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CPE NETWORK
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Topics for future editions may include:

- Taxation of High-Income Individuals
- Changing Tax Risks

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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

Taxation is the most dynamic area of accounting. It changes daily with decisions from the various courts, issuances from the IRS, and sometimes Congressional legislation. While not all changes affect all practitioners or their clients, it is important to have an awareness of the changes that occur. This segment highlights many of the recent changes and issues, whether involving Congress, the IRS, and/or the Courts in recent weeks.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze current issues in taxation, including analyzing the employee retention credit mills, applying the self-correction detailed in Rev. Proc. 2022-19, and assessing the impact of a deficit restoration obligation or a qualified income offset. [*Running time 32:59*]

PART 2. INDIVIDUAL TAXATION

The Inflation Reduction Act of 2022 (IRA) provided many climate-friendly tax incentives. Among those incentives are tax credits for clean energy vehicles, charging stations, and clean energy commercial vehicles. These will affect many of our clients; and practitioners should be aware of the complexity of the rules.

Learning Objectives: Upon completion of this segment, the user should be able to analyze issues related to tax credits in the IRA related to vehicles, including assessing the availability of vehicle tax credits available to taxpayers, determining the qualifications necessary for the various credits, and analyzing the limitations and/or tax planning potential when applying the credits. [*Running time 30:40*]

PART 3. BUSINESS TAXATION

Partnership taxation is one of the most difficult areas of taxation, but under many circumstances, provides benefits that are not available to other types of entities. For tax purposes, partnerships may be treated for some purposes as an aggregate of its owners or, in some situations, as an entity unto itself. This can have significant impact on incoming partners as well as when distributions are made. An election under IRC §754 allows adjustments to basis to be made under IRC §734(b) and IRC §743(b). The election must be in a written statement, and it remains in effect until revoked under §1.754-1(c). The IRS is not very liberal at revoking this election. Triggered by transfer of partnership interest by sale or death, the §743(b) adjustment adjusts the basis of assets for the incoming partner only. This can be either an increase or a decrease.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze issues related to §754 partnership adjustments, including assessing whether an election should be made, determining how and when to make an election, and applying the rules for adjustments on transfers and distributions. [*Running time 33:46*]

ABOUT THE SPEAKERS

Ian J. Redpath, JD, LLM, is a nationally recognized tax attorney and consultant from Buffalo, New York and is a principal in the Redpath Law Offices. Mr. Redpath has published numerous articles on contemporary tax issues and co-authored several books on tax topics. He has extensive national and international experience in developing, writing, and presenting professional CPE programs. In addition to his active tax practice, he serves as Chairman of the Department of Accounting and Director of Graduate Accounting Programs as well as Professor of Taxation and Forensic Accounting at Canisius College in Buffalo.

Lawrence Pon is a Certified Public Accountant, Personal Financial Specialist, Certified Financial Planner, Enrolled Agent, United States Tax Court Practitioner, and Accredited Estate Planner in Redwood Shores, California. Mr. Pon has been in practice since 1986 and enjoys helping his clients reach their financial goals. He frequently speaks nationally on tax and financial planning topics to tax professionals, financial advisors, and the general public. Mr. Pon received his BS in Business Administration with emphasis in Accounting and Finance from the University of California, Berkeley and an MS in Taxation from Golden Gate University in San Francisco.

Robert C. Lickwar, CPA is a tax partner with the accounting firm of UHY LLP in Farmington, Connecticut. Mr. Lickwar has more than 30 years' experience in public practice and has worked exclusively with privately held businesses and owners to provide compliance services and sophisticated tax planning strategies, including like-kind exchanges, tax-efficient workouts and restructurings, reorganizations, and estate planning services. He is also a nationally recognized presenter on many federal, state, and local tax issues.

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Instructional delivery method	Group Live
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Program Level	Update
Prerequisites (Circle One)	• Basic Accounting and Auditing professional experience
	• Basic Tax professional experience
	• Basic Governmental professional experience
Advance preparation	None required
Course registration and, where applicable, attendance requirements (1)	

(1) Insert instructions for your students to register for the class and any other attendance requirements (e.g., bring your laptop, be prepared to work in groups, you will be required to sign in and sign out of the session, etc.)

PART 1. CURRENT DEVELOPMENTS

Experts' Forum

Experts' Forum is a popular feature in which we review recent developments in taxation. This month, we begin with a discussion about the change in reporting requirements for Form 1099-K, Payment Card and Third-Party Network Transactions.

Let's join Ian.

A. IR-2022-89

Form 1099-K Reporting

Mr. Redpath

Hi, I'm Ian Redpath. Welcome to the program. This is the segment where we go over a number of issues, things that have happened within the IRS, announcements, things that will affect our practice, including some court cases. And we have a couple of interesting things, a revenue procedure and a court case in pass-through entities that really could affect a lot of our clientele.

So, let's just jump right in. And we start off with IR-2022-89. And in IR-2022-89, this is, it's not new, but it will be new for the 2022 tax year. The IRS previously had announced that they are changing the threshold for reporting payments on transactions using the 1099-K. And this is a huge change. So, *Payment Card and Third-Party Network Transactions*. Beginning this year, the 2022 tax year, the reporting is going to be the threshold, sales of goods and services, it's been reduced to $600, $600. The former reporting, you had to have 200 transactions and $20,000 in aggregate. But this is reduced. There's no longer an aggregate number of 200 transactions. And [$20,000] down to $600. So, it's basically exactly the same.

So, the ARPA changed the reporting threshold; it didn't change the way the income is taxed. So, if it's not taxable income, so for example, money received through a third-party payment like a PayPal, those could be gifts, could be reimbursement for expenses. Those are common things. People go out and, "Oh, I'll send you the money for my share of the meal." Or someone makes a gift. Well, they're still going to be gifts, but there's still some issues related to those in that business were going, "Well, wait a second, what exactly do we have to report? We don't know what it is." So, keep in mind that there could be some issues relative to these 1099-Ks that your clients might get in [2023] for the 2022 tax year.

B. IR-2022-189

Employee Retention Credit Mills

There's an interesting situation going on right now. Many of you have heard ads in the newspaper or you've had clients call you and going, "What is this? I can get up to $26,000 an employee and I want to know what's going on." The IRS refers to these as ERC, employment retention credit mills. There are, perhaps. I don't know. So, I'm not making a condemnation of anyone out there doing that. But the IRS is saying, "Watch out because there's a lot of these so-called mills." They kind of refer to those in the same type of breath as they talk about the offer in compromise mills. And we've all heard about that, right?

What the IRS has found is that there is a large number of organizations out there that have fraud schemes and that they are trying to get people in to claim the ERC. One of the problems is that you also have an issue with the income tax return because if you take the ERC, then you have to adjust the wages for the year. And of course, that's not always being done by these organizations. So, the IRS says that a lot of these providers are deliberately overstating the business claims. I heard one, "Oh, we've collected whatever, millions and millions of dollars for our clients." I heard that on radio the other day. And they charge costly

upfront fees, or they collect upfront contingency fees on the amount that they claim the person's going to get as a refund. And they may or may not get back that amount. So, they're saying, "Okay, this is how much we're going to save you. We're going to send this in, and you may not get it. It may be more than you were entitled to. You might not even qualify." But they've gotten this large contingency fee upfront based on that.

So, on October 19th, the IRS warned taxpayers about it. And in a previous program I mentioned this, that it's something that you should mention to your clients because they're going to hear that and they're not going to understand it. But it's also kind of a warning that something that we should look at and go back and see. Did we miss it? There were so many changes in that ERC that perhaps, yes, we did miss something for a client. So, it is certainly something worth looking at. But remember, there's also the income tax that has to be adjusted. So, a client might come in and say, "I got this big refund. I used this organization. You didn't even know about it."

Well, the income tax return may have to be an amended return filed. They didn't know about that. That wasn't part of the deal. And of course, what did they claim? You certainly want to review that. If there's an issue, the IRS says that you can report ERC mill activity using Form 3949-A. That is the information referral. And the AICPA has said that this is great. They are actively encouraging that because they believe that this is not going to reflect well on the profession. And so, the IRS has set this up to make a claim if you think there's something suspicious going on.

C. *Bittner v. United States*

Supreme Court Dkt. #21-1195

In a past program, we talked about the Bittner case. The Bittner case has now been appealed. And I mentioned it when we discussed it that this has got to go to the Supreme Court. Well, it's in the Supreme Court. And the Supreme Court in Bittner, B-I-T-T-N-E-R. The Supreme Court, this was an appeal. And what they're hearing is the issue of an FBAR penalty. So, the problem here is that the… penalty rather that applies if the value exceeds $10,000 and you have to file an FBAR, there's a split in the circuits.

Now, the Supreme Court decided to step in. [The government in] Bittner held that the $10,000 penalty for nonwillful failure to file applied to each account, and his added up to millions of dollars. Rather than in the Ninth Circuit. The Ninth Circuit said it's per FBAR. So, that one FBAR could have different accounts on it. There's one penalty. But the Fifth Circuit said, "No, no, no, it is a penalty per account that you have," making a significant penalty in the Bittner case. Oral arguments were held at the beginning of November before the Supreme Court. And the Supreme Court was rigorously questioning. The justices questioned the government on their case and the statute. And there seemed to be a lot of disagreement with the government's position. So, we'll wait and see what they finally come out with, but kind of an interesting approach.

D. Revenue Procedure 2022-19

And then we have a revenue procedure, Revenue Procedure 2022-19. If you have an S corp and there's a potential issue going on such as you had an LLC and you have for that LLC, you converted it to an S corp. Or you had a partnership that you converted to the S corp. Or the documents that were created, the bylaws were not artfully drafted by someone who is knowledgeable in the tax law. You as accountants should not be drafting these things, that's practicing law without a license. But you certainly should look at them to say, "Is there anything in here that we should be aware of or that we should pay close attention to?"

Well, one of the problems is the IRS has finally gotten to the point of saying, "We are so tired of getting requests for a letter ruling on an inadvertent termination." They've been very, very liberal on inadvertent terminations, very liberal, but kind of tired. They're constantly getting these requests for little things. And the IRS then has come out with this notice, which is great, great if you're in that type of situation. And they said essentially, you can get retroactive corrective relief without asking for a private letter ruling. And this could be for such things as a QSub. There's an issue with your QSub. There's an issue in

your governing documents. Or you may have made a distribution that could be arguably a disproportionate distribution, which could be a second class of stock. So, what they have done—and this can apply to an S election or a QSub election—is they said, "Okay, in certain circumstances we are going to allow this retroactive relief."

So again, they issue an election, a defective election to be an S corp or a qualified Subchapter S subsidiary, a QSub. And they list a series of different types of things that would be a termination event but can be used with this particular Rev. Proc. And essentially, they set up a series of criteria. The corporation has or had one or more non-identical governing provisions. In other words, does not comply with the S rules. Maybe you never changed your operating agreement from your LLC and you kind of adopted that as your bylaws, and your operating agreement now provides that you could have special allocations. Well, that's a second class of stock by definition, just by being in your governing instrument because your governing instrument provides for that. So, you have or had one or more. You have not made, and for federal income taxes, you are not deemed to have made, a disproportionate distribution to an applicable shareholder. And you filed all your returns as if you were an S corporation. So, you never made a distribution that would be disproportionate. You filed all of your returns as if you were an S corp, not recognizing the termination of that; in fact, you may have been terminated before you filed for your S election because your document provided for a second class of stock. And the IRS hasn't caught you yet.

Once the IRS catches you, this doesn't apply. So normally, disproportionate distributions generally don't constitute a second class of stock as long as the governing provisions don't provide for it. And also, the IRS has generally said, "You know what? If you made it—" And it's not unusual. At the end of the year, clients come in. And if your clients are anything like mine, you go, "What did you do?" They don't call me ahead of time and say, "Hey, do you think we should?" You find something and go, "What did you do?" "Oh, you know Jane, my fellow shareholder, Jane, she needed some extra money. Her kid's going to college, so she took out a little more this year." Well, that could be a second class of stock.

Well, normally the IRS has said, "Once you've discovered it, if you take reasonable steps to reverse it, to equalize the distributions, you're okay." So, in this particular case, the IRS says in the Rev. Proc essentially that just because you made a disproportionate distribution, if your instruments don't provide for it, it's not going to be a termination event.

Now, it is not going to eliminate the idea of you were doing it to circumvent the one class of stock rules. If this was not inadvertent, if it's something you've been doing intentionally to circumvent the one class of stock, then it's a termination event. But that's kind of an inadvertent thing. Yes, you knew you were doing it, but they didn't understand. So again, that still is not going to be a disqualifying event if your documents do not provide for that. So, what the revenue procedure essentially does is allows you, on behalf of your client, to essentially change it, change the documents, bring them into compliance. Of course, you're going to bring an attorney in to change those documents, bring them into compliance. And then as long as you haven't had any disproportionate distributions, as long as you have always treated yourself as an S corporation and filed the right 1120-S, all you have to do is prepare and keep in the permanent file—there is a corporate statement, and then there's a shareholder statement. Both of them have to be prepared. And essentially, they're prepared pursuant to Rev. Proc 2022-19, kept in the permanent file if it's ever questioned, filed under penalties of perjury. You have to sign them under penalties of perjury, and you have your relief. You don't have to ask for a private letter ruling.

Now, the IRS will never give you a ruling, an advanced ruling on that whole issue of whether or not it was an intent to circumvent the rules. But essentially, they're eliminating a lot of these things that they get. If in fact, following the same thing, for example, if there is an administrative letter is missing, well, the IRS says, "You can contact us to get a copy." But if there are any inadvertent errors and omissions. So, for example, you had a 2553 that the proper consents weren't signed, it wasn't properly executed. Again, you don't have to ask for a private letter ruling for relief. You can use this Rev. Proc to get relief. And the relief is retroactive. So yes, you had this in your document, it's retroactive. Yes, you didn't have the proper consent, it's retroactive as if you had. So, it's really important.

And this retroactive relief statements, there's a corporate governing provision statement and there's a shareholder statement. The nice thing, what do you put in there? Attached as an appendix to this Rev. Proc. are copies of the IRS statements. So, it gives you exactly the statement. It also lists in section four, it lists a

number of things the IRS will not give you. Any advanced letter ruling, they will not give you. They will not take a position on it and give you an advanced ruling. And so again, appendix A is a sample corporate governance provision. That's the statement filed prepared pursuant to the Rev. Proc. And then they have the shareholder statement that can be attached. And the shareholder statement is appendix B.

So, this is really important to look at on our S corps, especially to make sure that there are no errors. I always recommend that as accountants look at the governing instruments, our partnership agreements, our LLC operating agreements, look for things that shouldn't be there. For example, you have an LLC. If in the document, it provides for an unlimited deficit makeup, get it out of there. Because essentially, you're going to allow a back-dooring of liabilities because you're going to have to restore the deficit of your capital account. What do you want? You want a QIO, qualified income offset. You never have an unlimited deficit restoration. Now again, you have to have that to have a special allocation. But use the substitute, the QIO, because that unlimited deficit restoration, that's going to bring it back in.

I had a case down in Florida that I was handling, and the trustee made that exact claim, and the LLC members came in and said, "Oh, we don't owe anything because we're an LLC. And we didn't sign any personal guarantees." They were in bankruptcy by the way. And the trustee's position was, "Wait a second, you're right, you don't owe the creditors, but your operating agreement is basically a contract. It says you have an obligation to restore the negatives in your capital account. You restore that, I'm going to use that to pay creditors. So no, you don't owe the creditors, but you owe the LLC under your unlimited deficit restoration." So, watch out for things like that.

Well, here's another thing, if you have an S corp, do you have anything in there that could be interpreted as being a second class of stock, for example? Did they just simply take the operating agreement of an LLC and make it the bylaws essentially of the S corp? Are all the S corp elections, were they correct? Did they have the correct signatures? If you get a new client, you're going to want to have copies of these to know. It's really important now that we have this retroactive relief to know that.

E. *Clark Raymond & Company PLLC, et al. v. Commissioner*

TC Memo 2022-105

So now, in the partnership area, really interesting case, Clark Raymond and Company, PLLC accountants versus the Commissioner. It's a tax court case. Really interesting case involving the partners who were withdrawing from an accounting firm. The partners consisted of professional liability companies, professional services corporations, and professional limited liability companies. So, they were all limited liability entities that were the members of this PLLC, which was an accounting firm. The partners, they negotiated a buyout of a partner or partners. And the partnership agreement was restated. Shortly after, two partners withdrew with certain clients that basically they took with them.

So, the IRS looked at it because the entity, the partnership, did not really look at the value of the clients as being anything. What they did, and again, the tax matter, they reported on the 1065 the value of the defecting clients to the partnership formed by the partners who withdrew and otherwise then made allocations to the withdrawn partners' capital accounts.

Well, what the IRS said was… these are property distributions. They said among other things that the reported client distributions, they can't be disregarded. That in fact, they are distributions. So, the distribution to the withdrawing partner was made. And again, because the agreed-upon distribution was made only to the withdrawing partners, only their capital accounts should have been reduced. Thus, the withdrawing partners' capital accounts go negative; and they had a qualified income offset would've been triggered then to pick up income. We just talked about a QIO, right? That they had a QIO, and that triggered income then to bring their capital accounts back up to zero.

So, this is a really good case because it goes into what are special allocations and how do you handle intangible assets. So, they said this client-based intangible asset, they said customer list, a book of business is an example of an intangible asset; it has to be valued on the distribution. They also looked at goodwill and said the goodwill of the public accounting firm can, again, that's an intangible that attracts new

clients. It induces existing clients to stay with the firm. And it can include firm name, general or specific location, client files and workpapers, correspondence, tax returns, a reputation for general or specialized services, ongoing working relationships between the firm's personnel and clients, the services you provided by the firm. And again, it's things like client list, client files; these all are intangibles that have value. And again, the value, there's a value there. Even if the client is not contractually bound to keep bringing his business, just the goodwill of an ongoing client, even though they may not be obligated.

They then went into, "Okay, what is a special allocation?" Because you're specially allocating things to these partners. And it said it provides that the partnership agreement, you have to have the big three to have economic effect. And the big three, you have to maintain your capital accounts in accordance with 704-B. Only those with positives in their capital account get a distribution on liquidation and an unlimited deficit restoration.

Or in the alternative, a QIO. Here's the problem. They did not maintain their capital accounts under 704(b). And you might say, "Well, wait a second, I know that we now maintain our capital accounts and we report the capital account on the K-1 on a tax basis." Absolutely correct. The IRS requires the K-1 to be on a tax basis, but that's an AI issue. That issue is there so they can look at the liabilities you have, they're going to look at the capital account on a tax basis, and then they're going to look at your distributions. And they're going to be able to say, "Hey wait, did you have enough basis to cover those distributions?" That was put in for other reasons.

