



CPE NETWORK

TAX REPORT

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EXECUTIVE SUMMARY

PART 1. DISASTER RELIEF

WHEN DISASTER STRIKES – FEDERAL TAX RELIEF: PART 2..... 4

Laurie Stillwell explores both temporary and permanent federal disaster relief provisions, including the recently enacted Federal Disaster Tax Relief Act of 2023, that help individual taxpayers and businesses recover financially from the impact of a disaster. Relief may include the postponement of certain tax-filing and tax-payment deadlines, excludible qualified disaster relief payments, and deductible casualty losses. This month, Part 2 covers disaster relief payments, involuntary conversions, and postponement of certain tax-filing and tax-payment deadlines for taxpayers who reside or have a business in the disaster area. *[Running time: 31:37]*

Learning Objective:

Upon completion of this segment, the user should be able to:

- Identify taxable and non-taxable disaster relief payments, including those covered under IRC Sec. 139.
- Recognize the tax implications and deferral options available for involuntary conversions of property under IRC Section 1033, including special rules for principal residences affected by federally declared disasters.
- Understand the postponement of tax-filing and tax-payment deadlines provided under IRC Section 7508A, including mandatory and discretionary extension periods, and the triggering events for such relief.

PART 2. PARTNERSHIPS

PARTNERSHIP BASIS, SEC. 754 ELECTION, AND SEC. 743(B) ADJUSTMENTS 56

Ian Redpath explores partnership basis and the Section 754 election, with a focus on the complexities and practical implications of Section 743(b) adjustments. Through detailed explanations and illustrative examples, he covers inside basis, outside basis, and capital accounts before discussing the 754 election as it applies to the 743(b) adjustment on a transfer of a partnership interest. *[Running time: 58:22]*

Learning Objective:

Upon completion of this segment, the user should be able to:

- Define and differentiate among key partnership basis concepts, including outside basis, inside basis, and capital accounts.
- Identify the tax implications of contributing services or property to a partnership and apply relevant provisions of IRC Sections 83, 704(c), 743(b), and 754 to partnership transactions.
- Recognize the circumstances that warrant or trigger a Section 754 election, explain its purpose, and determine how Section 743(b) adjustments affect the transferee partner.

PART 3. ARTIFICIAL INTELLIGENCE (AI)

USING AI IN YOUR PRACTICE..... 70

Renee Rodda, JD, explores the rapidly evolving role of artificial intelligence (AI) in the tax profession. While AI is generating both excitement and apprehension among practitioners, it offers a range of opportunities to improve efficiency, accuracy, and client service from streamlining tax research to enhancing document review and communication. However, its limitations, particularly around data accuracy, privacy, and the need for human judgment, mean that thoughtful implementation is essential. This discussion addresses the benefits, challenges, and best practices for integrating AI into your tax practice.
[Running time: 18:14]

Learning Objective:

Upon completion of this segment, the user should be able to:

- Identify appropriate and secure uses of artificial intelligence (AI) in a tax practice, including the importance of effective prompt design.

ABOUT THE SPEAKERS

Laurie Stillwell, CPA, is licensed in New York. Her firm, Laurie A. Stillwell, CPA, P.C., specializes in working with small businesses, professional practices, and their owners. In addition to her practice, Laurie teaches continuing professional education seminars and webinars on ethics, business, and individual income tax issues. She is the author and editor of several continuing professional education texts and handbooks. Prior to forming her firm in 2001, Laurie spent more than a decade with local and regional accounting firms and specialized in providing tax and accounting services to closely-held businesses. She began her public accounting career with the international firm of Price Waterhouse, in Boston, Massachusetts.

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 Office. 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 developing, writing, and presenting professional CPE programs. In addition to his active tax practice, he serves as Chairman of the Department of Accounting, Director of Graduate Accounting Programs, and Professor of Taxation and Forensic Accounting at Canisius College in Buffalo.

Renee Rodda, JD, is Senior Vice President of Tax and Accounting for CeriFi, LLC. She is the editor of Spidell's California Taxletter and Spidell's Analysis & Explanation of California Taxes. She has been educating tax professionals for more than 20 years. Renee is also a member of the advisory board for the Franchise Tax Board, the California Department of Tax and Fee Administration, and the Board of Equalization. She is a graduate of Chapman University School of Law with a Tax Law Emphasis.

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PART 1. DISASTER RELIEF

When Disaster Strikes – Federal Tax Relief: Part 2

Welcome to the first segment of this month's program. In this series, Laurie Stillwell explores both temporary and permanent federal disaster relief provisions, including the recently enacted Federal Disaster Tax Relief Act of 2023, that help individual taxpayers and businesses recover financially from the impact of a disaster, especially when the federal government declares their location to be a major disaster area. Relief may include the postponement of certain tax-filing and tax-payment deadlines for taxpayers who reside or have a business in the disaster area, excludible qualified disaster relief payments, deductible casualty losses, and more. This month, Part 2 covers disaster relief payments, involuntary conversions, and postponement of certain tax-filing and tax-payment deadlines for taxpayers who reside or have a business in the disaster area.

Let's join Laurie.

Ms. Laurie Stillwell

We're going to switch gears here and talk about certain disaster relief payments. This is going to key in... We're really, for our purposes, going to focus on what are called qualified disaster relief payments under Section 139. And I don't intend this slide to be everything that a taxpayer, especially certain state and local resources, could expect to receive in the wake of the disaster, but these are the ones that our clients are most likely to be impacted by.

Federal disaster relief grants. So, for example, money to cover medical expenses. That's not going to be taxable at the federal level. I have to leave you to your own research devices for state and local tax impacts.

Disaster relief grants for businesses from the states. We saw a lot of this, uh, during, for example, the COVID pandemic. Two things here. That is generally going to be a taxable event at the federal level. However, depending on what the state grant, the nature of it, and what those receipts can or are used for, the involuntary conversion rules may apply under Section 1033, and the gain, while realized, could be postponed.

Section 139, these are qualified disaster relief payments. That's just a no, not taxable at the federal level. Sometimes it's an employer plan. Sometimes it's money from a government charitable organization. And we're going to key in under recent legislation two very specific types of qualified disaster relief payments that will escape federal taxation.

Qualified disaster mitigation payments, again, not taxable. For example, you have a taxpayer with a home on the shores, oceanfront, in North Carolina, and they may receive money, let's say through a, a local funding source, uh, \$80,000 to move that home up on stilts. That's an example of a qualified disaster mitigation payment. It's not taxable income to them, not at the federal level, but nor do they get to build basis for the cost of putting that home on stilts to the extent of the excluded funds.

Insurance reimbursements for normal living expenses, well, that's going to be taxable because you were going to make those payments anyway. But what about a taxpayer that has to move out of an apartment, and their rent was \$2,000 a month, and they now need to spend far more than that in temporary housing, maybe even a hotel, for insurance reimbursements for that delta, for the increased temporary living expense, excludable at the federal level. Any type of insurance reimbursement for rental income, I will say typically lost wages, uh, lost business, that is typically going to be taxable at the federal level.

Let's dig a little deeper here into Section 139. It is titled Disaster Relief Payments. General rule, gross income shall not include any amount received as an individual qualified disaster relief payment. Amount received by businesses, by and large, folks, going to be taxable events, and gross sales, gross receipts, gross revenues, let's say on that 1120S.

Individuals under Code Section 139 can exclude qualified disaster relief payments. So when we talk about that, what is that? Well, this is actually defined under Code Section 139. These are going to be amounts paid to or on behalf of an individual, not businesses. Businesses, they don't qualify for this exclusion under Code Section 139. These are going to be amounts paid to or on behalf of individuals to reimburse them or to pay reasonable and necessary personal, family, living, or funeral expenses incurred specifically as a result of a qualified disaster, to reimburse or pay reasonable and necessary expenses for the repair or rehabilitation of a personal residence or its contents or replacement thereof, again, attributable to a qualified disaster, by a person... And please know that need not be a natural person. I'm going to give you an example of this as we move forward. Engaged in the furnishing or sale of transportation, they're a common carrier. So think a, an airplane. By reason of death or personal physical injuries incurred as a result of a disaster, or if a federal, state, or local government or agency pays the amount in connection with a qualified disaster because it's been determined under their rules that's in, uh, the community's best interest to promote general welfare.

I will tell you anecdotally these have gotten much more popular, Section 139 plans, uh, at the employer level, as an excludable fringe benefit. And that's wonderful. Love a good fringe benefit, right? Employers get to take the deduction. Employees can exclude the amount. Just a word of caution there, um, that if you advise employers that either have or are looking to implement 139 plans, documentation and adherence to plan written policy is very, very important. So employers should have a written policy. They should determine who and what will be eligible, what types of disasters, what type of expenses will be covered. What is the methodology? Let's say caps on reimbursement. What type of documentation will they require from their employees for participation to receive reimbursement in the 139 plan? We want to make sure that employers really button that up tight.... because if a payment to an employee, an individual, at the end of the day under IRS scrutiny, is not deemed to be a 139 payment, then it's going to be taxable W-2 compensation, which is not a result that the employer is going to wish for.

There are two new provisions specifically under this Federal Disaster Tax Relief Act of 2023, enacted on December 12th of 2024, that we're now going to look at. The first are amounts received on or after February 3rd of 2023, that was the date of train derailment by what is now titled the East Palestine Train Derailment Payment System. So you're going to see, we're going to talk about what those payments are. This was, again, February 2023, a train derailment, big catastrophe, uh, in East Palestine. These payments now at the federal level, and we're going to define these together on the next slide, East Palestine Train Derailment Payments, are completely excludable from federal gross and taxable income. These train derailment payments are going to mean any amounts received on or behalf, again, of an individual. Payments received by businesses, that's going to be taxable. This is specifically compensation for loss, damage, expense, loss in real property value, closing costs with respect to real property, so that, think damaged property with a lesser fair market value sold after the date of derailment, and that can include realtor commissions or inconvenience payments, actually up to \$1,000. The 2024 1040 instructions note, received specifically from either a government, an agency, an instrumentality thereof, the common carrier itself, which is Norfolk Southern Railway, or any subsidiary, insurer, agent or successor to that common carrier. Again, quick note, state and local taxation. I leave that research to you, but these are completely excludable. There will be no 1099 reporting for these payments at the federal level.

The second component of the recent federal disaster related legislation is that federal gross income will not include any amount received, again, not by a trade or business, but by an individual, as what is called a Qualified Wildfire Relief Payment. This is what that is. Any payments received on or on behalf of an individual, so by or on behalf of a person, not a business, is compensation for loss, expense, damage, personal injury, death, emotional distress incurred as a result of a qualified wildfire disaster. Again, no double dipping, assuming that the same amount of loss has not already been compensated, let's say via an insurance check. A qualified wildfire disaster, look at the span of time here, means any federally declared disaster after 2014, after 2014 specifically as a result of a forest or range fire.

This only applies, doesn't go all the way back to 2015. The disaster does, but when we talk about the receipt of the payment itself, we are talking about excluding from federal gross and taxable income these qualified wildfire relief payments received by people in 2020 through 2025.

You would be quite correct in thinking, "Well, wait a second, Laurie, if I go back to 2020, I can't exclude those amounts because my client's statute of limitations for those early year or years has already closed. Their ability to get a credit or a claim for refund, it's gone." Fortunately, Congress followed that through. We don't have a huge window, but you have a year specifically for those early year or years. Now, maybe we go back, we're going to do an amendment, we're going to exclude from federal gross and taxable income these qualified wildfire relief payments. They have extended the statute of limitation specifically under Code Section 6511. That's your claim for refund one year from the date of enactment, so December 12th of 2025.

We're going to talk here just very briefly about involuntary conversions, and I say that because when we talk about Section 1033, there are a lot of different rules for involuntary conversions. So for example, farmers, agricultural taxpayers that are impacted by long periods of drought have very specific involuntary conversion rules under code section 1033 if they need to sell livestock prematurely due to that drought. We're not going to cover that here today. What we're going to specifically key in on is Section 1033(h).

Involuntary conversion. I have to be frank with you, that terminology never made any sense to me until I realized I had something, I don't have it anymore, it's been taken from me here as a result of a casualty, and what I got instead is insurance reimbursement. I have been, my asset has been involuntarily, against my will, converted to cash, converted to money. We mentioned couple of times earlier that it is not at all out of the realm of, of common insurance proceeds to exceed the tax basis of that destroyed property. If you do not reinvest under these involuntary conversion rules under 1033 specifically here (h) , that's a reportable casualty gain. We said generally for businesses, Form 4797, for individuals, Schedule D.

Let's talk here first about trade or business or investment property, so 1033(h) reinvestment. You have a realized, but not recognized gain, if property either held for use in a trade or business, or property held for investment is involuntarily converted because of a federally declared disaster, and is replaced with stuff, tangible property used in a trade or business. But now two caveats: one's good, one's not so good. It doesn't have to be like replacement property. So for example, my effective trade or business could have been a bowling alley, and I could take the dollars and open up a laundromat. It's not like the Code Section 1031 like-kind exchange rules. Replacement property does not need to be similar use to the involuntarily converted property.

However, here's where we do have a, a conundrum. Property loss could be either business or investment... but to have the involuntary conversion rules apply, you must reinvest in trade or business property. So, another way to say that is, I can have two kinds of stuff, business or investment, and I can reinvest that gain. But I can't reinvest in investment assets, I have to reinvest the gain for 1033 involuntary conversion purposes into trade or business property.

Now let's talk about a situation that taxpayers find themselves in, unfortunately, a lot. How do the involuntary conversion rules for people, individuals, they're in a disaster area, and now it's their principal residence. So, how does 1033 and Code Section 121, that's your gain exclusion code section, how do those two impact one another? Let's follow through the rules.

We have a principal residence, and we're going to use our Code Section 121 gain exclusion rule to determine that, right? Facts and circumstances. That principal residence is in a disaster area, and it's involuntarily converted. First rule, no gain is recognized on the receipt of insurance proceeds for what is called unscheduled personal property. Remember Juan's couch? That's unscheduled personal property. If you go and you look at your homeowner's policy, you're going to see contents. They're not specific that my couch is in there. That's what's called unscheduled personal property, and that is going to be free in terms of no federal casualty gain regardless of what our basis is, or as compared to the insurance. So, that's good news.

Number two, any insurance proceeds for the actual house itself in what are called separately scheduled contents, we don't have to, but we can choose to put those together. Separately scheduled contents, maybe it's that art collection that we talked about, something that is specifically carved out and treated as specific contents with a specific amount of insurance coverage. The taxpayer then can elect to recognize gain only to the extent that the funds exceed the cost of replacing both the residence and the contents. And any type of replacement contents, whether separately or non-separately scheduled, can go into this conversation. Insurance proceeds for separately scheduled property does not have to be reinvested. You can, but it doesn't have to be reinvested in the same type of property. You could just put it into a more expensive home. So, for example, let's say you get \$50,000 for that stamp collection that's now been destroyed. That \$50,000 could go back into a stamp collection, could go into an art collection, or could just go into the replacement principal residence.

Here, you have four years. Normally, when it comes to the involuntary conversion rules, you have two years. But because it's your principal residence, you have four years to reinvest. Recognize, take that gain off the table, four years after the close of the year in which the casualty gain was realized. Now, let's talk about how it impacts and coordinates with the Section 121 gain exclusion. Remember, that's a quarter of a million dollars if you meet all three use, ownership, two out of five-year rule under 121, or \$500,000 when both married filing joint spouses qualify. Any portion of the gain that is not otherwise sheltered under the 121 rules can be deferred, as we just talked about, under the involuntary conversion rules. And applying the 1033 involuntary conversion rules for whatever gain is left, the amount realized, generally insurance proceeds, is first going to be reduced by the gain excluded under 121.

That's pretty complicated, so let's reinforce that here with an example. In March of 2025, a federally declared disaster destroys Dan's personal residence. You go and you look at your original calculation, bought it, capitalized related closing cost, has a basis of \$70,000. Dan is single, and he meets the 121 gain exclusion rule. It's been his principal residence, owned and used for a decade. Dan receives \$400,000 in insurance proceeds, so he has a realized gain right now of \$330,000. That's how taxpayers can find themselves in the personal casualty gain situation. In November of 2025, he buys a new house with a cost of \$130,000. All right. Well, \$121,000 is going to spring in to help. So, the first thing that Dan will do is exclude his quarter of a million dollars of realized gain. In applying the Section 1033 involuntary conversion to the remaining gain, the amount realized is now treated as \$150,000. We had \$400,000 in insurance. We sheltered \$250,000 under 121. That nets out our amount realized to \$150,000. That's going to drop our realized gain now down to \$80,000. I have \$150,000 in proceeds. I had \$70,000 on the converted home. Our realized gain is \$80,000. However, I had \$150,000 net. I reinvested \$130,000 at the end of the day. So, even though my realized gain is \$80,000, my recognized, put it on my tax return Schedule D that year, 2025, is only \$20,000. The rest of the \$80,000 is still there. The \$60,000 theoretically is still there, because Dan has had to decrease his basis in the replacement property, \$130,000 minus the \$60,000. So, we've preserved the gain potential. We have, however, postponed it. Dan will not have that gain until somewhere down the road, he has another taxable disposition of that property. At which point, 121 will likely help him again.

The last component of our conversation is just a brief look at the postponement rules. There are, under this Code Section 7508A, there are two sets of rules. One is mandatory, 60-day automatic pause button on tax filing and certain tax payment deadlines. And IRS has the discretion to give up to, up to a one-year pause button, again, for taxpayers, both individual and business, impacted by federally declared disasters.

Let's start with the discretionary rule, and the IRS does not provide blanket relief here. There are some disasters where the IRS is very generous, and there are other disasters where they don't even exercise this up to one-year discretionary postponement period, and lots of situations in between. I will give you, to wrap up our chat, a couple of IRS resources where you can check what the IRS relief is. Sometimes they update it, sometimes they expand it by a disaster, by a disaster.

For taxpayers affected by a federally declared disaster or what's called a significant fire, IRS may specify up to one year that can be disregarded as it pertains to certain time-sensitive acts, and we're going to talk a little bit more about that as we move forward.... it puts the pause button on any accruing interest, failure to pay penalty, failure to, uh, file penalty, as well as extends the statute of limitation that would otherwise apply, let's say, for claim of refund or credit.

Certain time-sensitive acts. We get relief on the taxpayer side. The government's going to get relief as well, right? We extend for everybody. Let's look first at acts performed by the taxpayer. Filing of returns, and again, the IRS is very specific. This is not a one-size-fits-all. You don't get everything. They will carve out the package that they offer on a disaster-by-disaster basis.

Payment. Now, that's generally going to apply to things like income taxes, but isn't going to apply, for example, in most cases, to employers remitting employees' withholding taxes. Making contributions to things like employer retirement plans, recharacterizations, required minimum distributions, rollovers.

D, filing a petition, let's say, with the Tax Court. Filing a claim for refund or credit. You don't like your Tax Court outcome, bringing a suit. Or in... I'm going to give you a resource for this as we move forward, anything else that they feel like, and there's one big resource that you're going to find to be pretty helpful here. I'll share that with you in just a slide or two.

The government also gets time to assess, to ask for it, right, give notice or demand, to levy, to bring suit, to allow a credit or refund. That's basically the other side of the statute of limitation, or anything else that the Department of Treasury may determine.

