $5,000 distribution for a qualified birth or adoption, providing for a $10,000 total distribution allowance per married couple. An eligible adoptee includes any individual under the age of 18 or who is incapable of self-support, specifically excluding any child(ren) of the taxpayer's spouse. The distribution must be taken within a one-year period beginning on the date on which the child is born or on which the adoption of a child is finalized.

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M. Education benefits

1. Education credits

An individual taxpayer is allowed a nonrefundable education tax credit against income tax for the taxable year. The amount of the education tax credit is the total of the Hope Scholarship credit plus the Lifetime Learning credit.[13]

a. In the same taxable year, a taxpayer may claim a Hope Scholarship credit for each eligible student's **qualified tuition and related expenses** and a Lifetime Learning credit for one or more other students' qualified tuition and related expenses. However, a taxpayer may not claim both a Hope Scholarship credit and a Lifetime Learning credit with respect to the same student in the same taxable year.[14]

b. Subject to certain limitations, a Hope Scholarship credit may be claimed for the qualified tuition and related expenses paid during a taxable year with respect to each eligible student. Qualified tuition and related expenses paid during a taxable year with respect to one student may not be taken into account in computing the amount of the Hope Scholarship credit with respect to any other student. In addition, qualified tuition and related expenses paid during a taxable year with respect to any student for whom a Hope Scholarship credit is claimed may not be taken into account in computing the amount of the Lifetime Learning credit.[15]

c. Subject to certain limitations, a Lifetime Learning credit may be claimed for the aggregate amount of qualified tuition and related expenses paid during a taxable year with respect to students for whom no Hope Scholarship credit is claimed.[16]

d. As a result of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTRA), for tax years beginning in 2021, the Lifetime Learning tax credit that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified adjusted gross income between $80,000 and $90,000 ($160,000 and $180,000 for married individuals who file a joint return). Thus, taxpayers with modified adjusted gross income above $90,000 (or $180,000 for joint filers) may not claim an education tax credit.

- The increased limitations are the result of TCDTRA repealing the tuition and fees deduction for tax years beginning after 2020. Previously, §222 provided taxpayers with a deduction for qualified tuition and related expenses.

For 2024, the Lifetime Learning tax credit phases out as follows:

Taxpayer	MAGI Level Where Phaseout Begins	MAGI Level Where Phaseout Is Complete
Married, filing jointly	$160,000	$180,000
All other taxpayers	$80,000	$90,000

e. Subject to the phaseout of the education tax credit described above, the Lifetime Learning credit amount is 20 percent of up to $10,000 of qualified tuition and related expenses paid during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, and any claimed dependent during any academic period beginning in

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13 Treas. Regs. §1.25A-1(a).
14 Treas. Regs. §1.25A-1(b)(1).
15 Treas. Regs. §1.25A-1(b)(2).
16 Treas. Regs. §1.25A-1(b)(3).

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the taxable year (or treated as beginning in the taxable year).[17] Those expenses paid with respect to a student for whom the Hope Scholarship credit is claimed are not eligible for the Lifetime Learning credit.[18] Thus, in 2024, the maximum Lifetime Learning credit is $2,000.

Note:

> The Lifetime Learning credit is available to eligible students when the Hope credit/American Opportunity credit is not available. In 2022, the Lifetime Learning credit is 20 percent of the first $10,000 of qualifying expenses. The qualifying expense limit is not subject to an annual inflation adjustment.

f. For any taxable year beginning after 2008, the Hope Scholarship is redesignated as the American Opportunity credit.[19] For 2024, the American Opportunity credit is an amount equal to the sum of [20] 100 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to the eligible student during any academic period beginning in such taxable year) as does not exceed $2,000,[21] plus 25 percent of such expenses so paid as exceeds $2,000 but does not exceed $4,000.[22] For 2024, the maximum American Opportunity credit is $2,500.

The change generally increases the credit:

Qualified expenses	Hope Scholarship credit (as if still in force in 2024)	American Opportunity credit (in force for 2024)	Lifetime Learning credit
$500	$500	$500	$100
$1,000	$1,000	$1,000	$200
$1,300	$1,300	$1,300	$260
$1,500	$1,400	$1,500	$300
$2,000	$1,650	$2,000	$400
$2,400	$1,850	$2,100	$480
$2,600	$1,950	$2,150	$500
$3,000	$1,950	$2,250	$600
$3,500	$1,950	$2,375	$700
$4,000	$1,950	$2,500	$800
$5,000	$1,950	$2,500	$1,000
$9,000	$1,950	$2,500	$1,800
$10,000	$1,950	$2,500	$2,000

(i) The Act extends the period during which the credit applies. It not only applies to as many as four years of post-secondary education (provided that the student has not completed the first four years of post-secondary education before the beginning of the fourth taxable year),[23] but also to all four years of post-secondary education.[24]

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17 Treas. Regs. §1.25A-4(a)(2).
18 Treas. Regs. §1.25A-4(a)(3).
19 The American Recovery and Reinvestment Act of 2009.
20 I.R.C. §25A(i)(1).
21 I.R.C. §25A(i)(1)(A).
22 I.R.C. §25A(i)(1)(B).
23 I.R.C. §25A(b)(2)(A). I.R.C. §25A(i)(2).
24 I.R.C. §25A(b)(2)(C). I.R.C. §25A(i)(2).

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Planning point:

> Looking at the above table, the American Opportunity tax credit exceeds the Lifetime Learning credit at all levels of qualified expense. Formerly, one could squeeze an additional $200 (.20 x $10,000) at expense levels of or more than $10,000. The Lifetime Learning credit was larger for qualified expenses above $9,000. The effect of the provision is to limit Lifetime Learning credits to situations in which the taxpayer (or taxpayer's dependent) is a less-than-half-time student or has been convicted of a federal or state felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year within which such period ends, since in either case an individual does not qualify for the Hope Scholarship (or its surrogate, the American Opportunity, for 2009 through 2024) credit.[25]

(ii) In general, the personal credits are applicable only to the excess of the regular tax liability over the tentative tax; it is not applicable against any AMT, i.e., the excess of the tentative tax over the regular tax liability as reduced by the personal nonrefundable credits.[26] However, since 2000, Congress has enabled this and other such nonrefundable personal credits to be applied against the sum of the regular tax liability (reduced by the foreign tax credit) and the AMT (essentially the tentative tax).[27] This was made permanent by the 2012 ATRA legislation. That, in effect, permits this credit to offset and reduce an AMT liability.

(iii) The Hope credit is a nonrefundable personal credit. However, the Act treats 40 percent of so much of the education credit allowed as is attributable to the Hope Scholarship (American Opportunity) credit (after taking into account the income phase out, but without regard to the limitation of the credit against the AMT or regular tax liability, as the case may be) as a refundable credit.[28]

Note:

> This means that the American Opportunity tax credit must be bifurcated into the refundable and nonrefundable portions after computing the aggregate amount after income phase out, then the nonrefundable portion of the credit must be applied against the AMT or the regular tax liability in excess of tentative tax[29] and then the refundable portion must be applied as other refundable credits are.

Caution:

> However, no portion of the modified credit is refundable if the taxpayer claiming the credit is a **child to whom the kiddie tax applies for such taxable year** (generally, any child under age 18 or any child under age 24 who is a student providing less than one-half of his or her own support who has at least one living parent and does not file a joint return).

Example 1: Married Taxpayer has MAGI of $128,000 and has graduate school Lifetime Learning expenses of $10,000 and $5,000 of qualifying undergraduate expenses. Prior to TCDTRA, the Lifetime Learning Credit was $1,000 ($2,000 credit reduced by 50% due to AGI threshold). As a result of TCDTRA, the taxpayer can claim the entire $2,000 credit as her MAGI is under the new threshold limits.

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[25] I.R.C. §25A(b)(2)(B) and §25A(b)(2)(D).

[26] I.R.C. §26(a)(1).

[27] I.R.C. §26(a)(2).

[28] I.R.C. §25A(i)(6). It is not treated as a Hope credit, so the limitations (other than the income phase out) of §25A do not apply.

[29] Any reference in §25A or §§24, 25, 26, 25B, 904, or 1400C to a credit allowable under this subsection shall be treated as a reference to so much of the credit allowable as is attributable to the Hope Scholarship Credit.

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Example 2: Same as **Example 1** above, except that Taxpayer's MAGI is $170,000. In this case, the Lifetime Learning credit is phased out 50 percent ($170,000 MAGI - $160,000 threshold)/$20,000 to $1,000.

Comparison of American Opportunity Tax Credit and Lifetime Learning Credit

Credit	Maximum Amount	Refundability	Qualifying Expenses	Education Level	MAGI Phaseout
American Opportunity Tax Credit (AOTC)	$2,500 per student	40% Refundable	• Tuition and Enrollment Fees • Required Books, supplies, and course materials	• Maximum 4 years of post-secondary education • Must pursue degree	Single: $80,000-$90,000 MFJ: $160,000 - $180,000
Lifetime Learning Credit	$2,000 per return	Nonrefundable	• Tuition and Enrollment Fees	• Unlimited years • All levels of post-secondary education or courses to improve job skills	Single: $80,000-$90,000 MFJ: $160,000 - $180,000

Planning point:

Sometimes these credits can be utilized by the child/student because the parents cannot qualify under the AGI phase outs. In order to do so, the taxpayer who is eligible to claim the student as a dependent (usually the parent) must choose not to do so (and lose the dependency exemption). Then the student may claim the education credit for the student's qualified tuition and related expenses **even if** the tuition and expenses were paid by the parent. The surprise in the proposed regulations was the specific reference to the possibility of a parent to waive the exemption. Most practitioners believed that the exemption was mandatory because of "there shall be allowed" language.

Example 1: In 2024, Client pays qualified tuition and related expenses for Client's dependent, Child, to attend Ole Alma Mater during 2024. Client claims Child as a dependent on Client's federal income tax return. Therefore, assuming all other relevant requirements are met, Client is allowed an education credit on Client's federal income tax return, and Child is **not** allowed an education credit on Child's federal income tax return. The result would be the same if Child paid the qualified tuition and related expenses.[30]

Example 2: In 2024, Client has one dependent, Child. In 2024, Child pays qualified tuition and related expenses to attend Ole Alma Mater during 2024. Although Client is eligible to claim Child as a dependent on Client's federal income tax return, Client does not do so. Therefore, assuming all other relevant requirements are met, Child is allowed an education credit on Child's federal income tax return, and Client is not allowed an education credit on Client's federal income tax return with respect to Child's education expenses. The result would be the same if Client paid the qualified tuition and related expenses on behalf of Child.[31]

The new tax structure may suggest higher wages to be paid to certain children, since now the kiddie tax applies to a student who has not attained age 24 or a child who has not attained age 19 unless, in either case, the child has earned income in excess of one-half of the child's support. This means that a child,

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30 See Treas. Regs. §1.25A-1(f)(2), Ex. 1.
31 See Treas. Regs. §1.25A-1(f)(2), Ex. 2.

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assuming all other conditions are met, may earn up to $37,350 of earned income and pay no income tax if eligible for the American Opportunity credit or $33,200 if eligible for the Lifetime Learning credit.

Earned income	$37,350
Less Standard deduction	$14,600
Taxable income	$22,750
Tax before credits	$2,500
American Opportunity credit	$2,500
Net tax	$0

Earned income	$33,200
Less Standard deduction	$14,600
Taxable income	18,600
Tax before credits	$2,000
Lifetime Learning credit	$2,000
Net tax	$0

2. Qualified tuition expenses

For taxable years through 2017, taxpayers were allowed an above-the-line deduction for qualified tuition and related expenses paid by the taxpayer during a taxable year. The deduction was not allowed if the individual elects to apply the Hope/American Opportunity or Lifetime Learning credits. This popular provision was renewed on December 20, 2019 through December 31, 2020 for tax years 2018, 2019, and 2020.[32] During these tax years, a taxpayer was allowed to claim an above-the-line deduction of qualified tuition and related expenses, up to $4,000 if AGI did not exceed $65,000 ($130,000 joint) and up to $2,000 if AGI did not exceed $80,000 ($160,000 joint). To claim this deduction, eligible taxpayers had to file Form 8917.

[32] The Consolidated Appropriations Act, 2021.

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Form **8917** (Rev. January 2020) Department of the Treasury Internal Revenue Service

Tuition and Fees Deduction

► Attach to Form 1040 or 1040-SR.
► Go to www.irs.gov/Form8917 for the latest information.

OMB No. 1545-0074 | Attachment Sequence No. 60

Name(s) shown on return | Your social security number

CAUTION

Use this form for qualified tuition and fees paid in 2018, 2019, or 2020, and later years if legislation extends the deduction (see instructions). File a separate Form 8917 for each year after 2017 for which you qualify to take the deduction.

*You **can't** take both an education credit from Form 8863 and the tuition and fees deduction from this form for the **same student** for the same tax year.*

Before you begin: ✔ To see if you qualify for this deduction, see *Who Can Take the Deduction* in the instructions below.

✔ If you file Form 1040 or 1040-SR, figure any write-in adjustments.
- For 2018: Figure any write-in adjustments to be entered on the dotted line next to Schedule 1 (Form 1040), line 36.
- For 2019: Figure any write-in adjustments to be entered on the dotted line next to Schedule 1 (Form 1040 or 1040-SR), line 22.
- For 2020 and later years: Figure any write-in adjustments for Schedule 1 (Form 1040 or 1040-SR); see the Instructions for Forms 1040 and 1040-SR.

1	(a) Student's name (as shown on page 1 of your tax return) First name / Last name	(b) Student's social security number (as shown on page 1 of your tax return)	(c) Adjusted qualified expenses (see instructions)

2 Add the amounts on line 1, column (c), and enter the total . . . **2**

3 Enter the amount from your **"total income"** line of Form 1040 or 1040-SR . . . **3**

4 • For 2018: Enter the total of the amounts on your 2018 Schedule 1 (Form 1040), lines 23 through 33, plus any write-in adjustments you entered on the dotted line next to Schedule 1 (Form 1040), line 36.
• For 2019 and 2020: Enter the total of the amounts on your 2019 Schedule 1 (Form 1040 or 1040-SR), lines 10 through 20, plus any write-in adjustments you entered on the dotted line next to Schedule 1 (Form 1040 or 1040-SR), line 22.
• For later years: See *www.irs.gov/Form8917* to find out if the line references above for 2019 have changed . . . **4**

5 Subtract line 4 from line 3.* If the result is more than $80,000 ($160,000 if married filing jointly), **stop;** you can't take the deduction for tuition and fees . . . **5**

*If you're filing Form 2555, 2555-EZ, or 4563, or you're excluding income from Puerto Rico, see *Effect of the Amount of Your Income on the Amount of Your Deduction* in Pub. 970 to figure the amount to enter on line 5.

6 **Tuition and fees deduction.** Is the amount on line 5 more than $65,000 ($130,000 if married filing jointly)?

☐ **Yes.** Enter the smaller of line 2, or $2,000.
☐ **No.** Enter the smaller of line 2, or $4,000. } . . . **6**

Also enter this amount on line 21 of the 2019 and 2020 Schedule 1 (Form 1040 or 1040-SR), or line 34 of the 2018 Schedule 1 (Form 1040). See *www.irs.gov/Form8917* to find out if the line references above for 2019 have changed.

Beginning in 2021, the TCDTRA repealed the deduction for qualified tuition and related expenses and increased the income limitation phaseout range for the Lifetime Learning credit.

3. Coverdell education savings accounts (CESAs)

A Coverdell education savings account (CESA), a product of the Taxpayer Relief Act of 1997, is a tax-free savings account for educational expenses. A CESA is a trust or custodial account that is created or organized in the United States exclusively for the purpose of paying the qualified higher-education expenses of the designated beneficiary of the account. The account must be designated as a Coverdell

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education savings account when it is created in order to be treated as a Coverdell savings account for tax purposes.[33]

a. Taxpayers may deposit up to $2,000 per year into a CESA for a child younger than age 18. Parents, grandparents, other family members, friends, and the child may contribute to the child's CESA, provided that the total contributions for the child during the taxable year do not exceed the $2,000 limit. Amounts deposited in the account grow tax-free until distributed, and the child will not owe tax on any withdrawal from the account if the child's qualified higher-education expenses at an eligible educational institution for the year equal or exceed the amount of the withdrawal.

b. Any individual, again including the beneficiary, can contribute to a CESA if their modified adjusted gross income is under $110,000 ($220,000 for joint returns).

c. Distributions from a CESA are not included in the gross income of the distributee to the extent of the beneficiary's qualified higher-education expenses during the taxable year.[34] "Qualified higher-education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). They now include reasonable costs for room and board incurred by the designated beneficiary who is an eligible student for any academic period while attending such institution.[35] Unique to a CESA is the inclusion as qualified higher-education expenses "qualified elementary and secondary school expenses,"[36] meaning expenses for:

    (i) Tuition, fees, academic tutoring, special-needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under state law;

    (ii) Room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and

    (iii) The purchase of any computer technology, equipment, or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is educational in nature.

d. A distribution otherwise taxable from a CESA to the extent that the amount received is paid into another CESA for the benefit of the same beneficiary or a **member of the family** of such beneficiary not later than the sixtieth day after the date of such payment or distribution is not included in the gross income of the distributee.[37] A member of the family means: (i) the spouse of the beneficiary; (ii) a son or daughter of the beneficiary, or a descendant of either; (iii) a stepson or stepdaughter of the beneficiary; (iv) a brother, sister, stepbrother, or stepsister of the beneficiary; (v) the father or mother of the beneficiary, or an ancestor of either; (vi) a stepfather or stepmother of the beneficiary;

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33 Notice 97-60, 1997-46 I.R.B. 8, §3, Q&A-1.
34 I.R.C. §530(d)(2)(A).
35 I.R.C. §529(e)(3)(B)(i).
36 I.R.C. §530(b)(4)(A).
37 I.R.C. §530(d)(5). This includes, besides the taxpayer and spouse, sons, daughters, brothers, sisters, nephews and nieces, certain in-laws, etc. and any spouse of such persons.

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(vii) a son or daughter of a brother or sister of the beneficiary; (viii) a brother or sister of the father or mother of the beneficiary; (ix) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the beneficiary; (x) a first cousin of the beneficiary, but not the spouse of a first cousin; or (xi) any spouse of an individual named in (ii) - (ix).[38] However, the rollover does not avoid tax with respect to any payment or distribution if the rollover was applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.

e. Tax-free transfers or rollovers of account balances may be made from one CESA benefiting one beneficiary to another CESA benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a **member of the family of the old beneficiary** and is under age 30. Any balance remaining in a CESA is deemed distributed within 30 days after the date that the beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies). The age limitations with respect to rollovers and required distributions are eliminated in the case of a beneficiary who is a special-needs beneficiary. Thus, a deemed distribution of any balance in a CESA does not occur when a special-needs beneficiary reaches age 30.

f. Finally, the age-30 limitation does not apply in the case of a rollover contribution for the benefit of a special-needs beneficiary or a change in beneficiaries to a special-needs beneficiary.

Note:

The Department of Education has announced that for financial-aid purposes, it will no longer treat the CESA as the student's asset, but the parent's asset. Generally, 35 percent of the student's assets are considered available resources while only 5.6 percent of a parent's assets are so treated.