But 704(b), and this has become misunderstood; it didn't eliminate the need for 704(b). But to have that, you've got to be keeping that on a spreadsheet. You're keeping that off the book itself. Your tax basis for the K-1 off the return, though, you're doing your 704(b). Because when you test allocations for economic effect, how does it affect the capital account? But that's your 704(b) capital account, not that tax-basis capital account.

Any time partnership tax refers to the term book, it doesn't mean how you keep your books and records. Book means your 704(b) book. That's a fair market value account. And so, they weren't keeping their accounts, they didn't maintain a 704(b) capital account. A lot of detail in here on the proper maintenance of the capital account records.

Also, in valuing these intangibles and in applying the substantial economic allocations and what is called the economic equivalent test. In other words, all of these things, very interesting case, talks about the QIO and how that operates. So, I'll leave it to your reading, but it's an outstanding case in going over all of these things. The key issue here is you can't, just because they say on the K-1 keeping it on a tax basis, that doesn't mean that's all you have to do. If you're going to do special allocations, you've got to keep a separate one. If you have a minimum gain chargeback, that's based upon your 704(b) book capital account. The constructive liquidation scenario for recourse debts based upon your capital account under 704(b). So, keep that in mind. They didn't eliminate that. And that's kind of a misunderstanding. What you're reporting there and what you're doing these other things on did not eliminate the need for 704(b).

F. IRS Criminal Investigation FY 2022 Annual Report

We have an interesting [issue]. The IRS has come out—and I highlight this, so it's always good for clients who may be trying to work the edges here. The criminal investigation division of the IRS, in their 2022 annual report, they're responsible for tax fraud, narcotics trafficking, money laundering, public corruption, healthcare fraud, identity theft. But they're primarily with the IRS and reviewing. But the interesting thing here is if a client, if there's a tax case involving criminal investigation, they should know right away.

Now, first thing you should do is make sure they know to hire an attorney. Don't talk to you, hire an attorney. If it's criminal, you don't have any privileged communication. Now, for the fiscal year, they said they spent about 70% of their time on tax fraud cases. They collected—or they identified, I should say—about $31 billion from tax and financial crimes. They seized $7 billion in assets. And here's an important one. They had a 90.6% conviction rate on all prosecuted cases, 90.6%. So, that's quite successful in collection.

So, I want to thank you for joining me today. We had a lot of interesting cases. The Rev. Proc with S corps—I really think you should read it if you have S corp clients. And remember—not during tax season because

you don't have time—but otherwise, you should look over their operating documents, make sure they are in compliance, and understand you may have an easier way out now. And for partnerships that may be looking at any type of special allocation, or partners are leaving and you have intangible assets, the Clark Raymond case is something that's really worth looking at. It's an outstanding case that goes over. Really, the court did a great job in detailing 704(b), detailing special allocations, QIO. So, it's just a really good kind of study of that. So, I want to thank you again for joining me. Please be safe, and we'll see you next month.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. IR-2022-189

Form 1099-K Reporting

This client update reminds practitioners of the new lower threshold for reporting transactions on Form 1099-K, *Payment Card and Third-Party Network Transactions*. Beginning in 2022, the reporting threshold for sales of goods or services was reduced to $600. This can include only one transaction if the threshold is met. This will have an impact on service providers, those in the gig economy, and more.

The American Rescue Plan Act of 2021 (ARPA) lowered the reporting threshold for third-party networks that process payments for those doing business. Before 2022, the reporting was required only for third-party payment network transactions if the total number of transactions exceeded 200 for the year and the transactions' aggregate amount exceeded $20,000. Beginning in 2022, a single transaction over $600 can trigger reporting on a Form 1099-K.

It should be noted that the ARPA only changed the reporting threshold for Form 1099-K and did not change the characterization of the income. Money received through third-party payment applications from friends and relatives as personal gifts or reimbursements for personal expenses is still not taxable income.

The IRS reminds taxpayers who receive business payments through third-party payment networks to make estimated tax payments for that income and to consider the impact of self-employment taxes. In addition, individuals who are employees or pensioners may need to make estimated tax payments if the amount withheld from their income is not enough to cover their tax liability, or if they receive other types of income, such as interest, dividends, alimony, self-employment or gig income, capital gains, prizes, or awards.

B. IR-2022-183

Employee Retention Credit Mills

In a release, the Internal Revenue Service warned employers to be wary of third parties who are advising them to claim the Employee Retention Credit (ERC) when they may not qualify. Some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit. These third parties often charge large upfront fees or a fee that is contingent on the amount of the refund and may not inform taxpayers that wage deductions claimed on the business's federal income tax return must be reduced by the amount of the credit.

If the business filed an income tax return deducting qualified wages before it filed an employment tax return claiming the credit, the business should file an amended income tax return to correct any overstated wage deduction.

The IRS encourages businesses to be cautious of advertised schemes and direct solicitations promising tax savings that are too good to be true. Taxpayers are always responsible for the information reported on their tax returns. Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties and interest. These third parties are often referred to as “ERC mills.” Some providers deliberately overstate businesses' ERC claims and collect costly upfront contingency fees. The taxpayer may be entitled to a significantly smaller ERC or may not qualify at all, though the vendor omits this information. The IRS will allow anonymous reporting of perceived inappropriate ERC activity by using Form 3949-A. In general, CPAs have applauded the IRS’s decision to allow anonymous reporting of potential employee retention credit (ERC) fraud schemes by third-party vendors.

In an October 24th statement, Barry Melancon, President and CEO of the AICPA, noted: "For more than a year, the AICPA has communicated its concerns to the IRS and the Department of the Treasury

regarding the unscrupulous business practices of ERC mills, and we are encouraged by this acknowledgement by the IRS of these questionable business practices around the ERC."

Although the ERC expired for over a year, it has a three-year lookback period to file an amended Form 941X to claim the credit. Given the multiple changes to the ERC and confusion over eligibility, ERC mills have been able to capitalize on the uncertainty.

The IRS noted that if the ERC is taken, there must be a reduction in wages on the return for the year. If the business had previously filed a business tax return deducting qualified wages, that might also require filing an amended business return in addition to the amended Form 941.

1. The ERC has been a great benefit to many businesses that struggled during the pandemic. However, there are some bad actors that are taking advantage of the situation. These "mills" are similar to the so-called offer-in-compromise mills that regularly appear on the IRS "Dirty Dozen" list of tax fraud schemes.

C. *Bittner v. United States*

Supreme Court Dkt. #21-1195

On November 2, 2022, the Supreme Court heard oral arguments in Alexandru Bittner's appeal of his nonwillful FBAR penalty. Reports are that the justices seemed skeptical of the government's argument that the penalty for a nonwillful violation should apply per account rather than per FBAR. Under the Bank Secrecy Act (31 USC §5314), every U.S. person with a financial interest in, or signature or other authority over, one or more foreign financial accounts with an aggregate value of more than $10,000 must annually report the account to the Treasury Department (reportable account). U.S. persons comply with this section by filing a Report of Foreign Bank and Financial Accounts (also known as an FBAR). A U.S. person can use one FBAR to report multiple reportable accounts. Failure to report a reportable account on an FBAR may be subject to a penalty. The amount of the penalty depends on whether the failure was willful or nonwillful. The maximum penalty for a nonwillful violation of the reporting requirements is $10,000 (adjusted for inflation for violations after 2015). The failure to comply with section 5314 will not result in a penalty if the person's failure was due to "reasonable cause."

The Supreme Court agreed to hear Bittner's appeal after the Fifth Circuit held that the $10,000 penalty for nonwillful failure to file an FBAR applied to each account that should have been reported on an FBAR. The Fifth Circuit's decision conflicted with that of the Ninth Circuit, creating a circuit split.

D. Rev. Proc. 2022-19

The IRS issued this Revenue Procedure to provide S corporations and their shareholder-taxpayers with a method of self-correction of certain termination events and flaws in elections and documents, especially the one class of stock rules. With the growth of LLCs being taxed as S corporations, many found the operating agreement allowed for what could be interpreted as a second class of stock. The revenue procedure will reduce the need for costly letter rules for inadvertent termination relief. It contains both a corporate and shareholder correction statement that must be completed and signed under penalties of perjury and maintained in the permanent files in case of a future audit.

The issues addressed are those that the IRS historically has identified as not affecting the validity or continuation of a corporation's election as an S corporation (S election) or treating its subsidiary as a qualified Subchapter S subsidiary (QSub). It also provides taxpayers with a list of non-ruling areas.

The revenue procedure provides a description of certain situations in which taxpayers may retroactively validate or preserve an S election that was invalidated or terminated solely as the result of one or more "non-identical governing provisions" that result in a violation of the one class of stock rules under Reg. §1.1361-1(l)(1). It should be remembered that the rules refer to

the "governing instruments" and do not require an actual non-pro rata current or liquidating distribution.

Generally, an S corporation is eligible for retroactive corrective relief under the revenue procedure if all of the following requirements are met:

- The corporation has (or had) one or more non-identical governing provisions
- The corporation has not made, and for federal income tax purposes is not deemed to have made, a disproportionate distribution to an applicable shareholder. For purposes of the revenue procedure, "disproportionate distribution" is defined as any distribution (including an actual distribution, a constructive distribution, or a deemed distribution) of property by a corporation with respect to shares of its stock that differs in timing or amount from the distribution with respect to any other shares of its stock.
- The corporation timely filed a return on Form 1120-S for each taxable year of the corporation beginning with the taxable year in which the first non-identical governing provision was adopted and through the taxable year immediately preceding the taxable year in which the corporation made a request for corrective relief under the revenue procedure (a corporation is treated as having timely filed a required Form 1120-S for purposes of the revenue procedure if the Form 1120-S is filed within six months after its original due date, excluding extensions); and
- Before any non-identical governing provision is discovered by the IRS, all of the requirements described in the revenue procedure are satisfied.

If a corporation satisfies the requirements for relief under this provision, the IRS generally will not issue a PLR relating to the validity of the corporation's S election.

It also identifies the following issues for which a PLR will not be available or will not ordinarily be issued either because IRS does not believe there is an existing concern with the validity of the entity's S or QSub election or because there are other avenues to address the matter outside of the PLR process:

- Rulings that require a determination of the existence of a principal purpose is to circumvent the one class of stock requirement or the limitation on eligible shareholders.
- Rulings regarding the termination of S corporation status because of a disproportionate distribution made by a corporation so long as the governing provisions of the corporation provide for identical distribution and liquidation rights.
- Rulings as to whether a missing administrative letter relating to the IRS's acceptance of an election affect the validity of that election.
- Rulings relating to the validity or continuation of an S corporation election when the corporation has filed a federal income tax return that is inconsistent with the corporation's status as an S corporation or a QSub.
- Rulings regarding the validation of an S election (or QSub election) solely because of certain errors or omissions on the election form.

In regard to errors or omissions on election forms, the revenue procedure generally allows for self-correction of these oversights.

Practitioners should review the revenue procedure and the S corporation instruments, especially in the case of an LLC that converted to a corporation and elected S or simply elected to be a corporation for tax purposes and elected S status. In addition, if a QSub election was made for a former LLC, a review of those should be made. This is a very favorable revenue procedure for S corporations and practitioners.

E. *Clark Raymond & Company PLLC, et al. v. Commissioner*

TC Memo 2022-105

In a detailed opinion involving TEFRA partnership/accounting-professional services firm which treated client-based intangibles/goodwill/client lists as distributions to withdrawing partners (single-member entities) pursuant to a restated partnership agreement, the Tax Court rejected the IRS's determination to disregard them as "non-factual" and instead found that the distribution treatment was correct. They found that the partnership's method for valuing those assets comported with Reg. §1.704-

1(b)(2)(iv)(h)(1). However, considering agreement terms and surrounding facts and circumstances, including the fact that capital accounts were not maintained in accord with Reg. §704-1(b)(2). The Court further found that partnership's special income allocations to withdrawing partners lacked substantial economic effect and had to be reallocated in accord with their interests in the partnership under §704(b) and Reg. §1.704-1(b)(3). Since the withdrawing partners had negative capital accounts at the end of the applicable year and that partnership agreement included a "qualified income offset" provision, ordinary income had to be allocated first to those partners in amounts necessary to bring their respective capital accounts up to zero.

Many partnership/LLC agreements use boilerplate language for the allocation provisions. Typically, it provides that partners will maintain capital accounts and allocate profits and losses according to the ending balances of positive capital accounts. They will often have either a deficit restoration obligation (DRO) or a qualified income offset (QUI) as one of the provisions. It should be noted that an LLC should never have a DRO but use the QIO to avoid inadvertent liabilities. The language is generally to comport with §704 to allow for special allocations.

Special allocations must have "substantial economic effect" to be recognized for tax purposes. Essentially, there must be an economic effect separate from reducing tax. The impact must be substantial. Economic effect is met by the following:

1) capital accounts are maintained in accordance with §704(b) and the regulations thereunder;
2) only those with positives in their capital accounts are entitled to distributions on liquidation; and
3) either a DRO or a QUI.

If an allocation does not meet these rules, it will be reallocated in accordance with the partners' interest in the partnership.

The partnership agreement had a two-year non-compete provision for withdrawing partners. It treated any partners who withdrew and whom clients followed as receiving an in-kind distribution of an intangible asset—client goodwill—that belonged to the partnership. The value of the intangible asset reduced the partner's capital account.

The court's found that the partnership did not comply with the capital account maintenance rules of §704(b). This failure was fatal to a special allocation. This is an even greater area of confusion with the requirement to report the capital accounts on the K-1s on a tax basis. This does not mean that there is no longer the requirement for a §704(b) capital account if special allocations are made or desired. This would be on a separate spreadsheet off the return.

The Court suggested that partners who do not agree to "deficit restoration obligations" should be allocated income annually to close any deficit capital accounts. This could affect project developers who enter into tax equity partnerships and keep most of the cash, driving their capital accounts negative.

The partnership cannot allow a partner's capital account to go negative unless the partner has agreed to contribute more capital, when the partnership liquidates, to close any capital account deficit or a "deficit restoration obligation" or "DRO." In cases where a partner does not agree to a DRO, then the partnership cannot continue allocating that partner tax losses once its capital account hits zero. Any remaining losses shift to the other partners.

The partnership agreement must also have a "qualified income offset" provision that says when a partner's capital account is driven negative by an unexpected adjustment, allocation, or distribution, the partner must be allocated income as quickly as possible to eliminate the deficit.

The partnership agreement had standard language requiring maintenance of capital accounts for the partners. The partners did not agree to DROs. The agreement had a QIO provision that said if a partnership capital account was driven negative, the partnership would allocate income to the partner as quickly as possible to eliminate the deficit.

The federal income tax return that the remaining partner filed for the partnership showed the two withdrawing partners as having been distributed $742,569 in intangible assets attributable to clients who followed them to their new firm. This pushed their capital accounts negative. Therefore, the tax return allocated partnership income to close the deficits. The two withdrawing partners ended up being allocated larger shares of the income than they expected. Each of them filed a Form 8082 with the IRS.

The Court said the qualified income offset provision that required partners who did not agree to DROs to be allocated income to close any capital account deficits was key. However, it said the partnership should have first allocated among the three partners the amount that the intangible client goodwill had appreciated in value, thus pushing up their capital accounts. The partnership had a zero tax basis in it. The gain inherent in the intangible client goodwill should have been allocated under the partnership agreement in the same ratio used for other income as if it had been realized before applying the qualified income offset provision to redirect enough income to partners with deficit capital accounts to close the deficits for the year.

F. IRS Criminal Investigation FY 2022 Annual Report

The Criminal Investigation's annual report details the agency's work in fiscal year (FY) 2022. The report noted that in FY 2022, Criminal Investigation special agents spent about 70% of their time investigating tax-related crimes like tax evasion and tax fraud, and nearly 30% of their time was spent investigating money laundering and drug trafficking cases. During their investigations, special agents identified over $31 billion from tax and financial crimes and seized assets valued at approximately $7 billion. IRS's Criminal Investigation Division had a 90.6% conviction rate on prosecuted cases.

A. Discussion Problems

Your client, Sydney, called to inform you that she was contacted by a company that filed amended Form 941s and got her a refund of $260,000 based on the employee retention credit (ERC). They charged her a percentage of what she was expected to receive. In preparing her tax returns, you had determined her business was not eligible for the ERC.

In reviewing 2022 tax information for your client, PRP LLC, which is taxed as an S corporation, you find some problematic provisions in the LLC operating agreement that allow for "special allocations." No such allocations have ever been made.

In reviewing the tax information for SJV Partnership, you have found that they have made special allocations. The capital accounts are maintained on a tax basis. Based on certain transactions in the past, three of the five partners have negatives in their capital accounts and have had them for several years. They do not have a DRO in their partnership agreement.

Required:

1) What advice do you have for Sydney?

2) Discuss the options available for the PRP LLC to retain their S status.

3) Discuss the implication of not maintaining a §704(b) capital account and also the issue of negative capital accounts.

B. Suggested Answers to Discussion Problems

1) Sydney appears to have been contacted by what is known as an ERC mill. If you are confident in your analysis, Sydney will need to return the funds and the Form 941Xs must be amended back to the original amounts. If you believe that Sydney's business actually qualified for the ERC, you will need to amend the business returns to reduce the wage deduction for the credit. If the ERC was incorrectly claimed, you may consider reporting the ERC mill anonymously.

2) This appears to be the situation contemplated by the self-correction provisions of Rev. Proc. 2022-19. The provisions should be removed, and the appropriate corporation certification prepared and signed under penalties of perjury. Care should be taken to make sure all of the requirements are met.

3) To have special allocations, you must comply with the capital account maintenance rules of §704(b). Tax basis capital accounts are for the K-1 reporting. Absent a DRO, then the partners with deficits in their capital accounts should have been allocated income to restore the deficits and bring the accounts back to zero. Even with correct capital accounts, they will need to make those allocations before any other allocations are made.

PART 2. INDIVIDUAL TAXATION

Electric Vehicle Tax Credits

The Inflation Adjustment Act was signed into law in August 2022. One of the bill's main goals is to address climate change and slow down global warming. It includes incentives such as tax breaks for ordinary Americans to install new energy-efficient home improvements or to purchase electric vehicles. Ian Redpath and Larry Pon discuss some of the electric vehicle tax credits available and their effective dates.

Let's join Ian Redpath and Larry Pon as they discuss issues related to electric vehicle tax incentives.

Mr. Redpath

Larry, welcome to the program.

Mr. Pon

Hi, Ian.