Who gets this? I'm a person. My principal residence is in the disaster area. Business. My principal place of business is in the disaster area. We see it. Maybe it's an American Red Cross volunteer, relief worker. My principal residence or my personal place of business isn't in the disaster area, but my records are. An estate or trust that has records necessary to meet a deadline, and those records are maintained and housed in one of the covered disaster areas. The spouse. Any individual, business entity, including a sole proprietorship. You're not in the disaster area, but my records necessary to meet a deadline are indeed there. Any individual visiting the covered disaster area that's injured or killed as a result of the disaster, or again, IRS has lots of discretion here, anyone else that they determine.

Two really key things here. I guess three. Again, this is not a one-size-fits-all. How the IRS treats, for example, a tornado in Nebraska may be very different than an ice storm in Buffalo, New York. We have to be very careful and very granular and look at the actual disaster affecting our clients.

Two resources here. The first is this one. That's where the IRS is going to tell you, for that disaster, what we're doing. And we don't want to check just once. We may want to keep checking, because sometimes IRS will offer relief, and then they will offer either extended relief, or they will take the original relief and extend it, let's say, to more counties, and therefore, more affected taxpayers.

Also, Revenue Procedure 2018-58. This is a really helpful resource to have on hand. It's hundreds of pages long, but oftentimes the IRS will reference it and say, okay, the acts in Revenue Procedure 2018-58 also get this six, or nine, or up to one year discretionary pause button, and that includes hundreds of acts from things such as making a 754 election at the partnership level, making a change in method of accounting, certain elections. Very, very broad piece of guidance.

The second thing, this automatically kicks in. Okay, this is not IRS discretion. It's also much more modest, okay? Under Section 7508A, qualifying taxpayers are entitled to a mandatory 60-day postponement period. Again, pause button for those time-sensitive acts. When does this 60 days start? There used to be some confusion about this. Well, now, they have defined it. Relatively recent piece of guidance. This was November of 2021. The 2021 Infrastructure Investment and Jobs Act clarified by amending this code section, that in determining what that automatic extension period is, the 60 days is going to the last day, 60 days after whichever one is later, the earliest incident date or the date the disaster was declared. How are you going to know what those are? You're going to go to that FEMA website I mentioned. We kicked off today's conversation with that. It's going to tell you date of declaration, incident period.

They also clarified in that piece of 2021 legislation that if a taxpayer is subject to multiple declarations, uh, within any given 60-day timeframe, each one of the declarations gets its own 60-day timeframe.

The last thing I'm going to leave you with are some additional resources. This first slide, not tax-specific, but a lot of helpful information here. We have FEMA's disaster information, little bit more information, including how to best communicate with FEMA in the wake of a natural disaster, couple of resources here, specifically from the Small Business Administration, the SBA, and this is for preventive. www.ready.gov provides resources both for individual and business taxpayers on how both to prepare for, so readiness, to prepare for and also respond to various disasters and emergencies.

On the IRS side, IRS updates. Again, we want to stay on top of those. They are not static. They are evergreen. IRS, very helpful set of frequently asked Q&A. Some tips from the service on reconstructing records after a disaster. You know, sometimes these get overlooked. Pretty helpful though, the instructions to the Form 4684. Remember, we're going to do that whether we have casualty loss, casualty gain, whether we're individuals, whether we're a business. Publication 547, Casualties, Disasters, and Thefts. And I mentioned a little earlier the workbooks. These, remember I gave you a screenshot. We talked about the business. We had the chair. That is going to be Publication 584 for personal use and 584-B for our trade or business or held for the production of income property.

So, our learning objectives. We talked about who is an affected taxpayer, be they an individual or business taxpayer for purposes of federal disaster relief. We went through the general rules and also a detailed example of personal casualty loss deduction calculations, and actually just wrapped with a look at postponed tax filing and tax payment deadlines. So thank you, ladies and gentlemen. I hope you enjoyed the presentation.

When Disaster Strikes – Federal Tax Relief: Part 2



On-Demand Webinars

When Disaster Strikes – Federal Tax Relief

Presented by: [Laurie A. Stillwell, CPA](#)

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2 When Disaster Strikes – Federal Tax Relief



2

Laurie A. Stillwell, CPA

Laurie A. Stillwell is a CPA licensed in New York. Her firm, Laurie A. Stillwell, CPA, P.C., specializes in working with small businesses, professional practices, and their owners.

In addition to her practice, Laurie teaches continuing professional education seminars and webinars on ethics, business, and individual income tax issues for Checkpoint Learning. She is the author and editor of several continuing professional education texts and serves as technical editor for Thomson Reuters Checkpoint's 1040 Quickfinder and Small Business Quickfinder Handbooks.

Prior to forming her firm in 2001, Laurie spent more than a decade with local and regional accounting firms and specialized in providing tax and accounting services to closely-held businesses. She began her public accounting career with the international firm of Price Waterhouse, in Boston, Massachusetts.



3 When Disaster Strikes – Federal Tax Relief



3

Learning Objectives

Upon completion of this on-demand webinar, you should be able to—

- Define who is an affected taxpayer for purposes of federal disaster relief.
- Calculate a taxpayer's allowable personal casualty loss deduction.
- Identify postponed tax-filing and tax-payment deadlines.

4 When Disaster Strikes – Federal Tax Relief



4

When Disaster Strikes – An Overview

5 When Disaster Strikes – Federal Tax Relief



5

When Disaster Strikes – An Overview

- Tax policy is one of several policy tools that can be used for disaster relief. At various points in time, Congress has passed legislation to provide tax relief and to support recovery following disaster incidents.
- **Permanent** tax relief provisions may take effect following qualifying disaster events.
- **Temporary** tax relief provisions are designed to respond to specific disaster events.

6 When Disaster Strikes – Federal Tax Relief



6

When Disaster Strikes – An Overview

- **Key definitions.**

- *Casualty loss.* For losses of property not connected with a trade or business, or a transaction entered into for profit, losses arising from fire, storm, shipwreck, or other casualty, or from theft.
 - However, for personal losses that would otherwise be deductible in a tax year beginning after December 31, 2017, and before January 1, 2026, an individual can deduct a personal casualty loss only to the extent it is **attributable** to a *Federally declared disaster*.
 - A *casualty* is a loss arising from something sudden, unexpected, or unusual, and not from progressive deterioration due to a steadily operating cause, even if the damage was not discovered until it was complete. In addition, another prerequisite to a casualty loss deduction—physical damage to property—must also be met.

7 When Disaster Strikes – Federal Tax Relief



7

When Disaster Strikes – An Overview

- **Key definitions.**

- *Federally declared disaster* means any disaster determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act).
 - The Stafford Act constitutes the statutory authority for most federal disaster response activities—especially as they pertain to FEMA and FEMA programs—and established the presidential disaster declaration process.
- *Disaster area* means the area determined to warrant the federal assistance.

8 When Disaster Strikes – Federal Tax Relief



8

When Disaster Strikes – An Overview

www.fema.gov/disaster/declarations

Disasters and Other Declarations

Declaration Date

Year (Start)

2019

Year (End)

2025

TIP: Modify the start and end year(s) to broaden search.

Declaration Type

- Any -

Incident Type

- Any -

State/Tribe

Choose some options

Search and Filter Disasters

9 When Disaster Strikes – Federal Tax Relief



9

Casualties

10 When Disaster Strikes – Federal Tax Relief



10

Casualties

	Personal-Use Property	Business (or Income) Property	Loss Event Occurred	Deduction Limits Apply	Required to Itemize Deductions	When Deductible
Federal casualty loss	Y	N	State-declaration	\$100/ 10% AGI floor	Y	Year of loss
Disaster loss –Individuals	Y	N/A	County eligible for assistance	\$100/ 10% AGI floor	Y	Year of loss OR elect prior tax year
Disaster loss –Businesses	N/A	Y	County eligible for assistance	No limit	N/A	Year of loss OR elect prior tax year
Qualified disaster loss	Y	N	Specific disasters only	\$500/ no AGI floor	No; may add to standard deduction	Year of loss -OR- Elect prior tax year

11 When Disaster Strikes – Federal Tax Relief



11

Casualties

- A *qualified disaster loss* includes an **individual's** casualty loss of **personal-use property** that attributable to—
 - A major disaster declared under §401 of the Stafford Act in 2016.
 - Hurricane and/or Tropical Storm Harvey (2017).
 - Hurricanes Irma or Maria (2017).
 - California wildfires in 2017 and January 2018.
 - A major disaster declared under §401 of the Stafford Act and that occurred in 2018 and before December 21, 2019, and continued no later than January 19, 2020 (except those attributable to the CA wildfires in January 2018 that received prior relief).



12 When Disaster Strikes – Federal Tax Relief



12

Casualties

- The *Taxpayer Certainty and Disaster Tax Relief Act of 2020* (TCDTRA) expanded the definition of *qualified disaster loss* to include losses attributable to a **major** disaster and dated between January 1, 2020, and February 25, 2021.
- The *Federal Disaster Tax Relief Act of 2023* (FDTRA) extended the definition of *qualified disaster loss* to include losses attributable to a **major** disaster declared by the President during the period between January 1, 2020, and February 10, 2025. Note – the date of enactment of this legislation is December 12, 2024.
- However, additional rules pertain to the incident period of the disaster.

13 When Disaster Strikes – Federal Tax Relief



13

Casualties

	TCDTRA (2020)	FDTRA (2024)
Applies to major disasters	Yes	Yes
Date of declaration – period beginning	January 1, 2020	January 1, 2020
Date of declaration – period ending	February 25, 2021	February 10, 2025
Incident period beginning on or <u>after</u>	December 28, 2019	December 28, 2019
Incident period beginning on or <u>before</u>	December 27, 2020	December 12, 2024
Incident period <u>ending</u> no later than	January 26, 2021	January 11, 2025

14 When Disaster Strikes – Federal Tax Relief



14

Casualties

	Federal Casualty Loss Outcome	Qualified Disaster Loss Outcome
Adjusted gross income	\$150,000	\$150,000
Net personal casualty loss (net of casualty gains)	\$32,500	\$32,500
\$100 loss floor	(\$100)	NA
\$500 loss floor	NA	(\$500)
10% AGI floor	(\$15,000)	NA
Allowable casualty losses (Form 4684)	\$17,400	\$32,000
Deduct loss on Form 1040, Schedule A	Yes, as applicable	Yes, as applicable
Add loss to standard deduction	No	Yes, as applicable**

Note:

** See instructions to Form 4684 (Casualties and Thefts); a taxpayer's increased standard deduction reporting requires Form 4684 and Form 1040, Schedule A.

15 When Disaster Strikes – Federal Tax Relief



15

Amount Deductible

General rule.

- Figure the amount of loss using the following steps:
 1. Determine the amount which is equal to the fair market value (FMV) of the property immediately before the casualty reduced by the FMV of the property immediately after the casualty;
 2. Determine the amount of the adjusted basis (see Reg. 1.1011-1) for determining the loss from the sale or other disposition of the property involved before the casualty; and
 3. From the lesser of the amount determined in item 1 or 2, subtract any insurance or other reimbursement received, or expected to be received.

16 When Disaster Strikes – Federal Tax Relief



16

Amount Deductible

Impact of insurance.

- If an individual taxpayer's property is covered by insurance, they should file a timely insurance claim for reimbursement of their loss [see IRC Sec. 165(h)(4)(E)].
- If the individual taxpayer doesn't file an insurance claim, they can't deduct the full unrecovered amount as a casualty or theft loss; only the part of the loss that isn't covered by the insurance policy is deductible.
- The portion of the loss usually not covered by insurance (for example, a deductible) is not subject to this rule.
 - An insurance claim does not have to be filed for business-use property losses.

17 When Disaster Strikes – Federal Tax Relief



17

Amount Deductible

BUSINESS and INCOME-PRODUCING PROPERTY

Adjusted basis in the property (net of cost recovery deductions, as applicable)

MINUS any salvage value

MINUS any insurance or other reimbursement received (or anticipated)

Basis > (Salvage + Insurance) = LOSS on business or income-producing property

(Salvage + Insurance) > Basis = GAIN on business or income-producing property

18 When Disaster Strikes – Federal Tax Relief



18

Amount Deductible

Exception.

- However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of the property immediately before the casualty is **less** than the adjusted basis of such property, the amount of the **adjusted basis** of such property shall be treated as the amount of the loss for purposes of IRC Sec. 165(a).
- For example, business asset #10 has an adjusted basis of \$1,000 and FMV of \$750 immediately before the casualty event. Asset #10 is totally destroyed in the casualty event. The realized loss is \$1,000.

19 When Disaster Strikes – Federal Tax Relief



19

Amount Deductible

Identification.

- A loss incurred in a trade or business or in any transaction entered into for profit shall be determined by reference to the **single, identifiable** property damaged or destroyed (i.e., no aggregation of property).
- However, in determining a casualty loss involving real property and improvements not used in a trade or business or in any transaction entered into for profit, the improvements (such as buildings and ornamental trees and shrubbery) to the property damaged or destroyed shall be considered an integral part of the property and no separate basis need be apportioned to such improvements (i.e., **aggregation** of property for computing loss).

20 When Disaster Strikes – Federal Tax Relief



20

Amount Deductible

Method of valuation.

- In determining the amount of loss deductible, the FMV of the property immediately before and immediately after the casualty shall generally be ascertained by competent **appraisal**. This appraisal must recognize the effects of any general market decline affecting undamaged as well as damaged property which may occur simultaneously with the casualty.
- Taxpayers may be able to use an appraisal obtained for another purpose, such as getting a federal loan (or federal loan guarantee).

21 When Disaster Strikes – Federal Tax Relief



21

Amount Deductible

Method of valuation.

- Alternatively, the **cost of repairs** to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that—
 - a) the repairs are necessary to restore the property to its condition immediately before the casualty,
 - b) the amount spent for such repairs is not excessive,
 - c) the repairs do not cost more than the damage suffered, and
 - d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty [Reg. 1.165-7(a)(2)].
- Note that here the taxpayer must actually make the repairs; estimates of the costs of repair are not adequate.

22 When Disaster Strikes – Federal Tax Relief



22

Amount Deductible

Method of valuation.

- **Landscaping.** The cost of restoring landscaping to its original condition after a casualty may support the decrease in FMV. A taxpayer may be able to measure his loss by what he spends on the following:
 - Removing destroyed or damaged trees and shrubs, minus any salvage value received.
 - Pruning and other measures taken to preserve damaged trees and shrubs.
 - Replanting necessary to restore the property to its approximate value before the casualty.
- **Vehicles.** Books issued by various automobile organizations that list the manufacturer, and the model of the taxpayer's car may be useful in figuring the FMV of the affected vehicle. A taxpayer may use the retail value for the car listed in the book and modify it by such factors as mileage and the condition of his car to determine its value.

23 When Disaster Strikes – Federal Tax Relief



23

Amount Deductible

Deduction limit.

- The \$100 (or as applicable, \$500) limitation applies separately to each casualty and applies to the **entire loss** sustained from each casualty.
- For example, if as a result of a specific federal casualty event, a taxpayer sustains in 2024 a loss of \$40 and in 2025 a loss of \$250, no deduction is allowable for the loss sustained in 2024 and the loss sustained in 2025 must be reduced by \$60 (\$100 – \$40) [Reg. 1.165-7(b)(4)(ii)].

24 When Disaster Strikes – Federal Tax Relief



24

Amount Deductible

Deduction limit—10% rule.

- In cases of a Federal casualty losses or personal disaster losses, individuals must reduce their total federal casualty losses by 10% of their adjusted gross income.
 - Apply this rule after each loss is reduced by \$100.
 - Remember: This 10% limitation does not apply to qualified disaster losses.

Example. In September, your house was damaged by a tropical storm that was a federally declared disaster. Your loss after insurance reimbursement was \$2,000. Your adjusted gross income for the year the loss was sustained is \$29,500. Figure your casualty loss as follows.

1. Loss after insurance	\$2,000
2. Subtract \$100	100
3. Loss after \$100 rule	\$1,900
4. Subtract 10% of \$29,500	
AGI	\$2,950
5. Casualty loss deduction. . . .	\$ -0-

You don't have a casualty loss deduction because your loss (\$1,900) is less than 10% of your adjusted gross income (\$2,950).

25 When Disaster Strikes – Federal Tax Relief



25

Amount Deductible

- A special rule applies where personal casualty gains exceed personal casualty losses [IRC Sec. 165(h)(2)(B)].
 - The term *personal casualty gain* means the recognized gain from any involuntary conversion of property not connected with a trade or business (or a transaction entered into for profit) arising from fire, storm, shipwreck, or other casualty, or from theft.
 - The term *personal casualty loss* means **any** loss described in IRC Sec. 165(c)(3).
- If the personal casualty gains for any taxable year exceed the personal casualty losses for such taxable year, all gains are treated as gains from sales or exchanges of capital assets.

26 When Disaster Strikes – Federal Tax Relief



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Example #1: Amount Deductible

- Johnathon has AGI of \$140,000. After applying the \$100-per-casualty limit, he has \$10,000 of nonfederal casualty losses, \$40,000 in federal disaster losses, and \$30,000 of personal casualty gains for the tax year.
- The \$30,000 of personal casualty gains are netted with the \$10,000 of nonfederal casualty losses first, resulting in net \$20,000 personal casualty gains.
- Next, the \$40,000 in federal disaster losses is reduced by the \$20,000 personal casualty gains.
- The federal disaster loss is deductible to the extent it exceeds 10% of his AGI, or \$6,000 [\$20,000 net federal disaster losses – 14,000 (\$140,000 x 10%)].

27 When Disaster Strikes – Federal Tax Relief



27

Amount Deductible

Reminder.

- Four important **differences** exist between business and personal casualty losses:
 1. No percentage of AGI or \$100 (or \$500) per casualty threshold applies to limit the amount deductible for business casualty losses.
 2. For real property, a business casualty loss or involuntary conversion gain is calculated **separately** for each identifiable piece of property [Reg. 1.165-7(b)(2)].
 3. If business property is totally destroyed in a casualty and the fair market value of the property is less than its adjusted basis immediately before the casualty, the loss is calculated **solely** by considering the adjusted basis and the insurance proceeds. The decrease in FMV is not considered [Reg. 1.165-7(b)(1)(ii)].
 4. For tax years beginning after December 31, 2017, and before January 1, 2026, personal casualty losses of an individual are deductible only to the extent they are attributable to a federally declared disaster [IRC Sec. 165(h)(5)]. No such limitation exists for business casualty losses.

28 When Disaster Strikes – Federal Tax Relief



28

Amount Deductible

- The IRS has provided safe harbor methods for **individuals** determining their casualty losses for personal-use residential real property and personal belongings (Rev. Proc. 2018-8).
- If more than one property is owned, the election of a safe harbor is made separately for each property.
- If an individual owns two or more parcels of personal-use residential real property, the use of a safe harbor method for one parcel does not require the individual to use the same safe harbor method, or any safe harbor method, for any other parcel.

29 When Disaster Strikes – Federal Tax Relief



29

Amount Deductible

- **Rev. Proc. 2018-8** provides optional safe harbors for casualty losses on **personal-use residential real property** due to a Federally declared disaster.
 - Personal-use residential real property is real property, including improvements (such as buildings and ornamental trees and shrubbery), that is owned by the individual who suffered a casualty loss and that contains at least one personal residence.
 - A personal residence is a single-family residence, or a single unit within a contiguous group of attached residential units (for example, a townhouse or duplex), owned by the individual who suffered a casualty loss, and includes any structures attached to the residence or single unit.