The Case to Kill the Coverdell:

Once an attractive option for families looking to save for college, the popularity of CESAs have dwindled in recent years, especially due to the impact of the TCJA and the SECURE Act. Consider the following:

- CESAs once had the advantage of allowing qualified withdrawals for K-12 expenses. The TCJA expanded §529 plans by allowing qualified withdrawals for K-12 expenses, eliminating that advantage of CESAs over §529 plans.
- The SECURE Act expanded §529 plans by allowing qualified withdrawals for student loan repayment (up to $10,000) and apprenticeship programs. Student loan repayment and apprenticeship program expenses are not considered qualified withdrawals for CESAs.
- Combined contributions are capped at $2,000 per beneficiary, per year, not indexed for inflation.
- Section 529 plans have an indefinite life and can last for generations, whereas CESAs must be disbursed for qualified education expenses or given to another family member under age 30 by the time the original beneficiary turns 30 years old.
- Section 529 plans can qualify for state tax deductions and credits, whereas CESAs do not.

CESAs are not necessarily ***bad*** college savings instruments. CESAs generally provide a broad range of investment options, while §529 plan investment options are more limited in nature. Despite the broader range of investment options, recent law has made other options, such as §529 plans, much more attractive.

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[38] I.R.C. §529(e)(2).

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4. Qualified Tuition programs (§529 plans)

Prior to 2002, a qualified tuition program (QTP) generally referred to a program established and maintained by a **state**. The basic thrust of the program was to permit persons to: (i) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher-education expenses of the beneficiary; or (ii) make contributions to an account that is established for the purpose of meeting qualified higher-education expenses of the designated beneficiary of the account (a "savings-account plan"). The terms and conditions of these programs vary from state to state.[39] However, there are some standard federal income-tax rules that apply to these programs.[40] The tax on earnings attributable to prepayments or contributions is deferred until the earnings are distributed from the QTP.

Note:

Prepaid tuition plan: Account Owner (e.g., a parent) contributes cash to a plan account for Beneficiary (e.g., a child), and the contribution purchases tuition credits (e.g., credit hours) based on then-current tuition rates. Account Owner's contribution qualifies for the annual gift-tax exclusion. When Beneficiary attends a college participating in the program, Beneficiary's tuition credits may be used to pay for all or a portion of Beneficiary's tuition and other college expenses, regardless of tuition rates at that time. If Beneficiary does not go to college or goes to a nonparticipating college, the tuition credits will be refunded in cash (based on a set formula or index), which may then of course be used to pay tuition and other college expenses at a nonparticipating college. Prior to the 2001 Act, the difference between: (i) the value of the tuition and other expenses covered by the plan; and (ii) the total amount of Account Owner's contributions to the plan was taxable ordinary income to Beneficiary. Under the 2001 Act, that difference is generally tax-free.

College-savings plan: Account Owner contributes cash to a plan account for Beneficiary, and the contribution is invested according to the terms of the plan. Account Owner's contribution qualifies for the annual gift-tax exclusion. When Beneficiary attends virtually any college, the funds in the account (that is, Account Owner's contributions plus all of the investment earnings thereon) may be used to pay for Beneficiary's tuition and other college expenses. Prior to the 2001 Act, the investment earnings were taxable ordinary income to Beneficiary, but only at the time they were used for Beneficiary's tuition and other college expenses.

A specified individual must be designated as the beneficiary at the commencement of participation in a qualified tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a state or local government or a tax-exempt §501(c)(3) charity as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships.

a. Under the 2001 Act, tax-exempt status is granted to a qualified tuition program, which includes both a qualified tuition program as before and prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under §529 (other than the state-sponsorship rule).[41] In the case of a qualified tuition program maintained by one or more **private eligible educational institutions**, persons are able to purchase tuition credits or certificates on behalf of a designated beneficiary, but would not be able to make contributions to a savings-account plan.[42] For these purposes, the term "eligible

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39 Notice 97-60, 1997-46 I.R.B. 8, §6.
40 I.R.C. §529.
41 I.R.C. §529(b)(1).
42 I.R.C. §529(b)(1)(A)(i).

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educational institution" means an institution that is described in §481 of the Higher Education Act of 1965,[43] as in effect on June 7, 2001 (the date of the enactment), and is eligible to participate in programs under Title IV of that Act.[44]

b. The beneficiary pays tax on the earnings at the time of distribution. If amounts saved through a QTP are used to pay for college, the student or the student's parents still may be eligible to claim either the Hope Scholarship credit or the Lifetime Learning credit.[45] However, an amount contributed to a Coverdell savings account on behalf of a designated beneficiary during any taxable year in which an amount is also contributed to a qualified tuition program on behalf of the same beneficiary will not be treated as an excess contribution to the CESA.[46] However, cash distributions made in taxable years beginning after December 31, 2001 from qualified tuition programs are excluded from gross income to the extent that the distribution is used to pay for qualified higher-education expenses (as reduced by any in-kind distributions). This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a state (or agency or instrumentality thereof) for distributions made in taxable years after December 31, 2003.

c. Contributions by donors are eligible for the $18,000 annual gift-tax exclusion ($36,000 for "split" gifts by married couples). Therefore, for transfer-tax purposes such contributions are treated as a completed gift to the beneficiary.

Questions to ponder:

Should, say, grandparents, consider the implications of fully funding grandkids' secondary education taking that obligation away from the parents? Should that conversation be undertaken with the parents?

Planning point:

If the contribution is larger than the amount of the gift-tax annual exclusion, the donor may prorate the contribution to the prepaid tuition plan over five years for purposes of claiming the gift-tax annual exclusion. This allows the contribution of **up to five times the amount of the annual exclusion (up to $90,000 for an individual and up to $180,000 for split gifts)** to be made **without gift-tax consequences**.

The limits on the amount of contributions imposed by state plans vary. Some, however, have limits high enough to take advantage of this advantage. For example, Fidelity Investments' Unique College Investing Plan, which is open to New Hampshire residents, has an account maximum of $596,925 per beneficiary.

The gift-tax annual exclusion increases to $18,000 in 2024. Although the amount is indexed for inflation, it rounds down to the next lowest multiple of $1,000.[47]

Note:

The exemption of gifts of QTPs on a change of beneficiary is limited to cases where the new beneficiary is a member of the family of the old beneficiary. Also, the exemption does not apply if the new beneficiary is of a lower generation than the old beneficiary.

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43 20 U.S.C. 1088.
44 I.R.C. §529(e)(5).
45 Notice 97-60, 1997-46 I.R.B. 8, §6, Q&A-2.
46 Notice 97-60, 1997-46 I.R.B. 8, §6, Q&A-4.
47 I.R.C. §26(b)(2).

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d. PPA repealed the sunset provisions of Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that would have expired at the end of 2010 and that relate to qualified tuition programs (§529 plans):

  (i) The provision that makes qualified withdrawals from qualified tuition accounts exempt from income tax;
  (ii) The repeal of a pre-EGTRRA requirement that there be more than a de minimis penalty imposed on amounts not used for educational purposes and the imposition of the 10-percent additional tax on distributions not used for qualified higher education purposes;
  (iii) A provision permitting certain private educational institutions to establish prepaid tuition programs that qualify under §529 if they receive a ruling or determination to that effect from the Internal Revenue Service, and if the assets are held in a trust created or organized for the exclusive benefit of designated beneficiaries;
  (iv) Certain provisions permitting rollovers from one account to another account;
  (v) Certain rules regarding the treatment of room and board as qualifying expenses;
  (vi) Certain rules regarding coordination with Hope and Lifetime Learning credit provisions;
  (vii) The provision that treats first cousins as members of the family for purposes of the rollover and change-in-beneficiary rules; and
  (viii) Certain provisions regarding the education expenses of special-needs beneficiaries.

e. Three significant changes have been made recently to the rules for §529 plans:

  (i) The PATH Act of 2015 expanded the definition of qualified expenses to include computers and peripheral equipment. This modernized the rules to be more in step with today's use of technology in education.
  (ii) The TCJA added a provision to allow distributions to cover grades K-12, with an annual limit of $10,000.
  (iii) The SECURE Act expanded §529 education savings accounts coverage (discussed later).

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Note:

The Pension Protection Act of 2006 permanently extended the amendments to §529, which previously were scheduled to expire at the end of 2010, including the provision that exempts from federal income tax distributions made from §529 accounts that are used to pay qualified higher education expenses. At the same time, it also enacted §529(f), which provides that, notwithstanding any other provision of §529, such regulations as may be necessary or appropriate to carry out the purposes of §529 and to prevent abuse of such purposes are authorized. The Joint Committee on Taxation provided two examples of how present law creates the opportunity for abuse of §529 accounts. Abuse may arise because of the ability to change designated beneficiaries (DBs) in certain circumstances without triggering transfer tax. For example, taxpayers may seek to establish and contribute to multiple accounts (taking advantage of the five-year rule) with different DBs with the intention of subsequently changing the DBs of such accounts to a single, common beneficiary and distributing the entire amount to such beneficiary without further transfer-tax consequences. Abuse may also arise because taxpayers seek to use §529 accounts as retirement accounts, with all of the tax benefits but none of the restrictions and requirements of qualified retirement accounts.

The Service is aware of other situations where current law raises the potential for abuse of §529 accounts. For example, abuse may also arise if a person contributes a large sum to an account for himself or herself and then changes the DB to a member of his or her family who is in the same or a higher generation as the contributor. The contributor's contributions to his or her own account would not trigger the gift tax because an individual cannot make a gift to himself or herself. The contributor may claim that the subsequent change of DB to a member of the contributor's family who is in the same or a higher generation avoids the gift tax under the special transfer tax rules of §529. Abuse may also arise because contributions to accounts are treated as completed gifts to the DB even though the account owner (AO) may be able to withdraw the money at his or her discretion.

Accordingly, **the Service intends to issue a notice of proposed rulemaking to address the potential for abuse of §529 accounts**. The notice of proposed rulemaking will provide a general anti-abuse rule that will apply when §529 accounts are established or used for purposes of avoiding or evading transfer tax or for other purposes inconsistent with §529. In addition, the notice of proposed rulemaking will include rules relating to the tax treatment of contributions to and participants in QTPs, including rules addressing the inconsistency between §529 and the generally applicable income and transfer tax provisions of the Code. The notice of proposed rulemaking also will include rules relating to the function and operation of QTPs and §529 accounts. The Service anticipates that the forthcoming notice of proposed rulemaking also will address additional comments that have been received with regard to certain administrative, income tax, and other issues affecting QTPs and §529 accounts.

The Service anticipates that the new rules to be provided in the notice of proposed rulemaking will generally apply prospectively to all §529 accounts. However, the anti-abuse rule may be applied on a retroactive basis.

The IRS and the Treasury Department also anticipate that the notice may require some states (or agencies or instrumentalities thereof) and eligible educational institutions that have established and maintained QTPs to make changes to the terms and operating provisions of their programs in order to ensure that their programs remain qualified under §529. The forthcoming notice of proposed rulemaking will provide a grace period of no less than 15 months to implement most changes.

These changes are not proposed to apply to a CESA (§530). So presumably the changing beneficiary strategy outlined above will survive the modification proposed.

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Note:

> Present law creates opportunities for abuse of qualified tuition programs. For example, taxpayers may seek to avoid gift and generation-skipping transfer taxes by establishing and contributing to multiple qualified tuition program accounts with different designated beneficiaries (using the provision of §529 that permits a contributor to contribute up to five times the annual exclusion amount per donee in a single year and treat the contribution as having been made ratably over five years), with the **intention of subsequently changing the designated beneficiaries of such accounts to a single, common beneficiary and distributing the entire amount to such beneficiary** without further transfer-tax consequences. Taxpayers also may seek to use qualified tuition program accounts as retirement accounts with all of the tax benefits but none of the restrictions and requirements of qualified retirement accounts. The provision grants the Secretary broad regulatory authority to clarify the tax treatment of certain transfers and to ensure that qualified tuition program accounts are used for the intended purpose of saving for higher education expenses of the designated beneficiary, including the authority to impose related record-keeping and reporting requirements. The provision also authorizes the Secretary to limit the persons who may be contributors to a qualified tuition program and to determine any special rules for the operation and federal tax consequences of such programs if such contributors are not individuals.

5. SECURE Act update: Section 529 plans

Section 302 of the SECURE Act expands §529 education savings accounts coverage to include expenses associated with registered apprenticeship programs and distributions for qualified education loan repayments. In the past, distributions were only considered qualified to the extent that the expenses were incurred at a qualified higher education institution. With the rising costs of college, it has become increasingly common for individuals to go into trades or apprenticeships, and now §529 accounts can be used to pay related expenses.

In addition, the SECURE Act allows for up to $10,000 (lifetime maximum) to be withdrawn from a §529 plan to pay student loan principal amounts and related interest expenses for the beneficiary or the beneficiary's siblings. This provision applies to distributions made after December 31, 2018.

6. Student loan interest

There is an **above-the-line deduction for interest** paid on certain loans used to pay **qualified higher-education expenses**. This deduction applies to payments that would otherwise be treated as nondeductible personal interest except for the new special rules.[48] The amount allowable cannot exceed $2,500. It is not indexed for inflation.

Under current law, married couples are penalized, as the above-the-line deduction for interest is capped at $2,500 per return, not per individual. Over the years, legislation has been introduced to attempt to amend §221(b)(1) to allow married couples to apply the student loan interest deduction limitation separately to each spouse. Ultimately, no legislation has been passed to provide a $2,500 above-the-line deduction per individual (rather than per return), but it is possible that future legislation may be introduced to provide an expanded above-the-line deduction for interest.

Note:

> These income phaseout ranges are adjusted annually for inflation, rounded down to the closest multiple of $5,000.

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48 I.R.C. §221.

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In 2024, the education interest-expense deduction phases out as follows:

Taxpayer	MAGI Level Where Phaseout Begins	MAGI Level Where Phaseout is Complete
Married filing jointly	$165,000	$195,000
Single (including head of household)	$80,000	$95,000

N. Transportation

1. Mileage

a. For automobiles first provided by employers to employees that meet certain requirements, the value to the employee of the use of the automobile may be determined under the vehicle cents-per-mile valuation rule,[49] but only if the fair market value of the automobile on the first date the automobile is made available to the employee does not exceed a "base value" amount. For years prior to 2018 this base value was $16,000 ($17,900 for vans and trucks). In IRS Notice 2019-08, the Treasury Department raised these amounts for 2018 significantly to $50,000. The IRS Notice 2019-08 was issued to adjust the numbers because of the changes to the luxury automobile depreciation limits made by the Tax Cuts and Jobs Act of 2017. The $50,000 limit for 2018 also applies for the fleet-average valuation rules. The 2024 figure is $62,000.[50]

Planning note:

> The limitation on using the cents-per-mile method has been low for so long that many business owners have disregarded the method as an option. The increased limit should be considered by business owners to simplify record keeping.

b. For 2024, the standard mileage rate is the number of business miles driven multiplied by 67 cents.

c. For 2024, the standard mileage rate for deductible medical or moving expenses (available for active-duty members of the military) is 21 cents per mile.

d. The standard mileage rate for miles driven in connection with service of charitable organizations remains at 14 cents per mile.

2. Lease-deduction reduction

For leased automobiles, §280F(c) requires a reduction in the deduction allowed to the lessee of the automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. This reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table.

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49 Treas. Regs. §1.61-21(e).
50 IRS Notice 2024-13.

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Table for Autos with a Lease Term Beginning in 2024[51]

REV. PROC. 2024-13 TABLE 3

DOLLAR AMOUNTS FOR PASSENGER AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2024

Fair Market Value of Passenger Automobile Over	Fair Market Value of Passenger Automobile Not Over	1st Tax Year During Lease	2nd Tax Year During Lease	3rd Tax Year During Lease	4th Tax Year During Lease	5th Tax Year During Lease & Later
$62,000	$64,000	7	16	24	28	32
64,000	66,000	21	47	69	82	94
66,000	68,000	35	77	114	136	157
68,000	70,000	49	107	159	191	219
70,000	72,000	62	138	204	245	281
72,000	74,000	76	168	250	298	344
74,000	76,000	90	199	294	353	406
76,000	78,000	104	229	340	406	469
78,000	80,000	118	259	385	461	531
80,000	85,000	142	313	463	556	640
85,000	90,000	177	388	577	690	797
90,000	95,000	211	465	689	826	952
95,000	100,000	246	541	802	961	1,108
100,000	110,000	298	655	971	1,163	1,343
110,000	120,000	367	807	1,196	1,435	1,655
120,000	130,000	437	958	1,423	1,704	1,968
130,000	140,000	506	1,111	1,647	1,975	2,280
140,000	150,000	575	1,263	1,873	2,245	2,592
150,000	160,000	645	1,414	2,099	2,516	2,904
160,000	170,000	714	1,566	2,325	2,786	3,216
170,000	180,000	783	1,719	2,549	3,057	3,529
180,000	190,000	852	1,871	2,775	3,327	3,841
190,000	200,000	922	2,022	3,001	3,598	4,153
200,000	210,000	991	2,175	3,226	3,868	4,465
210,000	220,000	1,060	2,327	3,452	4,138	4,778
220,000	230,000	1,130	2,478	3,678	4,409	5,089
230,000	240,000	1,199	2,631	3,902	4,680	5,402
240,000	and over	1,268	2,783	4,128	4,950	5,714

3. Depreciation

There are limitations to the allowable depreciation on luxury vehicles. The depreciation limitations are applied, by reference to the year the vehicle was first placed in service. The §280F "luxury car" caps continue to be avoided by purchasing cars with "unloaded gross curb weights" of over 6,000 pounds and

51 Rev Proc. 2024-13.

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trucks and vans with a load capacity over 6,000 pounds. Leasing the car or vehicle also serves to avoid these caps, although there is a minimal add-back (i.e., annual income inclusion) that serves to offset the write-off.

The TCJA made changes to the luxury auto limits for tax years beginning after December 31, 2017.

a. Prior to TCJA, there were two sets of limits. One set of limits applied to autos (not trucks and vans), and the other applied to trucks and vans. Under TCJA, there is one set of limits for all passenger automobiles.

b. The law maintained the difference in how the 6,000-pound maximum weight is calculated for autos and for trucks and vans. For autos that are not trucks and vans, the maximum weight is the unloaded weight, but for trucks and vans it is the loaded weight (gross vehicle weight rating).

Note:

Certain "qualified non-personal-use vehicles" continue to be exempt from the luxury-auto limits *regardless of their weight*.

The annual depreciation dollar caps for vehicles that are in fact subject to the luxury-auto limits of §280F and placed in service in calendar year 2024 follow.

Autos (including trucks or vans):

- $12,400 for the placed-in-service year;
- $19,800 for the second tax year;
- $11,900 for the third tax year; and
- $7,160 for each succeeding year.

The additional-first-year (bonus) depreciation amount of $8,000 was reinstated by TCJA for vehicles acquired and placed in service after September 27, 2017.

Note:

As always, the dollar limits must be proportionately reduced if business/investment use of a vehicle is less than 100 percent.

Note:

The rule under §179 limiting the amount of the expensing deduction (after application of the phase-out rule) to the amount of taxable income from any of the taxpayer's active trades or businesses was not affected. Any amount that cannot be deducted because of the taxable-income limit may be carried over indefinitely until it can be deducted.

Note:

There is no AMT adjustment with respect to property expensed under §179.[52]

Caution:

For tax years beginning in 2024, the maximum is $1,220,000, phasing out for expenditures in excess of $3,050,000.[53]

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52 S. Rept. (1986).
53 TCJA, Rev. Proc. 2023-34.