Mr. Redpath

It's great to have you. Great to get your insight. The Inflation Reduction Act, it did a lot of things. Kind of a cut-down version of the Build Back Better. I'm not sure from what all the economists are saying how much inflation reduction we're going to have, but we certainly have a lot of other provisions in it that relate to the climate. You and I spoke in a program on the homes and the effect it will have on the climate and energy efficient homes. Vehicles, obviously there's some major changes. I know you're out in California, your state has some major legislation dealing with electric vehicles coming up. So, it's really a very timely topic. So, let's start with, because you're kind of in the forefront of electric vehicles out there in California. What's going on out there?

Mr. Pon

California leads the nation in the number of electric cars, and I see a lot of electric cars or electric hybrids and hybrid cars here in California; and that's been going on for many, many years. And there's legislation that the state has passed that you cannot buy a gas-powered car after 2030. So, that's going to change.

Mr. Redpath

Yes, that's not that far away. Now, is that going to include used cars or just new cars?

Mr. Pon

It just means they're not going to sell gas-powered cars after 2030. So, we'll see what happens when the law actually gets implemented at that point.

Mr. Redpath

Wow. That's definitely what we would call major legislation when it comes to that. So, we've had some incentives. There's been some limitations on them. We've had some incentives for people to buy electric vehicles, and some incentives obviously on manufacturers to build them. So, we have this electric vehicle and there's kind of new and used cars are into this. So, exactly where is the Inflation Reduction Act? What does it do as far as this is concerned?

Mr. Pon

It modifies the existing rules. And also, last year when the Build Back Better Act was being debated, there were some provisions affecting electric vehicles. So, there's been some substantial changes since the Build Back Better Act and some updates too, with the Inflation Reduction Act. So, most importantly, President Biden signed the law on August 16th, 2022. Why is that such an important date? That's when these new electric vehicle rules go into effect. If you bought the car after August 16th, or before August 16th. So, if you purchased a car before August 16th, you're subject to the old rules. Well, what are the old rules?

Well, the maximum credit could be up to $7,500. However, you're subject to a 200,000 vehicle limit for each manufacturer. So, to check to see if you do get a credit in your car, you go to the IRS website, type in electric vehicles, and there's a list of eligible vehicles; and it gives you an idea what the numbers are that you can plug into your tax return.

Mr. Redpath

So, it's very possible that you could buy an electric vehicle that doesn't qualify for any credit if the manufacturer already met their 200,000 cap.

Mr. Pon

And those include mostly Tesla, General Motors, and Toyota. So, those are the three manufacturers that come to mind the most. But check the website. So, if you purchased your car, and you might not have gotten it yet because of our supply chain issues. So, there's something called a binding contract rule we've got to look at. I know many people have bought their cars way back in May or even March, and they still haven't got them yet. So, since you bought them before August 16th, you'll still fall under the old rules and get the credit under the old rules, even though you might not get the car until November or later in the year. So, there's a huge backlog on these vehicles. So, that's the first consideration.

Mr. Redpath

There's kind of three things here that you have to look at, and there's also kind of an internal, a battery, different battery component, and there's multiple parts of this credit now. So, one of the things is assembled, and the other one is the battery, the minerals, what is being used in making the battery. What does that assembly rule mean?

Mr. Pon

Effective August 16th of 2022, the vehicle must be assembled in North America. Now, the Department of Energy has a webpage that you can look up which car is qualified, gives you all the details. It even has a column telling you if that manufacturer has already exceeded the 200,000 vehicle limit. Say on the batteries because you and I are not going to know about the battery content or the mineral content of a car. And I don't know anything about the kilowatt hours of the car. So, there's specific rules about that. But the handy dandy website's going to figure that out for us already.

Mr. Redpath

I don't think we're going to know that, what material, minerals that are in there. And the fact of the matter is that a lot of the batteries, for example today, as I understand it, most of the cobalt that's used comes from China.

Mr. Pon

Most of the... Yes.

Mr. Redpath

Yes. It wouldn't meet the rules. It wouldn't meet these critical minerals.

Mr. Pon

Exactly. So, the sourcing of the materials for the batteries, starting after [the proposed battery guidance date and before January 1, 2024], has got to be at least 40% from either the U.S. or a free trade country, a friendly country. And I don't think China fits into that definition of a friendly country right now.

Mr. Redpath

No. I think in fact, I think specifically China, Iran, North Korea, are all specifically not included in those countries that they will count the critical minerals. And that goes up, correct? That's an increasing number.

Mr. Pon

So, starting [after the proposed battery guidance date and before January 1, 2024], it's got to be at least 40%, and then it goes up to 80% [after] 2026. So, this gives the manufacturer some time to shift their resources and manufacture. We're hearing some news stories already of some battery manufacturers that were going to be outside of the United States; now they're relocating in the United States. And mines and a lot of permits are being applied for certain mines. I think the state of Nevada, the state of Utah has a lot of these resources. So, those applications are happening as we speak. So, we'll see; we'll stay on top of the news as this occurs.

Mr. Redpath

So, now it has to be assembled, there's a critical mineral component here. There's also, there's a cost of the vehicle and also modified adjusted gross income limitations on qualifying. So, what is that going to do?

Mr. Pon

Right. Now, this is effective, this doesn't apply in calendar year 2022. So, the MSRP and the AGI limitation does not apply in 2022. What does apply in 2022 is the North American assembly requirements. So, that applies for vehicles you buy in 2022. So, here's some tax planning we can do here. So, the MSRP limits starts in 2023. So, for cars, the MSRP is $55,000. For SUVs, trucks, and vans, that's $80,000 of MSRP. It's MSRP, not what you actually pay for the vehicle, because you might buy some extras, some accessories that get the price up there. So, you have to look at the MSRP, again, that's going to be on the Department of Transportation website. And the IRS website has links to all these. And if you have questions about where the cars are made, there's a VIN locator. So that website is

run by the Department Transportation. Type in the VIN number, that's a long string of letters and numbers and then your model year, and you get this handy dandy page that shows where your car was made.

And then there are modified adjusted gross income limitations we've got to look out for. Now, it's based upon your income for the current year or for the prior year. So, if your income for the prior year has already met these guidelines, you're okay. However, if your income's above these amounts, then you might do some tax planning for the current year, depending on how far you are from theirs, the limits. So, if you're single, the limit's under $150,000. If you're head of household, that's $225,000. And if you're married filing jointly, that's $300,000.

Mr. Redpath

The average cost of a vehicle is $69,000 in the United States. I'm having a problem here when I'm seeing a $55,000 MSRP and the average cost is $69,000.

Mr. Pon

Right. And the maximum dollar credit amount has not changed. The maximum is $7,500. However, the actual credit you get on your car is based on the actual vehicle. And there's a calculation for that. And for me, the easiest way to go is to go to the IRS website and they'll have the list of all the makes and models and the year of the car and the chart will show us what that amount is. And I had to do that for my car. I purchased a gas hybrid car, and my credit was $4,502. I would've never figured that out, but I just looked at the chart, that's why I input it on the form.

Mr. Redpath

I think one of the problems here is that when you look at these, and I understand that this is trying to get, and I know it's all your definition, but it's trying to get credits to get people, general, into vehicles. The people that are out there buying the $25,000, $30,000 vehicle, trying to get them into electric. But the people who are buying electric in many cases today are higher-income people.

Mr. Pon

Right.

Mr. Redpath

Many manufacturers, like a Tesla and the new one out in California there, Rian, I think, they're higher cost vehicles and they're aiming at a higher income market. So there seems to be little difference here in what the market is doing right now and what the government is saying they'd like the market to do. I think it's going to be interesting how the government, the market rather, reacts to this because a lot of vehicles just aren't qualifying as it stands right now. I don't know. Are they going to drop the prices dramatically, or do they come out with cheaper cars? I think that's an issue that hasn't been addressed yet. So, this sounds really good, but how many vehicles qualify for it?

Mr. Pon

Well, yes. Under the old rules, or the existing, there was no AGI limitation. So, in our client base, it's always our high-income clients who can afford to buy these $100,000 cars or $65,000 cars when most of us were shooting for a $25,000 car or something like that. But I can see what a trend could be. So right now, here's an example. In Germany, BMW, you could buy the car from BMW, right? But you want certain accessories. You don't buy the accessories, you lease them. And an example here, there's a brand-new car company there, right now I think they're only sold in California. It's actually from Vietnam of all places. And I asked them, how much does this car cost? They told me it's $41,000. I go, wow.

Well, the catch is, you buy the car for $41,000 but you don't own the battery, you lease the battery, and the price of lease depends on which battery you buy, the small one or the big one. And so, you pay a monthly amount for the battery and the catch is you don't own the battery. So, as battery technology improves or if the battery wears out, they'll just take it out and give you a new one, because you don't own the battery. So, I think we'll keep an eye on the auto market and see how these can change because I think the manufacturers might find a way of tweaking their prices. The car still can be a $100,000 car, but you might just pay $79,000 for it, but you lease the other parts of it or something like that. Most importantly, the battery.

Mr. Redpath

A lot of Teslas are like that where the car has everything on it, you just decide what options you want them to open up for you. And BMWs, you mentioned, heated seats. In the United States, you would expect if you're buying a BMW, you're going to get heated seats. All BMWs in Europe, for example, are coming out with

heated seats. The only difference is, it's a subscription. You've got to call and have them turn it on for you. And maybe that's where this is going to head, that we're going to have a base vehicle. Here's a vehicle, and we're going to charge you for all these bells and whistles if you want them. If you don't want them, well then you don't get them.

So, you said August 16th is where this, and you talked about the fact that if you had an existing binding contract before, which many people do, it's been hard to get vehicles if you're ordering out. I had a vehicle come off of lease back in March. I went in in January, and they told me that if you want a vehicle, you better order it now. Because right now, we're looking at a July delivery for that vehicle. And oh, by the way, you really don't have a choice of what you get. Whatever comes in, that's what you get. We'll just put your name on the list. So yes, it's been a serious problem. I can see where a lot of people are going to get caught up on this. So, how are you going to claim this credit?

Mr. Pon

Well, that's a good question. Currently, it'll be claimed on your tax return. You've filed the form to claim the tax; that's the current rule. But starting in 2024, you can get the credit upfront at the auto dealership. And so, basically, you're transferring the credit, and you're getting it up front. So, you actually reduce the price by $7,500. However, the risk you take is, what if you don't qualify because your AGI is too high, or the car's credit is not that high? And so, the risk is you can get $7,500 off the cost of your car; but you might have to pay it back when it comes time to filing the tax return. So, that's a risk for you to consider, because it depends on when you're buying the car. You're buying it, let's say in February, and you have a lot more year to go. You don't know what the rest of your year is going to look like. And let's say your AGI was too high the previous year, so I know we can't use the previous year exception. So, that's something to look out for. But that's something that would be coming up in 2024, because it takes a little time for the dealerships to get that infrastructure in place; because they have to provide all sorts of information to the IRS, and then you have to match it up on your tax return.

Mr. Redpath

At some point to get the credit, I think you're going to have to actually list the VIN number, correct?

Mr. Pon

Yes, list the VIN, and that's something we've been doing in the past. That's on Form 8936, and when you do the tax return. So, not only do we learn about doing tax returns, we're going to learn a lot about cars. So, my clients would give me that information. Yes, exactly. Because the make, the model, the VIN, and that all goes on the form. And that makes sense because I can understand the IRS can be concerned about people being too clever, where you buy the car, and then we share that credit among all our friends and family. Well, that's probably not going to fly.

Mr. Redpath

Right. Well, I think we've decided that a lot of our listeners, their clients are going to come in and go, "I can't afford a new electric vehicle, but I found a certified used electric vehicle out there. Because I'm afraid what happens if the battery goes, so I want to get a certified." Generally, this has been on new vehicles. What about the new law? Can we get it on a used vehicle?

Mr. Pon

Yes, this is brand new. We've never had that because we've had clients buy used electric vehicles, and they expect to get the credit. I say, "No, no, no, you don't get it on a used car." I think I had one client had four Teslas. Can you believe that? He had four Teslas, two used ones and two new ones. So anyway, he didn't get the credit on the used ones.

Mr. Redpath

Everybody should have four, at least, I think!

Mr. Pon

Exactly, exactly. Well, starting in 2023, there are new provisions for used electric vehicles. Now, there's a limit to the credits. It's not as generous as a new vehicle; it's the lesser of $4,000 or 30% of the sales price of the vehicle. However, the limit on the price of the vehicle is $25,000; the car can't cost more than $25,000.

Mr. Redpath

If you look at it, so you bought that Tesla, and it was $100,000 new. Does it matter how old it is?

Mr. Pon

I'm pretty sure you're not going to buy that for $25,000.

So, you're going to not meet that. The other requirement is that it's got to be at least a two-year old car, a two-year model car. For example, in 2023, it's got to be a 2021 model or older. So, that's another requirement. And the car has to have a gross weight of less than 14,000 pounds. The other consideration is also the modified adjusted gross income limits. Now, this is about half of what it is for new cars. If you're single, it's $75,000 or less. Head of households, $112,500 or less. And if you're married filing joint, it's $150,000 or less. And also, you have to buy this car for your own use. You can't be buying it that I'm trying to sell it later on. It's not for that purpose. How are they going to enforce that? That's a good question. It might be a checkbox on the form. We're not going to see the form until later next year because this is for 2023. So, if I were to give advice to the IRS, put a checkbox saying under penalty of perjury, I'm using this car for personal use, it's not for resale.

Now, there's more qualifications you have to be careful about here. Another one is you cannot be claimed as a dependent for the last three years. Because I can understand where this is coming from. My son, so my son's income is low, he meets the AGI limits, he needs a used car. But if he was my dependent for the last three years, he's not going to be eligible for this credit. Now, the car does not have to have final assembly in North America. There's no requirements there. And there's no battery or mineral requirements for the used cars. Those two requirements are out. But you can only get this credit every three years, every three years. And also, like I said, certified used, so you should buy it to get this credit. You can't just buy it from [anyone]; I can't buy it from you. I have to buy it from a certified dealer with the IRS; because starting in 2024, you'll be able to get this credit upfront when you buy the car, just like a new car. So, very similar rules, but pretty restrictive rules. We have to be careful if you qualify for it or not.

Mr. Redpath

I think a lot of the rules, because we've covered the new vehicle, the used vehicle, but boy, with all these limitations, and I'm starting to wonder exactly how effective is it really going to be? I don't know because I think if we applied it to the vehicles now, you'd find very few vehicles qualifying. So, how is this going to change, the average price today being $69,000 for a new vehicle, what does that mean for it? The cost of vehicles, meaning they're primarily for higher-income people.

Mr. Pon

And they're more expensive cars, because those battery components are very expensive. One more thing to point out though.

Mr. Redpath

Used cars, I think yes, but $25,000, has to be more than two years old. $25,000. How much is that car really depreciating over two years? Two to three years. I think we're going to see a lot of guidance on this as it comes out, but I'm not sure we should be jumping up and down yet, at this point.

Mr. Pon

I can use the example of my car too. For this clean vehicle credit, it also includes plug-in hybrids. So that's my car. I have a Toyota Prius Prime, so it's a gas hybrid. So, they bump up the battery requirement from five kilowatt hours to seven kilowatt hours. And a lot of gas hybrids have that. But here's the interesting thing you're talking about, about the price of cars, is you get an email from Carfax about my car. Well, guess what I can sell it for? $10,000 more than what I paid for it. Can you believe that? And that's because this whole shortage of vehicles thing and it's like, wow, I can sell my car for 10, but where am I going to buy another car? Right?

Mr. Redpath

That's exactly the case. I bought a car in December of 2020, and I get, literally almost every week, I'm getting emails from the dealership saying, we want to buy your car back. So, I finally called the guy I've been dealing there for years with, and I said, "Okay, tell me what's the deal?" He goes, "Ian, I will pay you more than you bought it for." And I said, "Wait." He goes, "Problem is, I can't get you another car." He said, "No, it's not a good deal. Sorry. I mean if you wanted to get rid of your car, great deal."

Mr. Pon

I think it's a great time if you're one of those people that have excess cars. Because yes, if you want a new car, you have no choice of what color or trim or whatever. Here it is, take it or leave it, because we've got 15 people behind you who want this car. Now, one important factor to consider about this credit. This has not changed, same as the old law. The credit is a nonrefundable credit, and there's no carryover. For example, I had an older client. She bought a Nissan

Leaf, and they qualify for the $7,500 credit. But what was her tax liability? It was only $2,000. So, being a nonrefundable credit, she can only use $2,000 of that credit, and the remaining $5,500 was just lost. So, for tax planning purposes, I told her, "Well, do you need any more money to take out of your IRS?" She said, "No, not really." So, I said, "Let's do a Roth conversion to bump up your adjusted gross income to get your tax liability to be at least $7,500 to get the use of this credit." So that's some other planning we've got to be careful about. You'd be amazed how many clients get electric cars, and they have no tax liability, and it's basically a waste. So, planning is very important, and there's no carryover provisions.

Mr. Redpath

It will be even more so with the expansion here to used cars. One of the complaints I hear about people when they get an electric vehicle. I have a neighbor who has an electric vehicle that complains all the time about how long it takes to charge. I've mentioned to them, "Well, have you rewired?" "No, I just plug it in, and it takes me all night or longer to get a full charge." There are charging stations out there, there's refueling. What is the government doing for those things?

Mr. Pon

For your home, for your home, there's the qualified refueling property credit, and that's on Form 8911. Alternative fuel vehicle refueling property credit. So, if you install a charging station in your home, hire an electrician, buy one of those charging stations. Now, your power outlet right now is 120 volts. This will be 240 volts. I am not a battery engineer. So, those are some questions you should ask your battery engineer, because there's those superchargers. Yes, you can charge your car really fast; but you might shorten the life of your battery. So, there's some engineering questions about that. But you get a 30% tax credit for installing a charging station at home.

Now, for our business clients, so you might have an apartment building. Or I have a client that owns a shopping mall, a shopping center. And I said, "Hey, what do you think of designating a couple spaces in your parking lot for a charging station? And I ran some numbers for him and how much to charge and all that. It's up to you how much to charge. If you don't want them to be camped out there too long, you put a time limit on it, or just start charging a lot of money. If you've been there for more than two hours, it's okay, charge 10 bucks an hour. And so, if they're paying for the parking space. But for a business, it's a 6% credit up to a maximum of $100,000. So, you have an apartment complex. That's a challenge about apartment complexes, right? I buy an electric car, no place to charge it. And I know people who live in apartment complexes, and they park somewhere else, and they have to walk home and leave their cars there overnight. And that could have some pros and cons. And it depends on the provider too.