30 When Disaster Strikes – Federal Tax Relief



30

Amount Deductible

- However, personal-use residential real property does not include any property used as rental property or any property containing a home office used in a trade or business or transaction entered into for profit.
- It also does not include any condo or co-op if the taxpayer does not own the structural components (e.g., foundation, walls, roof) or owns only a fractional interest in all the structural components (as opposed to specific components).
- Trailers and mobile homes are also excluded.

31 When Disaster Strikes – Federal Tax Relief



31

Amount Deductible

Personal-use residential real property.



Estimated repair cost safe harbor method

- Determine the decrease in FMV using lesser of two itemized cost estimates (prepared by licensed contractors).
- Do not include improvements or additions that increase FMV.
- Available for casualty losses of \$20,000 or less.



De minimis safe harbor method

- Determine the decrease in FMV by estimating cost to restore property.
- Do not include improvements or additions that increase FMV.
- Available for casualty losses of \$5,000 or less.



Insurance safe harbor method

- Determine the decrease in FMV by using the estimated loss as determined in reports prepared by the individual's homeowners' or flood insurance company (estimated loss).

32 When Disaster Strikes – Federal Tax Relief



32

Amount Deductible

Personal-use residential real property.



Contractor safe harbor method

- Determine the decrease in FMV using signed, binding contract with licensed contractor to restore property.
- Do not include improvements or additions that increase FMV.



Disaster loan appraisal safe harbor method

- Determine the decrease in FMV by using an appraisal prepared for the purpose of obtaining a loan of Federal funds or a loan guarantee from the Federal Government setting forth the estimated loss the individual sustained as a result of the damage to or destruction of the individual's personal-use residential real property from a Federally declared disaster.

33 When Disaster Strikes – Federal Tax Relief



33

Amount Deductible

- **Rev. Proc. 2018-8** also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.

- A personal belonging is an item of tangible personal property that is owned by the individual who suffered a casualty loss and that is not used in a trade or business or in a transaction entered into for profit.
- For this purpose, personal belongings do not include a boat, aircraft, mobile home, trailer, automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van or truck.
- Antiques and other assets that maintain or increase their value over time are also excluded.

34 When Disaster Strikes – Federal Tax Relief



34

Amount Deductible

- **Rev. Proc. 2018-8** also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.
 - Under the *de minimis safe harbor method*, an individual may make a good faith estimate of the decrease in the fair market value of the individual's personal belongings.

An individual using the *de minimis safe harbor method* must maintain records describing the personal belongings affected and detailing the methodology used for estimating the loss.

The *de minimis safe harbor method* is available for casualty losses of \$5,000 or less, prior to application of the limitations under IRC Sec. 165(h).

35 When Disaster Strikes – Federal Tax Relief



35

Amount Deductible

- **Rev. Proc. 2018-8** also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.
 - Alternatively, an individual may use the *replacement cost safe harbor method* to determine the fair market value of the individual's personal belongings located in a disaster area immediately before a Federally declared disaster in order to compute the amount of a casualty loss.

If an individual chooses to use the *replacement cost safe harbor method* for a Federally declared disaster, the individual must apply that method to all qualifying personal belongings for which a loss is claimed under IRC Sec. 165 for that Federally declared disaster.

An individual may not use this method for Federally declared disasters for a boat, aircraft, mobile home, trailer, vehicle, or an antique or other asset that maintains or increases its value over time. For purposes of this revenue procedure, a vehicle is an automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van, or truck.

36 When Disaster Strikes – Federal Tax Relief



36

Amount Deductible

- To use the *replacement cost safe harbor method*, an individual must first determine the current cost to replace the personal belonging with a new one and reduce that amount by 10% for each year the individual owned the personal belonging. This is the pre-disaster FMV of the belonging.
- If the personal belonging was owned by the individual for nine or more years, the pre-disaster fair market value is 10% of the current replacement cost under this safe harbor method.

37 When Disaster Strikes – Federal Tax Relief



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Example #2: Amount Deductible

- Juan's personal belongings included a couch destroyed by a hurricane in a Federally declared disaster area.
- Juan purchased the couch for \$700 four years prior to the hurricane. The cost to replace the couch with a new couch is \$1,000. The couch is not insured.
- Using the replacement cost safe harbor method for Federally declared disaster areas, Juan computes the FMV of the couch immediately before the hurricane by multiplying the current replacement cost of the couch, \$1,000, by 60%, or $\$1,000 \times 60\% = \600 .
- Juan then determines the decrease in the fair market value of the couch by subtracting \$0, the fair market value of the couch immediately after the hurricane, from \$600, the fair market value of the couch immediately before the hurricane, or $\$600 - 0 = \600 .
- Juan compares the basis of \$700 with the decrease in fair market value of \$600. Since the decrease in fair market value is less than the basis, the amount of his casualty loss is \$600.

38 When Disaster Strikes – Federal Tax Relief



38

Amount Deductible

No-cost repairs.

- Reimbursements to individuals may include the value of repairs to (or rebuilding of) the individual's personal-use residential real property provided by another party at no cost to the individual (known as *no-cost repairs*), such as the repair or rebuilding of an individual's personal residence by volunteers.
- No-cost repairs include repairs made for a *de minimis* or token cost, donation, or gratuity.
- An individual who uses any safe harbor method provided in Rev. Proc. 2018-8 to determine the decrease in the fair market value of or the amount of loss to the individual's personal-use residential real property or personal belongings must **reduce the loss** by the value of any no-cost repairs.

39 When Disaster Strikes – Federal Tax Relief



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Example #3: Amount Deductible

Schedule 1. Office Furniture and Fixtures

(1) Item	(2) Cost or other basis	(3) Insurance or other reimbursement	(4) Gain from casualty or theft ¹	(5) Fair market value before casualty	(6) Fair market value after casualty	(7) Column (5) minus column (6)	(8) Smaller of column (2) or column (7) ²	(9) Casualty/Theft Loss (column (8) minus column (3)) ³
<i>Example</i>								
<i>Bookcase</i>	250.00	50.00	.00	150.00	.00	150.00	250.00	200.00
<i>Chair</i>	695.00	375.00	.00	500.00	200.00	300.00	300.00	-0-
<i>Desk</i>	425.00	480.00	55.00					

¹ If column (3) is greater than column (2), enter the difference here and skip columns (5) through (9) for that item.

² If the property was completely destroyed or stolen, enter in column (8) the amount from column (2).

³ If zero or less, enter -0-.

40 When Disaster Strikes – Federal Tax Relief



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Effect of Insurance Proceeds

- Once the amount of the casualty loss is determined, it must be reduced by expected insurance or other reimbursements.
 - Note that the existence of insurance coverage may create an involuntary conversion gain rather than a loss.
 - Such a gain occurs when total reimbursements exceed the adjusted basis of the property (see IRC Sec. 1033 for more information regarding involuntary conversions and gain deferral rules).

41 When Disaster Strikes – Federal Tax Relief



41

Effect of Insurance Proceeds

- If an insurance reimbursement is expected but has not been received when the return is filed, the taxpayer must consider the expected reimbursement in determining the amount of loss [Regs. 1.165-1(c)(4) and (d)(2)(ii)].
 - If the eventual reimbursement turns out to be **less than expected**, a loss can be claimed in the year it is determined the taxpayer cannot reasonably expect any further reimbursement.

The original return is not amended [Reg. 1.165-1(d)(2)(ii)].

The additional loss is treated as if sustained in the year of settlement and is included with any other casualty losses for that year. However, the \$100 per-casualty limit (\$500 for a qualified disaster loss) applies separately to each casualty and applies to the entire loss sustained from such casualty or incident [Reg. 1.165-7(b)(4)(ii)].

42 When Disaster Strikes – Federal Tax Relief



42

Effect of Insurance Proceeds

- If an insurance reimbursement is expected but has not been received when the return is filed, the taxpayer must consider the expected reimbursement in determining the amount of loss [Regs. 1.165-1(c)(4) and (d)(2)(ii)].
 - If the taxpayer later receives a **larger reimbursement than expected**, the additional amount is included in income in the year it is received to the extent a tax benefit was obtained from the prior-year deduction [Reg. 1.165-1(d)(2)(iii)].

43 When Disaster Strikes – Federal Tax Relief



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Effect of Insurance Proceeds

- If **uncertainty** exists about the amount of the reimbursement, that part of the loss should not be deducted until it is reasonably certain no reimbursement will be received [Reg. 1.165-1(d)(2)(i)].



44 When Disaster Strikes – Federal Tax Relief



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Year of Deduction

- Generally, a loss shall be allowed as a deduction under IRC Sec. 165(a) only for the taxable year in which the loss is sustained.
- For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year.

45 When Disaster Strikes – Federal Tax Relief



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Year of Deduction

- However, if the casualty loss is a *disaster loss* or *qualified disaster loss*, the taxpayer may **elect** to deduct the loss on the return for the **immediately preceding year** [IRC Sec. 165(i); Reg. 1.165-1].
 - If that return has been filed, it may be amended for a refund of taxes already paid.
 - The election must be made within six months after the due date of the tax return for the disaster year, using Form 4684.
 - The election may be revoked by the filing of an amended return, including a revocation statement, for the preceding tax year. The revocation must be done on or before 90 days after the due date for making the original election.

46 When Disaster Strikes – Federal Tax Relief



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Reporting the Deduction

	Personal-Use Property Loss	Personal-Use Property Gain
Form 4684	Y	Y
Schedule A**	Y, if applicable	N
Schedule D	N	Y

Note:

** For *qualified disaster losses*, see instructions to Form 4684, *Casualties and Thefts* – a taxpayer’s increased standard deduction reporting requires Form 4684 and Form 1040, Schedule A.

Reporting the Deduction

Business and income-producing property—property held **1 year or less**.

- Use Form 4684 (Casualties and Thefts) to report gains and losses.
- Individuals report losses from income-producing property on Schedule A (Form 1040).
- Gains from business and income-producing property are combined with losses from business property and the net gain or loss is reported on Form 4797.

Reporting the Deduction

Business and income-producing property—property held *more than 1 year*.

- Use Form 4684 (Casualties and Thefts) to report gains and losses.
- Individuals report losses from income-producing property on Schedule A (Form 1040).
- If losses from business and income-producing property are **more** than gains from these types of property, combine the losses from business property with total gains from business and income-producing property. Report the net gain or loss as an ordinary gain or loss on Form 4797.
- Generally, if losses from business and income-producing property are **less** than or equal to gains from these types of property, report the net amount on Form 4797.
- Depreciable property. If the damaged property was depreciable property held more than one year, the taxpayer may have to treat all or part of the gain as ordinary income to the extent of depreciation allowed or allowable.

49 When Disaster Strikes – Federal Tax Relief



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Certain Disaster Relief Payments

50 When Disaster Strikes – Federal Tax Relief



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Certain Disaster Relief Payments

	Federal Taxable Income
Federal disaster relief grants (e.g., cover medical, housing, transportation, funeral expenses)	NO
State disaster relief grants for businesses	YES (gain postponement rules may apply)
Qualified disaster relief payments [IRC Sec. 139]	NO
Qualified disaster mitigation payments [IRC Sec. 139(g)]	NO (no basis increase allowed)
Insurance reimbursements for normal living expenses [IRC Sec. 123; Reg. 1.123-1]	YES
Insurance reimbursements for increased temporary living expenses [IRC Sec. 123; Reg. 1.123-1]	NO
Insurance reimbursements for loss of rental income	YES

51 When Disaster Strikes – Federal Tax Relief



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Certain Disaster Relief Payments

Sec. 139 Disaster relief payments


Internal Revenue Code of 1986

SUBTITLE A -- INCOME TAXES

Chapter 1 -- Normal Taxes and Surtaxes

Subchapter B -- Computation of Taxable Income

Part III -- Items specifically excluded from gross income

(a) General rule. Gross income shall not include any amount received by an individual as a qualified disaster relief payment. 

(b) Qualified disaster relief payment defined. For purposes of this section, the term "qualified disaster relief payment" means any amount paid to or for the benefit of an individual--

52 When Disaster Strikes – Federal Tax Relief



52

Certain Disaster Relief Payments

Qualified disaster relief payments.

- A *qualified disaster relief payment* is any amount paid to or for the benefit of an individual—
 1. To reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster;
 2. To reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for the repair, rehabilitation, or replacement is attributable to a qualified disaster;
 3. By a person engaged in the furnishing or sale of transportation as a common carrier by reason of death or personal physical injuries incurred as a result of a qualified disaster; or
 4. If a federal, state, or local government or agency pays such amount, in connection with a qualified disaster in order to promote the general welfare.

53 When Disaster Strikes – Federal Tax Relief



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Certain Disaster Relief Payments

- Under the recently enacted *Federal Disaster Tax Relief Act of 2023 (FDTRA)*, *East Palestine train derailment payments* are treated as qualified disaster relief payments [IRC Sec. 139(b)].
- This applies to amounts received on or after February 3, 2023.

54 When Disaster Strikes – Federal Tax Relief



54

Certain Disaster Relief Payments

- The term *East Palestine train derailment payment* means any amount received by or on behalf of an **individual** as compensation for loss, damages, expenses, loss in real property value, closing costs with respect to real property (including realtor commissions), or inconvenience (including access to real property) resulting from the East Palestine, Ohio, train derailment on February 3, 2023, if such amount was provided by—
 1. A Federal, State, or local government agency,
 2. Norfolk Southern Railway, or
 3. Any subsidiary, insurer, or agent of Norfolk Southern Railway or any related person.

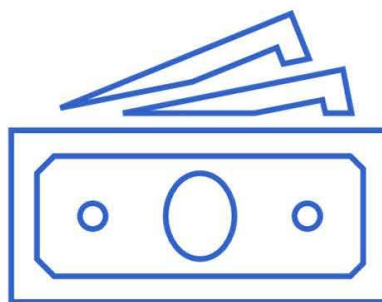
55 When Disaster Strikes – Federal Tax Relief



55

Certain Disaster Relief Payments

- Under 2024's FDTRA, federal gross income shall also not include any amount received by an individual as a *qualified wildfire relief payment*.



56 When Disaster Strikes – Federal Tax Relief



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Certain Disaster Relief Payments

Qualified wildfire relief payment.

- The term *qualified wildfire relief payment* means any amount received by or on behalf of an individual as compensation for losses, expenses, or damages (including compensation for additional living expenses, lost wages (other than compensation for lost wages paid by the employer which would have otherwise paid such wages), personal injury, death, or emotional distress) incurred as a result of a *qualified wildfire disaster*, but only to the extent the losses, expenses, or damages compensated by such payment are not compensated for by insurance or otherwise.

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Certain Disaster Relief Payments

Qualified wildfire disaster.

- The term *qualified wildfire disaster* means any federally declared disaster declared, after December 31, 2014, as a result of any forest or range fire.
- This section shall only apply to qualified wildfire relief payments received by the individual during taxable years beginning after December 31, 2019, and before January 1, 2026.

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Certain Disaster Relief Payments

Extension of period of limitation.

- In the case of a claim for credit or refund which is properly allocable to the exclusion of a qualified wildfire relief payment, the statute of limitation [see IRC Sec. 6511(a)] for the filing of such claim shall be treated as not expiring earlier than the date that is one year after the date of the enactment of the new act (so, December 12, 2025), and any limitation described in IRC Sec. 6511(b)(2) shall not apply.

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Involuntary Conversions

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Involuntary Conversions

- When insurance proceeds exceed the tax basis of destroyed property, a taxpayer has a potentially taxable profit [IRC Sec. 1033(a)(2)].
- The gain is called an *involuntary conversion gain* because the casualty event causes the destroyed property to be converted into cash from insurance proceeds.
- IRC Sec. 1033(h) provides special rules for property damaged by federally declared disasters.

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Involuntary Conversions

Trade or business or investment property.

- No gain is recognized if property held for use in a trade or business or for investment is involuntarily converted as a result of being in a location that the president declares a disaster area (i.e., a federally declared disaster) and is replaced with tangible property used in a trade or business [IRC Sec. 1033(h)(2)].
 - This rule applies even if the replacement property is not similar-use to the converted property.
 - Property **lost** in the involuntary conversion can be either business or investment property, but the **replacement** property must be “of a type held for productive use in a trade or business” [IRC Sec. 1033(h)(2)].

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Involuntary Conversions

Principal residences.

- The involuntary conversion rules for a disaster in a federally designated disaster area also apply to a taxpayer's principal residence [IRC Sec. 1033(h)(1)].



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Involuntary Conversions

Principal residences.

- The following occurs when a taxpayer's principal residence (or any of its contents) is located in a disaster area and is involuntarily converted as a result of a federally declared disaster:
 1. No gain is recognized on the receipt of insurance proceeds for unscheduled personal property that was part of the contents of such residence. This rule applies **regardless** of the taxpayer's basis in the unscheduled personal property or how the insurance proceeds are used [IRC Sec. 1033(h)(1)(A)(i); Rev. Rul. 95-22].

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Involuntary Conversions

Principal residences.

- The following occurs when a taxpayer's principal residence (or any of its contents) is located in a disaster area and is involuntarily converted as a result of a federally declared disaster:
 2. Any insurance proceeds for the residence or its separately scheduled contents can be treated as a common pool of funds. The taxpayer can elect to recognize gain only to the extent that the funds exceed the cost of replacing the residence and its contents. Any type of replacement contents (whether separately scheduled or unscheduled) qualify for this purpose. Insurance proceeds for separately scheduled property (e.g., jewelry, art) do not have to be used to purchase the same type of property [IRC Sec. 1033(h)(1)(A)(ii); Rev. Rul. 95-22].
 3. The taxpayer must make the replacement within four years (as opposed to the normal two-year period for involuntary conversion replacements) after the close of the year gain is first realized [IRC Sec. 1033(h)(1)(B)].

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Involuntary Conversions

Principal residences.

- Under IRC Sec. 121(d)(5), the involuntary conversion of a taxpayer's principal residence is treated as a sale of the residence eligible for the **IRC Sec. 121 gain exclusion** if the taxpayer otherwise meets the requirements of those gain exclusion rules.
 - Any portion of the gain that cannot be excluded (for example, because it exceeds the \$250,000 or \$500,000 limitations) may be deferred under the involuntary conversion rules.
 - In applying the IRC Sec. 1033 involuntary conversion rules for any remaining gain, the amount realized from the conversion (insurance proceeds) is reduced by the gain excluded under IRC Sec. 121 [IRC Sec. 121(d)(5)(B)].

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Example: Involuntary Conversions

- In March 2025, a federally declared disaster destroys Dan's personal residence that had a basis of \$70,000. Dan is single and owned and used this property as his principal residence for 10 years before its destruction.
- Dan received \$400,000 in insurance proceeds for the house. Therefore, Dan has a realized gain of \$330,000 (\$400,000 – \$70,000). In November 2025, Dan buys a new house at a cost of \$130,000.
- The destruction of the residence is treated as a sale for purposes of the Section 121 gain exclusion rules, so Dan can exclude \$250,000 of the realized gain. In applying the Section 1033 involuntary conversion rules to the remaining gain, the amount realized is treated as \$150,000 (\$400,000 – \$250,000), the realized gain is now \$80,000 (amount realized of \$150,000 – basis of \$70,000), but **the recognized gain is only \$20,000** (\$150,000 amount realized – \$130,000 cost of the new house).
- The remaining \$60,000 of gain is deferred and Dan's basis in the new house is \$70,000 (\$130,000 cost minus \$60,000 gain not recognized).