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The §179 expense limitation with respect to a sport-utility vehicle placed in service after October 22, 2004 is limited to $25,000. TCJA added a provision to index the $25,000 for inflation for years after 2018. The indexed amount for 2024 is $30,500.

c. A sport-utility vehicle is a four-wheeled vehicle that:
   - Is primarily designed or which can be used to carry passengers over public streets, roads, or highways (except any vehicle operated exclusively on a rail or rails);
   - Is not subject to §280F; and
   - Is rated at not more than 14,000 pounds gross vehicle weight.

d. However, a sport-utility vehicle does **not** include any vehicle that:
   - Is designed to have a seating capacity of more than nine persons behind the driver's seat;
   - Is equipped with a cargo area of at least six feet in interior length, which is an open area or is designed for use as an open area but is enclosed by a cap and is not readily accessible directly from the passenger compartment; or
   - Has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

Note:

> There are a number of vehicles that still do not meet the definition of a sport-utility vehicle. The provision does not make the sport-utility vehicle a passenger automobile, so it is eligible for depreciation using the general depreciation recovery scheme (20 percent, 32 percent, etc.) without recourse to the annual caps that apply to passenger automobiles.

Example: A purchases and places in service a used Hummer for $50,000 in 2023 and elects out of bonus depreciation. A takes a $27,000 §179 expense and $5,000 regular depreciation, a total of $32,000.

Because of changes included in the TCJA, used property qualifies for bonus depreciation. Since the vehicle is over 6,000 pounds, A can take 100-percent bonus depreciation on the vehicle.

4. Qualified transportation expenses

Employees can exclude a limited amount of **qualified transportation fringe** benefits provided by the employer from gross income and wages for both income and payroll taxes within specific limitations, without regard to working-condition fringe benefits and de minimis fringe benefits.[54] However, for tax years beginning after December 31, 2017, the amounts are not deductible by the employer.[55]

a. Qualified transportation fringe benefits include the following.

   (i) Transportation in a **commuter highway vehicle** is transportation provided by an employer to an employee in connection with travel between the employee's residence and place of employment.[56] A commuter highway vehicle is a highway vehicle with a seating capacity of at least six adults (excluding the driver) and with respect to which at least 80 percent of the vehicle's mileage is reasonably

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54 I.R.C. §132(a)(5).

55 I.R.C. §274(a)(4), as amended by the TCJA.

56 Treas. Regs. §1.132-9, A-2.

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expected to be used for transporting employees in connection with travel between their residences and their place of employment and on trips during which the number of employees transported for commuting is at least one-half of the adult seating capacity of the vehicle (excluding the driver).[57] Transportation is considered provided by the employer if the transportation is furnished in a commuter highway vehicle operated by or for the employer.[58]

(ii) Also included is any **transit pass,**[59] which is any pass, token, farecard, voucher, or similar item (including an item exchangeable for fare media) that entitles a person to transportation or transportation at a reduced price if such transportation is on mass-transit facilities (whether or not publicly owned), or is provided by any person in the business of transporting persons for compensation or hire in a highway vehicle with a seating capacity of at least six adults (excluding the driver).[60]

(iii) Finally, any **qualified parking** that is parking provided to an employee by an employer:[61]

- On or near the employer's business premises; or
- At a location from which the employee commutes to work by carpool, commuter highway vehicle, mass-transit facilities, transportation provided by any person in the business of transporting persons for compensation or hire, or by any other means.[62]

b. The amount of the fringe benefits that are provided to any employee and that may be excluded in 2024 may not exceed $315 per month in the aggregate for transportation in a commuter highway vehicle and transit passes,[63] and $315 per month in the case of qualified parking.[64]

c. Only employees are eligible for a qualified transportation fringe. For these purposes, an employee does not include a sole proprietor, a partner, or a more-than-two-percent shareholder of an S corporation.[65]

d. Unlike the de minimis fringe benefits rule, under which $1 above the facts-and-circumstances amount converts the entire benefit into a taxable benefit, the statute with respect to qualified transportation fringes merely places a limitation on the amount of the exclusion. Thus, the employer's payment of a $316 monthly parking fee only subjects $1 to tax in 2024.

5. Federal per-diem rates

The General Services Administration changed the COLI adjustment that affects the period October 1, 2024 through September 30, 2025. The per diem for 10/1/24 to 9/30/25 is $319 for any high-cost locality, consisting of $233 for lodging and $86 for meals and incidentals. The 2025 per diem is $225 for travel to any other locality, consisting of $151 for lodging and $74 for meals and incidentals.[66] Taxpayers may elect to treat this table as applicable to the calendar year 2025. The special M&IE rates for transportation

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57 I.R.C. §132(f)(5)(B).
58 I.R.C. §132(f)(5)(D).
59 I.R.C. §132(f)(1)(B).
60 Treas. Regs. §1.132-9, A-3.
61 I.R.C. §132(f)(1)(C).
62 Treas. Regs. §1.132-9, A-4(a).
63 I.R.C. §132(f)(2)(A), Rev. Proc. 2023-34.
64 I.R.C. §132(f)(2)(B). Both of these limitations will be adjusted to the nearest $5 to account for inflation.
65 I.R.C. §132(f)(7). A more-than-two-percent shareholder is treated the same as a partner for purposes of fringe benefits.
66 Notice 2024-68.

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workers are $80 for the continental United States and $86 for any locality outside the continental United States.

a. For travel away from home, the term "incidental expenses" has the meaning given to it in the Federal Travel Regulations.[67] For example, the term "incidental expenses" includes fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries but does not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, or the costs of telegrams or telephone calls.

b. In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who do not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may use an amount computed at the rate of $5 per day for each calendar day (or partial day) the employee or self-employed individual is away from home.

Note:

In 2010, the Internal Revenue Service requested public comment on the continuing need for the high-low method for substantiating, under §274(d) of the Internal Revenue Code, lodging, meal, and incidental expenses incurred in traveling away from home. The Service received no comments.[68] Accordingly, the Service announced that it intended to **discontinue authorizing the high-low substantiation method**.[69] In 2011, the Service planned to publish a revenue procedure providing the general rules and procedures for substantiating lodging, meal, and incidental expenses incurred in traveling away from home (omitting the high-low substantiation method). However, based on comments received from tax professionals, the Service withdrew this guidance and reinstated the high-low method.

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[67] 41 C.F.R. Part 300 (2003).
[68] Rev. Proc. 2010-39, 2010-42 I.R.B. 459.
[69] Ann. 2011-42, 2011-32 I.R.B. 1.

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In 2025:[70]

Localities eligible for $319 ($86 M & IE) Per-Diem Under High-Low Substantiation Method in 2024-2025		
State	**Key city**	**County or other defined location**
Alabama	Gulf Shores (June 1-July 31)	Baldwin
Arizona	Phoenix/Scottsdale (February 1-March 31)	Maricopa
	Sedona (October 1-December 31 and March 1-September 30)	City limits of Sedona
California	Los Angeles (October 1-September 30)	Los Angeles
	Mammoth Lakes (December 1-March 31)	Mono
	Monterey (June 1-August 31)	Monterey
	Napa (October 1-September 30)	Napa
	Palm Springs (October 1-April 30)	Riverside
	San Diego (October 1-September 30)	San Diego
	San Francisco (October 1-September 30)	San Francisco
	San Luis Obispo (June 1-July 31)	San Luis Obispo
	Santa Barbara (October 1-September 30)	Santa Barbara
	Santa Monica (October 1-September 30)	City limits of Santa Monica
	South Lake Tahoe (December 1-March 31)	El Dorado
	Sunnyvale/Palo Alto/San Jose (October 1-September 30)	Santa Clara
	Yosemite National Park (January 1-April 30)	Mariposa
Colorado	Aspen (October 1-September 30)	Pitkin
	Denver/Aurora (October 1-October 31 and April 1-September 30)	Denver, Adams, Arapahoe, and Jefferson
	Silverthorne/Breckenridge (December 1-March 31)	Summit
	Steamboat Springs (December 1-March 31)	Routt
	Telluride (October 1-September 30)	San Miguel
	Vail (October 1-September 30)	Eagle
Delaware	Lewes (June 1-August 31)	Sussex
District of Columbia	Washington D.C. (also the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland) (See also Maryland and Virginia) (October 1-September 30)	
Florida	Boca Raton/Delray Beach/Jupiter (January 1-April 30)	Palm Beach and Hendry
	Bradenton (February 1-March 31)	Manatee
	Cocoa Beach (February 1-March 31)	Brevard
	Fort Lauderdale (January 1-April 30)	Broward

70 Notice 2024-68.

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	Fort Meyers (January 1-March 31)	Lee
	Fort Walton Beach/De Funiak Springs (June 1-July 31)	Okaloosa and Walton
	Gulf Breeze (June 1-July 31)	Santa Rosa
	Key West (October 1-September 30)	Monroe
	Miami (December 1-May 31)	Miami-Dade
	Naples (December 1-April 30)	Collier
	Panama City (June 1-July 31)	Bay
	Sarasota (February 1-April 30)	Sarasota
	Sebring (February 1-March 31)	Highlands
	Stuart (February 1-March 31)	Martin
	Tampa/St.Petersburg (February 1-April 30)	Pinellas and Hillsborough
	Vero Beach (December 1-April 30)	Indian River
Georgia	Atlanta (January 1-March 31)	Fulton and Dekalb
	Jekyll Island/Brunswick (March 1-July 31)	Glynn
Idaho	Boise (October 1-October 31 and June 1-September 30)	Ada
	Coeur d´Alene (June 1-August 31)	Kootenai
	Sun Valley/Ketchum (December 31-March 31 and June 1-September 30)	Blaine and Elmore
Illinois	Chicago (October 1-November 30 and April 1-September 30)	Cook and Lake
Maine	Bar Harbor/Rockport (October 1-October 31 and May 1-September 30)	Hancock and Knox
	Kennebunk/Kittery/Sanford (July 1-August 31)	York
	Portland (October 1-October 31 and June 1-September 30)	Cumberland and Sagadahoc
Maryland	Ocean City (June 1-August 31)	Worcester
	Washington DC Metro Area (October 1-September 30)	Montgomery and Prince George's
Massachusetts	Boston/Cambridge (October 1-September 30)	Suffolk, city of Cambridge
	Falmouth (July 1-August 31)	City limits of Falmouth
	Hyannis (July 1-August 31)	Barnstable less the city of Falmouth
	Martha's Vineyard (October 1-September 30)	Dukes
	Nantucket (June 1-September 30)	Nantucket
Michigan	Mackinac Island (July 1-August 31)	Mackinac
	Petoskey (June 1-August 31)	Emmet
	Traverse City (July 1-August 31)	Grand Traverse
Minnesota	Duluth (October 1-October 31 and June 1-September 30)	St. Louis
Montana	Big Sky/West Yellowstone/Gardiner (June 1-September 30)	Gallatin and Park
	Kalispell/Whitefish (July 1-September 30)	Flathead
New Jersey	Tom's River (July 1-August 31)	Ocean

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New York	Glens Falls (July 1-August 31)	Warren
	Lake Placid (July 1-August 31)	Essex
	New York City (October 1-December 31 and March 1-September 30)	Bronx, Kings, New York, Queens, and Richmond
	Saratoga Springs/Schenectady (July 1-August 31)	Saratoga and Schenectady
North Carolina	Kill Devil Hills (June 1-August 31)	Dare
Oregon	Bend (June 1-August 31)	Deschutes
	Eugene/Florence (June 1-July 31)	Lane
	Seaside (July 1-August 31)	Clatsop
Pennsylvania	Hershey (June 1-August 31)	Hershey
	Philadelphia (October 1-November 30, and April 1-September 30)	Philadelphia
Rhode Island	Jamestown/Middletown/Newport (October 1 – October 31 and June 1-September 30)	Newport
South Carolina	Charleston (October 1-September 30)	Charleston, Berkeley and Dorchester
	Hilton Head (March 1-August 31)	Beaufort
Tennessee	Nashville (October 1-September 30)	Davidson
Utah	Moab (October 1-October 31, March 1-June 30, and September 1-September 30)	Grand
	Park City (October 1-September 30)	Summit
Vermont	Burlington (October 1-October 31 and May 1-September 30)	Chittenden
	Manchester (October 1-October 31 and August 1-September 30)	Bennington
	Montpelier (October 1-October 31 and August 1-September 30)	Washington
Virginia	Virginia Beach (June 1-August 31)	City of Virginia Beach
	Wallops Island (July 1-August 31)	Accomack
	Washington, DC Metro Area (October 1-September 30)	Cities of Alexandria, Fairfax, and Falls Church; counties of Arlington and Fairfax
Washington	Port Angeles/Port Townsend (July 1-August 31)	Clallam and Jefferson
	Seattle (October 1-September 30)	King
Wyoming	Jackson/Pinedale (October 1-September 30)	Teton and Sublette
***The per diem rate for all other localities within the continental U.S. is $225 ($74 M & IE)**		

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6. SIFL rates

Note:

The SIFL rates increased substantially in 2021 due to reduced airline seat miles because of the COVID-19 pandemic and government relief to the airlines. In response to this increase, the DOT published two alternative rates for the first half of 2021 that reflected the government relief the airlines received. The DOT also published alternative rates for the first and second halves of 2022. The IRS allows operators to use any of the three published sets of SIFL rates to make calculations for prior periods. The alternative rates for the second half of 2022 are as follows:

Alternative 1				
2022	Terminal Charge	Rate for Miles 0-500	Rate for Miles 501-1500	Rate for Miles Over 1,500
Jul.-Dec.	$44.97	$0.2460	$0.1875	$0.1803

Alternative 2				
2022	Terminal Charge	Rate for Miles 0-500	Rate for Miles 501-1500	Rate for Miles Over 1,500
Jul.-Dec.	$46.83	$0.2562	$0.1953	$0.1878

The "Alternative 1" rate takes into account grant assistance provided by the CARES Act to airlines. The "Alternative 2" rate takes into account grant assistance provided by the CARES Act as well as promissory notes provided by the CARES Act to assist airlines in covering payroll expenses. The DOT has announced that beginning with the SIFL rates for the first half of 2023, only one set of rates will be published.

a. The final regulations retain the aircraft travel valuation method based upon Standard Industry Fare Level ("SIFL") statistics published semiannually by the Civil Aeronautics Board of the Department of Transportation ("CAB/DOT"). The regulations provide the applicable SIFL statistics for the first half of 1989; updates are provided unless or until such time as the CAB/DOT discontinues publication of these statistics.[71]

Rates for the first half of 2024 are as follows:

2024	Terminal Charge	Rate for Miles 0-500	Rate for Miles 501-1500	Rate for Miles Over 1,500
Jan.1- Jun 30	$55.05	$0.3012	$0.2296	$0.2208

b. To determine the value of any employee's flight on a noncommercial aircraft, these cents-per-mile SIFL rates are multiplied by a percentage that varies with both the weight of the aircraft and the kind of employee (as a control or noncontrol employee), and that product is added to the terminal charge. Because the SIFL statistics have not kept pace with inflation in airline travel, these safe-harbor valuation rates offer a bargain, especially for noncontrol employees, in valuing any flight.

Aircraft Take-Off Weight	Multiple for a Control Employee	Multiple for a Noncontrol Employee
0-6,000	0.625	0.156
6,001-10,000	1.25	0.234
10,001-25,000	3	0.313
25,001 and above	4	0.313

[71] Treas. Regs. §§1.61-21(g)(5) and (6).

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Example: An executive flies 1,000 miles on the corporate aircraft having 15,000 lbs. take-off weight in May 2024; the value of this trip is $851.25 (((500 x $0.3012 + 500 x $0.2296) x 3) + $55.05); for the noncontrol employee it is $138.12 (((500 x $0.3012 + 500 x $0.2296) x 0.313) + $55.05).

Planning point:

Under the special valuation rules, the value of a flight is determined by using the Standard Industry Fare Level (SIFL) formula, which involves multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by an appropriate aircraft multiple, and then adding an applicable terminal charge for the period in which the flight was taken. The value of personal flights provided to employees under these special rules does not correspond with the employer's actual costs in providing the flights. In a recent case, the employer was entitled to deduct the full costs of providing its executives with a company jet for vacation flights, even though those costs exceeded the compensation that the employees included in income because of the flights.[72] This ran contrary to the Service's position, which caps the employer's deduction for a noncash fringe benefit by the amount of the recipient's reported income from the benefit.[73]

O. Social Security adjustments

1. Wage base

In 2024, the taxable wage base is $168,600[74] resulting in a maximum OASDI tax of $10,453.20 (employer's share), $10,453.20 (employee's share), or $20,906.40 (self-employed individual). The Medicare portion of the tax remains a combined 2.9 percent on all earned income.

Note:

The retirement benefits of a worker are determined with reference to the worker's primary insurance amount (PIA). The PIA is determined by the worker's adjusted indexed monthly earnings (AIME) over a computation period that generally encompasses the worker's "highest average" 35 years of AIME multiplied by "break point" percentages. (Earnings for this purpose cannot exceed the taxable wage base for the year the earnings accrue.) The indexing takes into account a recalculation of actual earnings increased to reflect percentage increases in the average wages of the population in the interim between the time the earnings are earned and the current year (but generally not after the time the worker turns 60).

2. Excess earnings

a. Deductions are made from the monthly benefits payable to a worker who is under normal retirement age and to the worker's dependents for each month the worker is charged with earnings in excess of certain amounts. A similar deduction is made in the dependent's benefits when the dependent has excess earnings. These rates do not apply to Social Security benefits based on disability, to persons who are age 70 or older, or to work performed outside the United States not covered by Social Security. Likewise, a divorced spouse's benefits are not reduced because of the insured's excess earnings, provided the divorce has been in effect for two years.

b. The maximum amount that a beneficiary, the year he or she reaches normal retirement age, might earn in 2024 without affecting the beneficiary's own benefit or those of dependents is $59,520 ($4,960 per month). Benefits are reduced by $1 for every $3 earned over the annual exempt amount. (Note that this limitation ends with the month in

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72 *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 14 (2000).

73 TAM 9615002 and 9715001. The case was overturned by the enactment of I.R.C. §274(e)(2).

74 SSA.gov *Update 2024*, https://www.ssa.gov/OACT/COLA/cbb.html.

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which the beneficiary attains full retirement age. Hereafter, a periodic cost-of-living increase in these benefits will be provided. There is no reduction for persons from full retirement age through age 69.

c. A lower number is used as a ceiling for those under the normal retirement age; this is $22,320 ($1,860 monthly) in 2024. Benefits are reduced $1 for every $2 if the individual is between 62 and the year preceding the year he reaches full retirement age. However, an individual is entitled to one grace year, usually the calendar year during which retirement occurs, when excess earnings are not offset against old-age benefits. The grace year occurs when a retiree or survivor entitled to benefits does not receive excess earnings for at least one month, called a **nonservice month**.

Planning point:

The excess earnings reduce the direct and derivate benefits that arise from that earner. Thus, the decision to take early benefits must be tempered by the reduction not just to the worker but also the spouse. Those intending to continue working may find the early retirement decision to result in a greater reduction than the nominal 25-percent reduction. However, note the repayment planning option discussed below.