Mr. Redpath

And a lot of people in my area, there have been many times that people get caught in snowstorms, or they get caught on a road sitting in a snowstorm. You better have a full charge if you're going to be sitting there. And that's one thing. Has California—and I'm using that because we know that you've had issues with the power grid. What would happen? What's going to happen in 2030 if everybody is trying to use the power grid to charge up their cars?

Mr. Pon

Right, we need to strengthen our power grid to accommodate for that and see how much of a load that's going to generate. Or I can program the charger in my house to only charge in the middle of the night when the rates drop, when the load is less. So, you can do that instead of charging when the rates are high or when the load is high. There's a lot of software out there that comes with the cars that are pretty darn smart. So, you can time these things and all that.

Mr. Redpath

And I think that is one of the downfalls right now. At least everything I'm reading is that, as it currently exists, the power grid isn't ready for a complete turnover of electric vehicles, if we want to continue to use the air conditioning and the other issues with the heat waves and everything, the greater demands on energy. And this could be a huge one if everybody was doing electric. So, those are all kind of fitting together here. It will be interesting to see where this all goes as we move forward.

Mr. Pon

I was going to add that last year, we had the passage of the infrastructure bill, and part of that infrastructure bill is supposed to be towards our power grid. Personally, I haven't seen it yet. And I'm sure when we drive around

at the transmission towers and the power stations, we'll see signs up there saying, "Hey, the Infrastructure Act is paying for the upgrades." So, it's a vulnerability we have in this country. We've got to strengthen our electrical grid.

Mr. Redpath

Yes, no question. Larry, thanks for being here. A lot of great insight. Appreciate it. A lot of planning opportunities to look at with our clients starting right now. So, Larry, thanks for being here.

Mr. Pon

Well, thank you, Ian.

Green Vehicle Credits in IRA 2022

By Ian J. Redpath, JD, LLM

A. Introduction

Electric vehicles (EV) appeal to a variety of car buyers with a wide variety of styles and performance available to capture not just the climate-conscious buyer. The market has experienced dramatic growth with registrations increasing by 60 percent through the first few months of 2022, according to Experian.

While there is a savings on the cost of gas, it is unclear how much this is offset with the cost of electricity; but there are also electric vehicle (EV) tax credits provided to those who purchase one. There may also be state incentives available which further enhance the cost of an EV.

The Inflation Reduction Act of 2022 (IRA) contained numerous provisions related to the climate and incentives for business owners, homeowners, and those purchasing vehicles. The tax incentives are aimed at "green" alternatives to traditional fossil fuels. The provisions are complex; and practitioners should work with their clients on understanding the basics to obtain the maximum benefits from "going green."

B. "Old" Rules for Vehicles

The EV tax credit [§30D] is a credit of up to $7,500 and applies to all electric and plug-in vehicles. To qualify, your vehicle must meet certain specifications, including:

- Have been purchased after December 31, 2009.
- Must be an electric or hybrid vehicle.
- Must be a new vehicle, not used.
- Must be a purchased vehicle, not leased.
- Have a weight rating of up to 14,000 pounds.
- Hold a battery capacity of at least four kilowatt hours (kWh).
- Use an external plug-in recharge source.

For tax years 2021 and 2022, the nonrefundable credit ranges from $2,500 to $7,500, and eligibility depends on the vehicle's weight, how many cars the manufacturer has sold, and whether the taxpayer owns the car. However, when a particular manufacturer reaches 200,000 electric vehicle models sold for use in the United States, those vehicles are no longer eligible for credits. In 2022, many popular models did not qualify for the credit. The taxpayer may rely on the certification of the manufacturer. To see a list of cars that likely qualify through the end of 2022 and into early 2023, you can reference the list of electric vehicles compiled by the U.S. Department of Energy on its website.

If you purchased an electric vehicle after the IRA enactment date of August 16, 2022, the vehicle must have been assembled in North America to qualify. If you had a binding contract to purchase prior to that date, and the vehicle is otherwise eligible for the old EV tax credit, you can claim that credit regardless of place of assembly.

Form 8936 must be filed with the IRS.

C. Clean Vehicle Credit

Clean vehicles are a class or category of vehicles certified to meet the clean-fuel vehicle standards for a particular tax year. The credit remains at $7,500 but is calculated differently. Taxpayers get a $3,750 credit for meeting the critical minerals requirement and a $3,750 credit for meeting the battery component requirement [§30D(b)]. The change in the calculation rules applies to vehicles placed in service after the date on which the proposed guidance is issued. The IRS is required to issue proposed guidance no later than December 31, 2022. The IRA eliminates the number of vehicles eligible for the credit beginning in 2023.

To qualify for the credit, the vehicle must meet the following requirements:

- The final assembly,
- The critical mineral, and
- The battery component.

Final assembly of the vehicle must occur in North America. "Final assembly" means the process by which a manufacturer produces a new clean vehicle at, or through 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 [§30D(d)(1)(G) & (d)(5)]. This applies to any vehicle sold after the date of enactment of the Act, August 16, 2022.

The critical mineral requirement requires that the percentage of the value of the applicable critical minerals, defined in §45X(c)(6), contained in the battery that were (i) extracted or processed in the United States or in any country with which the United States has a free trade agreement in effect, or (ii) recycled in North America, is equal to or greater than the applicable percentage (as certified by the qualified manufacturer, in such form or manner as prescribed by the IRS) [§30D(e)(1)(A)]. In the case of a vehicle placed in service after the proposed battery guidance date and before January 1, 2024, the applicable percentage is 40 percent. In the case of a vehicle placed in service during calendar year 2024, 2025, and 2026, the applicable percentage is 50 percent, 60 percent, and 70 percent, respectively. In the case of a vehicle placed in service after December 31, 2026, the applicable percentage is 80 percent. After 2024, qualifying vehicles do not include any vehicle in which applicable critical minerals in the vehicle's battery were from a foreign entity of concern. China, Russia, Iran, and North Korea currently would not qualify.

To receive the battery components portion, the percentage of the battery's components manufactured or assembled in North America would have to meet the following threshold amounts when placed in service:

2023	50%
2024	60%
2025	60%
2026	70%
2027	80%
2028	90%
2029 and later years	100%

The credit has a limit based on modified AGI. It is not allowed if the taxpayer's current year's or preceding year's modified AGI exceeds $300,000 for married taxpayers ($225,000 for head of household filers; $150,000 for other filers).

Clean vehicle credits are only allowed for vehicles that have a manufacturer's suggested retail price of no more than $80,000 for vans, SUVs, or pickup trucks, and $55,000 for other vehicles. According to Kelly Blue Book, as of August 2022, the average cost of an EV was $66,000. It is yet to be seen how costs may, if at all, be affected by these provisions.

Taxpayers are allowed only one vehicle per year; and no clean vehicle credit is allowed with respect to any vehicle unless the taxpayer includes the VIN on the taxpayer's return.

Under the IRA, the EV tax credit applies to any "clean vehicle." For example, a hydrogen fuel cell car or a plug-in hybrid vehicle with 4–7 kilowatt hours of battery capacity could qualify. Some commercial clean vehicles can also qualify, depending on weight.

For vehicles placed in service in 2024 and after, the taxpayer can elect, on or before the purchase date, to transfer the clean vehicle credit to the dealer who sold the vehicle in return for full payment of the credit amount. Making the election cannot limit the use or value of any other dealer or manufacturer incentive to buy the vehicle, nor can the availability or use of the incentive limit the ability of the taxpayer to make the election. Dealers must register with the IRS. This will not be income to the purchaser or deductible by the dealer. Dealers can get advanced payments from the IRS. The regulations are yet to be issued on this requirement.

D. Credit for Previously Owned Clean Vehicle

Beginning in 2023, the IRA provides a credit for used EV's. The sale price of the vehicle must be $25,000 or less; and it must be a model year at least two years earlier than the calendar year in which the vehicle is sold. It can only be claimed for vehicles sold by a dealer and on the first transfer. Taxpayers can only claim it once every three years and must include the VIN on the tax return. The credit applies after December 31, 2022 through 2032; thus for 2022, used vehicles do not qualify for a credit.

E. Refundable Credit

As noted previously, even if the vehicle otherwise qualifies for the credit, there is a cost of the vehicle limitation and a modified AGI limit. The combination of these and the current average cost of an EV make it unclear how effective this will be. On top of those, the credit is nonrefundable; so, if there is not enough tax due, the credit may further be limited. Because of the modified AGI limit combined with the nonrefundable nature of the credit, practitioners will have to provide guidance on maximizing the credit. For example, a Roth conversion could be done on an essentially tax-free basis by utilizing a credit that might otherwise be lost. An analysis should be done to determine if the taxpayer has any income harvesting that might be appropriate to take full advantage of the credit. Of course, the modified AGI has to be carefully monitored.

F. Qualified Commercial Clean Vehicles

The credit per vehicle is the lesser of: (1) 15% of the vehicle's basis (30% for vehicles not powered by a gasoline or diesel engine) or (2) the "incremental cost" of the vehicle over the cost of a comparable vehicle powered solely by a gasoline or diesel engine. The maximum credit per vehicle is $7,500 for vehicles with gross vehicle weight ratings of less than 14,000 pounds, or $40,000 for heavier vehicles.

The vehicle must be acquired for use or lease by the taxpayer, and not for resale. It must be manufactured for use on public streets, roads, and highways, or be "mobile machinery" as defined in §4053(8). The vehicle must have a battery capacity of not less than 15 kilowatt hours (7 kilowatt hours for vehicles weighing less than 14,000 pounds) and be charged by an external electricity source. Qualified commercial fuel cell vehicles are also eligible for the credit. Qualifying vehicles must be depreciable property. Only vehicles made by qualified manufacturers, who have written agreements with and provide periodic reports to the Treasury, can qualify.

G. Alternative Fuel Vehicle Refueling Property Credit

Before the enactment of the IRA, §30C provided a tax credit 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 30% of the cost of the property placed in service during the tax year at a given location, limited to $30,000 for qualifying property subject to an allowance for depreciation or $1,000 for property at a personal residence for personal use. The IRA extends the credit to eligible property placed in service before January 1, 2033.

For property placed in service after December 31, 2022, the IRA extends the credit for depreciable property at a rate of 6%, increasing to 30% if certain prevailing wage and apprenticeship requirements are met, subject to a limit of $100,000. It modifies the definition of eligible property to include bidirectional charging equipment and provides that the credit is available for electric charging stations for two- and three-wheeled vehicles that are intended for use on public roads.

The credit limitation applies per single item of qualified alternative fuel vehicle refueling property instead of all such property at an individual location. Charging or refueling property will only be eligible if placed in service within a low-income or rural census tract. Thus, for 2022, the existing rules apply.

H. Conclusion

The move to climate-conscious clean energy has had a potentially major incentive for some taxpayers with the IRS 2022 and its green-energy-related credits. The credits for electric vehicles and charging stations are no exception. The credit for 2022 remains essentially the same. However, for 2023 and beyond, the determination of the credit becomes much more complex. We will need to rely on the manufacturers or government agencies in determining if the various components of the credits have been met. The expansion to previously owned vehicles will most likely make the credit more widely available. Practitioners will have to take care to assure the requirements are met. Additionally, the credit for alternative fuel charging stations will assist those who purchase such vehicles to speed up the charging process and make the vehicles more desirable. There are many advantages provide by the IRA. But with those advantages is greater complexity for the practitioner. In addition, care must be taken to apply the appropriate rules for 2022, as many of the provisions of the IRA do not apply, or only partially apply, to 2022. The application of the credit for 2022 and beyond is a discussion to have with many clients, as many will be considering a new vehicle and may consider an electric vehicle. There must be proper planning to maximize the amount of any credit that may be available and used for electric vehicles and related property, such as charging stations.

A. Discussion Problems

In a conversation with your client, Amanda, she mentions that she is considering purchasing a new car. She has heard there are benefits to an electric vehicle (EV) but is concerned about the cost. She has been told that there are no tax benefits for used electric vehicles. Additionally, she is concerned about the length of time required to charge an EV and asks if there are any incentives for a charging station.

Required:

1) Discuss what considerations should be given in purchasing a new EV.

2) Discuss the considerations in purchasing a used EV.

3) Address Amanda's question regarding the charging station.

B. Suggested Answers to Discussion Problems

1) For 2022, the nonrefundable credit ranges from $2,500 to $7,500; and eligibility depends on the vehicle's weight, how many cars the manufacturer has sold, and whether the taxpayer owns the car. However, when a particular manufacturer reaches 200,000 electric vehicle models sold for use in the United States, those vehicles are no longer eligible for credits. In 2022, many popular models did not qualify for the credit. For 2023, clean vehicles are a class or category of vehicles certified to meet the clean-fuel vehicle standards for a particular tax year. The credit remains at $7,500 but is calculated differently. Taxpayers get a $3,750 credit for meeting the critical minerals requirement and a $3,750 credit for meeting the battery component requirement [§30D(b)]. The change in the calculation rules applies to vehicles placed in service after the date on which the proposed guidance is issued. The number of vehicles sold limit is eliminated. To qualify for the credit, the vehicle must meet the following requirements:

   - The final assembly,
   - The critical mineral, and
   - The battery component.

   The manufacturer will be able to certify if a vehicle meets the requirements. Two other considerations are the cost of the vehicle and Amanda's modified adjusted gross income, which could make the credit unavailable.

2) Beginning in 2023, there will be a credit for used EVs. The sale price of the vehicle must be $25,000 or less; and it must be a model year at least two years earlier than the calendar year in which the vehicle is sold. It can only be claimed for vehicles sold by a dealer and on the first transfer. For 2022, used vehicles do not qualify for a credit.

3) Section 30C provides a tax credit for the cost of any qualified alternative fuel vehicle refueling property placed in service by a business or at a taxpayer's principal residence. The credit is 30% of the cost of the property placed in service during the tax year at a given location, limited to $1,000 for property at a personal residence for personal use. The IRA extends the credit to eligible property placed in service before January 1, 2033.

PART 3. BUSINESS TAXATION

Section 754 Election and Section 743(b) Adjustments

Taxation and reporting can be quite complicated for both partners and partnerships. This segment involves IRC Section 754 and basis adjustments under Section 743(b). If a partnership has a Section 754 election in effect, a basis adjustment under Section 743(b) is made upon a sale or exchange of a partnership interest or a transfer of a partnership interest upon the death of a partner. Ian Redpath and Bob Lickwar discuss key factors regarding a Section 754 election and Section 743(b) basis adjustments.

Let's join Ian and Bob as they discuss Sections 754 and 743(b).

Mr. Redpath

Bob, welcome to the program.

Mr. Lickwar

Hey, Ian, thanks, glad to be here.

Mr. Redpath

Always great to have you here. Always great to get your insight. Especially, you're the guru of partnership tax; and this is an area, this 754, that I just think is so misunderstood. There's a lot of assumptions out there that practitioners make that are wrong. I think it's interesting that Senator Widen, in his reform bill that's supposed to simplify partnership tax, he wants to make these adjustments mandatory. I don't know if that's simplification. It's certainly a full employment of accountants act.

Mr. Lickwar

Yes, it's certainly not simplification, Ian. And in fact, I think I agree with you that this is the one of the most misunderstood areas of partnership taxation and, at the same time, one of the biggest draws to partnership taxation, Ian. We talk about basis step up to assets upon death. We're talking about a similar concept here, but the opportunity to equalize the tax consequences whether an entity sells assets or an interest is sold. And the reality is, Ian, there's no other entity choice generally that's going to allow you to do that. So, partnerships from that perspective are very unique.

Mr. Redpath

And this is significantly different because there's nothing like this in an S corp. You can't have a second class of stock. So, this is a whole different area. And one of the other unique things, I guess, and a difference in an S corp and a partnership, is in a partnership, we have three separate accounts. And I think a lot of times, people misunderstand the idea that there're three separate accounts, and they reflect different things for the partners. And there's an assumption that somehow, they're the same. Well, they could be, but probably not the same thing.

I guess if everybody just initially put in cash, everything would be the same. But once you start talking about property, all of a sudden, these things are different. So, we have the capital account. Boy, Bob, we've heard a lot about the capital account over the last few years, and we've done programs about the capital account and those changes. And then we've got the inside basis and the outside basis. So, can you go through those accounts? What are they, what are that reflecting, and what are things our viewers should be paying close attention to with those accounts?

Mr. Lickwar

Sure, I'd love to. The first thing you mentioned is the capital accounts, Ian. And back in 2020, the IRS started requiring partnerships to report capital accounts using a tax-basis methodology. For many partnerships, many of my clients, this was not an extremely difficult endeavor. We had most of the books and records in place. But that being said, it's not really an exact science for a lot of partnerships, Ian; because there are many things which affect your tax-basis capital account that those partnerships may not have had records to, for example, sales, gifts, etc., etc., which they are now finding out about. One of the things that I was most confused by with respect to partnership tax capital accounts is the removal of the Section 743(b) adjustment from the capital accounts. And we will talk, obviously, more about 743(b).

But what I find really interesting, Ian, is in August of 2022, the IRS announced that they're going to start auditing loss limitations and taxable distributions. And the trigger for that is going to be those negative capital accounts. Now, basis can never go below zero; and if it does, there's usually gain recognition, or income recapture, or what have you. But for purposes of the capital accounts, they can clearly go negative.

Mr. Redpath

And Bob, if I can interject here, one of the things that I think the IRS has done—and correct me if you think I'm wrong here—but they have changed a lot of these things simply to allow them to use more AI for audit purposes. And so, like the K-1 now, you've got the beginning capital account, ending capital account. If you remember, we used to have those things, those boxes—what's the capital account, and then you had a box as to how it was maintained, which really didn't give them a lot of information.

I mean, if I said 704(b), or that infamous "other" per books and records, or hybrid, I wasn't really giving them a whole lot of information. Yet now, boy, I'm giving them a lot of information on the capital accounts, the debts that we have, the debt allocations. Are there 704(c)? Are there allocations required under 704(c)? I have to report more on the 754 to give them more information. So, it seems to me that what's happened in partnerships is the K-1's are giving more and more information that they can use for audit. And this is just another example of that.

Mr. Lickwar

Yes, you've got that perfectly on the head, Ian. And I may be going out on a limb here to say, I have many clients who are involved or not really managing, but they certainly have invested large dollars in some pretty big hedge funds, Ian. And a lot of those hedge funds will report the K-1 information for tax purposes. But they'll also have in there things like unrealized gains and losses. And unless you were keeping a separate tax basis schedule, obviously there's a complete divorce between the information being shown potentially on a disposition or a sale of that interest versus what the tax basis should really be, and it could have gone either way. So, if you've included unrealized gains in your tax basis, that was incorrect. As incorrect as including unrealized gain and losses to reduce your tax basis capital account.