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Postponement of Time-Sensitive Acts

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Postponement of Time-Sensitive Acts

- The IRS has the **discretion** to suspend filing and payment requirements for up to **one year** for taxpayers affected by federally declared disasters [IRC Sec. 7508A(a)].
- In addition, a **mandatory** (automatic) **60-day** deadline extension period applies to *qualified taxpayers* impacted by federally declared disasters [IRC Sec. 7508A(d)].

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- For taxpayers affected by a federally declared disaster [IRC Sec.165(i)(5)(A)] or a significant fire, the Secretary may specify a period of up to one year that may be disregarded in determining, in respect of any tax liability of the taxpayer:
 1. Whether **certain time-sensitive acts** were performed timely (without regarding to any other type of extension);
 2. The amount of any interest, penalty, additional amount, or addition to the tax; **and**
 3. The amount of any credit or refund.

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- **Certain time-sensitive acts** [IRC Sec. 7508(a); Reg. 301.7508A-1] include acts performed by the taxpayer:
 - A. Filing any return of income, estate, gift, generation-skipping transfer tax, employment, or certain excise taxes;
 - B. Payment of any income, estate, gift, generation-skipping transfer tax, employment (not including IRC Sec. 6302 deposits), or certain excise taxes or any installment thereof or of any other liability to the United States in respect thereof;
 - C. Making contributions to a qualified retirement plan under IRC Secs. 219(f)(3), 404(a)(6), 404(h)(1)(B), or 404(m)(2); making distributions under IRC Sec. 408(d)(4); recharacterizing contributions under IRC Sec. 408A(d)(6); or making a rollover under IRC Secs. 402(c), 403(a)(4), 403(b)(8), or 408(d)(3);

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- **Certain time-sensitive acts** [IRC Sec. 7508(a); Reg. 301.7508A-1] include acts performed by the taxpayer:
 - D. Filing a petition with the Tax Court, or for review of a decision rendered by the Tax Court;
 - E. Filing a claim for credit or refund of any tax;
 - F. Bringing suit upon a claim for credit or refund of any tax; and
 - G. Any other act specified in a revenue ruling, revenue procedure, notice, announcement, news release, or other guidance published in the Internal Revenue Bulletin.

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- **Certain time-sensitive acts** [IRC Sec. 7508(a); Reg. 301.7508A-1] include acts performed by the government:
 1. Assessing any tax;
 2. Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;
 3. Collecting by the Secretary, by levy or otherwise, of the amount of any liability in respect of any tax;
 4. Bringing suit by the United States, or any officer on its behalf, in respect of any liability in respect of any tax;
 5. Allowing a credit or refund of any tax; and
 6. Any other act specified in a revenue ruling, revenue procedure, notice, or other guidance published in the Internal Revenue Bulletin.

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- **An affected taxpayer** includes:
 - Any individual whose principal residence is located in a disaster area;
 - Any business entity or sole proprietor whose principal place of business is located in a covered disaster area;
 - Any individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting in a covered disaster area;
 - Any individual whose principal residence or any business entity or sole proprietor whose principal place of business is not located in a covered disaster area, but whose records necessary to meet a deadline for an act specified here are maintained in a covered disaster area;

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- An *affected taxpayer* includes:
 - Any estate or trust that has tax records necessary to meet a deadline for an act here and that are maintained in a covered disaster area;
 - The spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife;
 - Any individual, business entity, or sole proprietorship not located in a covered disaster area, but whose records necessary to meet a deadline for an act here are located in the covered disaster area;
 - Any individual visiting the covered disaster area who was killed or injured as a result of the disaster; or
 - Any other person determined by the IRS to be affected by a federally declared disaster.

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Postponement of Time-Sensitive Acts

Up to One Year Discretionary Postponement Period.

- The rules of Reg. 301.7508A-1 demonstrate how the IRS generally implements IRC Sec. 7508A.
- The IRS may determine, however, that additional relief to taxpayers is appropriate and may provide additional relief to the extent allowed under IRC Sec. 7508A.
- See **Revenue Procedure 2018-58** (*Time for performing certain acts postponed by reason of service in a combat zone or a federally-declared disaster*).

(See also www.irs.gov/newsroom/tax-relief-in-disaster-situations.)

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Postponement of Time-Sensitive Acts

Mandatory (automatic) 60-day deadline extension period.

- In addition to (or concurrent with) the **authority** to postpone time-sensitive acts by reason of a federally declared disaster, qualified taxpayers are entitled to a mandatory 60-day postponement period during which the time to perform those time-sensitive acts is disregarded in the same manner as under IRC Sec. 7508A(a).

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Postponement of Time-Sensitive Acts

Mandatory (automatic) 60-day deadline extension period.

- The 2021 *Infrastructure Investment and Jobs Act* amended IRC Sec. 7508A(d) so that, in determining the automatic extension period, the ending date of that extension period would be 60 days after the later of—
 1. The earliest incident date described in IRC Sec. 7508A(d)(1)(A), or
 2. The date the disaster declaration was issued.

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Postponement of Time-Sensitive Acts

Mandatory (automatic) 60-day deadline extension period.

- The *Infrastructure Investment and Jobs Act* also provides a rule that would apply in situations in which there are multiple declarations relating to a disaster area.
 - Under this rule, for purposes of the automatic extension period, if multiple declarations relating to a disaster area are issued within a 60-day period, a separate period would be determined under IRC Sec. 7508(d) with respect to each declaration.

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Additional Resources

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Additional Resources

Additional government disaster relief resources include—

- FEMA's Disaster Information at www.FEMA.gov/disaster
- *The Best Way to Send Disaster Documents to FEMA* information flyer available at www.fema.gov/sites/default/files/documents/fema_best-way-send-disaster-documents_flyer.pdf
- SBA's Office of Disaster Assistance at www.sba.gov/funding-programs/disaster-assistance
- www.DisasterAssistance.gov
- www.READY.gov Resources for individuals and businesses on how to prepare for and respond to various disasters and emergencies.

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Additional Resources

Resources from the IRS include—

- IRS updates at www.irs.gov/newsroom/around-the-nation
- IRS FAQs at www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims
- Tips on reconstructing records after a disaster at www.irs.gov/newsroom/reconstructing-records-after-a-natural-disaster-or-casualty-loss
- Form 4684 (Casualties and Thefts) and Instructions
- Pub. 547: *Casualties, Disasters, and Thefts*
- Pub. 584: *Casualty, Disaster, and Theft Loss Workbook (Personal-Use Property)*
- Pub. 584-B: *Business Casualty, Disaster, and Theft Loss Workbook*

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Learning Objectives

You should now be able to—

- Define who is an affected taxpayer for purposes of federal disaster relief.
- Calculate a taxpayer's allowable personal casualty loss deduction.
- Identify postponed tax-filing and tax-payment deadlines.

GROUP STUDY MATERIALS

A. Discussion Questions

1. How is a qualified disaster relief payment defined under IRC §139?
2. What qualifies as a "qualified wildfire relief payment"?
3. Which disaster-related payments are generally taxable when received by businesses?
4. What are the reinvestment rules for business property involuntarily converted due to a federally declared disaster?
5. How is unexcluded gain under IRC §121 treated when a principal residence is destroyed by a federally declared disaster?
6. What kind of tax relief does IRC §7508A offer to disaster-affected taxpayers?
7. When does the 60-day automatic extension under IRC §7508A(d) begin?

B. Suggested Answers to Discussion Questions

1. How is a qualified disaster relief payment defined under IRC §139?

A qualified disaster relief payment, as defined in IRC §139, is any amount paid to or for the benefit of an individual to cover expenses resulting from a qualified disaster. These payments are excluded from gross income, meaning the individual does not owe federal income tax on the amount received.

Qualifying expenses include:

- Personal, family, living, or funeral expenses directly caused by the disaster
- Expenses to repair or replace a personal residence or its contents (e.g., furniture or appliances)

These payments may come from:

- Employers (as part of a formal §139 plan)
- Government agencies (federal, state, or local)
- Charitable organizations
- Common carriers (e.g., airlines providing compensation due to disaster-related injuries)

If an employer makes such payments to employees, they must ensure there is written documentation, including eligibility rules, expense types, and required supporting records. Without proper compliance, the IRS may recharacterize the payment as taxable W-2 compensation.

2. What qualifies as a "qualified wildfire relief payment"?

A qualified wildfire relief payment is a special type of tax-free compensation available to individuals (not businesses) who experience losses due to federally declared wildfire disasters.

To qualify:

- The payment must be received by or on behalf of an individual
- It must compensate for losses, damages, or expenses—including property damage, emotional distress, lost wages (excluding wages paid by an employer), additional living expenses, or personal injury
- The wildfire must have been declared a federal disaster after December 31, 2014

In addition:

- The payments must be received in tax years beginning after 2019 and before 2026
- No double-dipping is allowed—amounts already reimbursed by insurance or other sources cannot be excluded again
- These payments are excluded from gross income and are not reported on Form 1099

Congress also extended the statute of limitations under IRC §6511 for taxpayers to file refund claims related to these payments. If the claim relates to an earlier year (e.g., 2020), the taxpayer has one year from December 12, 2024 (the date of enactment) to file for a refund.

3. Which disaster-related payments are generally taxable when received by businesses?

While many disaster relief payments to individuals are excludable, payments to businesses are generally taxable. This includes:

- State disaster relief grants received during emergencies (e.g., pandemic-related grants)
- Insurance reimbursements for lost business income, rental income, or business interruption
- Compensation for property loss unless gain is deferred under IRC §1033

Such payments are usually included in:

- Gross receipts or gross income for the business
- Reported on tax returns such as Form 1120, 1120-S, or Schedule C for sole proprietors

4. What are the reinvestment rules for business property involuntarily converted due to a federally declared disaster?

When business or investment property is **involuntarily converted** (e.g., destroyed in a disaster and replaced with insurance proceeds), **IRC §1033(h)** provides rules that allow taxpayers to **defer recognizing gain** if certain conditions are met.

Key reinvestment rules:

- The property must be replaced with **tangible property used in a trade or business**
- The replacement **does not need to be similar in use** to the original property (unlike §1031)
- **Investment property** is eligible for deferral, but the replacement must be **business-use type property**
- The taxpayer has a standard **two-year reinvestment period**

5. How is unexcluded gain under IRC §121 treated when a principal residence is destroyed by a federally declared disaster?

If a taxpayer's principal residence is destroyed by a federally declared disaster and insurance proceeds exceed the IRC §121 exclusion limit (\$250,000 single / \$500,000 MFJ), the excess gain may be deferred under IRC §1033(h).

Step-by-step treatment:

1. First, determine how much gain qualifies for exclusion under §121 (ownership and use tests must be met).
2. The remaining gain (above the exclusion) is subject to tax unless:
 - The taxpayer reinvests the excess amount into a new principal residence, and
 - The reinvestment occurs within 4 years after the close of the year in which the gain is realized.

Additional benefits:

- Insurance proceeds for unscheduled personal property (e.g., general contents of the home) are not taxable, regardless of basis or reinvestment.
- Scheduled personal property (e.g., jewelry, art) can be pooled with residence proceeds for gain deferral if reinvested.

6. What kind of tax relief does IRC §7508A offer to disaster-affected taxpayers?

The IRS may grant up to a one-year postponement for certain tax acts. This includes:

- Filing tax returns (e.g., income, estate, gift, employment, and excise taxes)
- Paying taxes (installments or full payments)
- Making retirement plan contributions
- Filing petitions or claims for refund
- Bringing tax-related suits
- Other actions specified in IRS guidance

This relief also suspends the accrual of interest, penalties, and additions to tax during the postponement period. It can also extend the statute of limitations for assessments or refunds.

Eligible taxpayers include:

- Individuals whose principal residence is in a disaster area
- Businesses whose principal place of business is in the disaster area
- Those whose tax records are maintained in the disaster area
- Relief workers assisting in the disaster area
- Spouses on joint returns, estates, or others directly impacted
- Anyone else deemed affected by the IRS

Mandatory (Automatic) 60-Day Extension:

- IRC §7508A(d) also provides an automatic 60-day postponement for affected taxpayers. This begins on the later of the date the disaster is declared or the earliest incident date.
- If there are multiple disaster declarations within a 60-day period, each triggers a separate 60-day window. This ensures that full relief applies to each event, as clarified by the Infrastructure Investment and Jobs Act of 2021.

7. When does the 60-day automatic extension under IRC §7508A(d) begin?

The 60-day extension period begins on the later of the date the disaster was declared or the earliest incident date. This rule was clarified by the 2021 Infrastructure Investment and Jobs Act.

The 60-day extension begins on the later of:

- The date the disaster was declared, or
- The earliest incident date.

This rule was clarified by the 2021 Infrastructure Investment and Jobs Act.

Additionally, if multiple declarations relating to a single disaster area are issued within a 60-day window, then each declaration triggers its own separate 60-day extension. This ensures affected taxpayers receive full relief for each distinct declaration.

PART 2. PARTNERSHIPS

Partnership Basis, Sec. 754 Election, and Sec. 743(b) Adjustments

In the second segment of this month's program, Ian Redpath takes a closer look at partnership basis and the Section 754 election. With partnership audits on the rise and the IRS placing renewed emphasis on basis calculations, Ian explores the foundational concepts of inside basis, outside basis, and capital accounts, before diving into the practical application of Section 754 and the resulting 743(b) adjustments. Whether navigating a sale, exchange, or inheritance, understanding how and when these adjustments apply is critical.

Let's join Ian.

Mr. Ian Redpath

Hi everybody, welcome to the program. Today, rather than our normal expert forum, I'm going to be going over just one basic topic. So, today's topic that we're going to cover is one that is very misunderstood. It's pretty complex and it's partnership basis. And then the 754 election as it applies to the 743(b) adjustment on a transfer of a partnership interest.

You know, the IRS says that about 95% of partnership returns have what they call significant errors. The good news is the IRS doesn't necessarily know the rules either. I say that, and now we don't know what's going on. You know, we've got the cuts and budget cuts going on and all of these things, but the IRS set up a new, we have a new division that is specifically looking at partnerships, S Corps, estates, but they've said their primary emphasis, at least initially, is going to be on partnerships. So, we can expect to have a lot more partnership audits in the future.

So, you know, we've kind of had a stream of things that have happened, starting with getting the consolidated partnership audit rules, and then moving forward the IRS has said, going to do an audit, we're going to do an audit. Well, interestingly enough, one of the areas that they have always looked at audits is this basis. And they said, "You know, you don't have enough basis generally to take those losses." And this is usually where the audit has been. Your taxpayer takes a loss. They say, "Oh, no, you didn't have enough basis, therefore, you had to suspend those losses." They weren't allowed.

And the basis calculation is not always simple. And there's been a lot of confusion as the IRS adopted the new rules on, on capital accounts and how to keep your capital accounts. So, we're going to start and talk about all of that today. But let's start right off in the beginning.

So, the partnership is kind of a, it doesn't know what it is. You know, for some things, it's the aggregate theory. Partnerships aren't taxed. Everything flows through. The character of income gains, deductions, et cetera, that's determined at the partnership level and everything flows down on the K-1 to the partners. Liabilities are considered to be incurred by the partners and therefore you get a basis in your share of the liabilities because you are deemed to be responsible for those. Now, that's even, and we'll talk about this, but even if it's non-recourse debt. And then Section 704(c), that steps in to prevent someone from misassigning income.

So, if an individual transfers a piece of property that has a built-in gain or a built-in loss, and later the partnership disposes of that asset, well, let's say it's two people, 50/50. By basic rules you would assign 50% of the income to both of them. "Well, wait a second. I contributed cash and you contributed property and we're 50/50 partners, but I got to pick up half of that gain when I gave you a 50% interest? That doesn't seem right." Well, because you valued the interest at fair market value; right?

So, what's happened then is, you know, this problem that comes up with the assignment of the income. And so, the IRS deals with it by saying, this is really simple. The income, the built-in gain is going to be assigned to the partner that contributed the property. And then there's some other rules there. For example, if it's depreciable property, then you're going to make adjustments to adjust the amount of depreciation so that the partner that contributed is picking up more income, again, until that built-in gain is eliminated. And the IRS has a series of regulations that provide for specific rules as to how it can be done; the traditional method, traditional with curative, and the remedial method.

So, those are methods that you can use to allocate those types of things to make sure that the partner who contributed the built-in gain, they pick up the income on that property. And then, you know, if it's distributed within seven years to the non-contributing partner, then that partner, the contributing partner is going to still pick up the gain. So, you know, either way, you know, they're going to end up having to pick up that gain, and, you know, that makes sense. You know, they're 50/50 partners, that certainly makes sense as to how they're picking up the gain. So, that's the aggregate theory.

But then there's the entity theory. And the entity theory says, well, the partnership's an entity like a corporation is an entity. So, the entity determines the amount, the timing, the character of income. Every partner owns an interest. No partner owns a direct interest in the assets. The partnership owns the assets. The accounting methods, the periods, these elections are entity elections. They are not elections made by the owners, which would be an aggregate theory. And gain or loss on the transfer of the interest is determined outside of the entity, is determined by the partners that are involved in the transaction.

Now, when you hear "basis" and you're talking about a partnership, there are three types of basis; inside basis, outside basis, and capital account. Everybody's pretty familiar with outside basis because outside basis is your basis in the partnership. It's your interest basis. And generally, it is carryover basis from the assets you contributed plus any gain recognized less any boot.

Well, that gain recognized, the only time you're going to see it is Section 721(b). And the only time you have to look at it is if almost all the assets that are being put in, like if you see 80% or more of the assets that are being contributed are portfolio, then you may have to look at 721(b). That's the only exception to the rule that contribution is tax free. And 721(b) says, "You know what, if what you're trying to do is put your portfolio in here, you're going to recognize gain on that." And so, your basis would be the carryover basis plus the gain. So, the fair market value.

Now, again, if you inherit a partnership interest, it follows those rules. Step up or step down to the value at the date of death. Likewise, a gift carryover basis plus gift tax on the appreciation or, you know, if it's later disposed of and there is your determination, you have to look back and say, well, was the fair market value less than the basis at the time of the transfer? And if it was, then for a loss, you would have to use that lesser of the fair market value or the carryover basis. So, generally you do a fair market value for a loss, carryover basis for a gain.

Now what if it's in between? No gain or no loss. So, you're going to report it, and you're going to report, you know, how much, what you've received, the basis. And then as you know, there's that column now for the adjustment and that would be the adjustment to take it back to zero gain or loss.

So, again, you know, 721, no gain or loss is going to be recognized. Basis, general rules, carryover basis, plus gain. Again, only worry about that 721 gain. And that again would be, if this would be an investment company, had it incorporated under Section 351 of the Code, that's the general non-taxable provision for contributions to capital of a corporation.

If this would be characterized as an investment company under those rules, then you're going to have to recognize gain. And again, the only time you're going to worry about that, if you see 80% or more of the assets coming in a portfolio that are being contributed, look at the regulations under there.