3. Full retirement age

Listed below are the ages to receive full Social Security benefits (called "full retirement age" or "normal retirement age"). Persons born on January 1 of any year should refer to the previous year. Persons born in 1943 through 1954 may receive full retirement benefits beginning at age 66 years.

Year of Birth	Full Retirement Age
1937 or earlier	65
1938	65 and 2 months
1939	65 and 4 months
1940	65 and 6 months
1941	65 and 8 months
1942	65 and 10 months
1943-1954	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Note:

The basic benefits of a worker and the worker's dependents and survivors are reduced by early retirement. The wage earner's benefits are reduced five-ninths of one percent for each month the worker receives benefits before normal retirement age, up to 36 months, and five-twelfths of one percent for each month the worker receives benefits before normal retirement age in excess of 36 months.

If the full retirement age is older than 65 (that is, someone born after 1937), retirement benefits may still be taken at age 62, but the reduction in the benefit amount will be greater than it is for people retiring earlier. If your full retirement age is 67 (1960 and later birth years), the reduction for starting benefits at 62 is about 30 percent; at age 63, it is about 25 percent; at age 64, about 20 percent; at age 65, about 13-1/3 percent; and at age 66, about 6-2/3 percent.

If the full retirement age is 66, then the reduction for starting benefits at age 62 is 25 percent.

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Year of Birth	Full Retirement Age	Age 62 Reduction Months	Monthly % Reduction	Total % Reduction
1937 or earlier	65	36	0.555	20.00
1938	65 and 2 months	38	0.548	20.83
1939	65 and 4 months	40	0.541	21.67
1940	65 and 6 months	42	0.535	22.50
1941	65 and 8 months	44	0.530	23.33
1942	65 and 10 months	46	0.525	24.17
1943-1954	66	48	0.520	25.00
1955	66 and 2 months	50	0.516	25.84
1956	66 and 4 months	52	0.512	26.66
1957	66 and 6 months	54	0.509	27.50
1958	66 and 8 months	56	0.505	28.33
1959	66 and 10 months	58	0.502	29.17
1960 and later	67	60	0.500	30.00

Note:

Workers who delay retirement beyond age 66 and consequently do not receive benefits are entitled to an increase in old-age benefits of 8 percent per year for workers reaching retirement age in 2024.

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Note:

> A husband or wife of an insured individual is entitled to 50 percent of the PIA when the husband or wife reaches normal retirement age. Reduced benefits will be paid if the husband or wife is younger than the normal retirement age, if either spouse has excess earnings under the retirement test, or if either spouse is entitled to a public pension based on the person's own work in noncovered government employment. The benefit of a surviving widow or widower of a worker who died fully insured is generally entitled to 100 percent of the benefit the worker would receive if still living. The widow or widower receives the full benefit if the widow or widower is normal retirement age, or a smaller benefit if between ages 60 and normal retirement age (19/40 percent reduction in benefit per month for retirement prior to normal retirement age). Of course, a spouse may claim benefits based on his or her status as a worker rather than as a spouse. But since the spouse will automatically receive 50 percent of the retirement amount of the other spouse as a floor, certain spouses rejoining the workforce may have to work for some period of time in order to be entitled to a higher retirement benefit than a spousal Social Security benefit.

4. Medicare

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 imposes a premium on high-income enrollees in Medicare Part B (physician services) that will vary based on the income reported by each enrollee to the IRS for federal income-tax purposes.[75] The premium is calculated based on the most-recently-available tax returns (usually a two-year look back). The 2024 premium is based on taxable income for 2022. Termed the "income-related reduction in Part B subsidy," the new premium will effectively constitute an income-tax surcharge. The premium will be in addition to the current flat Part B premium. The two premiums together will be capped at 85 percent of the per-enrollee Part B program costs.[76] The premium applies to individual seniors with adjusted gross income exceeding $103,000 per year (adjusted for inflation) and to married couples with adjusted gross income exceeding $206,000 per year (adjusted for inflation). Furthermore, the Act phases in the maximum premium, so that seniors with even the highest incomes will pay only a fraction of the amount of the Part B subsidy in the early years.[77]

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75 42 U.S.C. §1395r(i), I.R.C. §6103(l)(20).
76 42 U.S.C. §1395r(i)(3).
77 The statute does not prescribe an explicit rate for the new premium. Rather, the rate will vary from year to year, based on the actuarial value of the Part B benefits for each year.

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In 2024:[78]

2022† AGI more than:	2022† AGI less than:	Premium
Single		
$0	$103,000	$174.70
$103,000	$129,000	$244.60
$129,000	$161,000	$349.40
$161,000	$193,000	$454.20
$193,000	$500,000	$559.00
$500,000		$594.00
Married filing jointly		
$0	$206,000	$174.70
$206,000	$258,000	$244.60
$258,000	$322,000	$349.40
$322,000	$386,000	$454.20
$386,000	$750,000	$559.00
$750,000		$594.00

5. Premiums for prescription drugs

The drug prescription program is implemented through private insurers so premiums vary from plan-to-plan. Starting January 1, 2011, the Part D monthly premium could be higher based on income. This includes Part D coverage from a Medicare Prescription Drug Plan, a Medicare Advantage Plan, or Medicare Cost Plan that includes Medicare prescription drug coverage. If modified adjusted gross income as reported on your IRS tax return from the most recent tax return information provided to Social Security by the IRS is above a certain amount, you will pay a higher monthly premium.

In 2024:

2022 MAGI more than:	2022 MAGI less than:	Monthly premium addition
Single		
$0	$103,000	$0
$103,000	$129,000	$12.90
$129,000	$161,000	$33.30
$161,000	$193,000	$53.80
$193,000	$500,000	$74.20
$500,000		$81.00
Married filing jointly		
$0	$206,000	$0
$206,000	$258,000	$12.90
$258,000	$322,000	$33.30
$322,000	$386,000	$53.80
$386,000	$750,000	$74.20
$750,000		$81.00

† The Social Security Administration will use the most recent Form 1040 available to it. Consequently, as of some point during 2024 the MAGI could reference 2023, rather than the current 2022.

[78] Data for Medicare Parts B and D are available at Medicare.gov.

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P. Medical expenses

1. Long-term-care insurance

Under the law, medical care includes **eligible long-term care premiums** for **qualified long-term-care insurance contracts**.[79] A qualified long-term-care insurance contract means any insurance contract if the only insurance protection provided under such contract is coverage of **qualified long-term care services**, the contract does not pay or reimburse expenses incurred for services or items to the extent that such expenses are reimbursable under Title XVIII of the Social Security Act or would be so reimbursable, but for the application of a deductible or coinsurance amount, they are guaranteed renewable, the contract does not provide for a cash-surrender value or other money that can be paid, assigned, or pledged as collateral for a loan, or borrowed, and all refunds of premiums and all policyholder dividends or similar amounts under such contract are to be applied as a reduction in future premiums or to increase future benefits. They must also generally conform to the long-term-care insurance model act promulgated by the National Association of Insurance Commissioners (as adopted as of January 1993).

a. For these purposes, **qualified long-term care services** means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and **maintenance or personal care services**, which are required by a chronically ill individual, and are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

(i) For these purposes, a chronically ill individual means any individual who has been certified by a licensed health care practitioner as:

- Being unable to perform (without substantial assistance from another individual) at least two **activities of daily living** for a period of at least 90 days due to a loss of functional capacity;
- Having a level of disability similar to the level of disability with respect to two activities of daily living; or
- Requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.

Such term does not include any individual otherwise meeting the requirements of the preceding sentence, unless within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements.

(ii) For these purposes, each of the following is an activity of daily living:

- Eating;
- Toileting;
- Transferring;
- Bathing;
- Dressing; and
- Continence.

A contract shall not be treated as a qualified long-term-care insurance contract unless the determination of whether an individual is a chronically ill individual takes into account at least five of such activities.

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[79] I.R.C. §213(d)(1) [flush language].

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(iii) For these purposes, maintenance or personal care services means any care the primary purpose of which is the provision of needed assistance with any of the disabilities as a result of which the individual is a chronically ill individual (including the protection from threats to health and safety due to severe cognitive impairment).

b. If the long-term-care insurance contract is an indemnity policy (one which reimburses actual long-term-care costs), all benefits received under the policy are tax-free. If, on the other hand, the long-term-care insurance contract is a per-diem policy (one which pays a set amount per day regardless of actual expenses), a taxpayer can exclude the greater of $400 per day or actual daily expenses.[80]

Planning point:

> The provision of long-term-care insurance is fast becoming a significant part of any retirement plan. Medicaid can only be relied on by the indigent (and, even then, not in every circumstance). It is often impossible (and always time-consuming and frustrating) to try to qualify for Medicaid as a member of the middle class. In addition, there is little personal choice in the context of Medicaid.

Age	2024 Maximum Deductible Premium
40 or less	$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	$5,880

2. Health savings accounts

The Medicare Act of 2003 established a new tax-favored vehicle, the **health savings account (HSA)**, which permits, effective for taxable years beginning after December 31, 2003, an eligible individual for any month during the taxable year to deduct for the taxable year an amount equal to the aggregate amount paid in cash during such taxable year by or on behalf of such individual to the HSA.[81] This deduction is taken above-the-line in determining adjusted gross income.[82]

a. The amount allowable as a deduction to an individual for the taxable year may not exceed the sum of the **monthly limitations** for months during such taxable year that the individual is an eligible individual.[83]

(i) The monthly limitation for any month is one-twelfth of an amount that depends on the kind of coverage under a high-deductible health plan as of the first day of such month:[84]

- In the case of an eligible individual who has self-only coverage, the amount of $4,150 in 2024;[85] or

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80 Per diem amount and maximum deductible premiums are from Rev. Proc. 2023-34.
81 I.R.C. §223(a).
82 I.R.C. §62(19).
83 I.R.C. §223(b)(1).
84 I.R.C. §223(b)(2).
85 Rev. Proc. 2023-23.

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- In the case of an eligible individual who has family coverage, the amount of $8,300 in 2024.[86]

(ii) In the case of an individual who has attained age 55 before the close of the taxable year, the applicable limitation is increased by the additional contribution amount.[87] The additional contribution amount is the amount determined in accordance with the following table.[88]

For taxable years beginning in:	The additional contribution amount is:
2009 and thereafter	$1,000

(iii) The limitation that would otherwise apply to an individual for any taxable year is reduced (but not below zero) by the sum of:
- The aggregate amount paid for such taxable year to Archer MSAs of such individual;[89] and
- The aggregate amount contributed to health savings accounts of such individual, which is excludable from the taxpayer's gross income for such taxable year under §106(d) and such amount shall not be allowed as a deduction.[90] The aggregate amount paid for such taxable year to Archer MSAs of such individual is not a reduction with respect to any individual in the following paragraph.

(iv) In the case of individuals who are married to each other, if either spouse has family coverage: both spouses are treated as having only such family coverage (and if such spouses each have family coverage under different plans, as having the family coverage with the lowest annual deductible)[91] and the monthly limitation (after the application of the reduction for aggregate contribution to Archer MSAs, and without regard to any additional contribution amount):
- Shall be reduced by the aggregate amount paid to Archer MSAs of such spouses for the taxable year; and
- After such reduction, shall be divided equally between them unless they agree on a different division.

(v) No deduction is allowed to any individual with respect to whom a deduction under §151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins.[92]

Caution:

The limitation for any month with respect to an individual is **zero** for the first month such individual is entitled to benefits under Title XVIII of the Social Security Act and for each month thereafter.[93]

b. An "eligible individual" means, with respect to any month, any individual if such individual is covered under a high-deductible health plan as of the first day of such month, and such individual is not, while covered under a high-deductible health plan, covered under any health plan that is not a high-deductible health plan, and that provides coverage for any

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86 Rev. Proc. 2023-23.
87 I.R.C. §223(b)(3)(A).
88 I.R.C. §223(b)(3)(B).
89 I.R.C. §223(b)(4)(A).
90 I.R.C. §223(b)(4)(B).
91 I.R.C. §223(b)(5)(A).
92 I.R.C. §223(b)(6).
93 I.R.C. §223(b)(7).

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benefit that is covered under the high-deductible health plan.[94] The term "high-deductible health plan" means a health plan:[95] (i) that has an annual deductible that is not less than $1,600[96] for self-only coverage, and twice that dollar amount for family coverage; and (ii) the sum of the annual deductible and the other annual out-of-pocket expenses required to be paid under the plan (other than for premiums) for covered benefits does not exceed $8,050[97] for self-only coverage, and twice that dollar amount for family coverage. Such term **does not** include a health plan if substantially all of its coverage is permitted insurance or coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.[98] A plan does not fail to be treated as a high-deductible health plan by reason of failing to have a deductible for preventive care (within the meaning of §1871 of the Social Security Act). [99]

c. Notice 2020-15 addressed the usage of High Deductible Health Plans (HDHPs) and HSAs in relation to COVID-19. An HSA-eligible HDHP will not lose its HDHP status under §223(c)(2)(A) if it covers costs for COVID-19 testing and treatment before plan deductibles are met. An individual with an HDHP that covers COVID-19 costs can continue to contribute to an HSA. The intent of this notice is to eliminate financial and administrative barriers to COVD-19 testing and treatment.

Q. Other

1. Tax benefits effective for individuals

a. The deductible limit for health insurance premiums for self-employed taxpayers in 2024 is the lesser of 100 percent of the premium or the earned income derived by the taxpayer from the trade or business with respect to which the plan providing the medical-care coverage is established.

b. The exclusion for foreign-earned income is $126,500 in 2024.

   (i) Under the new law, the base housing amount used in calculating the foreign housing cost exclusion in a taxable year is 16 percent of the amount (computed on a daily basis) of the foreign-earned-income exclusion limitation (instead of the present-law 16 percent of the grade GS-14, step 1 amount), multiplied by the number of days of foreign residence or presence (as previously described) in that year.

   (ii) Reasonable foreign-housing expenses in excess of the base housing amount remain excluded from gross income (or, if paid by the taxpayer, are deductible), **but** the amount of the exclusion is limited to 30 percent of the maximum amount of a taxpayer's foreign-earned-income exclusion. Under the 30-percent rule, the maximum amount of the foreign-housing-cost exclusion in 2024 is (assuming foreign residence or presence on all days in the year) $17,710 (($126,500 x 30 percent) – ($126,500 x 16 percent)).

Caution:

In a major change in calculating income tax, if an individual excludes an amount from income under §911, any income in excess of the exclusion amount determined under §911 is taxed

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94 I.R.C. §223(c)(1)(A).
95 I.R.C. §223(c)(2)(A).
96 Rev. Proc. 2023-23.
97 Rev. Proc. 2023-23.
98 I.R.C. §223(c)(2)(B).
99 I.R.C. §223(c)(2)(C).

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(under the regular tax and alternative minimum tax) by applying to that income the tax rates that would have been applicable had the individual not elected the §911 exclusion.

The Service has issued a notice that uses a higher daily rate for certain higher-priced foreign localities that is taken into account in determining the 30-percent multiplier.[100]

Example: An individual with $126,500 of foreign-earned income that is excluded under §911 and with $20,000 in other taxable income (after deductions) would be subject to tax on that $20,000 at the rate or rates applicable to taxable income in the range of $126,500 to $146,500.

c. In order for taxpayers in 2024 having adjusted gross income in excess of $150,000 in 2023 to avoid estimated tax penalties, estimated tax payments must be at least 110 percent of the 2022 tax liability.

d. The Disaster Act, passed on December 20, 2019 as part of the 2020 year-end spending package, amends IRC §213(f) and provides for a reduction in the medical expense deduction floor from 10% to 7.5%. Individuals were eligible to claim an itemized deduction for unreimbursed medical expenses to the extent that the expenses exceeded 7.5% of AGI for tax years beginning after December 31, 2018 and before January 1, 2021. The Consolidated Appropriations Act of 2021 makes the 7.5-percent-of-AGI threshold for the medical expense deduction floor permanent for itemizers claiming unreimbursed medical expenses. This provision is applicable for tax years beginning after December 31, 2020.

2. Interest rates for fourth quarter of 2024

The IRS has announced that the interest rates for the quarter beginning October 1, 2024, are 6 percent for overpayments (5 percent for a corporation), 8 percent for underpayments (noncorporate taxpayers and corporations), 10 percent for large corporate underpayments, and 5.5 percent for the portion of a corporate overpayment exceeding $10,000.[101]

Note:

For taxpayers other than corporations, the overpayment and underpayment rate is the federal short-term rate plus 3 percentage points. Generally, in the case of a corporation, the underpayment rate is the federal short-term rate plus 3 percentage points and the overpayment rate is the federal short-term rate plus 2 percentage points. The rate for large corporate underpayments is the federal short-term rate plus 5 percentage points. The rate on the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the federal short-term rate plus one-half of a percentage point.

[100] Notice 2007-77; 2007-40 I.R.B. 1.
[101] IR-2022-150.

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3. FUTA surtax reduced

Unemployment insurance (UI) is financed by a combination of state and federal taxes on employers based on the wages of each employee. The Federal Unemployment Tax Act (FUTA) had imposed a federal payroll tax on employers of 6.2 percent of the first $7,000 paid annually to each employee. The tax funds a portion of the federal/state unemployment benefits system. This 6.2-percent rate included a temporary (set in 1985 and extended thereafter) surtax of 0.2 percent. Employers in states that meet certain federal requirements were allowed a credit for state unemployment taxes of up to 5.4 percent, making the minimum net federal tax rate 0.8 percent. The surtax has expired, and the minimum net federal tax rate is now 0.6 percent.

4. Section 448(c)(1) gross receipts limitation

The gross receipts limitation of §448(c)(1) increases to $30,000,000 in 2024. Section 448(c)'s primary purpose has been to limit the ability of C corporations to use the cash method of accounting.
C corporations may use the cash method of accounting if their average gross receipts for the prior three years do not exceed the §448(c)(1) amount. However, the TCJA references the §448(c) limit for other purposes. Some impacted code sections include:

a. **Section 163(j) business interest limitation:** Businesses are not subject to the business interest limitation if they meet the gross receipts test of §448(c).[102]

b. **Section 263A capitalization rules:** A business is exempt from the §263A Unicap rules if it meets the gross receipts test of §448(c).[103]

c. **Section 460 accounting for long-term contracts:** A contractor that meets the gross receipts test of §448(c) may use the completed contract method to account for contracts if the taxpayer and contracts qualify under the provisions of §460.[104]

d. **Section 471 inventory requirement:** A business is not required to follow the inventory rules of §471 if they meet the gross receipts test of §448(c). They may instead treat inventories in a manner consistent with applicable financial statements or as non-essential materials and supplies. This means that businesses who were required to use the accrual method of accounting in the past because they had inventories and their gross receipts exceeded $1,000,000 may now use the cash method of accounting and change their inventory method.[105]

5. Educator expense deduction

The Educator Expense deduction was originally enacted in 2002, allowing teachers and other eligible educators to deduct up to $250 of out-of-pocket classroom expenses ($500 if married filing jointly and both spouses are eligible educators, but not more than $250 each). An individual is considered an eligible educator if, for the tax year, he or she is a kindergarten through grade 12 teacher, instructor, counselor, principal, or aide for at least 900 hours a school year in a school that provides elementary or secondary education as determined under state law. Qualified expenses for purposes of the Educator Expense deduction include amounts paid or incurred for participation in professional development courses, books, supplies, computer equipment, and supplementary materials used in the classroom. Additionally, qualified expenses include amounts spent on PPE, disinfectant, or supplies used to prevent the spread of the COVID-19 virus. In order to be eligible for the Educator Expense deduction, the expenses must be paid or incurred during the tax year.