So, the IRS, I think, Ian, said, "We need to have a program to match things up. We have the AI to match certain things, and we know people are getting this wrong because Subchapter K is so difficult, and this is how we're going to go about it." We can question the methodology; we can question some of the things that they did, that's for sure. But the bottom line is this is what we're living with. I know that there's many partnerships who still haven't converted over. But I want the audience to take away one big thing, and that is the fact that it's still your client's responsibility to maintain their basis records even in a situation where we're now using tax basis capital accounts.

Mr. Redpath

So, let's talk about the second one, this inside basis; and then we'll get to outside basis. What is inside basis?

Mr. Lickwar

Inside basis is a relatively simple concept. As we mentioned, Ian, outside basis is my basis in my partnership interest. And inside basis is relatively simplistic as well. It's the partnership's basis in the assets that it owns. So, it pays a million dollars for a piece of land; its inside basis in the land is a million dollars. It has $500,000 in cash on hand; its basis in the cash is $500,000. It has receivables, but it's a medical practice using the cash basis; the basis in those receivables is going to be zero. So, people get a little bit mixed up with inside and outside basis. But remember. Outside—just think outside the partnership balance sheet. Inside—what does the tax basis balance sheet look like?

Mr. Redpath

And so, what you're saying is that this outside basis… essentially the partners' interest in the partnership, the partnership isn't keeping track of that. That's essentially, as you said, off the books so to speak. You're not reporting that per se.

Mr. Lickwar

Well, you kind of are and you kind of aren't, right? You're reporting the activity on a transactional basis. If everybody contributed cash, and there's never been a change in partnership interest, or a death of a partner, or a divorce, or whatever is happening, or a gift, things should go along pretty good, and you should be perfectly fine. But in real life, Ian, those things don't go that swimmingly, and they don't happen that nicely, and

they don't all fall into place like they do in the textbook examples, unfortunately. And I'm not picking on the textbook examples because they're great; that's how you learn the concept. But the reality is, Ian, things change over time. People become partners, they leave, they retire; and that's where you're going to get a disconnect between potential inside and outside basis. So, you're kind of keeping the records; but then, you're really not responsible for it. It's a really confusing concept to me where the Service says keep tax basis, but you partner, you're the ultimate responsibility. It's where we are.

Mr. Redpath

So, outside basis then, that's your interest. What is your interest in the partnership? If I sell it, what's my basis that I'm going to get back? And also, that's how I'm looking at basis would be things like just how are distributions going to be taxed? Is it tax-free return of capital? Do I get to write off deductions and losses? One of the limitations is you have to have basis. So, that's that outside basis we're talking about, right?

Mr. Lickwar

That is absolutely correct, Ian, and we can liken it to, I would use the term previously taxed capital. The IRS loves to use the term previously taxed capital; but basically, what it represents is if certain events happen such as a sale by the partnership of its assets, how much would I get back tax free? So, that's a good way to think about previously taxed capital, PTC.

Mr. Redpath

How does 754 come into play here? And 754 is just an election, right? I mean, that just says I want to apply the other adjustments. That's not where the adjustments are. That's just the election. And the IRS has now said they finalized the regs and said you don't have to have a signature. That's of course to expedite filing electronically. So, if you have a 754 election in effect, what's the advantage then, and how does that affect those three accounts that we just talked about?

Mr. Lickwar

I think the best way to describe the advantage is probably a very simple example. You've decided to retire from your firm. I'm an attorney. I'm going to buy your firm out, your interest in the firm out, and we determine that with all the assets in, etc., receivables, what have you, I'm going to pay you $300,000 for your interest. That's not an offer to sell, Ian, that's not an offer to buy, that's just an example. So, I'm going to look at, I'm going to pay you $300,000 for your interest. The issue, Ian, is what comprises that $300,000? Is it goodwill? Is it accounts receivable? Is it equipment? Because what happens is my outside basis, Ian, is $300,000. You're going to recognize gain. Let's assume your basis in your interest is zero of $300,000. Some of that could be capital gain, some of that could be ordinary income under Section 751 and some of the other hot asset rules.

But the point is, the partnership is still holding on to the assets that I've already paid for. Your zero-basis capital account by operation of Subchapter K gets transferred over to me. Nowhere in the partnership books and records is that $300,000 accounted for. So, let's just assume for sake of argument that all of the value that I just bought is accounts receivable. Or maybe you're not an attorney; maybe it's inventory, or maybe it's even a building. And one month after I buy your interest in the partnership, guess what? The partnership decides to sell the assets that I just paid for. Am I going to reduce my share of the gain by the amount of the partnership's gain from the sale? The answer is no. There's a disconnect between my basis in my interest and the partnership's basis in its assets. So, if land was sold, for example, with a very small basis, but I've already paid you fair market value for it, that gain is going to pass through to me, Ian. I'm not going to be a really happy camper knowing that I paid you, and you recognize gain, and I'm going to pay tax again. The audience may be thinking, well, that's fine, Bob, let's liquidate. Well, what if that's not the plan? The plan is to continue the partnership, and there's other reasons not to liquidate. I've just missed out on an opportunity. So, what the 754 election allows me to do is to equalize my inside and outside bases by allowing the partnership to make an election and increase the basis in that property.

Mr. Redpath

So, the partnership makes the election, correct? Not the partner.

Mr. Lickwar

That is absolutely correct. The partnership makes the election, Ian. And you'll find in practice that there are many partnerships who do not want to make this election because of its complexity, because they're concerned that they have to track the basis adjustments, and just because they've made it a policy that they're not in the business of tracking 754 adjustments.

Mr. Redpath

If you make the election, you're stuck with it, right? I mean obviously stuck with it, but it applies to everything after you've made that election. In other words, it's not a one transaction thing. Once it's made, it applies to everything, correct?

Mr. Lickwar

That's exactly correct. Once it's made, it's enforced unless the IRS revokes it; and they have to give you permission to do so, which means from a practical standpoint that a copy of the election in the year that it's made should go into your permanent file. I know that doesn't happen a lot in practice. It's the 14th of March, you're making the election, I'll do it after tax season, and then you disappear to the Caribbean for three months. And by the time you get home, you probably are forgetting to do that. I've actually seen situations, Ian, where I attach a copy of the election in each year that I actually have a basis adjustment. I think that's a no harm, no foul rule. I don't think it hurts anybody unless the IRS says, well, I don't see the election from earlier years, so we're going to disregard it. I've never had that issue come up.

Mr. Redpath

And the IRS isn't very willing to do it. I mean, everybody thinks of the upside, oh, I get a step up in basis. And another example with that could be, let's say bonus depreciation had been taken. So, assets are in there. They have zero basis, and I just paid $300,000 for them, and I'm getting no depreciation. I'm not getting anything till I liquidate, essentially. So, this is trying to say, oh, my basis in those assets is $300,000. Bob, let me ask you, do I get to take bonus depreciation now?

Mr. Lickwar

If we have a Section 743(b) adjustment, Ian, and the property in question is otherwise bonus eligible, the answer is yes, because used property now qualifies for bonus depreciation. But be really careful here because a partnership's election out of bonus depreciation will apply to that layer applicable to the partner with the basis adjustment as well. What I've seen, Ian, in a lot of deals in the real world is that in a lot of these cases, people are using Revenue Ruling 99-5 and -6 transactions where there's actually a purchase of the assets rather than an interest in the entity; and it's allowing the buyer of the assets to make the bonus depreciation election rather than messing with Section 754.

I think 754 is a big deal, Ian, for my clients who do a lot of partnership deals. I want some reasonable satisfaction that my client who is buying into the deal is going to be able to reap the benefit of a partnership-level 754 election. And a lot of times, the partnerships will just say no. And at that point, you tell your client they're not going to do it. Are the economics of the deal otherwise solid? And there's a potential tax time limit there.

Mr. Redpath

And I think one of the things too that gets a little confusing is, Bob, you and I are old enough to remember that, at one time, if you had a net positive adjustment, you only stepped up the basis in assets that had appreciated. If you had a negative, you stepped down only the assets that had depreciated. But what a lot of times is missed now is you have to adjust all the assets up and down. So, while you may have exactly zero adjustment, $300,000, $300,000, no adjustment at all, 754, no adjustment. No, wait a second! If you have a 754 election, some assets went up, some assets went down; even though the net was zero, you still have to make the adjustments to those assets.

I think that we often miss that if that's 754. And again, we're talking about in a sale to or transfer of an interest, where here we're talking about 743(b) adjustment. So, you really have to watch this. You can't just, it's not something that, no harm, no foul, I'm just not going to do it. That's not how it works. So now, how does that K-1 look? I mean, how are we doing this on a K-1? Bob, you bought into my partnership; so, you bought me out, but I have other partners. Their inside basis isn't affected, right? They're not affected by any of this.

Mr. Lickwar

Yes, that's correct.

Mr. Redpath

Well, so how does your K-1 look? Because you got a step up in basis in these assets, they've depreciated everything, you haven't yet. So, what exactly, how is this going to show on the K-1? And I know this is confusing to a lot of people. A lot of people I've seen just attach a statement—boom here—this is the 754 adjustment. How do we attach this? What do we do to the K-1?

Mr. Lickwar

Things were a lot simpler, Ian, before the IRS had decided to enforce tax basis capital account reporting.

So, the provisions that you're talking about, 743(b) deals with sales or exchanges of interest as well as the death of a partner. We'll talk at another point about 734, which deals with distributions of cash and other property. But the operating rules are contained in Section 755. Everybody's very familiar with Section 754, but then you get into the nitty gritty with 734, 43, and 55. I sound like a quarterback. In any event, Ian, what happens from a K-1 perspective is when I buy your interest, your capital account balance, whatever it may be, transfers over to me. That does not mean that that is my basis in the interest because my basis is an outside interest.

And what I used to do, Ian, is merely zero out your capital account, credit my capital account, even though the partnership never saw the funds, and debit or credit the basis of the respective assets. With the IRS not wanting the 743(b) adjustment in the capital account anymore—I can't understand why—they still want the partners in a sale transaction to let the partnership know so that the election can be made. The new reporting regime, Ian, is not through the capital account, but it is through line 13 code V of the K-1, 743(b) adjustments, or line 11 if the adjustment is going a different way, positive or negative 743 adjustments.

Mr. Redpath

And that's code F on line 11, code V on line 13, whether positive or negative?

Mr. Lickwar

Correct. Correct. And what's also going to get attached, Ian, is a quasi-depreciation schedule, which will show the basis of the asset, the accumulated depreciation to date, and the net book value of the assets. But the point you made is that this is a per partner adjustment; none of the other partners will share in this adjustment.

Mr. Redpath

And I think the line that's confusing here, Bob, the line that's confusing is line 20, other information. You use code U, but you're kind of saying what's left, right? That's kind of an attachment you have to put, what's left here?

Mr. Lickwar

Yes, they basically want to know, for example, if you've allocated the land, and buildings, and receivables, or whatever you may be allocating to, how did you do that allocation? What's the accumulated depreciation? The tricky thing that I've found for the first couple of years of doing tax basis capital accounts is when the building in my example is eventually sold and there's a reduced amount of gain for the partner, do you reduce the gain on the 4797? I think the answer there is no; but you give a footnote to the partner that says you should reduce your share of gain by this amount for building and accumulated depreciation, and here's your unrecaptured 1250. Because otherwise you get a complete disconnect from the balance sheet, Ian; because when you record the sale, obviously that sale doesn't include that 743(b) positive or negative adjustment.

Mr. Redpath

There's another thing out there called 732(d). What is that?

Mr. Lickwar

I've actually used this a few times over the last couple of years, Ian. And 732(d) is a basis adjustment similar to a 754 adjustment whereby if a partner receives an interest in a partnership and the partnership does not have a 754 election in effect and will not make one, a distribution of properties to the partner will come with a basis increase as if a 754 election had been in place. But it's a pretty tight timeline; it's two years. I've seen this in the case of deaths where in both cases the 754 adjustment was missed on the death of one of the partners. We had gone past a year to try and make a late election; but 732(d) came to the rescue and allowed me to distribute those properties to the estate and the survivors with a basis step up as if a 754 election had been made. 732(d) can come in real handy.

Mr. Redpath

Now, I should mention that, on the 1065, there's question 10 A, B, and C and that deals with whether you've had a 754 and 732(d). The other thing is, there's this thing called a substantial built-in loss; and that makes these adjustments mandatory. What is a substantial built-in loss?

Mr. Lickwar

Well, a substantial built-in loss, Ian, is a loss of more than a quarter million dollars of variance between the actual tax basis of the assets and the fair market value. So, if the fair market value of the assets is dropped by more than a quarter of a million dollars based on the

basis of the asset, you may have to mandatorily make a 754 election whether you wanted to or not. So, let's assume that the only asset held by a partnership is worth $500,000, but the partnership acquired it for a million dollars, I should say, and one of the partners sells their interest. I, as the partner who's buying the interest, really don't have much interest in the partnership making a 754 adjustment because that eliminates the loss, which potentially gets allocated to me or I can recognize from a sale of that land. I am very disinterested; I don't want them to make a 754, and they may not. They may not have one in place. But what the substantial built-in loss rules say is that adjustment is mandatory. That is going to bring down my inside basis in that partnership asset.

Mr. Redpath

Now, one of the things you mentioned early on is the 743(b) adjustment is not in that tax basis capital. So, what are we doing with that? I mean, how is that being handled in practice?

Mr. Lickwar

Yes, it's not in the tax basis balance sheet. It's not on the balance sheet. My advice, Ian, is to maintain a tax balance sheet that will not get reported on the 1065. Therefore, you can track the capital accounts and the basis of the asset. But what you're doing is, as we mentioned earlier, if there's a negative 754, you're reporting other income on line 11 F; if it's an allocation of depreciation or amortization deductions, you're reporting that on line 13 with code V. You're also attaching a statement to the return that outlines your share of the basis in the properties. And additionally, you're answering those questions that you had referenced on 10 A, B, and C that yes, there's a 754 election in effect; yes, there's a basis adjustment; and here's the calculation, IRS. And lastly, the last question is whether there's been a substantial built-in loss. So, you're answering those questions, but it's kind of a mishmash of reporting. I'm not a really big fan, Ian, I liked it when I used to be able to book journal entries. I like T accounts. That's the way I always still do my accounting. I show a young person a T account these days; and they're looking at you like, what is that? They don't teach us that anymore.

Mr. Redpath

Right, well, it's different. The world's different. It's called a computer. There's this form out there which a lot of people aren't even aware exists, 15254. What is Form 15254 if we want to get out of this election? And what is the IRS going to look at? I mean, what things might we look at to get out?

Mr. Lickwar

It's a relatively new form, Ian, couple, three years old; and it's the first time the IRS has put a form out.… You have a 754 election in effect, and you just want to get out of it, you're going to have to secure permission from the IRS. The fact that you may have to step down the basis of the assets is probably not a very good reason or a good enough reason. But certain things are; for example, there's so many transactions that you just can't keep up with everything. You have 100 partners and there's 50 changes every year. That's something where the IRS may say, you know what? Yes, we get it. Administratively, it's extremely burdensome on you; so, therefore, we'll allow you out. So, you're going to have to have a really good non-tax motivated reason, Ian; and you'll ask them for permission with that form. And that form is generally due within 31 days after the end of the tax year. So, you can make the election after the end of the year. I've not yet used the form in practice because, quite frankly, I haven't seen many negative adjustments with respect to Section 754. Most of them deal with fully depreciated property or rapidly depreciated property and, therefore, I'm seeing basis increases. So, there may be a time where I see a decrease, particularly where we've been given and values being driven down because of the slow economy perhaps. But I just haven't seen it in practice, Ian.

Mr. Redpath

I've had two situations where we did get out; and the IRS did allow us out. The one, there were 350 partnership interests; but in one year, there were like 1,200 partners, and it was an administrative nightmare. They made this 754 election, there weren't that many partners. I mean, they weren't anticipating, but it had just changed. And the other one was just that the business had changed. They were a totally different type of business. The partners who made this election early on, it was a small, it's a growing partnership, many more interests now coming in. And the business was totally different. It wasn't what the original one that made it. And in both of those circumstances, I think they both were, if I would say, administrative nightmares. And the IRS recognized that it was just too costly; and really, the purpose of making it in the beginning, it was counterproductive now to have it.

So, you bought my interest. We mentioned that earlier. You have a notification requirement, right?

Mr. Lickwar

Yes, generally within 31 days, Ian. And if I don't notify the partnership that there's been that sale of the partnership interest, there are presumably penalties applicable to the individual partners. Now, I've researched what the penalties are; I can't find what the exact dollar amount is. I only know that there's penalties and there's a requirement to furnish that information. That allows the partnership, Ian, to figure out a couple of things. Number one, whether a Section 754 adjustment is applicable, and two, whether there are any hot assets whereby ordinary income needs to be disclosed to the partner who is selling the interest. And that will also allow for the preparation of Form 8308. I learned about Form 8308 one year into my professional career, 37 years ago. That form is still around, and it's a notification form. It doesn't have any numbers on it other than a social security number, but it notifies the IRS that there's been a sale of a partnership interest and there's the potential for recapture. I think this form, Ian, has probably outlived its life; because now, we're actually reporting 751 hot asset information right on the face of the K-1, but it's still there. So, we still have to be concerned with it.

Mr. Redpath

So, if it's there, we have to comply with it, and we have to follow. This isn't elective. But I think you've brought up a lot of good points that if you're looking at a transaction… Bob, if you're buying my interest, you're probably going to the partnership and saying, "Hey, I want a 754 election. I want that step up." If the partnership says, "No, sorry, Bob," you're probably going to come to me and go, "Hey Ian, you better talk to your partners and tell them to make a 754 election because I'm not going to pay you $300,000 without that. I might pay you [$200,000], but I'm not paying you [$300,000] without that election." But you might down the road go, why did I force that election? I wish I had never done that. You've really got to think about it. I don't think it's something you should just jump right into.

Mr. Lickwar

I agree with that 100%. That's a great analysis. And you raise a really valid point, Ian. And I've actually done this in working out deals with my clients where the partnership has unequivocally refused to make the election. And trust me, I don't disagree with their rationale behind it. They don't want to be in the recordkeeping. But I'm going to go back to you, Ian, as the seller and say, "Hey, this thing needs to be tax effective; because if they sell these assets, there's going to be a tax liability. That increases my cost of investment. It reduces my return on investment and my overall return. Ian, you need to, I'm sorry it's going to be no deal unless we renegotiate this." So, that's a very good bargaining chip. It's something you ought to consider when negotiating with your clients. The refusal to make the election by the partnership is not a killer of the deal as long as the two parties can work out something satisfactory to both of them.