And think of it this way, you know, one partner may recognize gain and the other partners are not because they didn't contribute portfolio income. And again, here's what the IRS is concerned with. You know, I've got, I'm heavy into real estate. You know, one of you is heavy into tech and the other is heavy into oil and gas. And we're sitting around and go, "You know what? I really want to diversify. I'm too heavy into one. I don't want to recognize gain. g I got all these gains. Ah, let's set up a partnership and I'll put in \$100,000 and you put in \$100,000 and you put in \$100,000. We're putting in \$100,000. I'm putting in \$100,000 of my real estate, \$100,000 of oil and gas, \$100,000 of the tech. One third, one third, one third. Oh, 721, no tax consequence."

Well, the IRS says, "All you did was diversify your portfolio. You can't do that tax free." That's what they're looking for. That's the concern. Although again, it could be just one partner contributing that. So, again, I would look at the Regs under that.

And so, we have an example here and we'll put up on a slide. Jane transfers a capital asset in exchange for a one-third interest in JBB LLC. The asset has an adjusted basis to Jane of \$10,000 and a fair market value of 30. Jane has a \$20,000 realized gain, the \$30,000 less than \$10,000 but under 721, she doesn't recognize any of the gain. The basis for her interest is the substituted or carryover basis of \$10,000.

Now, if it's capital or 1231, the holding period, the holding period will carry over to your interest if it's capital or 1231. If it is not, it starts all over. So, in this case, it's a capital asset. And so, the holding period will tack on to her interest.

Now, the LLC's basis for the contributed property is the carryover basis of \$10,000. And that ensures then that the \$20,000 deferred gain is going to be recognized if the LLC sold the property. Remember we talked about Section 704(c) is going to say, when it's sold, allocate that gain to Jane because it was built in gain at the time she contributed it.

So, we have another example here in a slide for you. In forming PA Partners, Pedro contributed \$100,000 in cash and Anita contributed property having a fair market value of \$100,000 but was originally purchased for \$60,000. Pedro will have 50/50 partners; right, \$100,000 and \$100,000. Pedro's initial outside basis is \$100,000 but Anita's initial outside basis is only \$60,000.

So, what is their inside basis? Well, inside basis is your pro rata share of the partnership's assets basis. So, what is the partnership's asset? Partnership takes the carryover basis; therefore -- and by carryover basis plus gain recognized, so, again, if there was that 721(b) gain, that would increase the basis to the partnership for the inside basis. We don't have that here.

So, its inside basis is \$60,000. So, they're going to have an inside basis equal to one half, they're 50/50, in the basis, partnerships basis in its assets, which is \$160,000. So therefore, they would each have an \$80,000 inside basis.

Now, services are handled very differently. You're going to be taxed on the services. Services do not fall under Section 721. And the individual who provides it, its compensation, its ordinary income equal to the value that you receive.

Now, the rule says that, and this is something that's misunderstood. Let's say the value of the service is \$50,000. But that isn't necessarily what it's going to end up being because it says, what is the amount that the other partners are giving up of their right to be repaid their capital on liquidation?

So, let's say it's a one third interest where you would have to look at one third of the capital account. That's what they're giving up. They're giving up one third. And so that's the value that you would use. That could be more or less than \$50,000, which would be the fair market value of the service.

So, the confusion often is people use \$50,000 because they say, "Oh, that's the fair market value of the service." That's not what the law says. The law says it's the amount that the other partners gave up of their right to be repaid their capital. So, let's say, as I said, it's a one third interest. That one third interest in the capital could be more or less.

Now, if the interest is going to be a subject of a substantial risk of forfeiture or hasn't vested, then you can elect under Section 83(b), you can elect to -- and that election, by the way, has to be filed within 30 days of receiving the interest -- you can file an election to say, "You know what? We want to pick it up at the time that it either vests, or at the time that the substantial risk is forfeiture. I only get it if I work for five years." That's a substantial risk of forfeiture. "I get it, but if I don't work five years, I'm going to lose it, or if I don't meet certain profitability margins." That is a substantial risk of forfeiture.

So, under 83(b), you can wait and you can pick it up at its value at the time that it either vests or the risk of forfeiture is up. Now, what if you say, "You know what, it's going to be worth five million. It's only worth \$80,000 now, but five million because I'm that good. When I come into the partnership, I'm going to just turn this around, we're going to be, and when it vests three years from now, it's going to be worth at least five million. Now, why do I want to pick up that. I'm going to make that. I'm going to pick it up now at \$80,000. I don't want to pick up five million three years from now. I know better." Well, then you find out two years later you weren't as good as you thought when you got fired.

The problem is, if you elect it, the risk is if it doesn't vest or you lose it by forfeiture, there's no deduction. So, whatever income you picked up that was income, you get no deduction.

Sometimes people to get a profits-only interest and where you have that, the law says basically that it's not taxable, a profits-only. There's a couple of minor exceptions, but generally it is not taxable if it's a profits-only.

Now, if you think of it, how could you make it a zero coming in. You tell the person, "When you come in, you own nothing of what we have. You only get what we get in the future." Okay. What did the other partners give up of their right to be repaid their capital? Nothing. You don't get anything that we own when you come into the business. You only share in the future.

That's a profits-only interest, but if you just follow the general rule, what is the value? What is the amount by which the other partners gave up of their right to be repaid their capital? Zero, they didn't give up any right; therefore, it's not taxable.

So, as I mentioned, you know, 83(b) election, and again, it has to be made within 30 days of the grant. And again, if you never get the interest, you can't deduct it. So, now, you know, one of the great advantages of the partnership over the S Corp is the treatment of liabilities. The ability to get a basis in your interest for the liabilities of the partnership.

The reason is, think of it like there's this escrow account called "Debt," and everybody has a share. And I've contributed into this escrow account. So, what I've contributed to cover all the debts is deemed contribution of cash. Well, it may be a deemed contribution of cash, but it has real cash as far as basis is concerned. It gives you a basis because you're deemed to have contributed cash. So, that gives you an increase in your basis.

And likewise, the opposite. When the liabilities go down, it's considered a distribution of cash. The partnership has taken the money and given it back to you to the extent they don't need you to pay back the liability and so therefore, that is a deemed distribution of cash, but it reduces your basis. And in fact, if it exceeds your basis, it could create a capital gain.

Now, in a partnership, you get a basis in both recourse and non-recourse debt. Recourse debt is the liability of recourse to the extent that any partner or related person has the economic risk, not risk of loss as in Section 465, but the economic risk, the real risk of loss. And so, the share is the extent to which you have the economic risk of loss for that liability.

Now, what does that mean? It's that you have it, whether it's by law, by agreement, to make the net payment to the creditor or any contribution I have to contribute back to the partnership to pay a liability. That means it's recourse to me.

Now, it might be a personal guarantee that I have, that I've personally guaranteed and the other partners didn't. Well, if I've personally guaranteed and the other partners haven't, who's economically at risk for that? I am. And so, I would get allocated all of that debt for basis purposes.

So, the partner who is the creditor for a liability that would otherwise be non-recourse has an economic risk of loss in that liability. So, one of the misunderstandings, how do you, how do you allocate recourse debt? Often recourse debt is allocated by saying, you know, their interests in the partnership are, it's 50/30/20. So, everything's allocated 50/30/20. And generally, your software is going to allocate it 50/30/20.

That may not be right. You know, that's going to be right as long as the capital accounts stay 50/30/20 and reflect the interest of the partners, but one year, one partner took out more. One partner got special allocations of depreciation. All right, now their capital accounts aren't reflecting at this point 50/30/20. So, if you're allocating the debt 50/30/20, and that's not their capital account, you may be allocating it incorrectly.

The law says, and I'm going to put up a slide here, you have the constructive liquidation scenario for recourse debt. So, in a recourse liquidation, first, all the partnership liabilities become payable in full. All of the partnership's assets have a value of zero except for property that's contributed to secure a liability. All of the property is disposed of by the partnership in a fully taxable transaction for no consideration except relief of liabilities for which the creditor's right to be reimbursed is limited solely to one or more assets of the partnership. What is that? That's non-recourse debt.

To the extent that there is non-recourse debt, they're not going to come after you personally. That property is going to be disposed of for the value of the debt. All items of gain or loss or deductions are going to be allocated to the partners and the partnership liquidates.

Now, you're supposed to do this every year, this hypothetical liquidation. And that then, the extent to which an individual has to contribute because you're going to allocate the partnership liabilities now based upon their share. What is their share? Well, their share is going to be based on their capital unless otherwise set forth in a different agreement. And so therefore, you would now allocate those liabilities.

The extent to which a person has a negative, they are required to restore to bring it back to zero, their capital account. So, what does that mean? It means that you're allocated that share to bring your capital account back to zero. That's going to be your share of the debt. Then if there's any debt left over, everybody shares it according to their capital accounts, so, 50/30/20.

That's how you allocate recourse debt. So, it's a little more complicated than what is, what we normally think of doing. Non-recourse debt is going to be allocated in a three-step process. The first is to allocate what's called "minimum gain." Minimum gain is if there's non-recourse debt.

So, let's say it was an interest only loan. The building is worth a million five, but the debt, non-recourse debt is a million. Okay. There's no built-in, there is no minimum gain. But after taking depreciation on the building, its basis now is less than the debt, because we're not reducing the debt, because it's interest only. That difference, the difference between the basis and the difference between the debt, that is minimum gain.

Now, some partnership, more complicated partnerships will allocate minimum gain differently than they allocate gains and losses. If you have that, you would allocate the minimum gain like oil and gas, often see it in that; otherwise, allocate it, so, 50/30/20.

Then the next step is you allocate any of that pre-contribution gain. Remember the example we had where the individuals contributed property and there was a pre-contribution gain? Well, since they're going to be allocated that share of the gain, they're going to get that share of the debt next to the extent that they have any built-in gain left. And then finally, it's allocated in accordance to their profit ratio, not their loss ratio. Why not loss? Because they can't come after them personally. They can only go after their interest in a partnership, so, their profit ratio.

So, now we've got our basis. Annually, we're going to adjust our basis for, you know, the share of income, the share of any increase in liabilities, because that's an increase, any additional capital contributions, those are all going to increase.

Now, when we take a, when we reduce, you first take out distributions. Distributions come before anything else. Now, one of the advantages is you could cash out, reduce your basis, current basis to zero, so you could you increase your basis first, cash out your existing basis.

Now, that may mean you're going to suspend your losses because you don't have enough basis to take it, but you're getting cash free, tax free cash because it's going to be a return of your basis. So, you'll suspend those losses in the future. So, you have to make a decision with your client what you want to do.

Now, when you suspend, what do you suspend? Well, you can't pick and choose. It's a pro rata share of each of the items. You can't pick and choose which items that you're going to suspend. It becomes a pro rata share of each of the items.

Now, inside basis, as I mentioned, that is the partner's pro rata share of the partnership's basis in its asset. Now, we already said contributed property is generally carryover basis. If there's a 721(b) gain, then that would adjust the basis upwards. You know, when the partnership, when a partner comes in, there's no adjustment to the inside basis of the assets absent 754. So, if someone buys an interest, A buys B's interest, A just steps into the shoes of B for inside basis.

Well, why is that important? Because everything that flows through is going to be based on that inside basis. So, depreciation, for example. And A says, "Wait, wait, wait, wait, wait, I paid five million, but I'm only getting deductions based on a million." Yes, well, that's what the inside basis was. So, yes, you're just going to flow through based upon your inside basis. So, ultimately, you'll get it back, right, when you dispose of your interest.

So, now we're going to talk a lot more about that, right, in the future. I just want to talk about capital accounts for a minute because there's a confusion here and there's a lot of confusion about how to calculate it.

In the Code, the term "book" means capital accounts maintained under the rules of Section 704(b) of the Code. If you're doing a special allocation, the first requirement is that your capital accounts are maintained under 704(b), called the Capital Account Maintenance Rules.

When we talked about minimum gain for allocation of non-recourse debt, and I said the difference between the debt and the basis, it's the basis for book purposes. The basis for 704(b). Yet the IRS came out and said, for purposes of reporting to the IRS, the amounts you're showing for the capital accounts to the IRS have to be on a cash basis.

Well, 704(b) is closer to GAAP than it is to a cash basis. The confusion is that, that, that does not say that you, for example, when you do your constructive liquidation scenario, that should be allocating, based on your and the assets are allocated based on 704(b). Okay, what is your capital account under 704(b)? Not this capital account.

Also, 754 adjustments for a transfer under 743 are not included. So, for many purposes like debt allocation, special allocation, allocations of non-recourse deductions, you have to maintain an off-the-return 704(b) capital account, a spreadsheet, making the adjustments based on 704.

Now, again, the capital account, the M2 analysis, that again is based on what the IRS wants to see, which is a tax basis. Now, if there's differences between what you're reporting on Schedule L, and what you're going to do then is you're going to attach a statement saying, you know, "These are the differences between Schedule L and the amounts on the M2." So, the, the capital account, that is a misunderstanding, and again the adjustments for 743 are not included for that purpose. A lot of misunderstandings.

Now, the other thing is liabilities are not included. Now, there's a, there's a common statement that says, you know, "Your capital account, it takes capital account plus liabilities, there's your basis." Many times that works out. Many, many times that works out correctly, but it's not going to work out correctly if you're talking about a 704(b) basis.

And again, with more partnership audits coming in, maybe the more potential that we're going to have to have these 704(b) capital accounts available to show why we made these certain adjustments.

So, let's look at a transfer of an interest then. So, I mentioned the five million and the million. Well, that's exactly what happens is you come in and you go, "Wait a second. You know, I'm getting, I only get a million dollars essentially of value for five million dollars that I purchased." Well, yes, because the fair market value, let's say the fair market value of all the assets was five million. Okay, that's you paid, you paid fair market value for that partnership interest, which was valued at five million, but that partner's share of the inside basis was only a million. Now, that million is called the "common basis." That's the basis for all the partners.

The additional adjustment is going to be called the "special basis," and that applies only to the transferee partner. Now keep in mind, if there's a 754 election in effect, you have to make these adjustments. They can be up or they can be down; right? You could have paid less than basis if the value has gone down.

So, here's an example. I have a slide here, Carl, one third partner in Partnership XYZ, sold his entire partnership interest to Evita for \$100,000. XYZ holds only one asset, land, with a basis of \$66,000 and a value of \$300,000. Following the purchase of the interest, Evita had an outside basis of \$100,000, a \$22,000 share of inside basis, and therefore a disparity of \$78,000 between inside basis and outside basis.

If XYZ had made a 754 election when Carl sold the interest to Evita or had one in effect at the time, Evita would have basis adjustment in the land equal to the difference between the outside and inside basis. Now, the nice thing is that the adjustments you make, if there is depreciable property, you are going to add it, you know, create a new asset depreciated under the same number of years, so a new seven-year asset. You just have to remind your software it's one asset, it's got two basis that you're depreciating.

It also is subject to bonus depreciation. Now, there's also what's called a "substantial built-in loss," and that is going to be required. Now, there's exceptions, for example, electing investment partnership, or securitization partnerships do not have to, but substantial built-in loss, a 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.

So, when you're making this adjustment, the adjustment is based on the partnership's interest, the partner's interest in what's called the previously taxed capital, which is equal to the cash, the transfer we would receive on a partnership liquidation following a hypothetical transaction plus any tax loss, plus.

So, that includes any allocations under 704 that would be allocated to the transferee from that hypothetical transaction minus any tax gain, minus any gain plus tax loss, minus any tax gain that would be allocated from that transaction. So, the hypothetical transaction is just simply a hypothetical disposition by the partnership of all of its assets immediately after the transfer of the interest, fully taxable transaction for cash equal to fair market value. Basically, it's the difference between the fair market value and the basis, essentially. There's a series of adjustments. It can, on occasion, be different, but normally that's what it is. So, once the adjustment is determined, the allocation of the basis has to be made then to specific assets.

Now, keep in mind, what if the total is zero? The net adjustment is zero. If there is a 754 election in effect, you have to make the adjustment even if the net amount is zero. Some assets go up, some assets go down, the net is zero. No, that's not. This asset, it went down. This asset, it went up. Oh, this one went down, this one went up. Well, what are those assets that went down and the assets that went up that you're reducing the basis of? It can have a difference in the tax effect, and so therefore, you have to make the adjustment to each of the assets, even if the net amount is zero.

So, in making it, you allocate between ordinary income and capital. So, the basis adjustment is allocated to the class of ordinary income property. How much is that going to be? That is equal to the income gain or loss that would be allocated to the transferee attributable to the acquired interest from the sale of the assets in that hypothetical transaction.

The amount of the basis adjustment to capital is equal to the amount not allocated to ordinary. Now, if the decrease in basis to capital exceeds the adjusted basis, you then allocate that loss back to ordinary and reduce ordinary income property, because remember you can have a gain or a loss.

Now, an asset in which the transferee has no interest isn't going to be taken into account. So, again, after allocating to the class, now you're going to go and allocate to the properties within the class. So, the amount of the basis adjustment that's allocated to an item of property within the class of ordinary income is equal to the amount of, again, income gain or loss that would be allocated to the transferee, again, in that hypothetical sale reduced by their proportionate part of any reduction in the total basis adjustment to all ordinary income property because you didn't have basis. Remember, you go back and allocate if you had too much reduction because you can't have reduce your capital below zero.

Now, once you've made the adjustment, now the adjustment to capital gain is the total amount of income gain or loss, again, that would be allocated from that sale of all your capital, again, reduced by the amount of any positive basis adjustments to the capital gain or loss, again, increased by the amount of any negative basis adjustments multiplied by a fraction, which the numerator is the fair market value of the item of inventory property – I'm sorry, not "inventory" -- the item of property to the partnership, and the denominator is the fair market value. So, it's a fair market value allocation. Fair market value times the over the total fair market value.

Now, a negative adjustment, so positive adjustments, you're going to create a new asset. So, a positive adjustment to a seven-year asset creates a new seven-year, a new 39-year, a new 15-year amortization.

What if you have negative? Well, a negative basis adjustment, you don't reduce the basis. Now, if it's capital asset, you do because there's no effect. But if it is depreciable or amortizable or depletable, what you're going to do is you're going to reduce that, take that negative basis and reduce the amount of cost recovery, your depreciation or amortization over the remaining useful life. If it exceeds that, in other words, you haven't recovered all the negative adjustment, then you're going to allocate that to any remaining property of a similar nature. So, other depreciable property. And if you don't have that, you're going to hold it in suspense until you have assets of that type.

Now, again, if depletion is going to have an adjustment, depletable property, it's determined separately, again, for each partner, including the transferee. And again, the depletion at the partner level, they have to take these basis adjustments into effect again, at the partner level.

So, I have an example here. ABC Partnership reports the following cash, accounts receivable, inventory, investment land, liabilities, and capital. You can see liabilities of \$10,000 fair market value. The capital accounts are \$28,000 and the basis of \$20,000. So, X buys A's basis for its fair market value of \$28,000 plus the share of the liabilities \$3,333. That provides X with an outside basis of \$31,333. That's their interest basis, their outside basis. But its basis in the assets, the inside basis, doesn't change. So, therefore, if they had disposed of the property, the difference, \$8,000. So, that net \$8,000 adjustment to ordinary income and capital. The ordinary income asset allocation, the amount of the basis adjustment that's allocated is \$1,333, which is one-third of the gain of \$4,000. The capital gain then is essentially the rest of it gets allocated, so \$6,667. The net 743 basis adjustment is \$8,000, \$1,333 to ordinary and the rest to capital.

So, here's what we're going to look at. And as you can see, the inventory adjustment to X, \$1,333, and the investment land adjustment of \$6,667, but note, that adjustment is only for X.