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[102] I.R.C. §163(j)(3).
[103] I.R.C. §263A(i).
[104] I.R.C. §460(e)(1)(B)(ii).
[105] I.R.C. §471(c)(1).

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For the first time since 2002, the IRS increased the maximum Educator Expense deduction from $250 to $300 in 2022, remaining at this level in 2023 and 2024. As a result, in 2024, an eligible educator can deduct up to $300 of qualifying expenses ($600 if married filing jointly and both spouses are eligible educators, but not more than $300 each). The limit will rise in $50 increments in future years based on inflation adjustments.

6. *Excess Business Loss Threshold*

For taxable years beginning in 2024, the excess business loss thresholds are as follows:

Filing Status	2024 Threshold Amount
Joint filers	$610,000
Other returns	$305,000

As discussed, the IRA extended the excess business loss limitation provision under §461(l) for two additional years. As a result, §461(l) applies for tax years beginning after December 31, 2020, and before January 1, 2029.

R. Retirement plan 2024 numbers[106]

1. *Maximum annual benefit*

The maximum single-life annuity for a defined-benefit plan in 2024 is $275,000, increased from $265,000 in 2023.

2. *Maximum annual addition*

The maximum annual addition to a defined-contribution plan in 2024 is $69,000, increased from $66,000 in 2023.

3. *Maximum compensation considered*

The maximum amount of compensation that can be taken into account under any qualified plan allocation or benefit formula in 2024 is $345,000, increased from $330,000 in 2023.

[106] Retirement plan numbers updated by IRS Notice 2023-75.

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Note:

Generalizations with respect to a defined-benefit plan are more difficult, as the contributions not only depend on compensation level but also the age of the participant and the number of years before the normal retirement age under the plan when the benefits must be fully funded. If the benefit formula is a fixed amount ($3,000 per month), the change in the limit has no effect. If the formula is a unit benefit type, where the benefit that is earned each year is based solely on the compensation for that year, the change in the maximum will require marginally more funding in all succeeding years for the highly compensated employee. The most interesting and potentially most expensive case is where the benefit formula is based on some percentage of a career-high average. As the higher compensation is taken into account, it not only increases the funding requirement for the current year, but generates in effect liabilities in respect of past years. Quantifying the effect for budgeting purposes requires the services of an actuary. Again, while the effect may be to require a higher funding level for the highly compensated to the extent there is an increased benefit, now is the time to have the additional costs determined so as to choose whether to continue the plan as is, or reduce, in respect of future years, the benefit formula.

Note:

Qualified retirement-planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan after December 31, 2001 are excludable from income and wages without regard to the requirements of an education-assistance program or fringe benefit. “Qualified retirement-planning services” are retirement-planning advice and information. The exclusion is not limited to information regarding the qualified plan, and thus, for example, applies to advice and information regarding retirement-income planning for an individual and his or her spouse and how the employer’s plan fits into the individual’s overall retirement-income plan.

Caution:

On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax-preparation, accounting, legal, or brokerage services.

The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees that is normally provided education and information regarding the employer’s qualified plan. It is intended that the treatment of retirement advice will be provided in a nondiscriminatory manner. It is intended that, in determining the application of the exclusion to highly compensated employees, the Service may permit employers to take into consideration employee circumstances other than compensation and position in providing advice to classifications of employees. Thus, for example, the Secretary may permit employers to limit certain advice to individuals nearing retirement age under the plan.

4. SIMPLE deferral maximum

The maximum amount of deferral in a SIMPLE plan in 2024 is $16,000, increased from $15,500 in 2023.

Table 1 -- SIMPLE Deferral Limits

For year beginning in calendar year:	The applicable dollar amount:
2024	$16,000

Table 2 -- Catch-Up Elective Deferrals for SIMPLE and SIMPLE-§401(k) Plans

For taxable years beginning in:	The applicable dollar amount is:
2024	$3,500

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Under a SIMPLE plan, an employer is generally required to make a contribution on behalf of each eligible employee in an amount equal to the employee's salary-reduction contributions, up to a limit of three percent of the employee's compensation for the entire calendar year.[107]

Note:

> For the business owner concerned about the maximum tax-shelter potential of the SIMPLE, note that the maximum matching contribution for an individual with $533,333 of compensation or more is $16,000. A $16,000 salary deferral, plus the $16,000 match, results in a maximum contribution of $32,000. Above $533,333 in compensation, the match cannot exceed $16,000. If the participant earns less than $533,333, the maximum contribution is less. For example, a person with compensation of $150,000 is eligible for the matching contribution of $4,500 (three percent of $150,000). The table below identifies the maximum contribution for individuals at various salary levels.

In 2024:

Maximum SIMPLE IRA Contribution			
Salary	**Maximum salary deferral**	**Matching contribution**	**Total contribution**
$50,000	$16,000	$1,500	$17,500
$75,000	$16,000	$2,250	$18,250
$100,000	$16,000	$3,000	$19,000
$125,000	$16,000	$3,750	$19,750
$150,000	$16,000	$4,500	$20,500
$160,000	$16,000	$4,800	$20,800
$175,000	$16,000	$5,250	$21,250
$533,333 or more	$16,000	$116,000	$32,000

5. SEP minimum compensation

The threshold level of compensation at which an employer must cover an employee in a SEP in 2024 remains $750.

a. If an employer establishes and maintains an individual retirement account or annuity that qualifies as a SEP, the maximum amount that the employer may contribute is the lesser of $69,000 in 2024 or 25 percent of the employee's compensation.[108] An employee for whom an employer contributes under a SEP is allowed a deduction for the employee's contributions to an IRA subject to the phaseout rule for active participants.

b. Generally, any employee is protected from current tax only if the employer's contribution does not exceed the lesser of 25 percent of the employee's compensation from that employer or $69,000 in 2024.

Example: Corporation Q has established a SEP arrangement for the benefit of its eligible employees. Employee A earns $100,000 in compensation from Q in 2024. For 2024, the most Q can contribute to the SEP of A (without causing tax to A) is $25,000 (25 percent of $100,000). Twenty-five percent of A's compensation is less than $69,000, so this is the applicable prong of the two-part limitation. Note that for purposes of calculating 25 percent of the employee's compensation, the employer's contribution to the employee's SEP is ignored. Thus, the limitation for Q is 25 percent of $100,000, not 25 percent of $125,000.

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[107] I.R.C. §§408(p)(2)(A)(iii) and (C)(ii)(I). See Notice 98-4, 1998-2 I.R.B. 25, Q&A, D-4.

[108] For the self-employed person, compensation means earned income as reduced for other contributions. I.R.C. §408(k)(7)(B). This is further reduced by the deduction for self-employment taxes.

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c. If an employer contributes more than the lesser of 25 percent of compensation or $69,000 in 2024 to the SEP of an employee, the amount in excess of that limitation is treated as an excess contribution by the employee to an IRA. On or before the due date for filing the employee's tax return (including extensions), the employee should withdraw the amount of the excess and any income on that amount. The employee thus would avoid a six-percent excise tax on the excess contribution, but must pay tax on the amount of the contribution that exceeds the limitation.

6. Maximum elective deferral

The maximum amount of deferral in a §401(k) plan or §403(b) plan in 2024 is $23,000, increased from $22,500 in 2023.

Elective deferrals increase to the applicable amount in accordance with the following schedule.

Table 3 -- Elective-Deferral Limits

For taxable years beginning in calendar year:	The applicable dollar amount is:
2024	$23,000

A qualified plan may now allow additional elective deferrals to be made to the plan by a participant who attains the age of 50 before the end of the plan year.

Table 4 -- Catch-Up Elective Deferrals for §401(k) and Other Qualified Plans

For taxable years beginning in:	The applicable dollar amount is:
2024	$7,500

The additional elective deferrals are generally not taken into account under the actual deferral percentage (ADP) or other limitations on such contributions. The applicable dollar amount increases in the cost of living at the same time and in the same manner as adjustments for annual benefits and additions, except that the base period taken into account is the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of $500 is rounded to the next lower multiple of $500.

Note:

Since elective deferrals generally represent amounts the employer would have deducted under §162 for reasonable compensation but for the preemptive effect of §404 with respect to amounts contributed to a qualified plan, the elective-deferral component of the contribution is deducted as compensation rather than as a contribution.

Planning point:

Elective deferrals remain an annual addition, but the amount subject to the 25-percent-of-compensation limitation does not include them, but only the matching and any other nonelective employer contributions. Subject to any other limitations (such as the annual-additions limitation), an employee may defer 100 percent of current salary **and** the employer may deduct not only the amount so deferred by the employee but also up to 25 percent of the total participant compensation for the year for other contributions.

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Planning point:

> One of the major motivations for the use of a money-purchase pension plan rather than a profit-sharing plan lay in the enhanced deductibility of contributions up to 25 percent of total compensation to "fully fund" the annual additions. The disadvantage of a money-purchase pension plan is that as a pension plan, the formula for contributions is fixed and creates an annual liability much as a defined-benefit plan does. The change in the deductibility of contributions to a profit-sharing plan puts the future of the money-purchase plan in some doubt, as the enhanced deductibility and the annual-additions limitation can now be met by a profit-sharing plan that does not commit the employer to any specific level of contributions annually.

7. Highly compensated employee

The minimum compensation of an employee owning less than five percent of the stock of the employer to be treated as a highly compensated employee is $155,000 in 2024, increased from $150,000 in 2023.

8. Self-employed persons

a. The §401(k) plan is essentially a profit-sharing plan with elective deferrals. The following worksheet assumes that the employer's contributions are allocated to each participant's account in accordance with compensation, i.e., the plan is not age-weighted or otherwise cross-tested.

b. Since the base of contributions to a SEP is earned income, the following worksheet is necessary to determine the contribution to a SEP on behalf of that self-employed person.

In 2024:

1. Nominal plan stated rate	
2. Add "1" to Step (1)	
3. Self-employed rate Step 1/Step 2	
4. Net earnings (Line 31, Sch. C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	
5. Self-employment income Step (4) x 0.9235)	
6. Taxable wage base	
7. Lesser of Step (5) or Step (6)	
8. Step (7) x 0.124	
9. Step (5) x 0.029	
10. Total self-employment tax Step (8) plus Step (9)	
11. Self-employment tax deduction Step (8) x 0.5 + .5 x Step (9)	
12. Earned income Step (4) – Step (11)	
13. Nominal contribution Step (12) x Step (3)	
14. $345,000 x Step (3)	
15. Maximum dollar annual addition	
16. Lesser of Step (14) and Step (15)	
17. Maximum deductible contribution lesser of Step (13) and Step (16)	
18. Elective deferral	
19. Catch-up contribution†	
20. Total maximum contribution (Step (17) + Step (18) + Step (19)	

† Only available to SARSEPS in place as of December 31, 1996. All other SEPS stop at line 17.

c. The contribution level for self-employed persons in a SIMPLE plan depends on the net earnings from self-employment. Remember, neither the §415 nor the compensation limitations generally apply.

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1. Net earnings (Line 31, Schedule C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	
2. Self-employment income Step (1) x 0.9235)	
3. Contribution rate	
4. Contribution Step (2) x Step (3)	
5. Elective deferral	
6. Total contribution sum of Step (4) and Step (5)	
7. Catch-up contribution	
8. Total contributions Step (6) and Step (7)	

To obtain the maximum contribution to a SIMPLE, the self-employed person must have bottom-line Schedule C income of at least $577,513.

1. Net earnings (Line 31, Schedule C; Line 34, Sch. F; Box 14, code A, Schedule K-1)	*$577,513*
2. Self-employment income Step (1) x 0.9235)	*$533,333*
3. Contribution rate	*0.03*
4. Contribution Step (2) x Step (3)	*$16,000*
5. Elective deferral	*$16,000*
6. Total contribution Sum of Step (4) and Step (5)	*$32,000*
7. Catch-up contribution	*$3,500*
8. Total contributions Step (6) and Step (7)	*$35,500*

Representative Table of Maximum SIMPLE contributions

Schedule C	Employer contribution	Elective deferral	Under-50 Maximum	Catch-up	Over-50 Maximum
$50,000	$1,500	$16,000	$17,500	$3,500	$21,000
$100,000	$3,000	$16,000	$19,000	$3,500	$22,500
$150,000	$4,500	$16,000	$20,500	$3,500	$24,000
$200,000	$6,000	$16,000	$22,000	$3,500	$25,500
$250,000	$7,500	$16,000	$23,500	$3,500	$27,000

9. IRAs

An IRA (other than SEP or SIMPLE) cannot accept more than $7,000 ($8,000 if age 50 or older) in contributions for any taxable year (not including rollover amounts) in 2024 (increased from $6,500, or $7,500 if age 50 or older in 2023).[109] This limit applies to both regular and Roth IRAs, but the annual contribution limit may be divided between such IRAs as the owner may determine. In certain circumstances, a married individual may make IRA contributions of more than $7,000 ($8,000 if age 50 or older) per taxable year. The contributions must be made to a combination of the married individual's own IRA and the nonworking spouse's IRA, because neither IRA is permitted to receive more than $7,000 ($8,000 if age 50 or older) in contributions per taxable year (excluding rollover contributions).

a. An IRA owner may never deduct more than the lesser of $7,000 ($8,000 if age 50 or older) or taxable compensation.[110] This amount may be further limited if the IRA owner or the owner's spouse is an "active participant" in an employer-sponsored retirement plan.

b. In 2024, the deductibility of contributions to regular IRAs for active participants is phased out in a pro rata fashion over the applicable phaseout range of AGI. For example, if the applicable phaseout range of AGI is $77,000 to $87,000, a taxpayer with AGI of $80,000 who actively participates in a qualified plan would be permitted to contribute $7,000 to an IRA, but would only be permitted to deduct $4,900 of that 7,000 contribution. The remaining $2,100 (0.3 of $7,000) would be a nondeductible contribution.

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[109] I.R.C. §408(o)(2); Rev. Proc. 2023-75.
[110] I.R.C. §219(b)(1).

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c. **AGI phaseout ranges** -- The phaseout range depends upon filing status and the year in which the contribution is made.

Taxable years beginning in:	Joint returns phaseout range	Single taxpayers phaseout range
2024	$123,000 - $143,000	$77,000 - $87,000

d. The maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between $230,000 and $240,000 in 2024.

e. For 2024, the dollar amount an individual who is not married may contribute to a Roth IRA is phased out ratably between modified AGI of $146,000 and $161,000; for a married individual filing a joint return, between modified AGI of $230,000 and $240,000 and for a married individual filing separately, between modified AGI of $0 and $10,000.

II. A Sneak Peek at 2025 Inflation Adjusted Figures

Revenue Procedure 2024-10, released October 22, 2024, provides the IRS annual inflation adjustment amounts for numerous tax provisions, including the following highlights.

A. 2025 Tax Rates

The tax rates for 2025 are as follows.

	2025 Income Thresholds			
Tax Rate	**MFJ**	**HOH**	**MFS**	**Other Filers**
37%	$ 751,600	$ 626,350	$ 375,800	$ 626,350
35%	$ 501,050	$ 250,500	$ 250,525	$ 250,525
32%	$ 394,600	$ 197,300	$ 197,300	$ 197,300
24%	$ 206,700	$ 103,350	$ 103,350	$ 103,350
22%	$ 96,950	$ 64,850	$ 48,475	$ 48,475
12%	$ 23,850	$ 17,000	$ 11,925	$ 11,925
10%	< $23,850	< $17,000	< $11,925	< $11,925

2025 Capital Gain Rates				
Tax Rate	**MFJ**	**MFS**	**HOH**	**Other Filers**
0%	$ 96,700	$ 48,350	$ 64,750	$ 48,350
15%	$ 600,050	$ 300,000	$ 566,700	$ 533,400
Note: “Kiddie Tax” child gross income threshold increased from $13,000 in 2024 to $13,500 in 2025				

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B. 2025 Standard Deduction

Standard Deduction			
	2024	2025	Increase
MFJ	$ 29,200	$ 30,000	$ 800
Single/MFS	$ 14,600	$ 15,000	$ 400
HOH	$ 21,900	$ 22,500	$ 600

C. 2025 Alternative Minimum Tax

Alternative Minimum Tax			
	2024	2025	Increase
Exemption, MFJ	$ 133,300	$ 137,000	$ 3,700
Exemption, Others	$ 85,700	$ 88,100	$ 2,400
Exemption Phaseout, MFJ	$ 1,218,700	$ 1,252,700	$ 34,000
Exemption Phaseout, Others	$ 609,350	$ 626,350	$ 17,000

D. Other Figures for 2025

Other Figures			
	2024	2025	Increase
Max Earned Income Tax Credit	$ 7,830	$ 8,490	$ 660
Monthly Qualified Transport. Fringe	$ 315	$ 325	$ 10
Foreign Earned Income Exclusion	$ 126,500	$ 130,000	$ 3,500
Estate Exclusion	$ 13,610,000	$ 13,990,000	$ 380,000
Annual Gift Exclusion	$ 18,000	$ 19,000	$ 1,000
Adoption Credit Maximum	$ 16,810	$ 17,280	$ 470
FSA, Max Salary Reductions	$ 3,200	$ 3,300	$ 100
Cafeteria Plan, Max Carryover	$ 640	$ 660	$ 20

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E. 2025 Qualified Retirement Plan Figures

IRS Notice 2024-80, released November 1, 2024, provides the following inflation-adjusted figures for qualified retirement plans.

Retirement Figures			
	2024	2025	Increase
Maximum Annual Benefit	$ 275,000	$ 280,000	$ 5,000
Maximum Annual Addition	$ 69,000	$ 70,000	$ 1,000
Maximum Compensation	$ 345,000	$ 350,000	$ 5,000
SIMPLE Deferral Maximum	$ 16,000	$ 16,500	$ 500
SEP Minimum Compensation	$ 750	$ 750	$ 0
Maximum Elective Deferral	$ 23,000	$ 23,500	$ 500
Highly Compensated	$ 155,000	$ 160,000	$ 5,000

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Miscellaneous Practice and Reporting Issues

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Miscellaneous Practice and Reporting Issues

Learning objective

Upon reviewing this material, the reader will be able to discuss miscellaneous practice and reporting issues a practitioner currently may encounter.

I. Current overview

A. Digital assets – The Infrastructure Investment and Jobs Act

On November 15, 2021, President Biden signed into law The Infrastructure Investment and Jobs Act (IIJA), containing provisions that significantly expand digital asset reporting requirements. Section 80603 of the IIJA made significant changes to the broker reporting provisions under §6045 to clarify the rules regarding how certain digital asset transactions should be reported by brokers, and to expand the categories of assets for which basis reporting is required to include all digital assets.

On June 28, 2024, final regulations were issued, requiring custodial brokers to report sales and exchanges of digital assets, including cryptocurrency. These final regulations reflect more than 44,000 public comments that were provided in response to the proposed regulations. The final regulations require brokers to report certain sale and exchange transactions that take place beginning in calendar year 2025 and will be reported on new Form 1099-DA.

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☐ CORRECTED (if checked)

Digital Asset Proceeds From Broker Transactions

OMB No. 1545-XXXX

2025

Form **1099-DA**

Copy B For Recipient

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

Applicable checkbox on Form 8949

1a Code for digital asset

1b Name of digital asset

FILER'S TIN

RECIPIENT'S TIN

RECIPIENT'S name

1c Number of units

Street address (including apt. no.)