Mr. Redpath

Bob, it's an area that really is misunderstood, but it's an area of a lot of complexity. And I really want to thank you for giving us a good overview of what the 743, the transfer exchange aspects of a 754 election, are. Bob Lickwar, thank you very much. As usual, great insight.

Mr. Lickwar

My pleasure. Thanks, Ian.

Section 754 and 743(b)

By Ian J. Redpath, JD, LLM

A. Introduction

Partnership taxation is one of the most difficult areas of taxation, but under many circumstances, provides benefits that are not available to other types of entities. An election under IRC §754 allows adjustments to basis to be made under IRC §734(b) and IRC §743(b). The election must be in a written statement, and it remains in effect until revoked under §1.754-1(c). The IRS is not very liberal at revoking this election.

The partnership form of doing business is often like an aggregate of sole proprietors. For example, the following are aggregate concepts of partnership taxation:

- Partnerships are not taxed;
- Character and amount of tax items flows through proportionately;
- Liabilities are treated as incurred by partners; and
- Section 704(c) prevents assignment of income.

However, for some purposes, it is treated like a separate entity. For example:

- There is entity determination of amount, timing, and character of income;
- Every partner owns partnership interest;
- No partner owns direct interest in assets;
- Accounting method and period elections are at the entity level; and
- Gain/loss on transfer of interest determined outside the entity.

One of the most important issues related to the §754 election is the concept of "inside" basis in the assets. A partner's basis in their partnership interest is referred to as an "outside" basis because it is determined outside the partnership under the aggregate theory. The "inside" basis is determined inside the partnership under the entity theory. "Inside" basis is the partnership's basis in the assets of the partnership. Each partner has its proportional share of these items. While the flow-through of items like depreciation is an aggregate concept, the determination of the basis and amount of depreciation are entity concepts. The result is that certain transactions may distort the differences between the two. Section 754 elections and the adjustments under §734 and §743 are meant to address these issues.

Triggered by transfer of partnership interest by sale or death, the §743(b) adjustment adjusts the basis of assets for the incoming partner only. The adjustment is the difference between initial outside basis and share of adjusted basis in partnership property and can be either an increase or a decrease. The §734(b) adjustment is triggered by distribution of property. The partnership adjusts the basis of the assets to the partnership and this, thus, affects all the partners. This also can be either an increase or a decrease.

B. Making the Election

The basis adjustments under §734(b) and §743(b) are only available if properly elected. Section 754 is the actual election; it is not the adjustment provision. The election must comply with Reg. §1.754-1(b).

The election is made by filing a written statement with the partnership's return for the tax year in which the distribution or transfer occurs. It must be filed by the due date, including extensions for such year for filing the partnership return. [Reg. §1.754-1(b)] If there is a transfer of an interest due to such an unforeseen event such as death, the election need not be made before the death occurred. It may be made when filing the partnership return for the year in which the death took place. [Rev. Rul. 57-347, 1957-2 CB 365] Likewise, an election may be made after a transfer of a 50% or greater interest that results in a partnership termination. [Reg. §1.708-1(b)(5)] The IRS is fairly liberal at granting

additional time to make the election if requested within the time for filing the election and reasonable cause exists. Reg. §301.9100-2 grants an automatic 12-month extension for filing a Section 754 election. To take advantage of the extension, an amended return with the election attached must be filed within 12 months from the original election deadline.

The written statement must:

- include the name and address of the partnership making the election,
- be signed by any one of the partners, and
- include a declaration that the partnership elects under §754 to apply the provisions of §734(b) and §743(b).

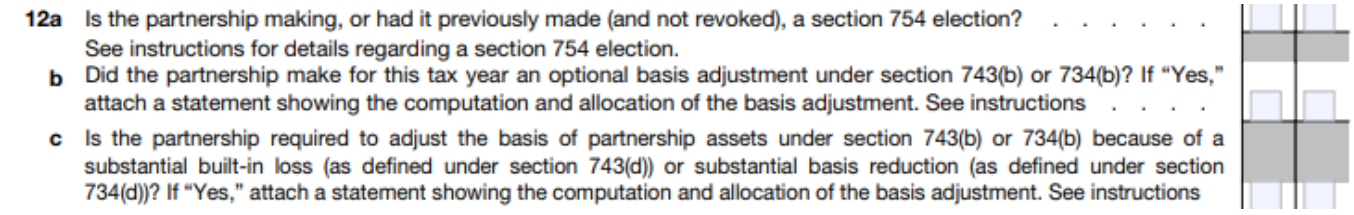
The election does not allow a choice of either adjustment. The election must include both adjustments. Once elected as provided in Reg. §1.754-1(c), the election remains in effect for all subsequent transfers or distributions unless revoked. Revocation requires IRS permission. It should be noted that a district court upheld an election made two years late, holding that the time limit for the election in the regulations is invalid as it is not in the Code. [N*eel, Sara, v. U.S.,* (1966, DC GA) 19 AFTR 2d 779, 266 F Supp. 7]

An application for revocation must be filed no later than 30 days after the end of the partnership tax year as to which the revocation is to take effect. The application must be signed by one of the partners. The IRS is not very liberal at granting a revocation and will not do so if the reason is simply that it is no longer beneficial to the partners, such as a situation where the value of the partnership has declined and there would be negative adjustments to basis. Examples of possible reasons acceptable to the IRS include:

- a change in the nature of the partnership business,
- a substantial increase in partnership assets,
- a change in the character of partnership assets,
- an increased frequency of retirements, or
- shifts of partnership interests that would result in an increased administrative burden from the election.

A partnership without an election may be required to make adjustments if there is a "substantial built-in loss," which is discussed later. These adjustments are made under both §734 and §743. These are mandatory and not elective, so no election is required.

If the election is in effect, then Form 1065, Schedule B, Question 12a, should be answered YES. If the election is in effect and an adjustment was made for the year under either section, then Question 12b should be answered YES and an attachment included with the return showing the computation and the allocation of basis. If no election is in effect but there is a "substantial built-in loss," then Question 12a would be answered NO and Question 12c answered YES with an attachment to the return showing the computation and allocation of the adjustment.



12a Is the partnership making, or had it previously made (and not revoked), a section 754 election? . . . . . See instructions for details regarding a section 754 election.

b Did the partnership make for this tax year an optional basis adjustment under section 743(b) or 734(b)? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions . . . .

c Is the partnership required to adjust the basis of partnership assets under section 743(b) or 734(b) because of a substantial built-in loss (as defined under section 743(d)) or substantial basis reduction (as defined under section 734(d))? If "Yes," attach a statement showing the computation and allocation of the basis adjustment. See instructions

C. Transfers of Partnership Interests

Adjustments to basis may be either elective or mandatory when a partner transfers a partnership interest to another person. The adjustment will not be made if the interest is obtained by a contribution to capital of the partnership. If the §754 election has been made, then the adjustments are considered elective. That being said, if the election is in effect, then they are required.

Basis adjustments are mandatory if there is a "substantial built-in loss." [§743(a)] There are exceptions for electing investment partnerships (EIPs) and securitization partnerships. A partnership has a "substantial built-in loss" if:

- the partnership's adjusted basis in the partnership property exceeds by more than $250,000 the fair market value of the property, or
- the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after the transfer. [§743(d)(1)].

For transfers of partnership interests before January 1, 2018, a partnership had a "substantial built-in loss" only if the partnership's adjusted basis in its property exceeded the fair market value of the property by more than $250,000.

If the election is in effect at the time a transfer of a partnership interest takes place, the partnership must increase or decrease the adjusted basis of its property by the amount by which a transferee partner's basis for his partnership interest differs from his pro rata share of the firm's adjusted basis for its assets. [§743(b)] As a result, the transferee partner will have a different basis for the partnership properties than the other partners. This creates a common basis for all partners and a special basis for the transferee partner.

The transferee's interest in the partnership's property is based on the partner's interest in the previously taxed capital, which is equal to the cash that the transferee would receive on a partnership liquidation following the hypothetical transaction, plus the tax loss. This includes any allocations under Reg. §1.704-3(d) that would be allocated to the transferee from the hypothetical transaction and minus the tax gain that would be allocated to the transferee from the hypothetical transaction. [Reg. §1.743-1(d)(1)] The hypothetical transaction is a hypothetical disposition by the partnership of all of its assets, immediately after the transfer of the partnership interest, in a fully taxable transaction for cash equal to the fair market value of the assets. [Reg. §1.743-1(d)(2)]

Once the amount of the adjustment is determined, an allocation of the basis adjustment must be made to the specific assets. An adjustment is made even if the net adjustment is zero. The adjustment is a three-step process. [Reg. §1.755-1 (a)]

The adjustment must be allocated between ordinary income and capital gain assets. The amount of the basis adjustment that is allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss (including remedial allocations) that would be allocated to the transferee (attributable to the acquired interest) from the sale of all ordinary income assets in the hypothetical transaction. [Reg. §1.755-1 (b)(2)(i)] The amount of the basis adjustment allocated to capital gain property is equal to the amount not allocated to ordinary income. If the decrease in basis to capital gain property exceeds the adjusted basis of such assets, the reduction must be allocated to ordinary income property. An asset in which the transferee partner has no interest in income, gain, losses, or deductions is not taken into account in applying the allocation to the class of capital gain property.

After allocating to a class, the basis adjustment must be allocated to the properties within a class. The amount of the basis adjustment that is allocated to an item of property within the class of ordinary income property is equal to the total amount of income, gain, or loss (including remedial allocations) that would be allocated to the transferee (attributable to the acquired interest) from the sale of the item of property, reduced by a proportionate part of reduction in the total basis adjustment to all ordinary income property because of a lack of sufficient basis in capital gain property. [Reg. §1.755-1 (b)(3)(i)] To capital gain property, the adjustment equals the total amount of income, gain, or loss (including remedial allocations) that would be allocated to the transferee from the sale of the item of property, reduced by the total amount of gain or loss (including remedial allocations) that would be allocated to the transferee from the hypothetical sale of all items of capital gain property, reduced by the amount of the

positive basis adjustment to all items of capital gain or property or increased by the amount of the negative basis adjustment to all items of capital gain property, multiplied by a fraction, the numerator of which is the fair market value of the item of property to the partnership, and the denominator of which is the fair market value of all of the partnership's items of capital gain property. [Reg. §1.755-1 (b)(3)(ii)]

A positive adjustment to depreciable or amortizable assets is treated as new property of the same class as the underlying assets. A negative basis adjustment is recovered over the remaining useful life of the depreciable or amortizable property for the partnership. [Reg. §1.743-1(j)(4)(ii)(8)] If a partner's negative adjustment to depreciation or amortization deductions with respect to a property in a particular year exceeds the partner's allocable share of deductions attributable to such property for the year, the negative adjustment will be applied to depreciation or amortization deductions of other property. If the negative adjustment exceeds all depreciation and amortization deductions allocable to the partner for the year, the partner will recognize ordinary income to the extent of the excess. [Reg. §1.743-1(j)(4)(i)]

If a depletable property's basis is adjusted, depletion is determined separately for each partner, including the transferee. Where properties are depleted at the partner level under §613A(c)(7)(D), the transferee partner must make the basis adjustments as described at Reg. §1.613A-3(e)(6)(iv). [Code Sec. 743(b); Reg. §1.743-1(j)(5)]

If there are successive transfers of a partnership interest, in computing the basis adjustment for the last transferee, any basis adjustments of the predecessor partners are ignored. When a donor makes a gift of a partnership interest, the donor transfers the portion of the basis adjustment attributable to the partnership interest that was the subject of the gift to the recipient.

A partner who receives a distribution of property on which another partner has a special basis adjustment, won't take the adjustment into account. Instead, the transferee partner with the special basis adjustment will reallocate it, under the rules of Reg. §1.755-1(c), to the remaining partnership property.

The basis adjustment has no effect on the partnership's computation of any of its items at the partnership level. Instead, the partnership adjusts the transferee's distributive share of the items allocated to the partner to reflect the effects of the transferee's basis adjustment. The adjustments to the transferee's distributive share do not affect the transferee's capital account. [Reg. §1.743-1(j)(1) & Reg. §1.743-1(j)(2)] However, for this partner, the “inside” and “outside” bases have been conformed.

Example:

	Basis	**FMV**
Cash	$15,000	$15,000
Accounts receivable	15,000	15,000
Inventory	20,000	24,000
Investment land	20,000	40,000
	$ 70,000	$ 94,000
Liabilities	$ 10,000	$ 10,000
A, capital	20,000	28,000
B, capital	20,000	28,000
C, capital	20,000	28,000
	$ 70,000	$ 94,000

X buys A’s interest for its FMV of $28,000 plus relief of liabilities of $3,333. This provides X with an outside basis of $31,333 but his basis in the assets (inside basis) does not change. Not until she disposes of the property will she recover the additional amounts of outside basis. The difference is $8,000 ($31,333 – $23,333).

Allocate net $8,000 adjustment to ordinary income and capital gain assets.

- Ordinary income asset allocation: The amount of the basis adjustment that is allocated to ordinary income property is equal to $1,333
- Capital gain asset allocation: The amount of the basis adjustment that is allocated to capital gain property is equal to $6,667, calculated as follows:
  - Net §743(b) basis adjustment, $8,000
  - Less amount allocated to ordinary income assets, $1,333
  - Equals adjustment allocated to capital gain property, $6,667

	Basis	**FMV**
Cash	$15,000	$15,000
Accounts receivable	15,000	15,000
Inventory	20,000	24,000
Inventory adj. (X)	1,333	
Investment land	20,000	40,000
Investment land adj. (X)	6,667	
	$ 78,000	$ 94,000
Liabilities	$ 10,000	$ 10,000
A, capital	28,000	28,000
B, capital	20,000	28,000
C, capital	20,000	28,000
	$ 78,000	$ 94,000

For T ONLY:

	Basis	**FMV**
Cash	$ 5,000	$ 5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Inventory, T Only	1,333	
Investment land	20,000	40,000
Land, T Only	6,667	
	$ 62,000	$ 76,000
Liabilities	$ 10,000	$ 10,000
T, capital	22,000	22,000
B, capital	15,000	22,000
C, capital	15,000	22,000
	$ 62,000	$ 76,000

D. Adjustments on Distributions

In order to avoid the possible double taxation or duplicate loss, a partnership with a §754 adjustment will be able to adjust the basis of the partnership property to reflect gain or loss recognized or postponed on a distribution. The increase or decrease in basis of the entity's property depends on the distribution's effect on the distributee partner. In determining the basis of the distributed assets in the hands of the partnership and in the hands of the partner, other basis adjustments in the partnership's assets, such as adjustments under §743(b) or §732(b), are taken into account. [Reg. §1.734-1(b)(1)(ii); Reg. §1.734-1(b)(2)(ii)] The basis adjustment is allocated to similar property as the underlying property. If the partnership doesn't have any, it will be used to adjust the basis of later acquired property.

Basis increases to a partnership's recovery property may be depreciated, under any applicable recovery period and method, as if it were newly purchased recovery property placed in service when the distribution or transfer occurs. However, no change is allowed in the depreciation deduction for the portion of the basis of recovery property for which there is no increase. Decreases in the basis of partnership recovery property are accounted for over the remaining recovery period of the property beginning with the period in which the basis is decreased. [Reg. §1.734-1(e)]

E. Special Election on Distribution

There is a special election that may be made by a taxpayer to get the result of a §754 election on a distribution. A distributee partner who acquired any part of his/her partnership interest by transfer and there was not a §754 election in effect, may elect to treat the property as if there was a §754 election in effect for that property. The distribution must be made within two years of the transfer. If the election is made, the adjustment is not reduced by any depletion or depreciation on that portion of the basis of partnership property that arises from the adjustment. [§732]

This election is mandatory if the fair market value of the property exceeds 110% of its adjusted basis at the time the transfer of interest occurred. This applies regardless of whether the distribution is made within two years after the transfer. [§732(d)] Regulations have applied this provision to require the adjustment if the 110% test is met, and:

- an allocation of basis under §732(c) on liquidation of the partner's interest immediately after the transfer would have resulted in a shift of basis from property not subject to depreciation, depletion, and amortization to property subject to these allowances; and
- a §743(b) special basis adjustment would change the basis of the distributed property to the transferee partner.

The election is made on the partner's return for the year of the distribution if the distribution includes any property subject to depreciation, depletion, or amortization. If no such property is included, then the partner elects for any tax year no later than the first tax year in which the basis of any of the distributed property is pertinent in determining. The partnership must provide the transferee with information necessary to compute the basis adjustments. [Reg. §1.732-1(d)]

F. Conclusion

In any partnership, consideration of a §754 election is often presented to the practitioner. It is important to be aware of the rules and their highly complex nature to property advise a client. This is especially important with the need for IRS approval once the election is made.

A. Discussion Problems

Your client, Cara, has interests in two LLCs (ABA LLC and CBA LLC) that are taxed as partnerships. She provides you with the following information:

In ABA LLC, all members have equal interests in capital and profits. Cara believes the LLC has made a §754 election but is unsure. Cara bought her interest in ABA LLC from Brock for $80,000. The balance sheet of ABA LLC immediately before the sale shows the following:

	Basis	**FMV**		**Basis**	**FMV**
Assets			**Capital Accounts**		
Cash	50,000	50,000	Brock	60,000	80,000
Depreciable Assets	130,000	190,000	Alissa	60,000	80,000
			Stu	60,000	80,000
Total	**180,000**	**240,000**	**Total**	**180,000**	**240,000**

Cara has an interest in CBA LLC, taxed as a partnership. Jane, another partner, had a basis of $50,000 in her partnership interest and received a building with a fair market value to the partnership of $100,000 in termination of her interest. Under the general rules of liquidation, Jane took a substituted basis of $50,000 under the proportionate liquidating distribution rules. The partnership had a §754 election in effect for the distribution.

Required:

1) What should be looked at in relation to the §754 election for Cara?

2) What is the adjustment for Cara if a §754 election is in effect, and how is it treated?

3) What is the effect on partnership property on the distribution to Jane from CBA LLC?

B. Suggested Answers to Discussion Problems

1) The first thing that must be done is to determine if a §754 election has been made and not terminated. If so, a determination should be made if it is in the long-term interest of the partners to elect §754 knowing that it is difficult to terminate the election. If it has not been elected and a decision is made to elect it, the election may be made by filing a written statement with the partnership return for the tax year in which the transfer occurs. It must be filed by the due date, including extensions, for such year for filing the partnership return.

2) The adjustment for Cara is the difference between the basis of Cara's interest in ABA LLC and her share of the adjusted basis of the LLC's property. The basis of her interest is Brock's purchase price, or $80,000. Her one-third share of the adjusted basis of the LLC's property is $60,000 ($180,000 × ⅓). The optional adjustment that is added to the basis of the LLC's property is $20,000. The $20,000 basis increase is allocated to the LLC's assets (except for cash). In this case, ABA LLC owns only depreciable assets, so the step up is treated as a new depreciable asset. Depreciation on the step up is allocated only to Cara. If the LLC later sells all of the underlying assets, Cara's share of the gain takes into account any remaining (undepreciated) basis in the step up.

3) If an optional adjustment-to-basis election is in effect, the partnership increases the basis of its remaining property by $50,000. The adjustment will increase the basis of similar property if available. If the partnership doesn’t have any, it will be used to adjust the basis of later acquired property when similar property is obtained.

Critical Minerals—Critical minerals as defined by the Inflation Reduction Act of 2022 include aluminum, antimony, barite, beryllium, cerium, cesium, chromium, cobalt, dysprosium, europium, fluorspar, gadolinium, germanium, graphite, indium, lithium, manganese, neodymium, nickel, niobium, tellurium, tin, tungsten, vanadium, yttrium, arsenic, bismuth, erbium, gallium, hafnium, holmium, iridium, lanthanum, lutetium, magnesium, palladium, platinum, praseodymium, rhodium, rubidium, ruthenium, samarium, scandium, tantalum, terbium, thulium, titanium, ytterbium, zinc, and zirconium. [Code Sec. 45X(c)(6), as added by Act Sec. 13502(a)]

Inflation Reduction Act of 2022—Signed into law on August 16, 2022, this $430 billion bill over 10 years has a stated goal of taming inflation and addressing the climate, tax, and health care issues. According to many economists, however, it will boost the level of GDP by about 0.2%-0.3% by the end of 2031 and will have no measurable impact on inflation. It is a slimmed down version of the $4.3 trillion Build Back Better plan.

Infrastructure Investment and Jobs Act—Public Law No. 117-58, also known as the Bipartisan Infrastructure Framework, was signed into law by President Biden on November 15, 2021 and includes approximately $1.2 trillion in spending to include funding for broadband access, clean water, electric grid renewal, and transportation and road provisions, along with tax-related provisions.

New Energy Efficient Home Credit—The IRA reinstates the credit under §45L available for eligible contractors for building and selling qualifying energy-efficient new homes. Qualified new energy-efficient homes acquired before January 1, 2033 are eligible for credits of $500, $1,000, $2,500, or $5,000, depending on which energy-efficiency requirements the home satisfies and whether the construction of the home meets the prevailing wage requirements.

New Qualified Plug-in Electric Drive Motor Vehicle (NQPEDMV) Credit—A personal tax credit for each new qualified plug-in electric drive motor vehicle placed in service during the tax year. The maximum credit is $7,500, regardless of weight. The credit phases out beginning in the second calendar quarter after that in which a manufacturer sells its 200,000th plug-in electric drive motor vehicle for use in the U.S. after 2009. The Inflation Reduction Act of 2022 extends and modifies this credit.

Setting Every Community Up for Retirement Enhancement (SECURE Act)—Part of the Further Consolidated Appropriations Act, 2020 (H.R. 1865, P.L. 116-94, the SECURE Act was enacted on December 20, 2019. It provides expanded opportunities for individuals for retirement savings and makes a number of administrative simplifications. It also includes a change to the kiddie tax.

CUMULATIVE INDEX 2022

BY TOPIC

BY CITATION

BY SPEAKER

Choose the best response and record your answer in the space provided on the answer sheet.

1. According to Ian Redpath, the minimum threshold for reporting payments on transactions using the 1099-K, *Payment Card and Third-Party Network Transactions*, has been reduced from $20,000 to which of the following for the 2022 tax year??

   A. $6,000
   B. $5,000
   C. $600
   D. $500

2. According to Ian Redpath, on which of the following forms should a corporation report employee retention credit mill activity?

   A. Form 941
   B. Form 1120
   C. Form 3949-A
   D. Form K-1

3. According to Ian Redpath, which of the following is on the Supreme Court docket for review?

   A. Bittner v. United States
   B. Clark Raymond & Company PLLC, et. al. v. Commissioner
   C. Revenue Procedure 2022-19
   D. TC Memo 2022-105

4. Which of the following does Ian Redpath recommend reviewing regarding special allocations and how to handle intangible assets?

   A. Bittner v. United States
   B. Clark Raymond & Company PLLC, et. al. v. Commissioner
   C. IR-2022-189
   D. Revenue Procedure 2022-19

5. According to Ian Redpath, the IRS Criminal Investigation FY 2022 Annual Report indicates that their conviction rate on all prosecuted cases is approximately what percentage?

   A. 10%
   B. 45%
   C. 75%
   D. 90%

Continued on next page

6. According to Ian Redpath and Larry Pon, on what date was the Inflation Reduction Act signed into law?

   A. January 15, 2021
   B. August 16, 2021
   C. January 15, 2022
   D. August 16, 2022

7. According to Ian Redpath and Larry Pon, which of the following is correct regarding the initial critical mineral requirement for sourcing of materials for batteries for electric vehicles, as required by the Inflation Reduction Act?

   A. 100% must come from the United States
   B. 75% must come from the United States or a free trade country
   C. 40% must come from the United States or a free trade country
   D. There are no requirements for sourcing of materials.

8. According to Ian Redpath and Larry Pon, what is the maximum clean vehicle credit available for 2023?

   A. $1,000
   B. $5,000
   C. $7,500
   D. $10,000

9. According to Ian Redpath and Larry Pon, how old must a ***used*** car be to qualify for the previously owned Clean Vehicle Credit in 2024?

   A. At least 2 years old
   B. At least 4 years old
   C. At least 6 years old
   D. At least 10 years old

10. According to Ian Redpath and Larry Pon, what is the modified adjusted gross income limit for married filing jointly taxpayers to take the previously owned Clean Vehicle Credit on a ***used*** car in 2023?

    A. $75,000
    B. $112,500
    C. $150,000
    D. $300,000

Continued on next page

11. According to Ian Redpath and Bob Lickwar, which of the following describes inside basis?

    A. A partner's basis in his partnership interest
    B. A partner's income distribution for the year
    C. The partnership's basis in assets owned by the partnership
    D. The partnership's outstanding liabilities

12. According to Ian Redpath and Bob Lickwar, which of the following describes outside basis?

    A. A partner's basis in his partnership interest
    B. A partner's income distribution for the year
    C. The partnership's basis in assets owned by the partnership
    D. The partnership's outstanding liabilities

13. According to Ian Redpath and Bob Lickwar, which of the following allows a Partner A to equalize her inside and outside bases in Partnership ABC?

    A. A 743(b) election by Partner A
    B. A 743(b) election by Partnership ABC
    C. A 754 election by Partner A
    D. A 754 election by Partnership ABC

14. According to Ian Redpath and Bob Lickwar, which of the following is used to request revocation of a Section 754 election?

    A. Schedule K-1
    B. Form 1065
    C. Form 8308
    D. Form 15254

15. According to Ian Redpath and Bob Lickwar, which of the following is used for notification regarding sale of a partnership interest?

    A. Schedule K-1
    B. Form 1065
    C. Form 8308
    D. Form 15254

CPE Network®
Tax Report
Volume 35, Issue 11 **December 2022**

Subscriber Survey

Evaluation Form

Please take a few minutes to complete this survey related to the **CPE Network® Tax Report** and return it by mail to 2395 Midway Road, Carrollton, Texas 75006, Attn: Managing Editor. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to **CPLgrading@thomsonreuters.com.**

How would you rate the topics covered in the December 2022 **CPE Network® Tax Report?** Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	**Topic Content/ Coverage**	**Topic Timeliness**	**Video Quality**	**Audio Quality**	**Written Material**
Experts' Forum	|_____|	|_____|	|_____|	|_____|	|_____|	|_____|
Electric Vehicle Tax Credits	|_____|	|_____|	|_____|	|_____|	|_____|	|_____|
Section 754 Election and Section 743(b) Adjustments	|_____|	|_____|	|_____|	|_____|	|_____|	|_____|

Which segments of the December 2022 issue of **CPE Network® Tax Report** did you like the most, and why?

Which segments of the December 2022 issue of **CPE Network® Tax Report** did you like the least, and why?

What would you like to see included or changed in future issues of **CPE Network® Tax Report**?

Are there any other ways in which we can improve **CPE Network® Tax Report**?

How would you rate the effectiveness of the speakers in the December 2022 **CPE Network® Tax Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Ian Redpath	_____	_____	_____
Larry Pon	_____	_____	_____
Robert Lickwar	_____	_____	_____

Which of the following would you use for viewing CPE Network® A&A Report? DVD ☐ Streaming ☐ Both ☐

Are you using **CPE Network® Tax Report** for: CPE Credit ☐ Information ☐ Both ☐ _____

Were the stated learning objectives met? Yes ☐ No ☐ _____

If applicable, were prerequisite requirements appropriate? Yes ☐ No ☐ _____

Were program materials accurate? Yes ☐ No ☐ _____

Were program materials relevant and contribute to the achievement of the learning objectives? Yes ☐ No ☐ _____

Were the time allocations for the program appropriate? Yes ☐ No ☐ _____

Were the supplemental reading materials satisfactory? Yes ☐ No ☐ _____

Were the discussion questions and answers satisfactory? Yes ☐ No ☐ _____

Were the audio and visual materials effective? Yes ☐ No ☐ _____

Specific Comments: _____

_____

Name/Company _____

Address _____

City/State/Zip _____

Email _____

Once Again, Thank You…
Your Input Can Have a Direct Influence on Future Issues!

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: _____

Account #: _____

Location: _____

Program Title: CPE Network Tax Report, December 2022 Date: _____

Name	Email	Total Hrs	IRS PTIN ID (if applicable Tax only)	Sign In	Sign Out

I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network® newsletter, and earned the number of hours shown.

Instructor Name: _____ Date: _____

E-mail address: _____

License State and Number: _____

Group Study PO Box 115008, Carrollton, TX 75011 -5008 Fax (888) 286.9070 CPLgrading@thomsonreuters.com

CPE Network/Webinar Delivery Tracking Report

Course Title	
Course Date:	
Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of 3 times per CPE hour. This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

			First CPE Hour			CPE Hour 2			CPE Hour 3			FOR TR USE ONLY
First Name	Last Name	Student Email	Poll 1	Poll 2	Poll 3	Poll 1	Poll 2	Poll 3	Poll 1	Poll 2	Poll 3	Certificate Issued?

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED SEPTEMBER 3, 2021

Welcome to CPE Network!

CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- **"Group Live" Format:** The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- **"Group Internet Based" Format:** Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- **"Self-Study" Format:** Each participant can take the self-study version of the CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants

following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to Thomson Reuters.

If you have any questions on this documentation or requirements, refer to the "Getting Help" section at the end of this User Guide **BEFORE** you conduct your training.

We are happy that you chose CPE Network for your training solutions. Thank you for your business and HAPPY LEARNING!

“Group Live” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at “group live” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **attendance sheet.** This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they

attended should be documented on the sign-in sheet and will be reflected on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a **qualified, real time instructor while the program is being presented.** Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study either in print or online.

- If the print materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his/their CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group live" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the "group live" session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group live" session, it is required that the firm hosting the "group live" session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- https://get.adobe.com/reader/

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your "group live" session should be sent to Checkpoint Learning Network by one of the following means:

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

Email: **CPLgrading@tr.com**

Fax: 888.286.9070

When sending your package to Thomson Reuters, you must include ALL of the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Attendance Sheet		Use this form to track attendance during your training session.
Subscriber Survey Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to Thomson Reuters any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at “group internet based” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report.** This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism) to periodically check the participants’ engagement throughout the delivery of the program.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and ask that participants confirm their attendance by using the "raise hands" feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone's hands and continues the training.
2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing "Present" into the Teams chat box. The moderator records the participants who have entered "Present" into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app's report.

Additional Notes on Monitoring Mechanisms:

1. The monitoring mechanism does not have to be "content specific." Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
2. You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
4. **You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a "group internet based" delivery format.**

Real Time Moderator During Program Presentation

"Group internet based" programs must have a **qualified, real time moderator while the program is being presented.** Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers

during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Make-Up Sessions

Individuals who are unable to attend the "group internet based" session may use the program materials for self-study either in print or online.

- If print materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group internet based" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the "group live" session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group internet based" session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be "virtual") of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. It should look something like the screenshot below. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- https://get.adobe.com/reader/

Alternatively, for those without a DVD drive, the email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your "group internet based" session should be sent to Checkpoint Learning Network by one of the following means:

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008
Email: **CPLgrading@tr.com**

Fax: 888.286.9070

When sending your package to Thomson Reuters, you must include ALL the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Webinar Delivery Tracking Report		Use this form to track the attendance (i.e., polling questions) during your training webinar.
Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to Thomson Reuters any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Self-Study” Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Print

Follow these simple steps to use the printed transcript and DVD:

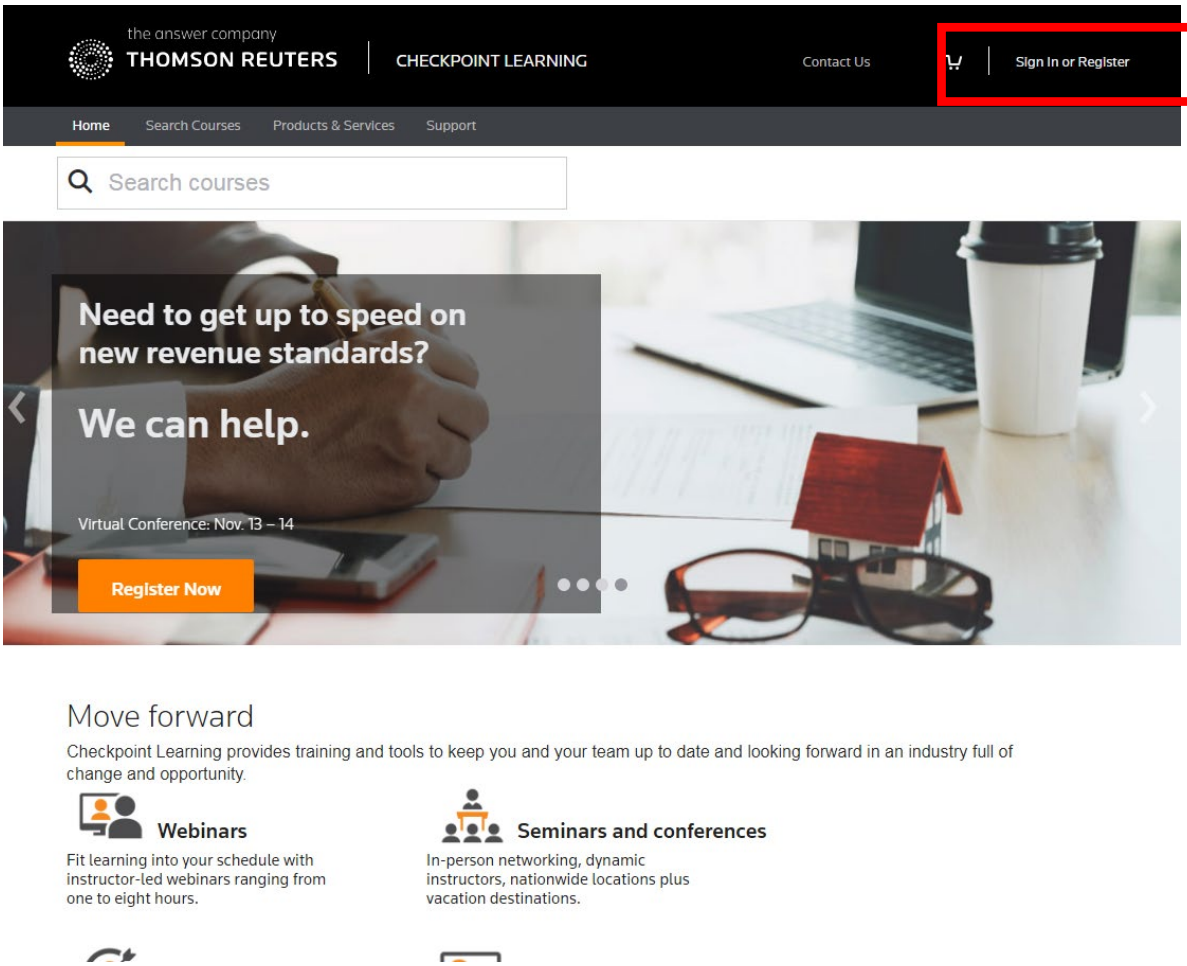
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- Mail your completed quizzer and survey to:

  Thomson Reuters
  PO Box 115008
  Carrollton, TX 75011-5008

Self-Study—Online

Follow these simple steps to use the online program:

- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Sign In or Register”).



Move forward

Checkpoint Learning provides training and tools to keep you and your team up to date and looking forward in an industry full of change and opportunity.

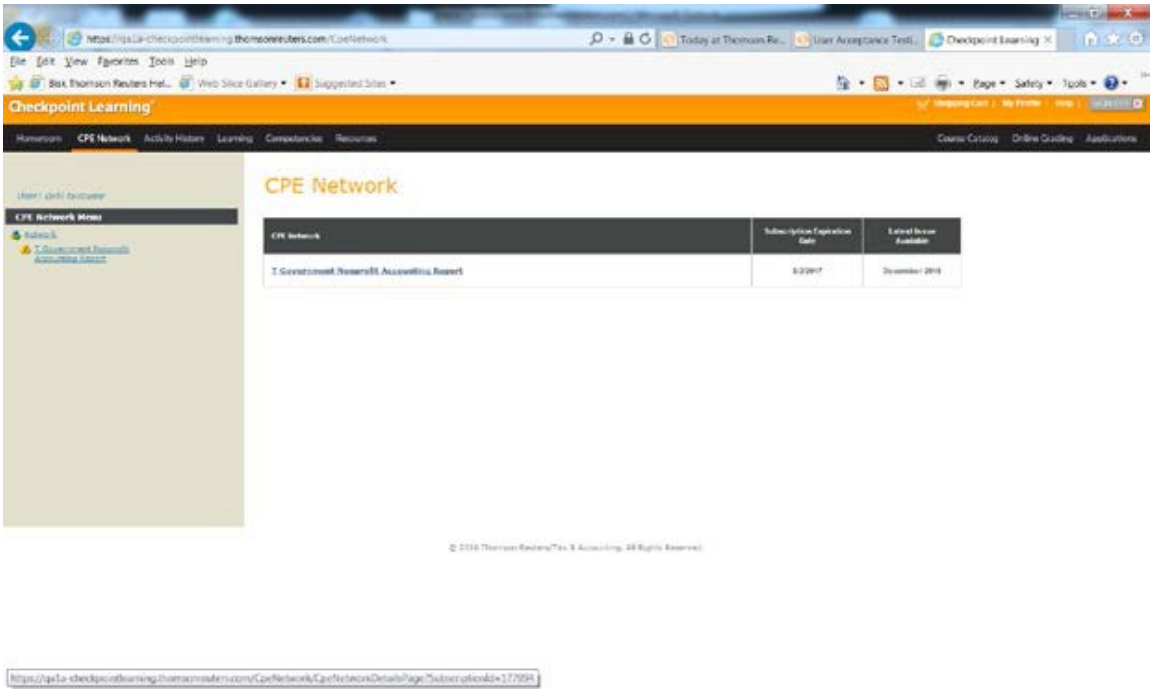
Webinars

Fit learning into your schedule with instructor-led webinars ranging from one to eight hours.

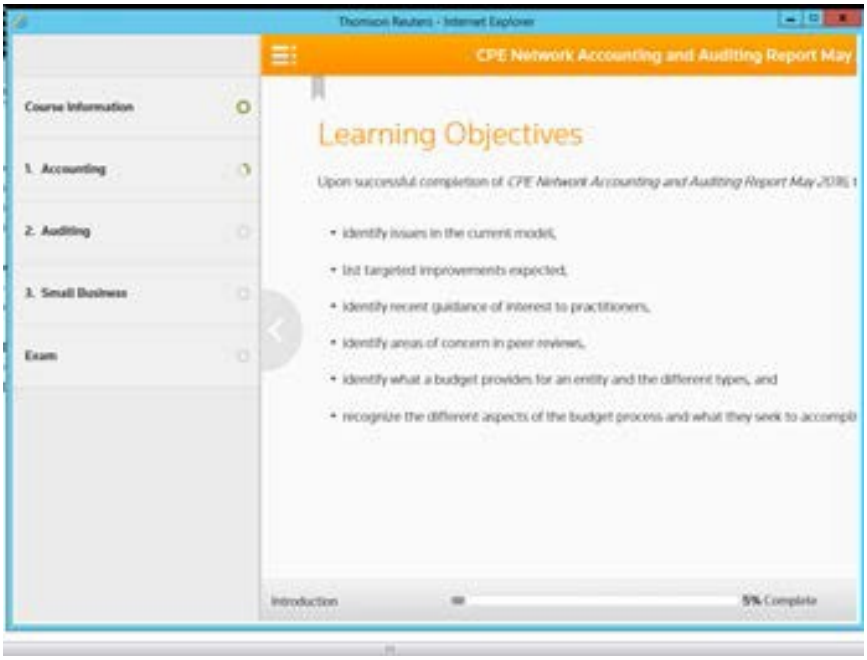
Seminars and conferences

In-person networking, dynamic instructors, nationwide locations plus vacation destinations.

- In the **Network** tab, select the Network Report for the month desired.

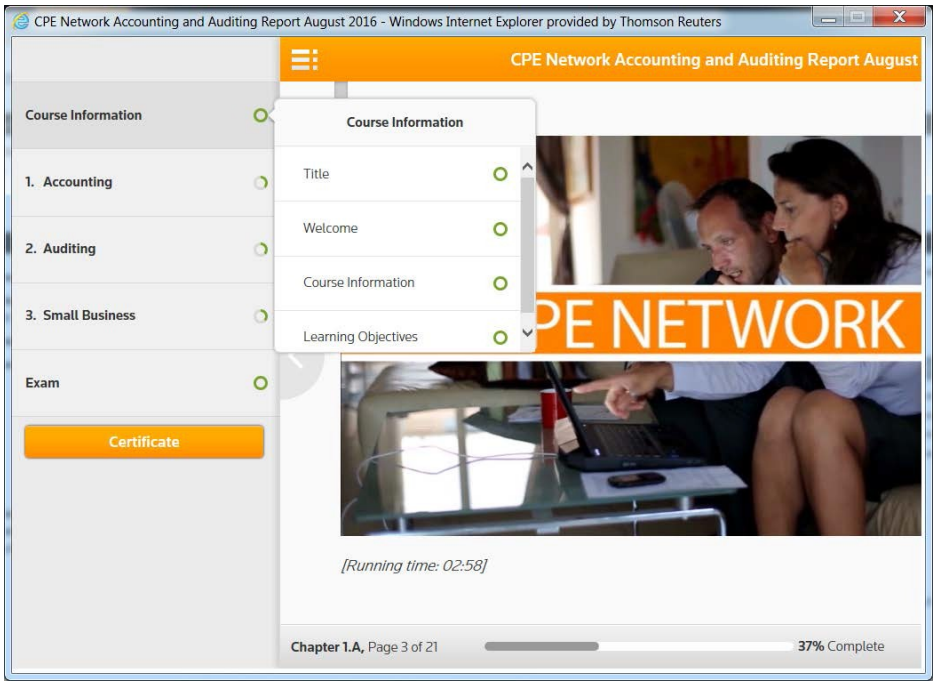


The Chapter Menu is in the gray bar at the left of your screen:



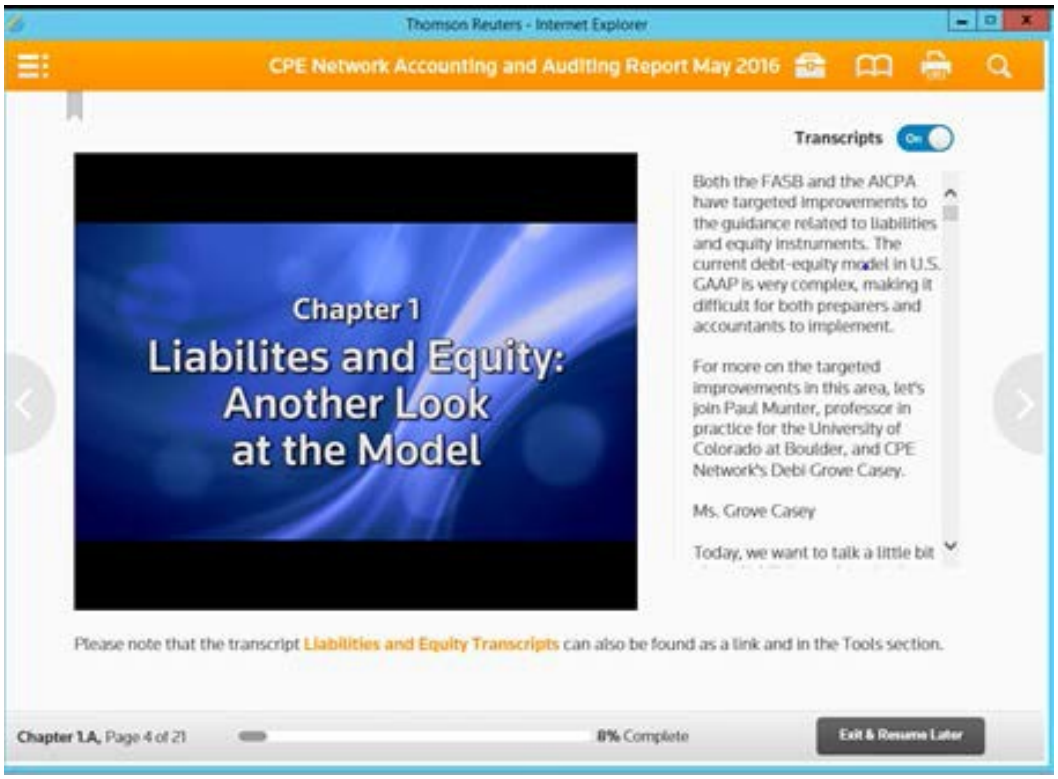
Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives

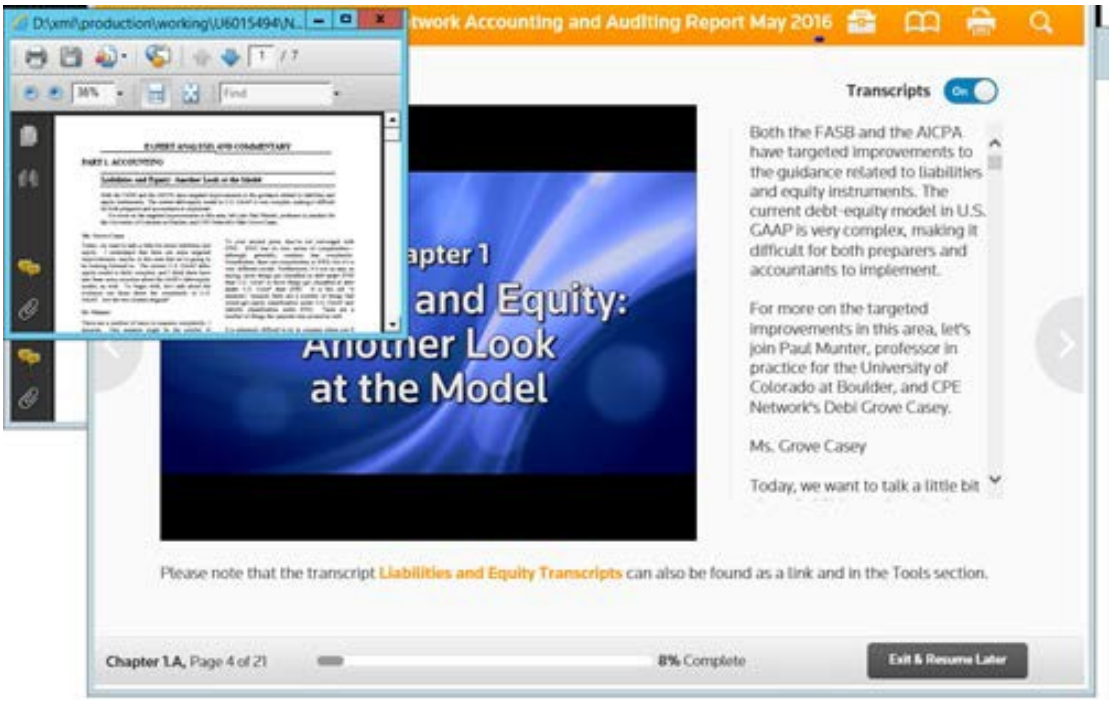


- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This more streamlined approach allows administrators and users to more easily access the related materials.

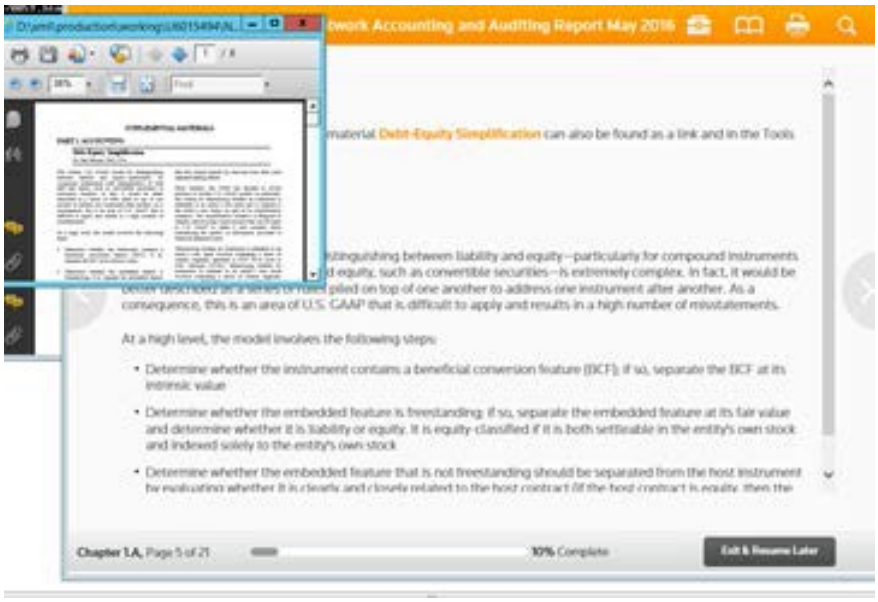
Video segments may be downloaded from the CPL player by clicking on the download button.



Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.

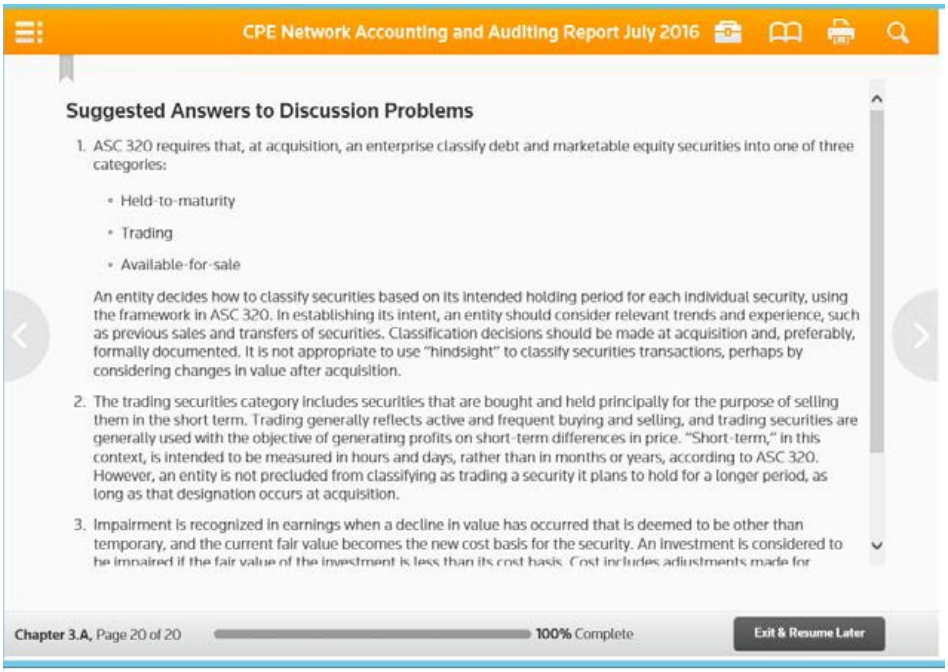


Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



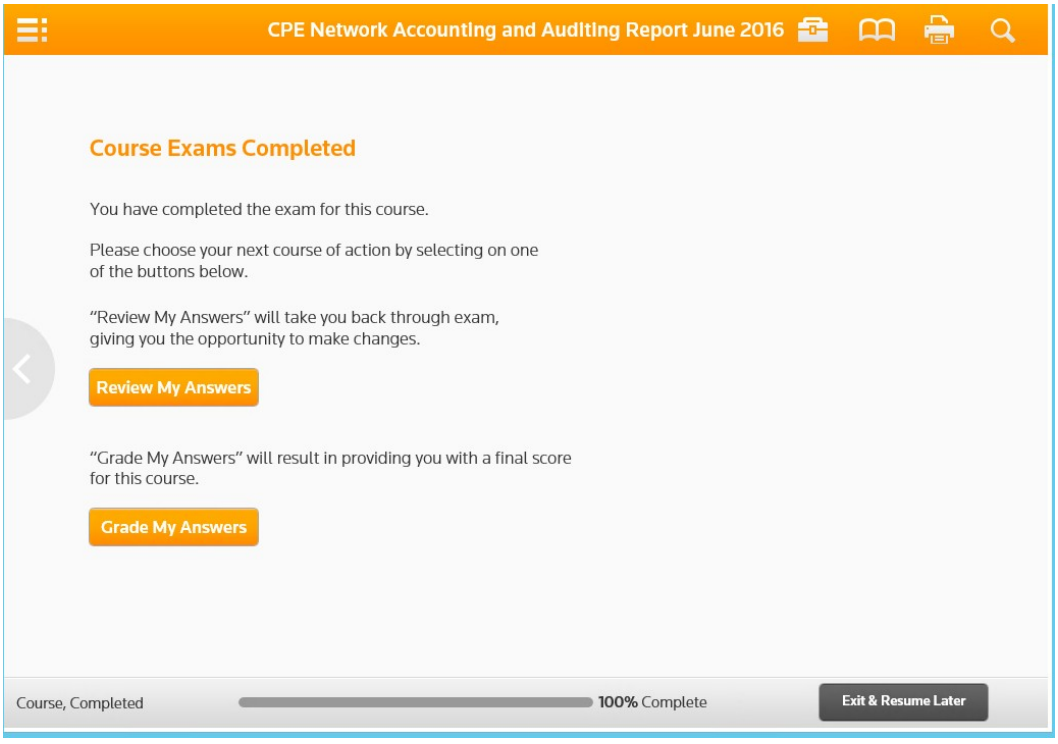
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

The Suggested Answers to the Discussion Problems follow the Discussion Problems.



The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the quizzer, click the button labeled **Grade or the Review button**.



- Click the button labeled **Certificate** to print your CPE certificate.
- The final quizzer grade is displayed and you may view the graded answers by clicking the button labeled **view graded answer**.

Additional Features Search

Checkpoint Learning offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. **For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements.** Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and "no shows")
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants' attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following

information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits**).**

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a qualified, real time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early. Attached is a sample *Certificate of Attendance* you may use for your convenience.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate.
3. Program materials were accurate.
4. Program materials were relevant and contributed to the achievement of the learning objectives.
5. Time allotted to the learning activity was appropriate.
6. Individual instructors were effective.
7. Facilities and/or technological equipment were appropriate.
8. Handout or advance preparation materials were satisfactory.
9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic

signable format)

- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" / "Group Internet Based"	Advertising / Promotional Page	Transcript	Complete this form and circulate to your audience before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track attendance during your training session.
"Group Internet Based"	Webinar Delivery Tracking Report	Transcript	Use this form to track the 'polling questions' which are required to monitor attendance during your webinar.
"Group Live" / "Group Internet Based"	Evaluation Form	Transcript	Circulate the evaluation form at the end of your training session so that participants can review and comment on the training.
Self Study	CPE Quizzer Answer Sheet	Transcript	Use this form to record your answers to the quiz.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	800.431.9025 (follow option prompts	checkpointlearning.techsupport@thomsonreuters.com	• Browser-based • Certificate discrepancies • Accessing courses • Migration questions • Feed issues
Product Support	800.431.9025 (follow option prompts	checkpointlearning.productsupport@thomsonreuters.com	• Functionality (how to use, where to find) • Content questions • Login Assistance
Customer Support	800.431.9025 (follow option prompts	checkpointlearning.cpecustomerservicet@thomsonreuters.com	• Billing • Existing orders • Cancellations • Webinars • Certificates