Now, if you look at Schedule B, Schedule B is requiring some reporting now, and this is why the IRS is looking at these very closely. Schedule B, Line 10a says, is the partnership making or has it previously made and not revoke a 754 election? If so, enter the date. Schedule B, Line 10b says, for this year, did the partnership make an optional basis adjustment under Section 743? It also then, the line is going to ask us for 734. If yes, enter the total aggregate net positive amount and the total aggregate net negative. What was the total aggregate positive, total aggregate negative? If their answer is yes, then you'd attach a statement showing both the computation and the allocation to each basis, the basis of each adjustment, each asset. Where are you putting this?

Then Schedule B line 10d says, the partnership required to make an adjustment under either 743 or 734 for distributions because of a substantial built-in loss or a substantial basis reduction? If yes, enter the total aggregate of the adjustment and/or attach a statement showing that computation and the allocation to basis.

So, the partnership has to attach the statement to the 1065, the name and the transferee partner, the EIN or Social Security number of the transferee partner, the computation of the 743(b) adjustment, and the identity and partnership properties to which it is allocated.

Now, for K-1 purposes, if the basis of the partnership property has been adjusted for a transferee partner, the partnership must adjust the transferee's distributive share of items of the partnership. So, here's how it's reported. Schedule K, transferee partners again under Code U, Line 20 of the K-1, that's used to report the total remaining 743b adjustments that are applicable.

So, you're going to adjust the transferee's distributive share of items and then you have to list here. So, their K-1 is going to look different than the others, right, because you're making these adjustments. Their basis is different in assets. Then under Code, for Code U, under Line 20, you're going to say, okay, this is what we have remaining.

Now, note that the tax preparer should identify the partnership item being adjusted and the amount. That's usually going to take an attachment. And if it's more than one trade or business that the partnership's engaged in, then you have to report those separately.

So, Line 11 of the Schedule K-1, what we're going to do in this is we're going to pick up the net adjustments, report them here. Other income or loss. And that's the share of the net positive income that results from all the 743(b) adjustments and again, Code it as F, and the amount again in Box 11 is the excess of all 743(b) adjustments allocated to the partnership that increase the partner's taxable income over all of the adjustments that decrease it. It's the net amount.

So, you're picking up the ordinary amounts that you would in the normal return, the return would look the same as the others if they're all equal partners but then this partner, you're going to pick up that adjustment here. And then on Line 20, you're going to report what's left of the 743 adjustment.

And Line 13, you know, Schedule K-1, the other deduction, Code V, so, the partnership's that contain the partner share of the net negative income resulting from those adjustments. All right. So, Line 11, you're picking up under Code F, the excess income and the other deductions, Line 13 Code V, the excess deduction.

I have an example here. Jane is a partner, slide here. Jane is a partner in JK Partnership, has a 743(b) positive adjustment of 30 relating to a 15-year intangible and a 743(b) positive adjustment of \$2,000 relating to a five-year equipment depreciated under straight line method. For the tax year 2025 or 2024, whichever you'd like, Jane has allocated \$2,000 of depreciation for 743 adjustment for asset X and \$400 depreciation for asset Y. The partnership would allocate depreciation expense on that adjustment of \$2,400 depreciation for Jane and would report that expense on her K-1 Line 13 Code V. If it was a negative adjustment, then that would be picked up again on her K-1 Line 11 Code F.

So, another thing to remember is that the notice requirement and the notice requirement says that if there's a transfer of an interest, the transferee has to, within 30 days of the transfer, has to notify the partnership because the partnership has to make these adjustments that we spoke about on the K-1. So, they have to know what the adjustments are. And so, they have to give written notice and provide the information necessary for the partnership to do the return.

Now the partnership can rely on this statement unless they have reason to believe that it's incorrect. And so, the statement, the notice, the names and addresses of the transferee and the transferor, if possible, the taxpayer ID number of the transferee and the transferor, if possible, any relationship between the parties, the date of the transfer, any liabilities assumed or taken subject to by the transferee, the money and fair market value of property delivered or to be transferred for the interest in the partnership, and then any other information necessary to compute the transferee's basis.

Now, if the transferee, now, if there's a death, the same thing, but it's within one year the estate can file that. If that information is not provided and the partnership has knowledge that or reason to believe that there's been a transfer, then they should attach a statement with the name and the ID number of the transferee, if it's known, it may not be known. And then on the front page of the return and the first page of any schedule or other information statements, attached to for the transferee's share of income credits deductions and that would like be for example a K-1 it should say, "Return file pursuant to Section 1.743-1(k)(5)" and that way you're not going to be held to something that you just don't have the information for.

Now, there's been another change, and this could possibly be a big change, is that in June the IRS issued proposed regulations that proposed that the 754 adjustments under 743 and 734 for transfers and distributions are transactions of interest and reportable transactions and fall under the reportable transaction rules. They put a threshold of 5 million, so, they've the adjustment. Now, they're focused on related parties, but it's something to read carefully if you have any adjustment that reaches the threshold.

Now, the regulations have been finalized, and I would refer you to IR 2025-06 and TD 10028. Now, the big change with the regulations as far as making them reportable transactions is, or a transaction that has interest under the reportable transaction rules is the threshold. So, the threshold for these adjustments would be a change in basis because they refer to these as, "basis shifting transactions."

Then the, for transactions before 2025, it's \$25 million and thereafter \$10 million. So, they've significantly increased that \$5 million from the proposed Regs. But if you have adjustments that come up to those amounts of the threshold, you better look at the regulations carefully to make sure that you report.

Now, for open years, there was a reporting requirement which extended the reporting period for those open years to 90 days after the Regs were finalized. So, again, if you have one, I'd refer you to that for your reporting requirements.

So, I want to thank you again for joining me. You know, “basis” is a real interesting one. In a future program, we're going to talk about the 754 election and how it affects the basis reduction. So, what happens when you have a distribution? So, how do distributions come in to play when there could in fact be a gain or loss recognized by a partner which could affect the partnership's assets.

So, I want to thank you for joining me and hope to see you again on another program, and as always, please be safe.

SUPPLEMENTAL MATERIALS

There are no supplemental materials for this segment. Go to the next page for discussion questions.

GROUP STUDY MATERIALS

A. Discussion Questions

1. What is a partner's outside basis?
2. What does §83 apply to and how does it affect taxation?
3. How does a positive §743(b) adjustment to a depreciable asset affect the transferee partner?
4. When is a Section 754 election beneficial to a partnership and its partners?
5. When is a Section 754 election typically filed, and how long does it remain in effect?

B. Suggested Answers to Discussion Questions

1. What is a partner's outside basis?

A partner's outside basis is the partner's tax basis in their partnership interest. It typically includes the amount of cash and the adjusted basis of any property contributed to the partnership, plus the partner's share of partnership liabilities, and is adjusted annually for income, losses, distributions, and other items.

2. What does Internal Revenue Code §83 apply to, and how does it affect taxation?

IRC §83 applies to the transfer of property in connection with the performance of services.

Under §83, the recipient includes the value of the property in income when it becomes substantially vested (i.e., transferable or no longer subject to a substantial risk of forfeiture), unless the recipient makes an §83(b) election to include the value at the time of transfer.

This affects the timing and character of income recognized and can have significant tax planning implications.

3. How does a positive §743(b) adjustment to a depreciable asset affect the transferee partner?

A positive §743(b) adjustment occurs when a partner purchases a partnership interest for more than their share of the partnership's inside basis in its assets.

For depreciable assets, this adjustment increases the transferee partner's share of basis in those assets, resulting in additional depreciation deductions allocated only to that partner.

This allows the transferee partner to recover their purchase price through increased depreciation or amortization over time.

4. When is a Section 754 election beneficial to a partnership and its partners?

A Section 754 election is beneficial when:

- A partner sells or transfers their interest, or
- A partner receives a distribution that causes a substantial basis reduction or gain/loss recognition under §734 or §731.

This election allows the partnership to adjust the inside basis of partnership assets under §743(b) or §734(b), aligning asset basis with the economic reality of the transferee partner.

It can reduce disparities between inside and outside basis, prevent double taxation, and provide additional depreciation/amortization to transferee partners.

5. When is a Section 754 election typically filed, and how long does it remain in effect?

A Section 754 election is filed by attaching a written statement to the partnership's timely filed (including extensions) Form 1065 for the year in which the relevant transfer or distribution occurs.

Once made, the election is irrevocable without IRS consent and remains in effect for all subsequent years unless formally revoked.

Careful consideration is required, as the election affects future transactions and imposes additional administrative tracking for basis adjustments.

PART 3. ARTIFICIAL INTELLIGENCE (AI)

Using AI in Your Practice

In the third segment of this month's program, Renee Rodda explores the rapidly evolving role of artificial intelligence in the tax profession. While AI is generating both excitement and apprehension among practitioners, it offers a range of opportunities to improve efficiency, accuracy, and client service from streamlining tax research to enhancing document review and communication. However, its limitations, particularly around data accuracy, privacy, and the need for human judgment, mean that thoughtful implementation is essential. This discussion addresses the benefits, challenges, and best practices for integrating AI into your tax practice.

Let's join Renee.

Ms. Renee Rodda

Artificial intelligence, or AI, is something that is creating in equal measures, some excitement and some anxiety. And I think for us, it's important to talk about the pros and cons and really how we can make it work for us as tax practitioners, because there are a lot of potential benefits of using AI in your practice. It's certainly going to help to free up resources. And as these tools get better, they're going to help you to provide new insights into your clients, how to better advise them, do some tax planning, making sure they're not missing tax incentives, things like that, as well as accelerating your research on certain items.

Those insights and accelerated research, I think we're going to walk before we run. So we'll talk about some concerns I still have in that area. But I think as practitioners, I've heard a lot of people say, well, I'm concerned that AI is going to make me obsolete. And we're not in anywhere near a situation where we as practitioners are going to become obsolete because of AI in our industry.

I think AI is going to make us better practitioners and it's going to continue to get better. But at the end of the day, there is still a human experience involved in what we do other than the very basic tax return preparation, right? That, I think, ultimately will be something that is far more automated.

But it's also going to help us identify inaccuracies in the returns that we're preparing for clients. But we also want to watch out and be careful about inaccurate data that we're getting back from AI tools. And, I think we cannot have a conversation about using AI in your tax practice without discussing the fact that there are some security concerns.

So I think when I say there's equal measures of excitement and anxiety related to AI, there are some practitioners that I talked to that are really looking for any way they can incorporate AI into their practice. And then there's other practitioners that are saying to me, I don't want to use AI. I'm not ready to use AI. I'm not comfortable with it.

And I think for me, this reminds me of two scenarios. First of all, I've been likening it to our cell phones because the iPhone was invented or was released in 2007. And if you think about our life before iPhones and how we used our cell phones, they were truly just that, phones. And then we started using them to send text messages, but we had to push the button multiple times just to get to the correct letter that we wanted. And if we fast forward to today, in not that long of a period of time, our phone is now our phone, our calendar, our camera. We can watch movies, we can read books, do research online. There's all sorts of things that we do with what we used to just consider our cell phone.

And I think it's also interesting to compare this to practitioners' initial thoughts about e-filing. I remember when we first started talking about mandatory e-filing and I would be at the seminars and practitioners would come up to me and say, absolutely not. I'm not doing mandatory e-filing. My clients aren't comfortable with e-filing. I need to know how I can opt out for all of my clients. And today we're in a scenario where I get emails regularly from practitioners complaining about forms that still can't be e-filed because it's so difficult for them to have to file a form that can't be e-filed. We just start to incorporate these tools in our lives, and it really changes the way we function and the way we think about things. And I think sometimes we don't even realize that it's happening.

And I think when we talk about AI, there's a lot of us that are using AI tools that we probably aren't thinking of as AI, because I think a lot of people think AI is just ChatGPT or Claude, but artificial intelligence is used in a number of areas in your practice already. Many software providers already have AI that's incorporated to scan W-2s and 1099s and other common tax forms. They're using it to make the diagnostics better. So I think you'll notice this year during filing season, getting better diagnostics on your clients' returns. It's because those AI tools are really helping the software to analyze the data in the return. And the ability to analyze data quickly is really one of AI's biggest advantages.

So when we talk about the different types of AI for tax professionals, it's important to realize that AI does a lot of different things, right? We have what we call machine learning and machine learning feeds data in to detect patterns and make predictions. So that's the type of AI that's going to be used to review returns for errors or predict the likelihood of an audit.

We have what we call natural language processing which processes data. So it can help you to summarize guidance. It can help you to draft client letters or scan documents. And then going forward, I think we're going to see more use of what we call expert systems that apply decision logic to those fact patterns. So they're going to help you to walk through decision trees and to automate workflows for your clients to really help you do what you do in a more efficient way.

Where we stand today, many of our software providers or the research services that you use have what we call proprietary AI tools. And we're not just talking about sort of open AI like we have with the free versions of Claude or ChatGPT.

No matter what you're doing, I think one thing we want to be very careful about at this point in time, unless we're using a proprietary form of AI that truly has very strong data protection, you want to make sure you're not putting any confidential information into that AI tool.

And I think that going forward, you know, we're really going to see AI used more to help. Even today, help draft responses to notices that your clients receive. Help draft client letters. So you want to be careful not just about the information that's going in, right? We don't want to put in social security numbers and other confidential information. We also want to pay attention to the data that the AI is putting out when we're reviewing those letters and those responses. We want to make sure that there's no confidential information being shared out that shouldn't be sent.

And you want to make sure that any AI tools that you're using complies with privacy regulations and standards. And I think some of those are going to be standards that you set internally in your practice. And some are going to be just sort of industry wide regulations and standards to make sure that we're protecting confidential information if we're including it in, if we're adding it to those systems.

Of course, doing what we do here at Spidell, we spend hours and hours reading through court cases, regulations, new legislation. And so my initial gut reaction was AI can read thousands of pages in seconds and give you summaries or answers to questions.

For me at this point, AI is not really where we want it to be for complicated tax research. I think even those AI tools that you're going to find in your research services, they are much better than the general tools like Claude or ChatGPT. We'll even talk about some specific AI tax research tools that I think are a little better like TaxGPT.

But I still at this point, I am not comfortable assuming that the responses we're getting from those types of tools are 100% accurate. We have found that AI will make up code sections and private letter rulings. I'm going to talk about the art of writing prompts, when you're using these tools in your practice, because I think prompts can really make or break the responses that you get. But we're still seeing it have trouble with some more nuanced questions.

And look at the example that we have on page 6-4. We asked Claude whether California treats a rollover from a medical savings account to a health savings account, whether we conform to federal law. And we got a very detailed response that was exactly the opposite of the correct answer. So essentially, Claude told us that we conformed where we did not and that we didn't conform where we did. So if we had relied on that response for a client, we would have been 100 % incorrect.

So I think you can still use it to benefit you. For example, I might ask it to make a brief outline for me of a detailed document so I have sort of a tree to follow through to make sure I'm not missing any sections of a new piece of legislation. But I'm definitely not comfortable at this point asking it to read tax content and give me a detailed answer.

Now I will say for very basic questions, we could get some good answers out of these tools, especially the ones that are tax specific. But again, that's where the art of writing a prompt is going to become important. So for those of you who haven't used any of these tools, you go into the tool and you can type in a question. That's what we call a prompt. But what you ask is very much going to inform the type of answer that you get.

So you're not going to ask a very general question like, how much depreciation can my client claim? But you might ask a question that says, should my client claim bonus depreciation or section 179 for a new oven that they are purchasing to use in a restaurant that they own? We've asked a very specific question about what type of depreciation the asset might qualify for. We've stated what the asset is. We've stated that it was purchased, not leased. We talked about the type of business and the fact that they own the business.

All of those facts are important in answering the question, right? So you're asking it to help you analyze that. You also want to be sure to tell it what research materials to use. So do you want it to look in the code and the regulations? Do you want it to look through court cases? Always ask for citations when you are asking a question so that you can check the citations.

We were recently researching some state specific rules about names for tax practitioners and CPAs and how they have to or how they may name their businesses. And it was interesting because as we were looking through the code sections, it cited a code section that was correct seven or eight years ago. Even the version, even though the version of the data that it's supposed to be reviewing was allegedly current data. I think for some of those more nuanced topics like a state business and profession code to determine how a tax professional can name their business was a little too nuanced at this point for these research services. I think, always ask very specific questions, ask for citations so that you can check them, and then go ahead and check them to make sure they're correct. Like anything else, some sources are better than others. So I don't love ChatGPT for asking tax questions, but there are sources like BlueJ Tax and TaxGPT that have much better information and can give you much more informed answers.

The one thing I think as tax practitioners that we can really be using AI for today is to help improve client communication. You can use AI to draft engagement letters, opinion letters, client letters, Sandy Weiner on our team, she even got it to make tax poetry. There's an example of that for you there on page 6-5, if you want to take a look. But I think, you know, one of the things we do at Spidell is we create a lot of charts and checklists and handy tools and client letters, and we reference them throughout the materials. We don't do that because we think you're not able to do it, we know you are, but it's our job to make your lives easier and help you to do these things faster.

I also don't really expect you to use the client letters, in particular, in exactly the form that we've created, but I do think it's a good starting point. One thing I find if I'm trying to draft an email or a letter, the hardest part for me is getting started. But if I have a starting point and all I need to do is tailor it to sound more like myself or to address my client's specific fact patterns, that's a lot easier than it is to start from scratch. And I think that's an area where using AI is going to be very helpful in your practice. Use it as a starting point and then go ahead and modify it for your own purposes.

I also think it's interesting, and when I talk about writing prompts, there are courses that you can take, free courses online, even some more advanced paid courses if you're interested in that. But I like playing with prompts to kind of see how I can make the output better. And for example, if you're asking it to draft a letter, you might want to try asking it to draft a letter considering that the audience is a small business owner or that the audience is a fellow tax professional or that the audience is a high school student. And it's very interesting to see how a similar response can be drafted so differently for different audiences.

Going forward, I think we're going to see more use, like I said, of AI to analyze client data, see who's impacted by a law change or a tax incentive. That's an area where I think it's improving. It's not quite where we would want it to be yet.

When we talk about dangers and strategies, again, don't put confidential information into OpenAI. My recommendation is to never put secure client data into OpenAI. That's where you want to find a proprietary AI so that that information isn't accessible to the public.

AI is at a point where I think it definitely can help to review returns for errors and inconsistencies, but it's still not going to replace a seasoned tax professional. I think your software provider is probably already using something or they may have an additional tool that you can add on. So you might want to ask them what options are available to you. But AI is getting to the point where it can help to point out issues like multi-state filing requirements.

We're seeing more tools for creating planning scenarios for clients. And the thing with AI, and really commenting on the fact that AI isn't going to replace us as tax practitioners, AI can analyze your client's data and make recommendation, but it's not going to understand your client's personalities. We all know that you have certain clients that even if decision A is better for them, they're going to go with decision B because it makes them more comfortable. That's something that you understand as a practitioner, AI is not going to have that type of reasoning that understands your client's personality.

AI also isn't going to help you predict proposed law changes. That's the type of thing that AI really isn't able to help us with yet. It's good at taking data, analyzing it, and giving us concrete answers. It's not going to make A or B type decisions for you or predict what might be coming in the future.