1d Date acquired

1e Date sold or disposed

City or town, state or province, country, and ZIP or foreign postal code

1f Proceeds $

1g Cost or other basis $

1h Accrued market discount $

1i Wash sales loss disallowed $

2 Check if basis reported to IRS ☐

3a Reported to IRS: ☐ Gross proceeds ☐ Net proceeds

Account number

3b Check if proceeds from: ☐ Reserved for future use ☐ QOF

4 Federal income tax withheld $

CUSIP number

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

5 Check if loss is not allowed based on amount in 1f ☐

6 Gain or loss: ☐ Short-term ☐ Long-term ☐ Ordinary

7 Check if 1f is only cash ☐

8 Check if broker relied on customer-provided acquisition information ☐

9 Check if digital asset is a noncovered security ☐

10 Digital asset is a noncovered security because:
☐ Broker did not provide custodial services for it
☐ Broker provided custodial services and it was transferred in to broker
☐ Broker provided custodial services and it was acquired prior to 2026

11a Check if gross proceeds reported in 1f is an aggregate amount for:
☐ Qualifying stablecoins
☐ Specified NFTs

11b If 11a checked, number of transactions

11c For aggregate reporting of specified NFTs, aggregate gross proceeds reported in 1f that are attributable to first sales by creator or minter $

12a Number of units transferred in

12b If transferred in, provide transfer-in date

13

14 State name

15 State identification no.

16 State tax withheld $ $

Form **1099-DA** (Keep for your records) www.irs.gov/Form1099DA Department of the Treasury - Internal Revenue Service

TREASURY/IRS AND OMB USE ONLY DRAFT September 9, 2024 DO NOT FILE

Per the final regulations, brokers include operators of custodial digital asset trading platforms, certain digital asset hosted wallet providers, digital asset kiosks, and certain processors of digital asset payments (PDAPs). The majority of digital asset transactions occur using these brokers, so the final regulations cover the greatest number of taxpayers. The final regulations do not include reporting requirements for decentralized or non-custodial brokers that do not take possession of the digital assets being sold or exchanged. The U.S. Treasury Department and the IRS intend to provide rules for these brokers in a different set of final regulations.

In addition to the broker reporting rules, the regulations provide rules for taxpayers to determine their basis, gain, and loss from digital asset transactions. Basis reporting will be required by certain brokers, for transactions occurring on or after January 1, 2026. The regulations also provide backup withholding rules. Real estate professionals are also required to report the fair market value of digital assets paid by buyers and received by sellers in real estate transactions with closing dates on or after January 1, 2026. Lastly, the final regulations provide for an optional, aggregate reporting method for certain sales of stablecoins

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and certain non-fungible tokens (NFTs) applicable only after sales of these stablecoins and NFTs exceed de minimis thresholds.

The IRS provides transitional and penalty relief from reporting and backup withholding rules on certain transactions to help phase-in implementation. Notice 2024-56 provides general transitional relief from reporting penalties and backup withholding for any broker who does not timely and accurately file information returns and furnish payee statements for sales and exchanges of digital assets during calendar year 2025, provided that the broker makes a good faith effort to comply with the reporting obligations. Notice 2024-56 also provides limited relief from backup withholding for certain sales of digital assets during 2026 for brokers using the IRS's TIN-matching system in place of certified TINs. Further, Notice 2024-56 provides backup withholding relief for exchanges of digital assets in return for specified NFTs and real property and for certain sales effected by PDAPs.

Lastly, Notice 2024-57 PDF informs brokers that until the U.S. Treasury Department and the IRS issue further guidance, brokers will not have to file information returns or furnish payee statements on digital asset sales and exchanges for the following six types of transactions:

1. Wrapping and unwrapping transactions;
2. Liquidity provider transactions;
3. Staking transactions;
4. Transactions described by digital asset market participants as lending of digital assets;
5. Transactions described by digital asset market participants as short sales of digital assets; and
6. Notional principal contract transactions.

B. Form 1099-K reporting

Through December 31, 2021, a two-step de minimis standard existed, in which Third Party Settlement Organizations were required to report third party network transactions of a participating payee on Form 1099-K if:

- The amount that would otherwise be reported exceeded $20,000; and
- There were over 200 transactions.

A Third Party Settlement Organization is a central organization that has the contractual obligation to make payments to participating payees (generally, a merchant or business) of third party network transactions. Per IRS FAQs, an example of a third party settlement organization is an online auction payment facilitator like an online marketplace, which operates as an intermediary between buyer and seller by transferring funds from the buyer to the seller for the provision of goods or services. [1]

The American Rescue Plan Act (ARPA) amended the two-step de minimis standard and instead created a single standard with a single $600 reporting threshold. This change was to take effect for years beginning after December 31, 2021; however, on December 23, 2022, the IRS announced that calendar year 2022 would be treated as a transition year. Not long after, on November 21, 2023, the IRS issued Notice 2023-74, announcing that calendar year 2023 would also be treated as a transition year. As a result, third party settlement organizations who issue Forms 1099-K must follow the $20,000/200 transaction threshold for calendar years 2022 and 2023. Taxpayers may have received a Form 1099-K at the lower threshold, despite Notice 2023-74. Due to the large number of taxpayers affected by the new

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[1] FS-2023-06.

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reporting provisions under ARPA, the IRS plans to implement a threshold of $5,000 for tax year 2024 as part of a phase in for the $600 reporting threshold.

Although the IRS delayed the $600 reporting threshold requirement, the legal requirement for reporting income has not changed, regardless of the reporting threshold for providing a Form 1099-K. Taxpayers are responsible for accurately reporting all income, regardless of whether Form 1099-K (or any other information return, such as Form 1099-MISC or Form 1099-NEC) is received.

It is important to note that for payment cards (credit cards, debit cards, gift cards, etc.), there is no threshold amount that has to be met to receive a Form 1099-K due to payments received through a payment card transaction. Therefore, if an individual received $0.01 of payments from a payment card transaction, they should receive a Form 1099-K for those payments. Additionally, certain states may have a lower reporting threshold for TPSOs, which could result in an individual receiving a Form 1099-K, even if the total gross payments they received in the year did not exceed the federal reporting threshold.

A reportable payment transaction is any payment card transaction and any third party network transaction. Transactions meeting the aggregate payment de minimis standard must be reported to all payees who accept payment from a third party settlement organization. The IRS released FAQs in March 2023 (FS-2023-06) detailing a variety of scenarios subject to Form 1099-K reporting.[2]

The gain or loss on the sale of a personal item may be reported on Form 1099-K. IRS FAQs remind taxpayers that the gain on the sale of a personal item is taxable and must be reported on Form 8949, *Sales and Other Dispositions of Capital Assets*, and Schedule D, *Capital Gains and Losses* (Form 1040). Losses on the sale of personal items are not deductible. Taxpayers who receive Form 1099-K for the sale of a personal item that resulted in a loss should report the sale on Form 1040, Schedule 1 as follows:

- Proceeds should be reported on Line 8z, using the description “Form 1099-K Personal Item Sold at a Loss.”
- Costs, up to but not exceeding the proceeds amount reported on Form 1099-K, should be reported on Line 24z, using the description “Form 1099-K Personal Item Sold at a Loss.”

Example: Robert broke up with his fiancé, Amy, and sold her engagement ring for a loss on December 31, 2024. Robert received Form 1099-K, reporting proceeds of $1,500. Robert originally purchased the ring for $5,000 on January 31, 2024. Robert’s loss is reported as follows:

DRAFT FORM: NOT FOR FILING

SCHEDULE 1 (Form 1040)
Department of the Treasury Internal Revenue Service

Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2024
Attachment Sequence No. **01**

z	Other income. List type and amount: FORM 1099-K PERSONAL ITEM SOLD AT LOSS	**8z**	1,500		
9	Total other income. Add lines 8a through 8z			**9**	1,500
10	Combine lines 1 through 7 and 9. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8			**10**	1,500

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040) 2022**

z	Other adjustments. List type and amount: FORM 1099-K PERSONAL ITEM SOLD AT LOSS	**24z**	1,500		
25	Total other adjustments. Add lines 24a through 24z			**25**	1,500
26	Add lines 11 through 23 and 25. These are your **adjustments to income**. Enter here and on Form 1040 or 1040-SR, line 10, or Form 1040-NR, line 10a			**26**	1,500

Schedule 1 (Form 1040) 2022

DRAFT FORM: NOT FOR FILING

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[2] FS-2023-06, FS-2024-03.

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Alternately, taxpayers may report the sale of a personal item at a loss on Forms 8949 and Schedule D. Taxpayers should enter "L" in column (f) of Form 8949 to explain that the loss is nondeductible. Then, the amount of the nondeductible loss should be entered as a positive number in column (g). Using the same facts in the example above, Robert would report his loss as follows on Form 8949:

DRAFT FORM: NOT FOR FILING

Form **8949** — Department of the Treasury, Internal Revenue Service

Sales and Other Dispositions of Capital Assets

File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

Go to *www.irs.gov/Form8949* for instructions and the latest information.

OMB No. 1545-0074 — 2024 — Attachment Sequence No. **12A**

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g).
FORM 1099-K PERSONAL ITEM SOLD AT A LOSS	01/31/2024	12/1/2024	1,500	5,000	L	3,500	0

DRAFT FORM: NOT FOR FILING

If a taxpayer sells multiple items within a single online transaction, any gain and loss must be reported separately.

***Example**:* On November 5, 2023, Jen sold two sets of concert tickets (four tickets total) in a single online transaction. She received total proceeds of $2,000: $1,200 for one set of tickets and $800 for the second set of tickets. Jen purchased the tickets for personal use on August 5, 2023. She paid $900 for the first set of tickets and $1,000 for the second set of tickets.

Jen must report the gain and loss separately, as the loss on the second set of concert tickets cannot offset the gain on the first set of tickets. Jen reports the $300 gain from the sale of one set of tickets ($1,200 sales price less $900 purchase price) on Form 8949 and Schedule D. Jen reports the $200 loss from the sale of the other set of tickets ($800 sales price less $1,000 purchase price) by entering $800 (proceeds) on Schedule 1, Lines 8z and 24z.

Form 1099-K does not adjust the gross amount of payment card/third party network transactions for any fees, refunds, chargebacks, or other costs. Taxpayers should include all fees, including any processing or selling fees, associated with the sale of their personal items in their basis when computing any gain or loss on the sale. Taxpayers should keep adequate records to substantiate any adjustments made to basis.

If a taxpayer's records are lost, destroyed, or not available due to circumstances beyond their control, and the taxpayer's return is audited, IRS examiners may allow the taxpayer to either present reconstructed records or provide oral testimony.

If a taxpayer receives a reimbursement from another individual, the reimbursement is generally not taxable, as the reimbursement is not payment for the sale of goods or services. If a taxpayer believes that Form 1099-K was issued in error or that the information on Form 1099-K is incorrect, they should contact the filer. If the taxpayer cannot get Form 1099-K corrected, IRS FAQ #8 specifies that the error should be reported on Form 1040, Schedule 1, Part I, Additional Income, Line 8z, Other Income, with an offsetting entry in Part II, Adjustments to Income, Line 24z, Other Adjustments.

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Example: Danielle and Alexandra went on a luxurious cruise to the Bahamas. Danielle purchased the tickets, which cost $3,000 each. Alexandra reimbursed Danielle $3,000 for the cruise tickets, and Danielle received a Form 1099-K reporting the $3,000 as gross proceeds. Danielle was unable to receive a corrected Form 1099-K. As a result, Danielle reports the following on Form 1040, Schedule 1:

DRAFT FORM: NOT FOR FILING

SCHEDULE 1 (Form 1040)
Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/Form1040* for instructions and the latest information.

OMB No. 1545-0074
2024
Attachment Sequence No. **01**

z	Other income. List type and amount: FORM 1099-K RECEIVED IN ERROR	**8z**	3,000		
9	Total other income. Add lines 8a through 8z			**9**	3,000
10	Combine lines 1 through 7 and 9. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8			**10**	3,000

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040) 2022**

z	Other adjustments. List type and amount: FORM 1099-K RECEIVED IN ERROR	**24z**	3,000		
25	Total other adjustments. Add lines 24a through 24z			**25**	3,000
26	Add lines 11 through 23 and 25. These are your **adjustments to income**. Enter here and on Form 1040 or 1040-SR, line 10, or Form 1040-NR, line 10a			**26**	3,000

DRAFT FORM: NOT FOR FILING **Schedule 1 (Form 1040) 2022**

C. New FinCEN reporting requirements in 2024

Due to regulations under the Corporate Transparency Act of 2020 (CTA), most small corporations, LLCs and partnerships will be required to report beneficial ownership information to FinCEN. Beneficial ownership information is identifying information about the individuals who directly or indirectly own or control a company. FinCEN estimates approximately 32.6 million reports will be filed initially, with an additional 5 million filings annually for the next nine years.

On September 30, 2022, FinCEN issued the Beneficial Ownership Information Reporting Requirements final rule ("final BOI reporting rule"), and on March 24, 2023, released FAQs regarding the requirements. [3] These requirements took effect as of January 1, 2024.

On March 1, 2024, in the case of *National Small Business United v. Yellen*, the U.S. District Court for the Northern District of Alabama rendered a summary judgment declaring the Corporate Transparency Act unconstitutional. This ruling has prompted the potential of similar legal challenges from other business groups. In response to the court's decision, the Justice Department, representing the Department of the Treasury, filed a Notice of Appeal on March 11, 2024. In response to the court ruling, as of March 1, 2024, FinCEN has ceased enforcement of the CTA for the plaintiffs involved in the lawsuit, which includes approximately 65,000 members of the National Small Business Association. All other entities are required to continue complying with the law.

Currently, there is no centralized database that contains complete information about owners and operators of legal entities within the United States. Most jurisdictions do not require the identification of an entity's individual beneficial owners at or after the time of formation. Many states require little to no disclosure of contact information or other information about an entity's officers or others who control the entity. The beneficial ownership information reporting requirement was created to "enhance U.S national security by making it more difficult for criminals to exploit opaque legal structures to launder money, traffic humans and drugs, and commit serious tax fraud and other crimes that harm the American taxpayer." [4]

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[3] 87 FR 59498 (September 30, 2022) and FinCEN Beneficial Ownership Information Reporting Frequently Asked Questions (March 24, 2023).

[4] 87 FR 59498 (September 30, 2022).

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The final regulations cite the following examples in which corporate entities were used to conceal illicit activities:

- In June 2021, a group of individuals, using synthetic identities, worked together to fraudulently apply for $24 million of PPP loans.
- In July 2022, an individual was sentenced for using multiple shell entities to fraudulently submit 63 loan applications for PPP and EIDL loans.

Reporting companies are required to report beneficial ownership information to FinCEN. The two types of reporting companies are:

- **Domestic Reporting Companies**, defined as:
  - Corporations;
  - LLCs; or
  - Any other entity created by the filing of a document with a secretary of state or any similar office under the law of a state or Indian tribe.
    - Common structures include limited liability partnerships, limited liability limited partnerships, business trusts, and most limited partnerships.
- **Foreign Reporting Companies**, defined as:
  - Corporations, LLCs, or other entities formed under the law of a foreign country; and
  - Registered to do business in any U.S. state or in any tribal jurisdiction, by the filing of a document with a secretary of state or any similar office under the law of a U.S. state or Indian tribe.

Limited exemptions from the reporting requirement apply, and most exempt entities are already subject to federal and state information reporting.

Exempt Entities	
Securities reporting issuer	Insurance company
Governmental authority	State-licensed insurance producer
Bank	Commodity Exchange Act registered entity
Credit union	Accounting firm
Depository institution holding company	Public utility
Money services business	Financial market utility
Broker or dealer in securities	Pooled investment vehicle
Securities exchange or clearing agency	Tax-exempt entity
Other Exchange Act registered entity	Entity assisting a tax-exempt entity
Investment company or investment adviser	Large operating company
Venture capital fund adviser	Subsidiary of certain exempt entities
	Inactive entity

An entity may qualify as a large operating company if the following six conditions apply:

1. The entity employs more than 20 full-time employees (with respect to a calendar month, employees who are employed an average of at least 30 hours of service per week with an employer);
2. More than 20 full-time employees of the entity are employed in the United States;
3. The entity has an operating presence at a physical office within the United States, meaning an entity regularly conducts its business at a physical location in the United States that the entity owns or leases and that is physically distinct from the place of business of any other unaffiliated entity;
4. The entity filed a federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross receipts or sales;

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5. The entity reported greater than $5,000,000 as gross receipts or sales (net of returns and allowances) on the entity's IRS Form 1120, consolidated IRS Form 1120, IRS Form 1120-S, IRS Form 1065, or other applicable IRS form; and
6. When gross receipts or sales from sources outside the United States, as determined under federal income tax principle, are excluded from the entity's amount of gross receipts or sales, the amount remains greater than $5,000,000.

Recently, FinCEN released updated FAQs, clarifying that Homeowners Associations (HOAs) may be reporting companies. If an HOA was not created by the filing of a document with a secretary of state or similar office, then it is not a domestic reporting company. An incorporated HOA or other HOA that was created by such a filing may qualify for an exemption from the reporting requirements. An incorporated HOA that is not a §501(c)(4) organization may fall within the reporting company definition and therefore be required to report BOI to FinCEN.

Additionally, entities formed under Tribal law are required to report beneficial ownership information if the entity meets the reporting company definition and does not qualify for any exemptions to the reporting requirements. Under the Corporate Transparency Act, a legal entity is a reporting company only if it is created or registered to do business under the laws of a state or Indian Tribe. Tribal corporations formed under federal law through the issuance of a charter of incorporation by the Secretary of the Interior are not created by the filing of a document with a secretary of state or similar office under the laws of an Indian Tribe, and are therefore, not reporting companies required to report beneficial ownership information to FinCEN.

Further, "governmental authorities" are not required to report beneficial ownership information to FinCEN. A "governmental authority" is an entity that:

- Is established under the laws of the United States, an Indian Tribe, a state, or a political subdivision of a state, or under an interstate compact between two or more states; and
- Exercises governmental authority on behalf of the United States or any such Indian Tribe, state, or political subdivision.

As a result, a Tribal entity that is such a "governmental authority" is not required to report beneficial ownership information to FinCEN. This category includes tribally chartered corporations and state-chartered Tribal entities, if those corporations or entities exercise governmental authority on a Tribe's behalf.

FAQs also clarified that an entity that is a regulated public utility as defined in 26 U.S.C. 7701(a)(33)(A) and that provides telecommunications services, electrical power, natural gas, or water and sewer services within the United States is not required to report its beneficial ownership information to FinCEN.

A beneficial owner is any individual who:

- Directly or indirectly exercises substantial control over the reporting company; or
- Directly or indirectly owns or controls 25% or more of the "ownership interests" of the reporting company.

Per FAQs, a beneficial owner typically exercises substantial control over a reporting company if they "direct, determine, or exercise substantial influence over important decisions the reporting company

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makes."[5] Individuals may directly or indirectly exercise substantial control. Individuals can exercise substantial control through contracts, arrangements, understandings, relationships, or otherwise.

Any senior officer is deemed to have substantial control over a company. Examples include a president, chief financial officer, general counsel, chief executive officer, or chief operating officer, as well as any other officers that perform functions similar to such roles.

Examples of directly exercising substantial control over a reporting company include:

- Board representation;
- Ownership or control of a majority of voting power or voting rights; or
- Rights associated with financing or interest.

Examples of indirectly exercising substantial control over a reporting company include:

- Controlling one or more intermediary entities that separately or collectively exercise substantial control over a reporting company; or
- Through arrangements or financial or business relationships with other individuals or entities acting as nominees.

Similarly, individuals may directly or indirectly own or control ownership interests in a reporting company. An example of a direct way of owning or controlling ownership interests is having joint ownership with one or more other individuals. Examples of indirect ways of owning or controlling ownership interests include:

- Owning or controlling one or more intermediary entities, or the ownership interests of any intermediary entities, that separately or collectively own or control ownership interests of a reporting company; or
- Owning or controlling ownership interests through another individual acting as a nominee, intermediary, custodian or agent.

An HOA that meets the reporting company definition and does not qualify for any exemptions must report its beneficial owner(s). There may be instances in which no individuals own or control at least 25 percent of the ownership interests of an HOA that is a reporting company. Individuals who meet one of the following criteria are considered to exercise substantial control over the HOA:

- The individual is a senior officer;
- The individual has authority to appoint or remove certain officers or a majority of directors of the HOA;
- The individual is an important decision-maker; or
- The individual has any other form of substantial control over the HOA.

It is also important to note that beneficial owners can own or control a reporting company through trusts. They can do so by either exercising substantial control over a reporting company through a trust arrangement or by owning or controlling the ownership interests of a reporting company that are held in a trust.

There are five exceptions to the definition of a beneficial owner. When an individual who would otherwise be a beneficial owner of a reporting company qualifies for an exception, the reporting company does not

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[5] FinCEN Beneficial Ownership Information Reporting Frequently Asked Questions (March 24, 2023).

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have to report that individual as a beneficial owner in its BOI report to FinCEN. The five exceptions to the definition of a beneficial owner follow:

Exception 1: Minor Child

- An individual qualifies for this exception if the individual is a minor child, as defined under the law of the state or Indian tribe in which the domestic reporting company is created or the foreign reporting company is first registered.
- The reporting company may instead report information about the parent or legal guardian of the minor child.
- This exception only applies if a parent or legal guardian's information is reported in lieu of the minor child's information.
- When the minor child reaches the age of majority, the exception no longer applies, and the reporting company must file an updated BOI report providing the individual's own information.

Exception 2: Nominee, intermediary, custodian, or agent

- An individual qualifies for this exception if the individual merely acts on behalf of an actual beneficial owner as the beneficial owner's nominee, intermediary, custodian, or agent.
- In such situations, the actual beneficial owner must be reported.
- Examples of individuals who likely qualify for this exception include individuals who perform ordinary advisory or other contractual services, such as tax professionals.

Exception 3: Employee

- An individual qualifies for this exception if all of the following apply:
    - The individual is an employee of the reporting company, when applying the meaning of "employee" provided in 26 CFR 54.4980H-1(a)(15). Generally, this means that the individual is subject to the will and control of the employer in what and how to do work, and that the employer may discharge the individual from work;
    - The individual's substantial control over, or economic benefits from, the reporting company are derived solely from the employment status of the individual as an employee; and
    - The individual is not a senior officer of the reporting company.

Exception 4: Inheritor

- An individual qualifies for this exception if the individual's only interest in the reporting company is a future interest through a right of inheritance, such as through a will providing a future interest in a company.
- Once the individual actually inherits the interest, the exception no longer applies, and the individual may qualify as a beneficial owner. Additionally, the reporting company may have to file an updated BOI report providing the individual's information.

Exception 5: Creditor

- An individual qualifies for this exception if the individual is a creditor of the reporting company.
- A creditor is an individual who would meet the definition of a beneficial owner of the reporting company solely through rights or interests for the payment of a predetermined sum of money, such as a debt incurred by the reporting company, or a loan covenant or

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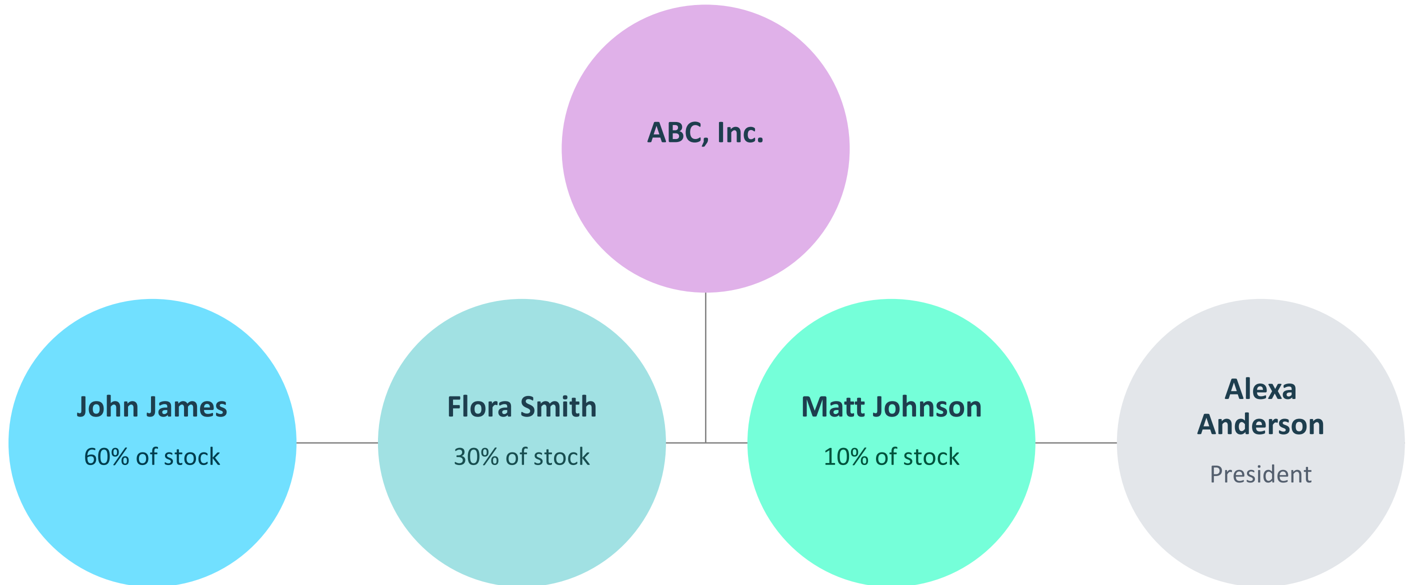
other similar right associated with such right to receive payment that is intended to secure the right to receive payment or enhance the likelihood of repayment.

- An individual qualifies for the creditor exception if the individual is entitled to payment from the reporting company to satisfy a loan or debt, so long as this entitlement is the only ownership interest the individual has in the reporting company.

Example 1: ABC, Inc. is a reporting company that has the following organization chart:



Which individual(s) are considered beneficial owners?

- John James is considered a **beneficial owner** because he has 25% or more of the ownership interests of the reporting company, ABC, Inc.
- Flora Smith is considered a **beneficial owner** because she has 25% or more of the ownership interests of the reporting company, ABC, Inc.
- Alexa Anderson is considered a **beneficial owner** because although she does not have 25% or more of the ownership interests of the reporting company, ABC, Inc., she is a senior officer that is deemed to have substantial control over the company.
- Matt Johnson only owns 10% or more of the ownership interests of the reporting company, ABC, Inc., and he does not directly or indirectly exercise substantial control over ABC, Inc. Therefore, Matt Johnson is not a beneficial owner.

Example 2: XYZ, Inc. is a reporting company that has the following organization chart:

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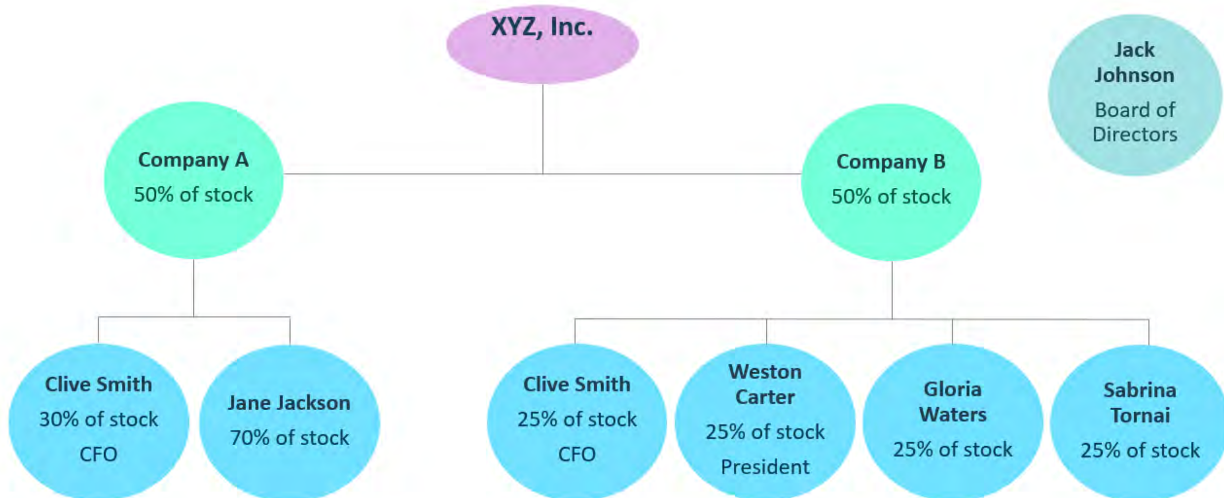

Which individual(s) are considered beneficial owners?

- Clive Smith is considered a **beneficial owner** because he is a senior officer (CFO), which means he exercises substantial control over the company. Additionally, Clive is also considered a **beneficial owner** who indirectly owns 27.5% of the XYZ Inc.'s stock (reporting company) through direct ownership of both Company A and Company B, which each own 50% of XYZ, Inc.
  - Clive owns 15% of XYZ Inc. (reporting company) through Company A (50% x 30%)
  - Clive owns 12.5% of XYZ Inc. (reporting company) through Company B (50% x 25%)
  - In total, Clive owns 27.5% of XYZ Inc.
- Jane Jackson is considered a **beneficial owner** because she indirectly owns 35% of the reporting company, XYZ Inc. As a result, she is considered a beneficial owner because she has 25% or more of the ownership interests of the reporting company, XYZ, Inc.
  - Jane owns 35% of XYZ, Inc. (reporting company) through Company A (50% x 70%).
- Weston Carter is considered a **beneficial owner** because he is a senior officer (CEO), which means he exercises substantial control over the company. Weston is also considered a **beneficial owner** despite only indirectly owning 12.5% of the XYZ Inc.'s stock (reporting company) through direct ownership of Company B, which owns 50% of XYZ, Inc.
  - Weston owns 12.5% of XYZ, Inc. (reporting company) through Company B (50% x 25%).
- Jack Johnson is considered a **beneficial owner** because he is on XYZ, Inc.'s board of directors and makes important decisions on XYZ Inc.'s behalf, thereby exercising substantial control over it. Jack is considered a beneficial owner despite not owning any ownership interest, because he exercises substantial control over the reporting company.
- Gloria Waters is not considered a beneficial owner because she only indirectly owns 12.5% of XYZ, Inc. and she does not exercise substantial control over XYZ, Inc.
  - Gloria owns 12.5% of XYZ, Inc. (reporting company) through Company B (50% x 25%).
- Sabrina Tornai is not considered a beneficial owner because she only indirectly owns 12.5% of XYZ, Inc. and she does not exercise substantial control over XYZ, Inc.
  - Sabrina owns 12.5% of XYZ, Inc. (reporting company) through Company B (50% x 25%).

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If a reporting company is created or registered on or after January 1, 2024, the reporting company will also need to report information about itself, its beneficial owners, and its company applicants. If a reporting company was created or registered before January 1, 2024, the reporting company only needs to provide information about itself and its beneficial owners. The reporting company **does not** need to provide information about its company applicants.

A **company applicant** is:

- The individual who directly files the document that creates, or first registers, the reporting company; and
- The individual that is primarily responsible for directing or controlling the filing of the relevant document.

  Note: No reporting company will have more than two applicants.

The information that a reporting company must report about itself includes:

- The company's legal name;
- Any company trade names, "doing business as" (d/b/a) names, or "trading as" (t/a) names;
- The current street address of its principal place of business if that address is in the United States, or, for reporting companies whose principal place of business is outside the United States, the current address from which the company conducts business in the United States;
- The company's jurisdiction of formation or registration; and
- The company's TIN.

FAQs clarify that a company is not required to report its beneficial ownership information to FinCEN if it ceased to exist as a legal entity before Jan. 1, 2024, meaning that it entirely completed the process of formally and irrevocably dissolving. A company that ceased to exist as a legal entity before BOI reporting requirements became effective Jan. 1, 2024, is not subject to the BOI reporting regime and, thus, is not required to report its beneficial ownership information to FinCEN.

If a Reporting Company continued to exist as a legal entity for any period of time on or after Jan. 1, 2024, (i.e., it did not entirely complete the process of formally and irrevocably dissolving before Jan. 1, 2024), then it is required to report its beneficial ownership information to FinCEN, even if the company had wound up its affairs and ceased conducting business before Jan. 1, 2024. Similarly, if a Reporting Company was created or registered on or after Jan. 1, 2024, and subsequently ceased to exist, then it is required to report its beneficial ownership information to FinCEN – even if it ceased to exist before its Initial BOI report was due.

The information that a reporting company must report about a beneficial owner or company applicant includes:

- The individual's name, date of birth, and current personal address; and
  - A unique identifying number for the individual from an acceptable identification document (examples include driver's licenses, passports, or identification documents issued by a U.S. state or local government or Indian tribe). Note: The reporting company must submit an image of such identification document to FinCEN.

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Certain reporting companies must include information about their company applicants in their BOI reports. A reporting company is required to report its company applicants if it is either a:

- Domestic reporting company created on or after January 1, 2024; or
- Foreign reporting company first registered to do business in the United States on or after January 1, 2024.

A reporting company is not required to report its company applicants if it is either a:

- Domestic reporting company created before January 1, 2024; or
- Foreign reporting company first registered to do business in the United States before January 1, 2024.

Reporting companies that are required to report company applicants must report at least one, but at most two, company applicants. There are two categories of company applicants:

1) **Direct Filers**:
    - A direct filer is the individual who directly filed the document that created a domestic reporting company, or the individual who directly filed the document that first registered a foreign reporting company. In other words, this individual directly physically or electronically filed the document with the secretary of state or similar office.
    - The direct filer must be identified by all reporting companies that have a company applicant reporting requirement.
2) **Directs or controls the filing action**:
    - Another potential company applicant is an individual who was primarily responsible for directing or controlling the filing of the creation or first registration document. This individual is a company applicant even though the individual did not actually file the document with the secretary of state or similar office.
    - Not all reporting companies that have a company applicant reporting requirement will have this individual to report.

The information that a reporting company must report about a beneficial owner or company applicant includes:

- The individual's name, date of birth, and reporting company's business street address; and
- A unique identifying number for the individual from an acceptable identification document (examples include driver's licenses, passports, or identification documents issued by a U.S. state or local government or Indian tribe).
    - Note: The reporting company must submit an image of such identification document to FinCEN.

FinCEN will issue to an individual or reporting company upon request a "FinCEN identifier," a unique identifying number, after the individual or reporting company provides certain information to FinCEN. An individual or reporting company is not required to obtain a FinCEN identifier; however, the company may include FinCEN identifiers in its BOI report instead of certain required information about beneficial owners or company applicants. Individuals (including beneficial owners or company applicants) may electronically apply for FinCEN identifiers. The individual must provide the same information required for beneficial owners and company applicants in BOI reports. After an individual submits an application, the individual

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will immediately receive a FinCEN identifier unique to that individual. A reporting company may request a FinCEN identifier when it submits a BOI report by checking a box on the reporting form.

A reporting company created or registered to do business before January 1, 2024, will have until January 1, 2025 to file its initial beneficial ownership information report. Under the initial BOI reporting requirements, a reporting company created or registered on or after January 1, 2024, would have 30 days to file its initial beneficial ownership information report. On November 29, 2023, FinCEN issued a final rule, extending the filing deadline from 30 days to 90 days for entities created or registered on or after January 1, 2024, and before January 1, 2025. This 90-calendar day deadline runs from the time the company receives actual notice that its creation or registration is effective, or after a secretary of state or similar office first provides public notice of its creation or registration, whichever is earlier. Under the final rule, entities created or registered on or after January 1, 2025, will have 30 days to file their initial BOI reports with FinCEN. FinCEN began accepting beneficial ownership information reports on January 1, 2024, and there is no fee for submitting the report.

If an entity previously qualified for an exemption to the reporting company definition but no longer qualifies, they must file a BOI report within 30 calendar days of the date on which the entity stopped qualifying for the exemption. If any previously reported information about the reporting company or its beneficial owner changes, the reporting company must file an updated BOI report no later than 30 days after the date on which the change occurred. It is important to note that a reporting company is not required to file an updated report for any changes to previously reported personal information about a company applicant.

FinCEN lists the following common examples which require an updated BOI report:

- Registering a new DBA.
- A change in beneficial owners, such as a new company executive, a sale that changes who meets the ownership interest threshold of 25%, or the death of a beneficial owner.
  - Note: If a beneficial owner dies, the changes must be reported within 30 days of when the deceased beneficial owner’s estate is settled. Any new beneficial owners, if applicable, should be identified in the updated BOI report.
- Any change to a beneficial owner’s name, address, or unique identifying number provided in a BOI report.
  - Note: If the beneficial owner’s identifying document changed (for example, he or she received a new driver’s license with a changed name, address, or identifying number), the reporting company also would have to file an updated BOI report with FinCEN, including an image of the new identifying document.

Entities that are required to report beneficial ownership information to FinCEN may do so electronically through FinCEN’s secure BOI E-Filing site: https://boiefiling.fincen.gov. Anyone whom the reporting company authorizes to act on its behalf, including an employee, owner, or third-party service provider, may file a BOI report on the reporting company’s behalf. Such individuals may be required to provide basic contact information about themselves, including their name and email address or phone number. Updated BOI reports should also be filed electronically through the secure BOI E-Filing site.

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Under the CTA, FinCEN can disclose the beneficial ownership information to the following requesters:

- U.S. federal agencies engaged in national security, intelligence, and law enforcement activities;
- State, local, and tribal law enforcement agencies with court authorization;
- The U.S. Department of the Treasury;
- Financial institutions using beneficial ownership information to conduct legally required customer due diligence, provided the financial institutions have their customer's consent to retrieve the information;
- Federal and state regulators assessing financial institutions for compliance with legally required customer due diligence obligations; and
- Foreign law enforcement agencies and certain other foreign authorities who submit qualifying requests for the information through a U.S. federal agency.

As discussed, many taxpayers may be unaware of the existence of these reporting requirements that are quickly approaching. FinCEN estimates approximately 32.6 million reports will be filed initially, with an additional 5 million filings annually for the next nine years. Significant penalties can result from failure to comply with these new reporting requirements. Any person who willfully provides false or fraudulent information to a reporting company or willfully fails to file a complete initial or updated report with FinCEN is subject to a $500-per-day fine up to $10,000 and imprisonment for up to two years.

Senior officers of an entity that fails to file a required BOI report may be held accountable for that failure. An individual may also be subject to civil and/or criminal penalties for willfully causing a company not to file a required BOI report or to report incomplete or false beneficial ownership information to FinCEN.

D. Status of COVID-19 relief provisions

In recent years, there has been significant relief provided to businesses and individuals as a result of the COVID-19 pandemic. Major COVID-19 relief legislation included:

- The CARES Act;
- ARPA; and
- The CAA 2021.

Many relief provisions were temporary in nature, but some provisions continue. Additionally, while some provisions have expired, there may be opportunities to file an amended return.

1. Business meals deduction

The CAA 2021 temporarily increased the 50% limit on the business meals deduction to 100% for tax years 2021 and 2022 only. To qualify for the increased deduction, expenses had to be paid or incurred in 2021 and 2022 for business meal food and beverage expenses, including delivery and carry-out meals, provided by a restaurant. In 2023, the business meals deduction reverts to 50%.

2. Executive compensation

Prior to ARPA, the deduction for executive compensation was capped at $1 million for certain covered employees of publicly traded companies, including the CEO, CFO, and next three highest compensated officers. For purposes of the §162(m), these five covered employees are permanently considered covered employees, often referred to as the "once a covered employee, always a covered employee" rule. ARPA modifies §162(m) by capping the deduction at $1 million for the next five highest-paid employees in addition to the CEO, CFO, and next three highest compensated officers. These next five highest-paid

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employees are to be determined on an annual basis and are not subject to the “once a covered employee, always a covered employee” rule. As a result of this new modification, companies with highly paid non-officer employees may be subject to a disallowed deduction. Companies may also face increased recordkeeping requirements, as they will track their “permanent” covered employees, as well as the next five highest-paid covered employees on a yearly basis. Companies should begin to think about what systems they need to put into place in order to track this information. This provision takes effect for tax years beginning after December 31, 2026, providing companies with adequate time to prepare for the change. However, it would be wise for companies to begin reviewing compensation agreements sooner rather than later to determine the impact of the new ARPA provisions.

3. *Employee Retention Tax Credit*

The CARES Act created a refundable Employee Retention Tax Credit (ERTC) for employers subject to closure due to COVID-19. The ERTC deadline was initially set to expire December 31, 2020, but The Consolidated Appropriations Act of 2021 (CAA 2021) extended it through June 30, 2021. The American Rescue Plan Act (ARPA) initially extended the ERTC through December 31, 2022, but the Infrastructure Investment and Jobs Act (IIJA) terminated the ERTC as of September 30, 2021. Recovery Startup Businesses were exempt from this provision and could continue to take the Employee Retention Tax Credit through December 31, 2021. Recovery startup businesses were defined as employers who: (i) began operations after February 15, 2020; (ii) who had average annual gross receipts for a three-taxable-year period ending with the taxable year which preceded such quarter not in excess of $1,000,000; and (iii) were not otherwise an eligible employer due to a full or partial suspension of operations or a decline in gross receipts.

The 2020 ERTC was equal to 50% of qualified wages, up to $10,000. In other words, the 2020 ERTC was worth up to $5,000 per employee. The CAA 2021 increased the credit from 50% to 70% of qualified wages in 2021 but maintained the wage limit on a per-employee basis of $10,000 per quarter. As a result, the ERTC was worth up to $7,000 per employee per quarter in 2021. Recovery startup businesses were eligible to receive a maximum ERTC of $50,000 in Q3 and Q4 of 2021.

Taxpayers have up to three years (from the due date of the original return) to file an amended Form 941 to claim the ERTC. If the taxpayer filed a federal income tax return deducting qualified wages prior to filing an employment tax return claiming the ERTC, the taxpayer must file an amended income tax return to correct any overstated wage deduction. Any wage deduction claimed on the taxpayer’s federal income tax return must be reduced by the amount of the credit.

The IRS has issued warnings that false ERTC claims could result in the taxpayer being required to repay the credit along with penalties and interest. The IRS has noticed an increase in third parties “aggressively promoting” ERTC schemes on the radio and internet. Such third parties often charge significant upfront fees or contingent fees. These third parties often fail to inform taxpayers that wage deductions claimed on their federal return must be reduced by the amount of the credit.

Per IR 2023-40, the IRS is “actively auditing and conducting criminal investigations related to these false claims,” and warns that “people need to think twice before claiming this.” It is always important to carefully review ERTC eligibility guidelines when determining whether to amend a return.

On September 14, 2023, the IRS issued IR-2023-169, ordering an immediate stop to new ERTC claim processing due to concerns over an influx of improper claims. Per the release, the IRS would continue to

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work ERTC claims filed prior to September 14, 2023, but processing times would extend from the typical goal of 90 days to 180 days, or much longer if the claim faces further review or audit.

The release announced that the IRS would develop new initiatives to help businesses who found themselves victims of aggressive promoters. Such developments included:

- A new settlement program for repayments for those who received an improper ERTC payment, with more details being announced in the coming months; and
- A special withdrawal option for those who have filed an ERTC claim but the claim has not yet been processed or paid, allowing taxpayers to avoid potential repayment issues if misled by promoters.
    - Per the announcement, if a business claimed the ERTC earlier and the claim has not been processed or paid by the IRS, they can withdraw the claim if they now believe it was submitted improperly – even if their case is already under audit or awaiting audit.
    - The IRS reminds taxpayers that those who have willfully filed fraudulent claims, and withdrew such fraudulent claims, will not be exempt from potential criminal investigation and prosecution.

In October 2023, the IRS issued FS-2023-24, establishing the special claim withdrawal option for those who have filed an ERTC claim. This initiative was implemented to safeguard small business owners and other affected parties who might have been coerced or misled by promoters or marketers of the ERTC into filing ineligible claims. The purpose of this claim withdrawal option is to prevent taxpayers from inadvertently receiving refunds for which they are not entitled.

In FS-2023-24, the IRS emphasized that employers who request a withdrawal are asking the IRS not to process their entire adjusted employment tax return for the tax period that included the ERTC claim. The IRS clarified that withdrawn claims would be treated as if they were never filed, and the IRS would not impose penalties or interest on such withdrawn claims. The IRS reminded taxpayers that any taxpayer who incorrectly claimed the ERTC and did not withdraw the claim has to pay back the claim, along with any penalties or interest. Additionally, those who willfully filed a fraudulent claim, or those who assisted or conspired in such conduct, will not be immune from potential criminal investigation and prosecution by withdrawing a fraudulent claim.

Employers can use the ERTC claim withdrawal process if all of the following apply:

- The employer made the claim on an adjusted employment tax return (Forms 941-X, 943-X, 944-X, CT-1X);
- The employer filed the adjusted return only to claim the ERTC, and they made no other adjustments;
- The employer wants to withdraw the entire amount of their ERTC claim; and
- The IRS has not paid the employer's claim, or the IRS has paid the claim, but the employer has not cashed or deposited the refund check.

Employers may request to withdraw an ERTC claim in the following ways:

- Employers that filed their ERTC claim through a **professional payroll company** (such as Certified Professional Organizations (CPEOs) or Professional Employer Organizations (PEOs) may request to withdraw an ERTC claim by contacting the entity that filed the claim on their behalf.

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- Taxpayers who filed an amended return on their behalf must follow the following steps for each tax period for which they are requesting a withdrawal.

  Employers who haven't received a refund and haven't been notified their claim is under audit: If the employer filed an adjusted return (Form 941-X, 943-X, 944-X, CT-1X) to claim the ERTC and would like to withdraw the entire claim, they may request a withdrawal using the following steps for each tax period:

  1) Make a copy of the adjusted return with the claim they wish to withdraw.
  2) In the left margin of the first page, write "Withdrawn".
  3) In the right margin of the first page:
     - Have an authorized person sign and date it.
     - Write their name and title next to their signature.
  4) Fax the signed copy of the return to the IRS's ERTC claim withdrawal fax line at 855-738-7609 using a computer or mobile device. This is the withdrawal request.

  Employers that haven't received a refund and have been notified their claim is under audit: Employers facing an IRS audit may still withdraw their ERTC claim. If a taxpayer has been notified that the IRS is auditing the adjusted return that includes their ERTC claim, they should prepare their withdrawal request as follows:

  1) Make a copy of the adjusted return with the claim they wish to withdraw.
  2) In the left margin of the first page, write "Withdrawn".
  3) In the right margin of the first page:
     - Have an authorized person sign and date it.
     - Write their name and title next to their signature.
  4) If the taxpayer has been assigned an examiner, they should communicate with the examiner about how to fax or mail the withdrawal request directly to them. If the taxpayer has not been assigned an examiner, they should respond to the audit notice with the withdrawal request, using the instructions in the notice for responding.

  Employers who received a refund check but have not cashed or deposited it: Taxpayers that received a refund check but have not cashed or deposited it, can still withdraw their ERTC claim. The taxpayer must mail the voided check with their withdrawal request using the following steps:

  1) Make a copy of the adjusted return with the claim they wish to withdraw.
  2) In the left margin of the first page, write "Withdrawn".
  3) In the right margin of the first page:
     - Have an authorized person sign and date it.
     - Write their name and title next to their signature.
  4) Write "Void" in the endorsement section on the back of the refund check.
  5) Include a note that says, "ERTC Withdrawal" and briefly explain the reason for returning the refund check.
  6) Make copies for tax records of the front and back of the voided check, the explanation notes and the signed and dated withdrawal request page.

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7) Do not staple, bend or paper clip the voided check; include it with the claim withdrawal request and mail it to the IRS. Note: The taxpayer should track the package to confirm delivery.

After submitting an ERTC withdrawal request, the taxpayer will receive a letter from the IRS, indicating whether the withdrawal request was accepted or rejected. It is important to note that if the IRS accepts the withdrawal, the taxpayer may need to amend their income tax return. It is crucial to highlight that the IRS continues to closely examine ERTC claims to ensure compliance with eligibility criteria. The IRS disclosed that the claim withdrawal process for those with unprocessed ERTC claims has led to more than 7,300 entities withdrawing $677 million.

Recently, in December 2023, the IRS announced its intention to dispatch an initial wave of more than 20,000 letters to taxpayers, notifying them of disallowed ERTC claims. Specifically, taxpayers deemed ineligible for the ERTC, either because their entity did not exist during the claimed period or did not have employees during that time frame, will receive Letter 105 C, *Claim Disallowed*. The IRS plans additional letters beyond the disallowance letters as part of its ongoing review process.

On December 21, 2023, the IRS announced a new Voluntary Disclosure Program to assist taxpayers who wished to return funds they received after filing ERTC claims in error. To participate in the program, taxpayers were required to submit their application by March 22, 2024, utilizing the newly introduced Form 15434, *Application for Employee Retention Credit Voluntary Disclosure Program.*

If the tax period(s) for which the ERTC was claimed included any tax period ending in 2020, a completed, signed ERTC Voluntary Disclosure Program Form SS-10, *Consent to Extend the Time to Assess Employment Taxes, for the 2020 Tax Period(s)*, was required to be submitted with Form 15434. Additionally, if the ERTC was claimed by a third-party payer on behalf of the taxpayer, the third-party payer was required to attach a copy of the relevant pages of the Schedule R (Form 941), *Allocation Schedule for Aggregate Form 941 Filers*, that was attached to each Form 941, *Employer's Quarterly Federal Tax Return*, on which the third-party payer claimed the ERTC for the taxpayer.

Taxpayers accepted into the program were only required to repay 80% of the credit amount they received. The IRS selected an 80% repayment requirement due to the fact that many ERTC promoters charged a percentage fee that they collected at the time of payment or in advance of the payment, leaving recipients with less than the full credit amount. Any taxpayer that has claimed the ERTC and has received a credit or refund was eligible to participate in the Voluntary Disclosure Program, provided they met the following requirements:

- The taxpayer is not under criminal investigation and they have not been notified that the IRS intends to commence a criminal investigation;
- The IRS has not received information from a third party alerting the IRS to the taxpayer's noncompliance, nor has the IRS acquired information directly related to the noncompliance from an enforcement action;
- The taxpayer is not under an employment tax examination by the IRS for any tax period(s) for which the taxpayer is applying for this Voluntary Disclosure Program; and
- The taxpayer has not previously received notice and demand for repayment of all or part of the claimed ERTC.

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Additionally, the taxpayer had to provide the IRS with the names, addresses and telephone numbers of any advisors or tax preparers who advised or assisted them with their claim, along with a summary of the provided services.

If the IRS paid interest on the taxpayer's ERTC refund claim, the taxpayer is not obligated to reimburse that interest. The IRS will not charge taxpayers in the Voluntary Disclosure Program any interest or penalties on any repaid credits. However, if the taxpayer is unable to repay the required 80% of the credit at the time of signing their closing agreement, then the employer will be required to pay penalties and interest in connection with entering into an installment agreement. If the taxpayer is unable to repay 80% of the credit, they may be considered for an installment agreement on a case-by-case basis. Should the IRS approve the request for an installment agreement, interest may accrue from the date of agreement onward.

Since the Voluntary Disclosure Program settlement eliminates a taxpayer's eligibility for and entitlement to all of the claimed ERTC, taxpayers are not required to reduce wage expense with respect to any of the previously claimed ERTC. As a result, if the taxpayer had not previously reduced wage expense by any of the claimed ERTC, participants need not file amended returns or Administrative Adjustment Requests (AARs) to reduce wage expense.

Likewise, if taxpayers had previously reduced wage expense by any of the claimed ERTC, taxpayers should not reduce wage expense by any of the claimed ERTC if they file an amended return or AAR adjusting the previous reduction to wage expense. Pursuant to the settlement, a taxpayer has no income with respect to the resolution of the employment tax obligation by remittance of payment of only 80% of the claimed ERTC, including both the refundable and non-refundable portions.

The first Voluntary Disclosure Program ended in March 2024, with more than 2,600 applications from ERTC recipients that disclosed $1.09 billion worth of credits. On August 15, 2024, the IRS announced that there is a limited time reopening of the Voluntary Disclosure Program to help businesses fix incorrect Employee Retention Credit claims as the agency continues compliance work (IR-2024-212).

The program will run through November 22 and allow businesses a chance to correct improper payments at a 15% discount (reduced from the first program's 20% discount) and avoid future audits, penalties and interest.

On August 8, 2024, the IRS announced that it issued 28,000 disallowance letters, preventing an estimated $5 billion in improper payments. Thousands of ERTC claims are currently under audit, and 460 criminal cases have been opened to investigate potential fraud. The IRS has identified 50,000 valid low-risk ERTC claims. The IRS projects payments will begin in September with additional payments going out in subsequent weeks. The IRS anticipates adding another large block of additional low-risk claims for processing and payment.

The IRS announced a shift in its moratorium on processing new ERTC claims due to newly available information. Previously, the IRS was not processing any ERTC claims filed after September 14, 2023. The IRS will now begin carefully processing claims filed between September 14, 2023, and January 31, 2024. The agency will prioritize the highest- and lowest-risk claims within this period, focusing on cases where there is a clear basis to either approve or deny the claim. As the IRS processes additional claims, businesses may receive payments for valid tax periods, such as specific quarters, while other periods

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remain under review. ERTC eligibility can vary by tax period based on factors like the cessation of government orders, increases in gross receipts, or the use of a forgiven Paycheck Protection Program loan. Qualified wages might also be limited if an employer has already claimed the maximum amount in an earlier period.

On August 21, 2024, the National Taxpayer Advocate (NTA) released a blog post regarding the Employee Retention Credit. Per the blog post, the IRS's recent batch of ERC disallowances deviates significantly from standard procedures. Normally, disallowances occur after an examination, where taxpayers can support their claims. Taxpayers typically have 30 days to protest the disallowance and request a review by the IRS's Independent Office of Appeals.

For these disallowed ERC claims, the IRS used a risk-scoring analytics process instead of a traditional examination. The analytics determined claims that posed a high risk of being incorrect without first conducting a taxpayer audit. This method contrasts sharply with the typical process, where disallowance follows after an in-depth examination. A taxpayer's response to a disallowance will not go directly to Appeals as usual. Instead, the IRS will first review the response and send it to a Revenue Agent for further consideration. This "quasi-exam" process allows the IRS to either allow the claim, request more documentation, or uphold the denial before sending it to Appeals. The IRS is still working to finalize this process, but taxpayers should receive a letter from the IRS informing them a review of their response has been conducted and their case is being forwarded to Appeals.

Under current procedures, Appeals does not consider new information the IRS did not review first. If the IRS does not provide the taxpayer the opportunity to provide new information as part of the IRS review process, the taxpayer may do so once in Appeals. In this circumstance, Appeals would send the case back to the IRS review function for further consideration of the new facts. This process could significantly prolong the resolution of the case, adding unnecessary time to an already lengthy IRS procedure.

Taxpayers and practitioners should be aware that any IRS process involving a review of facts, followed by a referral to Appeals, will take considerable time. Taxpayers should expect that it could take many months, or longer, for the IRS to make a determination before forwarding the protest to Appeals. Once the case is with Appeals, it may take up to five months or more to schedule an initial Appeals conference. Taxpayers who qualify may consider requesting an Appeals Fast Track (FT) to resolve disputes quickly. It is currently unclear if taxpayers responding to this batch of ERC disallowances will qualify for FT. FT is typically designed to resolve disputes between IRS Exam and the taxpayer, but the "exam-like" review process for these disallowances may disqualify them from FT.

If a business does not wish to contest the ERC disallowance, no further action is required. However, businesses that want to pursue their claim in court may file a lawsuit in a U.S. district court or the U.S. Court of Federal Claims. This can be done after receiving the notice of claim disallowance, regardless of whether they first sought review in Appeals. Taxpayers have two years from the date on the notice of claim disallowance to file a lawsuit. The two-year period begins from the date listed on the top right-hand corner of the notice. The IRS cannot issue a refund if the two-year period has expired, even if Appeals sides with the taxpayer. Going to Appeals does not extend the two-year time limit unless a Form 907 is signed by both the IRS and the taxpayer. Filing a lawsuit can be costly, so taxpayers should carefully consider whether the disallowance is justified. Taxpayers should evaluate whether they have compelling reasons to claim the ERC that warrant further review.

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The IRS's notices of claim disallowance caused confusion among many taxpayers. Some notices lacked clear explanations of the reasons for disallowance, and language explaining taxpayer rights was omitted. The IRS stated that over 90% of notices were "validly issued," but this does not mean they were error-free. Errors in the notices have led to further uncertainty, even if the notices were deemed valid by the IRS. The IRS acknowledged in their August 8, 2024, news release that some notices omitted important language about filing an appeal. The IRS is taking steps to send corrected information to all affected taxpayers. Taxpayers still have the right to appeal, even if the notice did not clearly state this.

Taxpayers have reported receiving incorrect explanations for the disallowance of their ERC claims, raising concerns about the IRS's risk-scoring filters. These incorrect explanations put taxpayers in a difficult position when responding to the disallowance. Taxpayers are unsure whether to provide documentation addressing only the perceived errors or to submit broader support for the ERC claim. The IRS has provided limited information about the process for reviewing responses and forwarding cases to Appeals. The IRS plans to send letters acknowledging notice errors, reiterating appeal rights, and correcting disallowance explanations.

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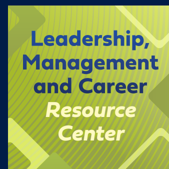

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