I think regardless of if you want to use AI in your practice or if you don't want to use AI in your practice, if you have employees, you need to make sure that you're considering your options for using AI or not using AI, that you're educating yourself and any staff, especially if you are using AI, and that you establish a policy about where AI can and can't be used and what platforms are approved. Because I think especially if you have staff that are really trying to do a great job and taking advantage of new tools, they might not understand some of these security risks. And so you want to be very clear about what processes you're going to use in your practice and policies for how they can be used. And then make sure you communicate those security concerns and limitations so that you don't have a situation where someone gets into trouble unexpectedly.

Using Artificial Intelligence in Your Practice

Lately, tax professionals cannot open a trade newsletter, blog, post, etc., without being inundated with reminders about the arrival of new artificial intelligence (AI) tools and how they are going to transform the tax professional's practice by:

- Freeing up resources by letting AI handle mundane, routine tasks;
- Accelerating tax research; and
- Providing whole new insights into tax planning and strategies.

On the flip side, we are being warned that AI is going to:

- Take over the work currently being performed by tax professionals, making our work obsolete;
- Just make us dumb faster because it is filled with inaccuracies and hallucinations;
- Eliminate the benefits of human experience and nuance that only comes from having years of real-life experience; and
- Pose heightened security and privacy risks.

The reality is there is some truth to all the above, and tax professionals need to start examining how we can maximize all the benefits that AI can offer while minimizing the downsides that can arise.

Today, it's impossible for us to imagine doing our work without our tax software, our tax research subscriptions, and even Google. Five to 10 years from now, we will likely be feeling the same way about AI. AI may become tax professionals' greatest tool by freeing us from performing routine and mundane tasks, speeding up our research, and focusing our time on providing value added services such as tax planning and business development.

AI IS ALREADY HERE

AI is already currently being used in many applications, such as programs that scan and populate information from documents such as W-2s and some 1099s directly into tax software. However, we know that these programs have been receiving mixed reviews, and many practitioners question the cost-effectiveness of these tools given all the time required to review the accuracy of the populated data.

But AI is a smart learner, and the more data it receives, the more it will learn. Common errors that we may now see AI performing in terms of scanning and analyzing 1099-DIVs may be a faint memory a year from now. We also know that Thompson Reuters, CCH, and Avalara, among others, are among some of the larger tax research/software platforms integrating AI into their platforms.

AI is likely already being used in software diagnostic programs. One of AI's great advantages is that it can analyze a huge amount of data quickly and identify patterns and anomalies. The "smarter" AI becomes, the more valuable it will be as a partner in reviewing returns and financial statements and assisting us in identifying errors or areas where additional scrutiny is required.

And imagine what it can do for you in terms of preparing client letters and research. Ask any high school student today about how to use AI to write a cover letter or a basic research paper. ChatGPT, Claude, and other AI platforms could easily do that for you today, but there are currently significant shortcomings that you need to be aware of so you can minimize the risks of using AI.

Types of AI for tax professionals

There are several different types of AI that could be valuable for tax professionals:

Machine learning

Machine learning involves feeding large datasets into algorithms that can detect patterns and make predictions. In tax, machine learning could be used for tasks like:

- Analyzing past returns/financials to identify potential errors, inconsistencies, or audit risks;
- Reviewing large volumes of transaction data to determine proper tax treatment (like populating data from information returns); or
- Predicting the likelihood of certain deductions/positions being allowed based on historical IRS rulings.

Natural language processing

Natural language processing (NLP) refers to the ability of AI to understand, interpret, and generate human language. NLP could assist tax professionals with:

- Summarizing tax laws, rulings, and other guidance in plain language;
- Drafting customized client communications like opinion letters; or
- Extracting key information from documents like contracts using optical character recognition.

Expert systems

An expert system uses human expertise and decision logic to solve complex problems systematically. For tax, an expert system could:

- Walk through decision trees for certain tax situations;
- Systematically apply tax rules and regulations; and
- Automate workflows around tax prep or compliance processes.

While still emerging, all of these AI types show potential to improve efficiency, insights, and scalability for tax advisory work. However, until this technology is better developed and vetted, care is needed to validate outputs, manage risks like data privacy, and maintain human expertise in the loop.

SECURITY AND PRIVACY RISKS

While AI offers many potential benefits, tax professionals must be extremely cautious about the security and privacy risks involved with these technologies.

Data breaches/exposure

Many AI models require uploading or inputting large volumes of client data during the training process. This data could be susceptible to breaches or unintended exposure if not properly secured. Unauthorized access to client financial data, personal information, etc., could be disastrous.

Unintended disclosure

Even if client data doesn't get breached, the outputs generated by AI themselves could reveal sensitive information if not controlled. For example, an AI platform writing client communications could inadvertently disclose confidential facts or figures.

Lack of compliance

AI companies may not necessarily comply with the same data privacy regulations and standards as professional service firms. Their security protocols may be insufficient.

To mitigate these risks, tax firms should follow best practices such as:

- Only use AI tools from reputable, compliant companies with strong data security;
- Avoid AI that requires uploading complete client data sets when possible;
- Implement robust access controls, encryption, and monitoring around any client data used;
- Thoroughly vet AI outputs for any unintended disclosures before releasing externally;
- Get clients' explicit approval if using any of their data for AI model training; and
- Ensure AI usage complies with all relevant data privacy laws and regulations.

The risks are real but can be responsibly managed through a security-minded approach. Data governance and privacy must be top priorities when adopting AI.

BENEFITS OF AI

Below are the areas where we see AI being useful.

Tax research

AI will be invaluable in helping you "cut to the chase" in conducting your tax research. It can quickly scan through thousands of pages of statutes, regulations, official guidance, cases and rulings, and analysis to assist you in your research.

The dangers

While using AI to conduct your research has the potential to save you a lot of time, you cannot automatically assume that the research will necessarily be on point, nor can you assume that it's 100% accurate.

We've all heard stories of AI:

- Not addressing the issue or missing relevant issues;
- Making up code sections or PLRs that don't exist. This is commonly referred to as "hallucinating"; and
- Being plain wrong.

One example of our AI experience

When we asked an AI platform how California treats a rollover from a medical savings account (MSA) to a health savings account (HSA), one of the responses we received was:

Claude's response

"CA conforms for HSAs — California fully conforms to federal law for HSAs. Contributions, earnings, and qualified distributions are exempt from CA state income tax.

CA Does Not Conform for MSAs — However, California does NOT conform to federal law for MSAs. Contributions to MSAs are not deductible and earnings are taxable for CA purposes.

Rollover Amount Taxable — Because of this difference, the amount rolled over from an MSA to an HSA becomes taxable income for California. It does not qualify for the same tax-free rollover treatment."

The actual law

California has never conformed to the federal treatment of HSAs (R&TC §17215.4), and it does conform to the federal treatment of MSAs. (R&TC §17215) A rollover from an MSA into an HSA would be a taxable distribution subject to the premature withdrawal penalty for California purposes.

The strategies

The dangers listed above do not mean that you should never use AI. It means you need to use it wisely. Some key ways to address the issues raised above include:

- Making sure you are writing clear and specific prompts. If you ask AI a question such as "How much depreciation can my client claim?", you are going to get a very different response than if you ask, "Should my client claim bonus depreciation or IRC §179 for a new oven they are purchasing to use in a restaurant they own?";
- Asking AI to only use certain materials in responding to your prompt. For example, you can ask it to only use the Internal Revenue Code, Treasury Regulations, and Internal Revenue Service guidance, or you can also ask it to only look at court cases in the last 10 years. This ensures that AI is not utilizing erroneous information from random sources on the internet; and
- Asking AI to provide citations for its conclusions, and always review the source documents that AI references.

Prompting is a science in and of itself

Getting a good response from AI is largely dependent on the prompts that are used. As we discuss below, it may be a wise investment to sign up staff for training on creating effective prompts.

Comment

While there are "universal" AI platforms that anyone can use, we are starting to see more AI platforms targeting the tax world specifically, ensuring that the data AI is accessing is much more targeted to reliable tax guidance (e.g., the IRC, current regulations, IRS guidance, etc.). Examples of this include Blue J Tax and TaxGPT.

Improving client communication

One of AI's best uses is to assist in translating complex ideas into simple language. Tax professionals can easily utilize AI to help in drafting engagement letters, opinion letters, and client letters.

ChatGPT can even summarize tax issues in poetry

In demonstrating the ability of ChatGPT-4 to conduct tax research and determine a couple's tax liability, a demonstrator even showed how ChatGPT can present complex tax issues in rhyming poems:

*In the year of twenty-eighteen,
Alice and Bob, a married team,
Their income combined reached new heights,
As they worked hard day and night.*

*Their son Charlie was their joy,
A little baby, a lovely boy,
A household they maintained together,
Yet lived apart, without a tether.*

*To calculate their tax, it's true,
A standard deduction we must construe,
For married folks who file jointly,
Twenty-four thousand dollars, quite pointy.*

*Their income sum, seventy-eight thousand nine eighty-one,
Minus the standard deduction, the math's begun
With exemptions being zero, the next line we trace,
A taxable income of fifty-four thousand nine eighty-one takes place.*

*Now to the tax table, a liability we seek,
For married couples, the outlook's not bleak,
In range of thirty-six thousand nine to eighty-nine thousand one fifty,
The formula's set, no longer shifty.*

*Five thousand five hundred thirty-five, it starts,
Plus twenty-eight percent of the excess imparts,
Eighteen thousand eighty-one, the difference we fined,
Multiplied by point two eight, the tax liability's designed.*

*Ten thousand five hundred ninety-seven dollars and sixty-eight cents,
A tax liability for Alice and Bob, a sum quite dense.
In this world of numbers, a story unfolds,
Their financial journey, in a poem is told.*

For those looking for less artistic uses of AI, it can also be used to identify clients who may be impacted by specific legal, regulatory, or case law changes.

The dangers

Tax professionals must be extremely careful about opening access to private and confidential information to an AI platform as this information then enters the AI ethos.

The strategies

It's important not to use an "open" AI platform such as Microsoft Azure, Google Tenserflow, or ChatGPT when using confidential client information. Investing in a proprietary AI system means that the data and information you load into your AI platform will not be accessible to the public. It will remain in your private AI domain. If you load your client data into the AI platform, no one else will be able to access this information. However, the AI program will be able to help analyze and classify all the uploaded information.

Diagnostics

AI can review returns for errors and inconsistencies and ensure that what's reported complies with current tax law and regulations. While AI can assist with this, it can't replace the eye of a seasoned tax professional. We never recommend relying solely on AI to identify errors.

AI can, however, be especially useful for your multistate clients. AI can help you identify nexus issues, filing issues, help analyze nuanced categorizations (e.g., whether a sale is tax-exempt in a particular state), and help you stay on top of registration and reporting requirements for all the various state and local taxing jurisdictions.

Planning

AI can help tax professionals play out various scenarios and hypotheticals to assist in tax planning. It can also assist in reviewing and analyzing historical data and provide suggestions regarding potential tax savings.

However, AI will likely fall far short in understanding your client's unique personalities, perspectives, and capacities. This is where the tax professional comes in to bridge the gap between what is possible to what is the best fit for your clients.

Also, when multiple variables come into play, AI may not be able to grasp all the various nuances. As one article put it:

"Tax laws, as known to practitioners, are intricate and can offer multiple interpretations. This complexity is amplified by the differing sets of tax laws across jurisdictions. While AI can identify patterns from past rulings, it lacks the capacity to draw the type of actionable analogies essential for understanding diverse precedents in varying contexts. Tax practitioners possess a unique ability to connect disparate tax provisions and interpret the implications of seemingly unrelated factors, an essential skill for pioneering solutions." (Alarie, Benjamin, et al. "Will AI Replace Tax Practitioners," State Tax Notes, October 30, 2023.)

AI will also not be able to really weigh and predict how statutory and regulatory changes may impact your clients. AI's expertise is applying the law based on historical data. However, if the law changes, AI will not be able to predict the outcomes, especially how a change in one area of the law may impact other areas.

Your AI action plan

As you are considering integrating AI into your workflows, it's important to do so in a thoughtful manner. First and foremost, you must weigh the benefits and risks, conducting in-depth evaluations of the AI solutions before choosing one, and should ensure to make time for ongoing AI workshops for your leadership teams and staff.

Once this is done, it's important for you to be clear on your:

- **Policy:** Establishing a company-wide policy, e.g., Are you using AI at all? What AI platforms can be used? Can you utilize client information in your AI searches? What kind of training is required before using AI?
- **Process:** Good technology follows good process. Be clear how generative AI will be incorporated into your workflows.
- **Strategy:** Will consultants and/or trainers be hired to work with your staff and establish your processes and work with staff on how to design effective prompts, etc.? What type of evaluation system are you putting in place to determine if AI is generating the results you are hoping for? Who is responsible in the firm to spearhead and oversee these efforts?
- **Security:** Establishing systems so staff works with these tools in a safe and secure manner.

GROUP STUDY MATERIALS

A. Discussion Questions

1. Why is it important to learn how to write effective prompts when using AI tools for tax research?

B. Suggested Answers to Discussion Questions

1. Why is it important to learn how to write effective prompts when using AI tools for tax research?

Learning to write effective prompts is crucial because it directly affects the quality, accuracy, and usefulness of AI-generated responses. AI is only as good as the information it receives—and this starts with the prompt.

Key Reasons Prompting Matters:

- **Precision yields better answers:** A prompt that includes specific facts—such as the type of asset, the business use, ownership details, and the intended code sections—can yield a much more targeted and relevant response.
 - Vague prompt: *“How much depreciation can my client claim?”*
 - Improved prompt: *“Should my client claim bonus depreciation or §179 for a new oven in a restaurant they own?”*
 - Specific prompts provide more relevant, actionable responses.
- **Reduces AI errors:** A well-written prompt can help narrow the AI’s data sources, limiting its response to reliable authorities such as the Internal Revenue Code, Treasury Regulations, or IRS rulings. Moreover, instructing AI to provide citations and then verifying those citations ensures that the user can catch and correct any erroneous information before relying on it for client advice.
 - AI may “hallucinate” code sections or rulings.
 - Directing AI to use trusted sources (IRC, Treasury Regs, IRS guidance) helps minimize misinformation.
 - Always ask for citations—and verify them.
- **Prompting is a skill:** Creating effective prompts can help tax professionals consistently generate accurate, useful AI outputs while avoiding costly errors caused by ambiguous or overly broad queries.
 - Writing good prompts is teachable.
 - Training staff in prompt design can improve research efficiency and output quality.
- **Maximizes efficiency while mitigating risk:** Well-crafted prompts maximize the efficiency benefits of AI—like faster research and improved client communication—while minimizing the risks of misinformation and client exposure. When AI is guided properly, it becomes a powerful assistant in scanning regulations, generating draft letters, or identifying audit risks. But without clear prompting, those same tools may produce misleading or incomplete information that creates more work than it saves.

GLOSSARY

Book Capital Accounts—Each partner has separate capital accounts that represent the equity that the partner has in the partnership. The partners' share of equity is the amount that would be received if the partnership were liquidated and all of the assets were sold at their book value, all liabilities paid, and the net proceeds distributed. As the partnership carries on the trade or business, these capital accounts will change depending on the agreement between the partners as to how they will share in the profits and losses. The capital accounts should reflect the economic arrangement between the partners. The term book refers to the rules under IRC §704(b).

Casualty Loss—The complete or partial destruction of property resulting from an identifiable event of a sudden, unexpected, or unusual nature. Examples include floods, storms, fires, earthquakes, auto accidents, and terrorist attacks. Individuals may deduct a casualty loss if the loss is incurred in a trade or business or is incurred in a transaction entered into for profit. For tax years 2018–2025, personal casualty losses are only deductible if incurred in a federally declared disaster area. A taxpayer who suffers a personal casualty loss from a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act will still be able to claim an itemized deduction for tax years 2018–2025. Individuals deduct personal casualty losses as itemized deductions on Schedule A. Use of Form 4684, *Casualties and Thefts*, is required.

Inside Basis—Inside basis is the adjusted basis of contributed property in the hands of the partnership kept on a tax basis. The inside basis for a partnership is governed by IRC Section 723, which employs the aggregate theory to give the partnership a carryover basis in the assets contributed. The inside basis should be contrasted to the outside basis, which is the partner's adjusted basis in their partnership interest.

Involuntary Conversion—Forced disposition of property due to condemnation, theft, or casualty. Upon conversion, you usually receive cash through insurance proceeds or condemnation awards. Tax on gain from involuntary conversion may be deferred if replacement property is purchased.

IRC Section 754 Election—A partnership may make an election under IRC §754 to adjust the basis of the partnership's assets under IRC §743(b) as they relate to a particular partner(s) to reflect the fair market value of partnership property at the time of a purchase/sale of a partnership interest or the death of a partner. Pursuant to an election under IRC §754, a basis adjustment may also be made under IRC §734(b) when a partnership makes certain property distributions to one or more of its partners.

Outside Basis—Outside basis is the adjusted basis of contributed property in the hands of the partner kept on a tax basis. The outside basis for a partnership is governed by IRC Section 721, which employs the aggregate theory to give the partner a substituted basis in the assets contributed. The outside basis should be contrasted to the inside basis, which is the partnership's adjusted basis in the partnership assets. The adjusted basis of a partner's partnership interest is ordinarily figured at the end of a partnership's tax year. If there has been a sale or exchange of all or part of the partner's interest or a liquidation of the entire interest in a partnership, however, the adjusted basis is figured on the date of the sale, exchange, or liquidation.

Tax Report

Volume 38, Issue 5

June 2025

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

1. Which code section allows individuals to exclude qualified disaster relief payments from gross income?
 - A. Section 1033
 - B. Section 121
 - C. Section 139
 - D. Section 165

2. What is required for employers offering Section 139 disaster relief payments to employees?
 - A. Employees must pay back unused funds.
 - B. Employers must issue Form 1099-MISC.
 - C. Payments must be reported on Form W-2.
 - D. The plan must have clear written documentation.

3. Which type of insurance reimbursement is generally **not** taxable?
 - A. Additional temporary housing expenses
 - B. Business interruption compensation
 - C. Loss of rental income
 - D. Normal living expenses

4. What is the maximum time allowed to reinvest insurance proceeds under Section 1033(h) for principal residences?
 - A. One year
 - B. Two years
 - C. Three years
 - D. Four years

5. What is the maximum discretionary postponement period that the IRS may grant for time-sensitive tax acts under IRC Sec. 7508A?
 - A. 30 days
 - B. 60 days
 - C. 6 months
 - D. 1 year

Continued on next page

6. Which of the following is **not** one of the three types of basis related to partnerships?
- A. Capital accounts
 - B. Depreciable basis
 - C. Inside basis
 - D. Outside basis
7. Under Section 704(c), built-in gain on contributed property is generally allocated to:
- A. All partners equally
 - B. The contributing partner
 - C. The non-contributing partners
 - D. The partnership
8. What does 'minimum gain' refer to in a partnership context?
- A. Gain realized by partners when distributions are made
 - B. The difference between outside and inside basis
 - C. The excess of non-recourse debt over the basis of the securing asset
 - D. The portion of guaranteed payments taxed as capital gains
9. Which type of debt provides a basis increase for a partner who has economic risk of loss?
- A. Non-recourse debt
 - B. Qualified nonrecourse financing
 - C. Recourse debt
 - D. Trade payables
10. What is the main purpose of a Section 754 election?
- A. To adjust the basis of partnership assets when a transfer or distribution occurs
 - B. To allow partners to allocate income equally
 - C. To avoid recognizing gain on contributed property
 - D. To simplify depreciation calculations

Continued on next page

11. Which of the following typically causes a disparity between inside and outside basis?
 - A. A partner's guaranteed payment
 - B. Non-deductible expenses
 - C. Section 179 deductions
 - D. Transfer of partnership interest
12. Which of the following is a reporting requirement when a Section 743(b) adjustment is made?
 - A. Adding the adjustment to the partner's guaranteed payments
 - B. Amending the prior year's return
 - C. Disclosing the adjustment on Schedule K-1, line 20, code U
 - D. Reporting the adjustment on Form 8283
13. Under Section 743(b), the basis adjustment applies to:
 - A. All existing partners
 - B. Only the transferee partner
 - C. The general partner only
 - D. The partnership as a whole
14. Which of the following is a primary advantage of using AI in a tax practice?
 - A. It eliminates the need for tax professionals.
 - B. It enhances diagnostic capabilities and speeds up data analysis.
 - C. It guarantees accurate responses for tax research.
 - D. It predicts future tax law changes.
15. Which of the following is **not** a recommended use of public AI tools in a tax practice?
 - A. Analyzing sensitive client financial data
 - B. Brainstorming responses to IRS notices
 - C. Drafting a client letter using general details
 - D. Writing an outline of a long piece of legislation

SUBSCRIBER SURVEY

Evaluation Form

Please take a few minutes to complete this survey related to the **CPE Network® Tax Report** and return with your quizzer or group attendance sheet to CeriFi, LLC. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to CPLgrading@cerifi.com.

How would you rate the topics covered in the June 2025 issue of **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
Segment 1	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Segment 2	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Segment 3	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Which segment of this issue of **CPE Network® Tax Report** did you like the most, and why?

Which segment of this 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 this issue of **CPE Network® Tax Report**? Rate each speaker on a scale of 1–5 (5=highest):

	Overall	Knowledge of Topic	Presentation Skills
Speaker 1	<input type="text"/>	<input type="text"/>	<input type="text"/>
Speaker 2	<input type="text"/>	<input type="text"/>	<input type="text"/>
Speaker 3	<input type="text"/>	<input type="text"/>	<input type="text"/>

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: _____ Date: _____

<u>Name</u>	<u>Email</u>	<u>Total Hrs</u>	<u>IRS PTIN ID</u> <u>(if applicable Tax only)</u>	<u>Sign In</u>	<u>Sign Out</u>
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____

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: _____

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 <u>3 times per CPE hour</u> . 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.

[illegible]

CHECKPOINT LEARNING NETWORK

CPE NETWORK[®]

USER GUIDE

REVISED June 1, 2025

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 the 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 CeriFi, LLC.

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!**

Copyrighted Materials

CPE Network program materials are copyrighted and may not be reproduced in another document or manuscript in any form without the permission of the publisher. As a subscriber of the **CPE Network Series**, you may reproduce the necessary number of participant manuals needed to conduct your group study session.

“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 online.

- If the emailed 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 email 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

The entire transcript is available as a pdf via the link in the email sent to administrators.

Requesting Participant CPE Certificates

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

Email: CPLgrading@cerifi.com

When sending your package to CeriFi, 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 CeriFi 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. Participants’ two-way video should remain on during the entire presentation.

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 asks 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.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

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 emailed 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 email 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

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 the following means:

Email: CPLgrading@CeriFi.com

When sending your package to CeriFi, 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 CeriFi 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—Email

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

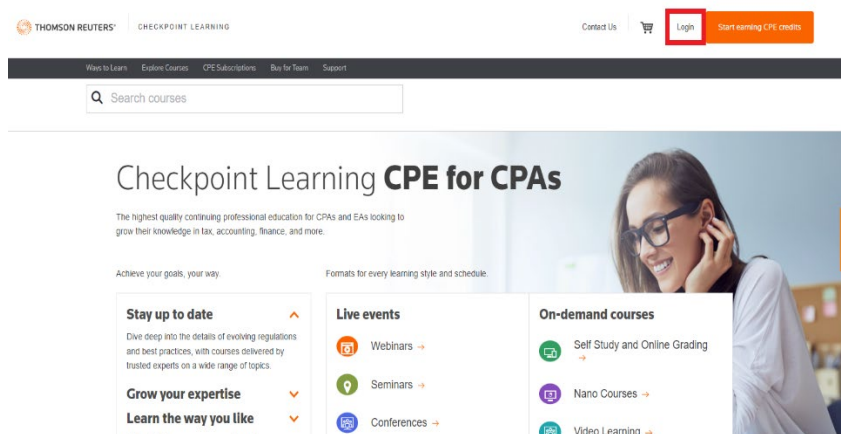
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

CPLgrading@cerifi.com

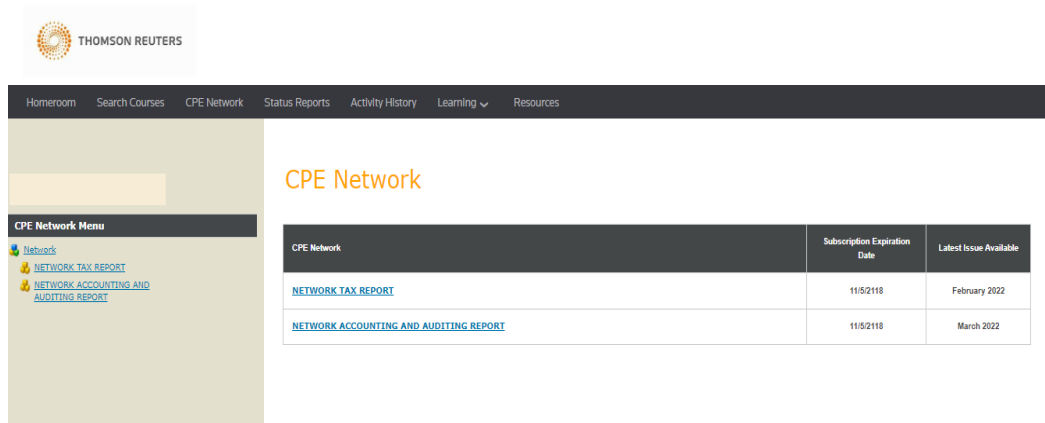
Self-Study—Online

Follow these simple steps to use the online program:

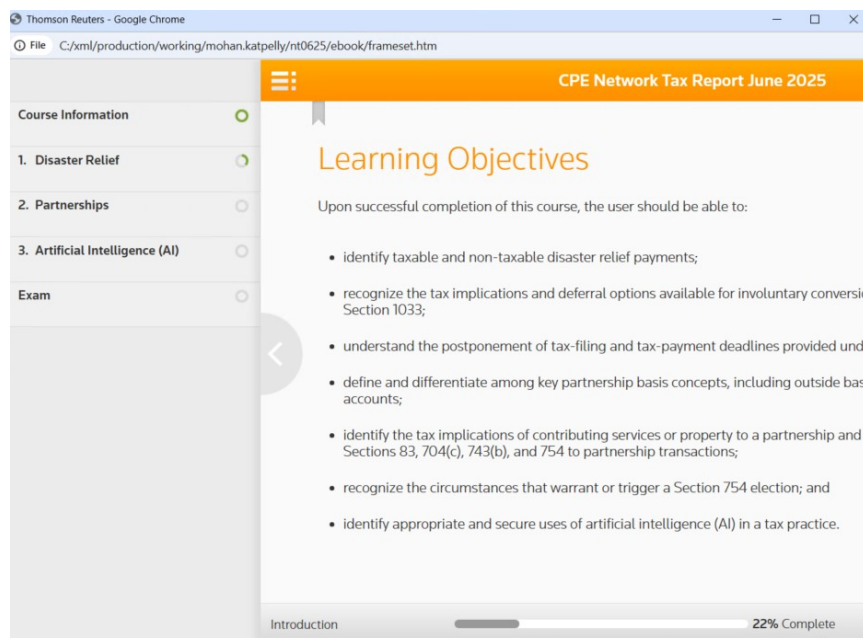
- Go to <https://checkpointlearning.com/>.
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.

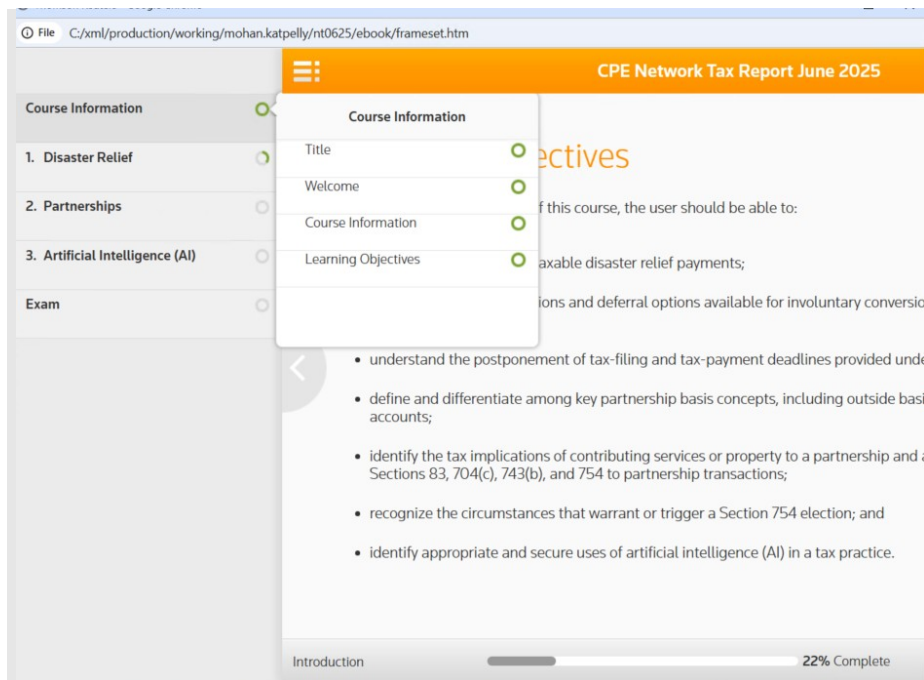


The Chapter Menu is in the gray bar at the left of your screen:

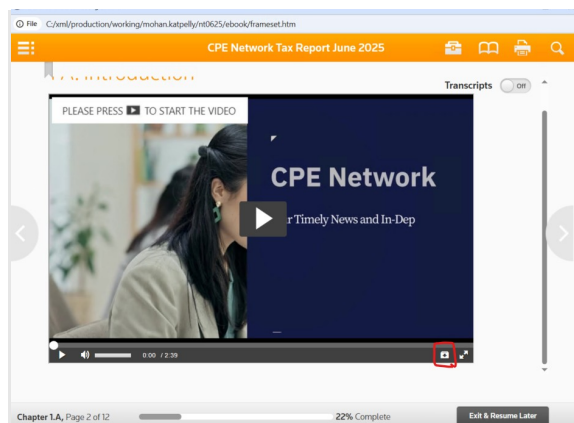


Click down to access the dropdown menu and move between the program Chapters.

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



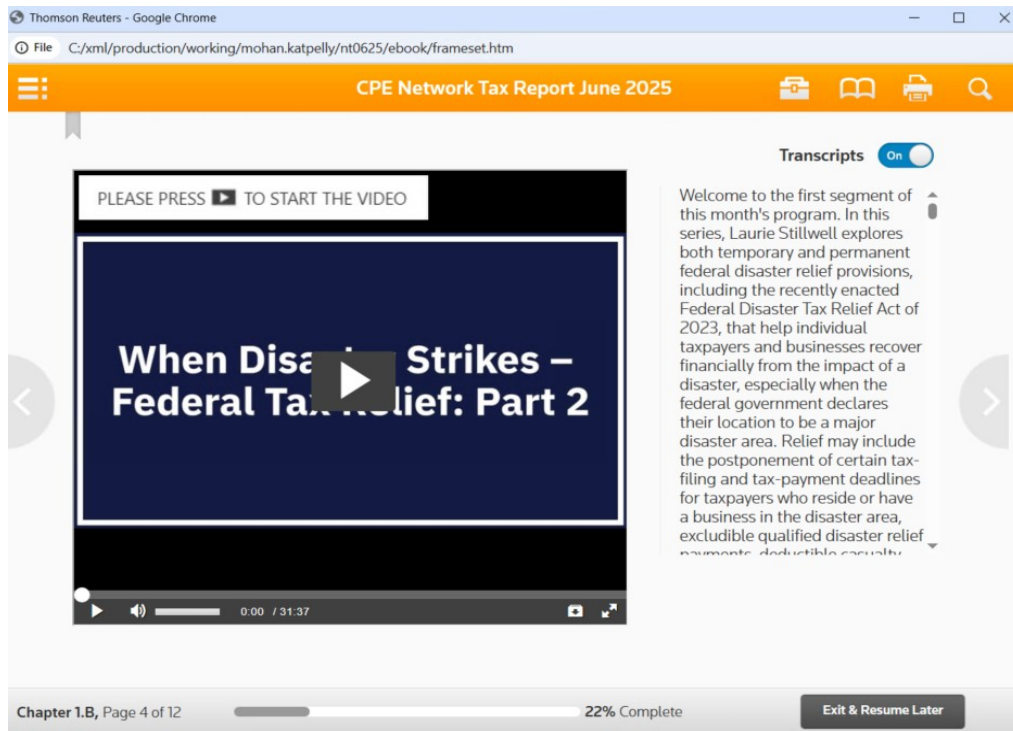
- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the self-study questions. This streamlined approach allows administrators and users to more easily access the related materials.



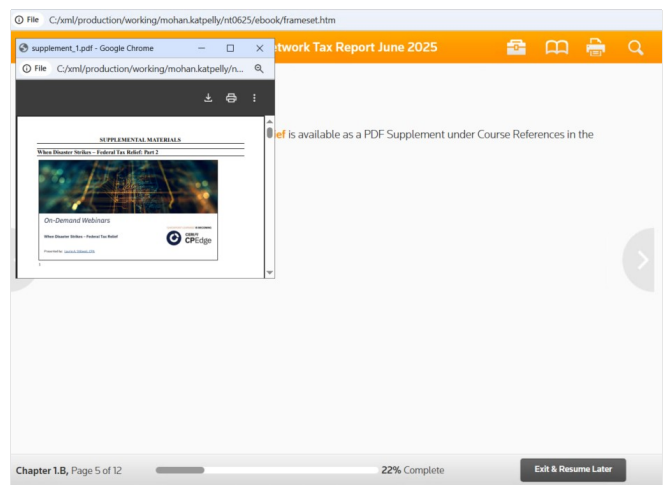
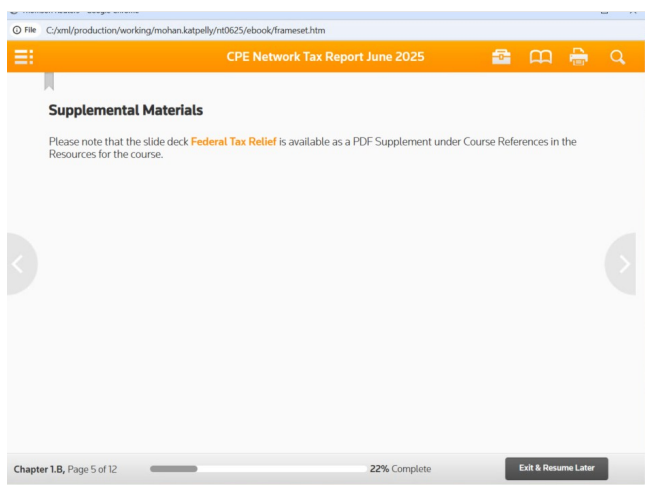
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts**

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.



The supplemental materials are 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 self-study questions related to the segment.

The screenshot shows a web application interface for a CPE Network Tax Report. The browser's address bar displays the file path: C:/xml/production/working/mohan.katpelly/nt0625/ebook/frameset.htm. The application has an orange header bar with the text "CPE Network Tax Report June 2025" and icons for a folder, a book, a printer, and a search function. Below the header, the main content area is titled "Chapter 1: Study Question" in orange. Underneath, it says "Select the best answer." and poses a question: "Which of the following is a key requirement for a payment to qualify as a qualified disaster relief payment under IRC Sec. 139?". There are four radio button options: A. It must be for personal expenses due to a qualified disaster. B. It must be paid to a business for losses. C. It must be reported on Form W-2. D. It must be reported on Schedule C. Navigation arrows are visible on the left and right sides of the question area. At the bottom, a status bar shows "Chapter 1.B, Page 6 of 12", a progress bar at "22% Complete", and a button labeled "Exit & Resume Later".

File C:/xml/production/working/mohan.katpelly/nt0625/ebook/frameset.htm

CPE Network Tax Report June 2025

Chapter 1: Study Question

Select the best answer.

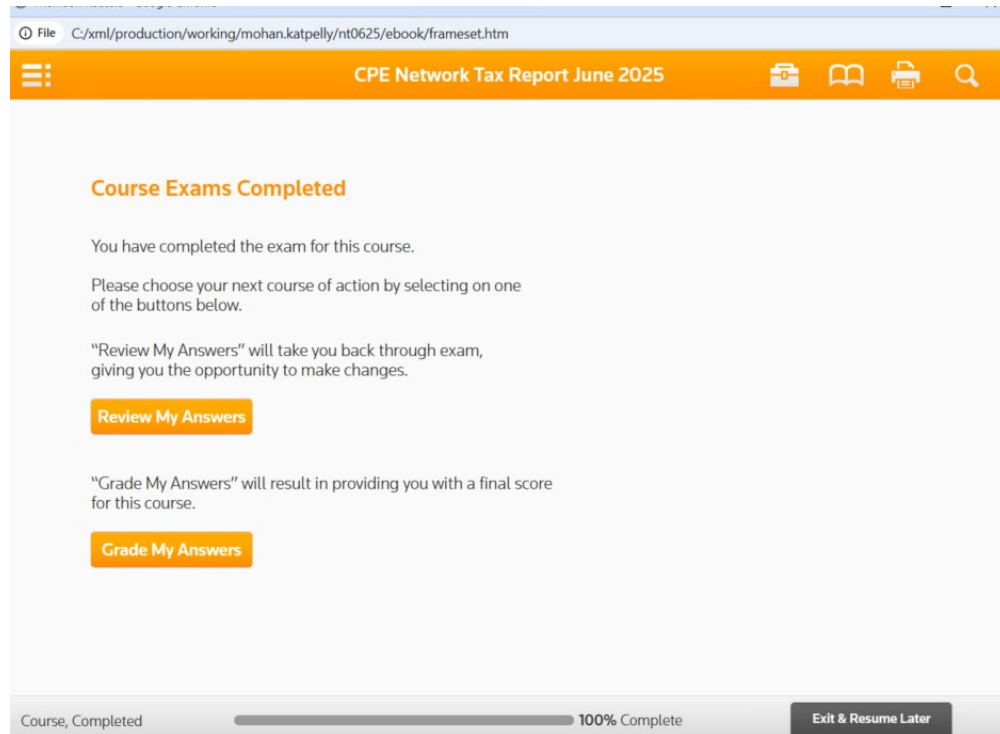
Which of the following is a key requirement for a payment to qualify as a qualified disaster relief payment under IRC Sec. 139?

- ☐ A. It must be for personal expenses due to a qualified disaster.
- ☐ B. It must be paid to a business for losses.
- ☐ C. It must be reported on Form W-2.
- ☐ D. It must be reported on Schedule C.

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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.

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 (if any).
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	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates