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CPE NETWORK TAX REPORT

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Topics for future editions may include:

- Assessment and Collection Statutes
- Refund Statutes Expiration Date
- Self-Employment Tax – Partnerships

EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

There are constant changes affecting tax practice. It is incumbent on practitioners to stay abreast of these developments, not only to advise current clients, but also potential new clients. This material covers some updates since the last segment. The IRS is consistently providing guidance on a number of matters, and this past month was no exception. This material covers some of those changes and developments since the last segment.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze current issues in taxation, including determining the K-2 and K-3 reporting for negative items, assessing the ERC Claims, and identifying gain and loss for digital assets transactions. [*Running time 32:00*]

PART 2. INDIVIDUAL TAXATION

There can be a number of situations in which a client asks their tax practitioner to disclose tax return information to a third party. This could be a bank or other lender, a potential investor, and/or buyer. Even if the request is in a signed writing, it does not necessarily provide protection to the tax practitioner disclosing it. Care must be taken to ensure that firm policy and the consents meet the very rigid requirements of the IRS.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze issues relating to the consent to disclose taxpayer information, including determining the general information that must be included, assessing the use of handwritten disclosures, and evaluating the use of electronic disclosures. [*Running time 32:26*]

PART 3. BUSINESS TAXATION

In the acquisition of a business, the buyer and seller will usually have adverse interests relative to each other. The tax treatment afforded the sale of assets and the sale of stock are generally significantly different for both the buyer and seller, so they will often differ on the desired form. Determining the ultimate transactional form is a matter of negotiation and may be driven by the party most motivated—seller to sell or buyer to buy. The price may be related to the form of the transaction, for example, if a premium is required. It is essential that practitioners advise clients, either buyer or seller, on the wide range of options and possible tax implications associated with each. It is also important that the parties make sure there is an agreement and consistency in what is reported by the other party on Form 8594 to mitigate potential audit issues.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze issues related to stock and asset acquisitions, including analyzing the rules for stock sales as they apply to both buyers and sellers, assessing the use of Section 338(g), and determining the tax consequences of making a Section 338(h)(10) election. [*Running time 34:41*]

ABOUT THE SPEAKERS

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

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Gregory Urban, CPA, CVA, is a partner in the Tax Advisory Group of Dopkins and Company, LLP, in Buffalo, New York, and serves on the firm's Leadership, Executive, and Recruiting Committees. Greg's almost 20 years of experience in public accounting includes several years with KPMG, LLP. He specializes in partnership taxation, oversees tax compliance and consulting engagements, and co-chairs the firm's business valuation practice.

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	• Basic Tax professional experience
	• Basic Governmental professional experience
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EXPERT ANALYSIS AND COMMENTARY

PART 1. CURRENT DEVELOPMENTS

Experts' Forum

Experts' Forum is a popular feature in which we review recent developments in taxation. Ian Redpath begins this month with a discussion about Fact Sheet 2023-20. This fact sheet is about a frequently asked question that addresses how pass-through entities electronically file and report negative amounts to the IRS on Part Two of Schedules K-2 and K-3.

Let's join Ian.

A. Fact Sheet 2023-20

Mr. Redpath

Hi everybody, I'm Ian Redpath for Network Tax. Thank you for joining me again. This is the segment where we go over a number of things that have happened since the last time we were together, from the IRS, from the courts, and from Congress.

A lot of things have happened, so let's just jump right in with a change. Frequently asked questions, FS-2023-20. These are the frequently asked questions [FAQs] that relate to the reporting of negative amounts to the IRS on Schedules K-2 and K-3. Again, there is a question. Can you have negative reporting numbers? So, the question, for the 2022 tax year—and you might want to look back at how you did this—a pass-through entity receives information (for example, a K-3 from a lower-tier pass-through) that certain gross income amounts reported on Schedules K-2 and K-3 are actually negative. But the current schema for electronic filing of K-2 and K-3 doesn't permit negative values for some of the lines in Part II of Section 1 of the Schedules K-2 and K-3. So, what do you do? How do you report this?

With this change, the IRS says that a pass-through entity has to attach a General Dependency (XML) schema to the Schedule K-2, identify the line items and the negative values and, on the form itself, it will end up being reported as a zero. So, in Part II, Section 1, a zero, and if it actually is a negative amount, it will be reported on the attachment that will be filed with it. Then, the pass-through entity has to report to its partners any changes to the amounts reported on the original K-3 issued to the partners, again, through an attachment.

Interestingly enough, the IRS says in this FAQ that they are not opining on the legality of having negative values on the K-2 or the K-3. They're just saying, "If you have it, here's how you report it."

B. IR-2023-157

Well, we've got IR-2023-157. The IRS now has announced that effective next year (so, we have to get ready for this), effective January 1, 2024, businesses that have to file the [Form] 8300, which is the report of cash payments over $10,000—again, note it's not for the 2023 tax year, it's beginning on January 1, 2024—for payments over $10,000, you must file them electronically if the business is required to file at least 10 (a pretty low threshold) other information returns electronically. So, if you have to file at least ten information returns other than the 8300, you're going to be required to file the 8300 electronically.

Now, there is a religious exemption that applies, and you can potentially use that. But if you're going to ask for any waiver of electronic filing—a hardship, for example—you must file with the IRS Form 8508, which is an application for a waiver from electronic filing of information returns. Clarify what it is that you are asking because the IRS says if you're granted a waiver, it applies to all information returns for the calendar year. So, if you want to get out of the 8300, you are saying, "I am not going to electronically file any of my information returns." Again, you cannot just file a waiver saying, "I want to waive the 8300." You have to say, "We're going to waive all information filing."

The IRS also warns that e-filing of the confirmation is not, in and of itself, satisfying the new recordkeeping requirement. You also are required to keep a copy of the form, whether electronically or on paper. Now, you also have your e-filing confirmation. These must be kept—both of those—for five years from the filing date. So, a bit of a change; keep that in mind. It begins January 1, 2024.

C. IRS Mulls Future of Employee Retention Credit as Enforcement Ramps Up – July 25 Roundtable

You know, this never seems to stop, but the IRS is again pointing out that on July 25, at a roundtable, Commissioner Werfel said the IRS is caught up on its backlog (as we mentioned in our last program); and they are actually—and I think this is interesting—because of all of the fraud that they believe is out there, the so-called "ERC mills" that are out there, the IRS said that they are going to work with Congress to try to get Congress to take action. Now, what action can Congress take? One of the actions that they are considering is to require the filing of any of these returns [by] shortening the statute. Right now, ERC claims can be filed up to April 15, 2025. Werfel says there is a lot of concern going forward—a lot of fraud; we are really concerned about this. Therefore, while it's a great program for those who actually qualified—a really great program, but [there is] so much fraud.

So, what does this mean for us as practitioners? It means that if we have a client that can actually qualify, then I think we need to look at that and say, "Let's get this filed," understanding that the IRS is working aggressively with Congress on some type of help for the IRS to try to eliminate the fraud. And the best way that they can see to eliminate it is to reduce the filing period left to make the claim for the ERC. So, just keep that in mind. It may be a reason to accelerate if we're doing a longer-term plan, [thinking] we have time. Maybe you want to look at those clients. Maybe you don't have so much time. So, just something to keep in mind.

D. IR-2023-160

Now, we have IR-2023-160, and this is just really to make people understand the requirements if you're looking to buy a clean vehicle and get the Clean Vehicle Credit. The IRS says for plug-in and other vehicles, you have to have a qualified manufacturer. The Inflation Reduction Act of 2022 made a number of different changes, so you have to be aware that, number one, it has to be a qualified manufacturer. But that is not enough. You also have to [be aware that] it doesn't apply for certain taxpayers, depending on your adjusted gross income. A qualified manufacturer has to be one that has entered into an agreement with the IRS to supply the valid VIN number that they can match, at the time of filing, to the VIN number reported on the return. To claim the credit, you are going to have to have the VIN number. Then, when purchasing a new or a used [vehicle], you have to check to make sure, does the make and model [qualify]? Is it eligible? Not all vehicles are eligible; just because it is a plug-in or electric vehicle doesn't mean it's eligible for the credit. The seller has to provide the buyer with a seller report verifying the vehicle purchased qualifies for the credit, and that should include the make, model, and VIN number. Keep in mind that this is a nonrefundable credit.

E. CCA 202335014

CCA 202335014—this is interesting—it's a Chief Counsel Advice. It deals with S corps, and it deals with an electing small business trust, the ESBT. An ESBT is a qualified shareholder. It can hold multiple S corps, but it can also hold other assets. The way it works (and this is just simplistically), you have the S portion, which is the S items that come through from different S corps, and then you have the regular portion, which is just taxed as a trust. For the S portion, the question here is, if NOLs flow through to the electing small business trust and the electing small business trust does not have any other income to offset in the S portion, what does it do?

Well, what the IRS said is interesting, as I said. There are a number of actual cases involving this; but, to date, those cases have not gone up an appeal, and they haven't gone to court. They've handled them through appeals, I should say, but they haven't appealed to the courts. The IRS said this is something we had better look at because we're seeing it. So, what they did was they presented a set of hypothetical facts to clarify the question. Basically, the S corporation incurred an NOL. It passed it through to the sole shareholder, which was an ESBT. The ESBT had sufficient basis to claim the loss; however, it did not have the income in the S portion to cover the loss, so it was an NOL at the trust level. What happens to that NOL at the trust level? The Service said we're going to ignore that the ESBT might also have a grantor portion—that portion created by the owner or grantor or someone else under the general rules of trust. They said we're not going to talk about that. What we're going to talk about is the S portion and only the losses flowing through from the S. They had insufficient income (in the facts). So, who gets allocated that loss if it exceeds the shareholder's (the ESBT's) gross income for the year? What do they do with it? Does it disappear? Do they flow through the loss, anyway, to the beneficiaries of the trust? What exactly do they do? The Service answered this question by simply saying, if you have this situation (an NOL flows through, and there is insufficient income at the trust level to offset it), what you are going to do is you are just going to treat it as an NOL, and it will carry over at the trust level, the ESBT level, to the S portion of the ESBT. It will carry over. You just carry it over into the future, just as you would any other NOL, but it gets carried over at the trust level. It doesn't disappear; it doesn't flow through. At the S level, it is essentially an S-level NOL because it is an item taken into account by reason of Section 1366 in a prior or subsequent year. So, it's deductible under 172. It is an NOL, so it will be just simply carried over as an NOL to the S portion—just the S portion—of the ESBT.

F. Private Letter Ruling 202335002

We now have a really interesting private letter ruling, Private Letter Ruling 202335002. This is really interesting because we know the like-kind exchange rules were changed, so it basically is real estate held for investment [in a] trade or business. And it's very broad, what you can exchange real estate for, as long as it's held for investment or in a trade or business for other real estate held for investment or in a trade or business. It's not as limited as, for example, the involuntary conversion rules that say it has to have the same functional use to the owner—an office building for an office building, not an office building for timberland. Like-kind exchange rules were broader but, of course, now they're limited to real estate.

Well, what this private letter ruling deals with is a limited partnership's transfer of development rights. They're called "transferable development rights" [TDRs]. Are development rights real property for purposes of 1031? They intended to acquire the development rights as the replacement property. The IRS looked at this and said, "What's happening here?" The taxpayer holds real property directly in its own name, and there is a series of single-member limited liability companies that are disregarded entities. The taxpayer owns Property 1, located in City A, through one of its disregarded entities—Disregarded Entity 1. The taxpayer is the sole member of that disregarded entity. Property 1 has been held for productive use in a trade or business or investment. That's not a question; it is 1031 property. The taxpayer intends to sell Property 1 and acquire these development rights, these transferable development rights, as part of a like-kind exchange that's going to be structured as a reverse exchange.

The taxpayer owns Property 2, located in city B, through one of its disregarded entities—another one, Disregarded Entity 2. As part of the reverse exchange, Disregarded Entity 2 loans funds to what is called an exchange accommodation title (EAT), a title holder, to purchase those rights. The initial closing, then, for the rights acquisition occurs on Date 1; and the EAT, the exchange accommodation title holder, holds title to the purchased rights. Now, to complete the reverse exchange, Disregarded Entity 1 is going to sell Property 1 through a qualified intermediary, and the qualified intermediary is going to transfer the sale proceeds to the EAT. The EAT will then transfer those rights directly from the EAT to Disregarded Entity 2. The EAT then will use the proceeds it received to pay back the loan from Disregarded Entity 2.

Now, the taxpayer is going to use those development rights to enhance the taxpayer's property project on Property 2, increasing the floor area to an amount greater than would otherwise be permitted by zoning regulations. There is a whole issue here as to what, exactly, those are, but what the IRS did say is—and this is the important fact—they said that the TDRs that were intended as replacement property became permanent in the purchaser's hand because they had to file a certificate of transfer of development rights and, when that was recorded, it became [permanent]—this is the same as real estate. So, they said it qualifies for like-kind exchange under 1031. The development rights for that are, in fact, considered to be real property, or at least a real property interest such that it qualifies for like-kind exchange treatment. An interesting case to look at, this private letter ruling.

G. IR-2023-153

Now, we have IR-2023-153. These are the somewhat long-awaited regs. They don't all apply currently, but these are the proposed regs requiring brokers to report sales and exchanges of digital assets. They rely on the Inflation Reduction Act and the issues of defining a digital asset. They use that to define brokers, but they expand it significantly, and they talk about intermediary brokers. Now, this doesn't apply until January 1, 2025, but things like digital asset trading platforms, digital asset payment processors, and digital asset-hosted wallet providers are going to have to report gross proceeds on a new form, called the 1099-DA (digital asset), and provide the payee statements to customers. The brokers will also be required to include gain or loss and basis information on sales that take place after January 1, 2026. Now, the proposed regs also—and this is kind of expanded—after 2025, they include certain title companies, closing attorneys, mortgage lenders, and real estate brokers, who are going to be treated as brokers for the disposition of digital assets, [to report] when there is a disposition of digital assets paid as consideration by real estate purchasers to acquire real estate in a real estate transaction after that date. They're also going to be required to include Form 1099-S, the fair market value of the digital assets paid to sellers of real estate in real estate transactions—again, after January 1 of 2025.

In addition, this goes on to discuss the idea of the reporting; and in Proposed Regs. 1.1001-7 and 1.1012-1(h) and (j), it generally expands and talks about how to treat gain or loss for purposes of digital assets. How do we record the basis? What are the proceeds? And what do we do with the transaction costs? The IRS has indicated that certain things, [such as] a taxpayer's transfer of digital assets from one wallet into a different wallet is not a sale or exchange, but payment of a transfer fee with the digital assets to effectuate that transfer is a sale or other disposition of the assets used to pay the fee. So, I'm moving it from my wallet A to my wallet B, and I'm charged a fee, but the fee is taken out in digital currency. I have a gain on the digital currency that was used to pay the fee. That's interesting.

There are a number of fact patterns here. For the amount realized, it discusses how to look at the gain or loss; but it also indicates that the general rule for determining the amount realized on a sale or disposition of digital assets for cash or other property differing materially either in kind or in extent, or for services. What does that mean? It means going from one digital asset to another may be considered a sale if it's materially different. It also talks about services, [receiving] digital assets for services. Then, the allocation of any costs—I should say fees—that apply, and how do we allocate these? There is an allocation of transaction fees, transfer taxes, and other commissions; and basically, the rules for allocating digital asset transaction costs to the disposition (or acquisition) of an asset apply to any digital asset transaction costs paid with the sale or the disposition of the assets that are used or withheld to pay other digital asset transaction costs. So, it provides the general rule for allocating digital asset transaction costs on the dispositions. In other words, the total digital asset transaction cost that's paid by the taxpayer is allocated to the disposition of digital assets. So again, you're going to have to make a specific allocation of costs in this particular case.

The Service, however, has said that in certain transactions, if the digital asset transactions are paid to effect the exchange of one digital asset for another digital asset (so, you have gone digital asset to digital asset), but the digital assets are materially different, then you're not going to make any type of allocation, per se, you are just going to allocate the cost 50/50. That is just a given in the regs.

So, you might wonder, why are we discussing this? Well, because the IRS states that these proposed rules will apply essentially to anything, any transaction. They are (from this one and not the others, not the reporting) as far as the gain, loss, and allocation of costs, these are reliance regs. Taxpayers are free to rely on these at any time, beginning now; you can rely on these as reliance regs.

The other thing is, how do you know what you're selling? Well, the IRS has very specific (just like stocks) identification rules and allows you to be able, if you have just a general amount and you are selling 100, it allows you to specifically identify the units you are disposing of. You have to specifically identify no later than the date and time of sale. You identify, on the books and records, the specific unit to be sold, and it can be by reference to the identifier, purchase date, time, purchase price for the unit—anything that is sufficient to identify the basis and holding period of the units. If you don't specifically identify, you're going to use FIFO. So, as you are determining what is the gain or loss, it is going to be on a FIFO basis.

Right now, these are proposed regs. This portion—the gain or loss and the identification rules—these are going to take place immediately as reliance regs. You don't have to follow them, but if you do, the IRS can't penalize you if they change their mind. The other thing to keep in mind is the IRS does say that the method of specifically identifying is not a method of accounting, so you don't have to worry about that.

H. Notice 2023-62; IR-2023-155

Now, Notice 2023-62. In SECURE 2.0, we have these additional amounts. For people with wages over $145,000, any catch-up amounts that are being made to their retirement have to be made as designated Roth contributions. The companies also have to make that available to anyone who may not meet [$145,000 in wages]. It is required at $145,000 if you want to make a catch-up contribution. For others, it can be elective. Well, they have been getting a lot of heat about this. Businesses are just not ready to implement this. So, what the IRS has said is that there is going to be a two-year [catch-up period]. For taxable years beginning after December 31 of this year, there is a two-year catch-up period, which is a transition period; in that administrative transition period, [businesses are] not going to be penalized if these rules are not followed (in other words, if it goes into a non-Roth IRA). The rules will be deemed to be followed during this two-year period for the administrative work to catch up. So, if you have a company that has been worried about this and how they're going to do it, or if the administrator has been telling you they can't get it all done, you have some hope.

I. IR-2023-152

Then, lastly, IR-2023-152. This is just a reminder, but employers who have educational assistance programs can use them to help pay the student loan obligations. Remember, this will apply until December 31, 2025. Generally, it was only for books, equipment, supplies, fees, and tuition for an employee, limited to $5,250 per employee per year. The payments can be made directly to the lender, or they can be made to the employee who then pays the lender. For employers who don't have an assistance program, you might want to consider making one up. It is a real benefit. Remember, it has to be in writing, and it can't discriminate in favor of highly compensated individuals, but it's definitely something that you may want to consider.

Well, thank you very much for joining me again. The government, the courts, and the IRS always give us a lot of new information to talk about. So, I want to thank you very much for joining me, and, as always, please be safe.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. Fact Sheet 2023-20

This fact sheet addresses how pass-through entities electronically file and report negative amounts to the IRS on Part II of Schedules K-2 and K-3. This Q&A is posted in frequently asked questions (FAQs). Note that an FAQ may be used to avoid penalties but will not be relied on or used by the IRS to resolve a case.

Q. For the 2022 tax year, a pass-through entity receives information (for example, a Schedule K-3 from a lower-tier pass-through entity) that certain gross income amounts to be reported on the Schedules K-2 and K-3 are negative. However, the current schema for electronic filing of Schedules K-2 and K-3 does not permit negative values for specific line items in Part II, Section 1 of Schedules K-2 and K-3. How should these negative amounts be reported on Schedules K-2 and K-3 to the IRS and to the partners or members?

A. A pass-through entity electronically filing Schedules K-2 and K-3 for the 2022 tax year should enter zero on the line items in Schedules K-2 and K-3, Part II, Section 1, for which the schema does not permit negative values. A pass-through entity must attach a General Dependency (XML) schema to the Schedule K-2 identifying the line items and the negative values for which the pass-through entity reported zero on Part II, Section 1. A pass-through entity should also attach a list of the impacted line items and the negative numbers, partner by partner. A pass-through entity should report to its partners or members any changes to the amounts reported on the original Schedules K-3 issued to the partners or members.

The IRS has not opined whether using negative values is legally appropriate.

B. IR-2023-157

The IRS reminded businesses that, starting January 1, 2024, they will be required to e-file Form 8300, Report of Cash Payments Over $10,000, *if* they are required to file at least ten information returns *other than* Form 8300. Thus, while e-filing will be required for those businesses filing at least ten other information returns, it is not required for businesses falling under that threshold. A business may still seek a waiver on grounds of undue hardship. There is also a religious exemption if using e-filing technology conflicts with a filer's religious beliefs. Details on how to seek or claim a waiver or exemption and related rules are set out.

The waiver application is submitted using Form 8508, Application for a Waiver from Electronic Filing of Information Returns. The IRS clarified that if a waiver is granted, it applies to *all information returns for a calendar year, not just Form 8300*. There is an automatic religious exemption if the e-filing technology conflicts with the filer's religious beliefs. Note also that the e-filing confirmation emails themselves are not enough to satisfy the new recordkeeping requirement. "When e-filing, filers must also save a copy of the form prior to finalizing the form submission," according to the release. "They should associate the confirmation number with the saved copy. Prior to finalizing the form for submission, businesses should save a copy of the form electronically or print a copy of the form." Copies of each Form 8300 e-filed and any supporting documents must be kept for *five years* from the filing date.

C. IRS Mulls Future of Employee Retention Credit as Enforcement Ramps Up – July 25 Roundtable

The IRS is poised to crack down on fraudulent promotors while increasing scrutiny on post-pandemic claims, possibly spelling trouble for some taxpayers selected for audit. Speaking on July 25 at a tax roundtable event in Atlanta, IRS Commissioner Danny Werfel announced the agency had cleared its backlog of legitimate ERC claims and indicated the focus will shift toward increased enforcement against promotors and returns with erroneous ERC claims. Werfel added that the IRS and Treasury will work with Congress to "explore legislative solutions" to curtail fraudulent claims, which he hinted may include "potentially putting an earlier ending date for businesses to claim the credit and increase IRS oversight of return preparers." Currently, the end date for ERC claims is April 15, 2025, which, Werfel said, "raises future concerns."

IMPORTANT UPDATE:

IR-2023-169, Sept. 14, 2023

IRS Commissioner Danny Werfel ordered the immediate moratorium on processing ERC claims, beginning September 14, 2023, and at least through December 31, following growing concerns inside the tax agency and from tax professionals, as well as media reports, that a substantial share of new claims from the aging program are ineligible and increasingly putting businesses at financial risk of being pressured and scammed by aggressive promoters and marketing.

The IRS emphasizes that payouts for these claims will continue during the moratorium period but at a slower pace due to the detailed compliance reviews. With the stricter compliance reviews in place during this period, existing ERC claims will go from a standard processing goal of 90 days to 180 days—and much longer if the claim faces further review or audit. The IRS may also seek additional documentation from the taxpayer to ensure it is a legitimate claim. This enhanced compliance review of existing claims submitted before the moratorium is critical to protect against fraud and also to protect businesses from facing penalties or interest payments stemming from bad claims pushed by promoters, Werfel said.

In addition, the IRS is finalizing details that will be available soon for a special withdrawal option for those who have filed an ERC claim, but the claim has not been processed. This option—which can be used by taxpayers whose claims have not yet been paid—will allow the taxpayers, many of them small businesses misled by promoters, to avoid possible repayment issues and paying promoters' contingency fees. These filers of more than 600,000 claims awaiting processing will have this option available. However, those who have willfully filed fraudulent claims or conspired to do so should be aware that withdrawing a fraudulent claim will not exempt them from potential criminal investigation and prosecution.

Advice for Taxpayers as the IRS Works Through Questionable ERC Claims

As the IRS continues working through additional details of the ERC, there are several steps that the agency recommends for businesses, depending on where they are in the process:

- **For those currently awaiting an ERC claim.** For those with an ERC claim on file, the IRS will continue processing these claims during the moratorium period but at a greatly reduced speed due to the complex nature of these filings and the need to protect businesses from being improperly paid. Normal processing times could easily stretch to 180 days or longer. The IRS cautions that many applications will face additional compliance scrutiny, which means the payments could take even longer to be processed. While the IRS works on compliance measures during this period, the agency cautions businesses to expect extended wait times due to the large volume of claims and the complexity of the applications.

Due to these large volumes and the need for compliance checks to protect against fraud, the IRS is unable to expedite individual claims. The IRS believes many of the applications currently filed are likely ineligible. Tax professionals note anecdotally that they are seeing instances where 95 percent or more of claims submitted in recent months are ineligible as promoters continue to aggressively push people to apply regardless of the rules.

Those currently with a pending application at the IRS should review the options below to determine if any of them could help with their current situation.

- **For those who have not yet filed a claim, consider reviewing the guidelines and waiting to file.** For those considering filing a claim, the IRS urges businesses to carefully review the ERC guidelines during the processing moratorium period. The IRS urges businesses to talk to a trusted tax professional—not a tax promoter or marketing firm looking to make money by generating applications that take a big chunk out of the ERC claim. The new question-and-answer guide can also help. A careful review of the rules will show that many of these businesses do not qualify for the ERC, and avoiding a bad claim will avoid complications with the IRS.

- **For those who have already filed, withdraw an existing claim.** Those who have filed and have a pending claim should carefully review the program guidelines with a trusted tax professional and check the new question-and-answer guide. For example, the IRS is seeing repeated instances of people improperly citing supply chain issues as a basis for an ERC claim when a business with those issues will very rarely meet the eligibility criteria. Under any scenario, if a business claimed the ERC earlier and the claim has not been processed or paid by the IRS, they can withdraw the claim if they now believe it was submitted improperly—even if their case is already under audit or awaiting audit. More details will be available shortly.
- **For those who may have received an ERC in error, wait for the IRS ERC settlement program to be finalized.** If a business has already received an ERC that they now believe is in error, the IRS will be providing additional details in the fall on the settlement program that will allow businesses to repay ERC claims. The settlement program will allow businesses to avoid penalties and future compliance actions. The IRS continues to assess options for dealing with businesses that had a promoter contingency fee paid out of the ERC payment.

D. IR-2023-160

The Inflation Reduction Act of 2022 (IRA) made several changes to the new Clean Vehicle Credit for qualified plug-in electric drive motor vehicles, including adding fuel cell vehicles. The IRA also added a new credit for previously owned and commercial clean vehicles. Taxpayers should be aware of these changes before purchasing a clean vehicle to be sure a qualified manufacturer made the vehicle and to satisfy that other requirements, such as the modified adjusted gross income limits, are met.

To be a qualified manufacturer, the manufacturer must enter into an approved agreement with the Internal Revenue Service and supply the IRS with valid vehicle identification numbers (VINs) that can later be matched at the time of filing to the VIN reported on the return. When purchasing a new or used clean vehicle, purchasers should check if the make and model are eligible. Not all vehicles qualify. Also, to be eligible for a Clean Vehicle Credit, the seller must provide the buyer with a seller report, including the make, model, and VIN, verifying that the vehicle purchased will qualify for the credit.

E. CCA 202335014

The Chief Counsel determined that the S portion of an electing small business trust (ESBT) may carry forward to another year the NOL passed through from an S corporation. This is the first time this issue has been addressed.

The facts are hypothetical. An S corporation incurred an NOL that it passed through to its sole shareholder, an ESBT. The ESBT had sufficient basis in its stock to fully claim the loss. However, it did not have sufficient income in its S portion to cover the loss, thus creating an NOL at the trust level. The ESBT carried the NOL to its Y taxable year to use against the income of the S portion.

Section 1.641(c)-1(a) provides that an electing small business trust is treated as two separate trusts. The portion of an ESBT that consists of stock in one or more S corporations is treated as one trust (the S portion), and the portion that consists of all the other assets in the trust is treated as a separate trust (the non-S portion). Section 1.641(c)-1(d)(2)(i) provides, in general, that the S portion takes into account the items of income, loss, deduction, or credit that are taken into account by an S corporation shareholder. In the case of an individual S corporation shareholder who is allocated a loss from the corporation, if the amount of the loss exceeds the shareholder's gross income for the taxable year, the shareholder may sustain an NOL, which the shareholder may carry to another taxable year pursuant to Sec. 172(b) and claim an NOL deduction. However, if such a loss is allocated to the S portion of an ESBT shareholder and creates a trust-level NOL, the special rules of Sec. 641(c)(2)(C) are implicated, complicating the question of whether such NOL may be carried over to another taxable year of the trust and taken into account by the S portion in that year.

Counsel concluded that if a loss flowing through to the S portion of an ESBT under Sec. 1366 cannot be used in the current taxable year because of the lack of offsetting income, it is nonetheless an item "taken into account" by reason of Sec. 1366 in the prior or subsequent year in which it is deductible under Sec. 172.

F. Private Letter Ruling 202335002

The IRS determined that a limited partnership's transferable development rights (TDRs) were "real property" for purposes of the like-kind exchange rules under Sec. 1031. They further noted that the TDRs that the taxpayer intended to acquire as replacement property became permanent in the purchaser's hands when the "Certificate of Transfer of Development Rights" was recorded. Accordingly, the TDRs were deemed to be like-kind to the specified property.

G. IR-2023-153

The IRS has issued a series of proposed regulations that would require brokers to report sales and exchanges of digital assets by customers. The proposed regulations cover a range of digital asset issues where there have been questions, including defining brokers and requiring proceeds to be reported to the IRS on new Form 1099-DA. The new reporting is for digital asset sales or exchanges that occur on or after January 1, 2025. The proposed regulations would require brokers, including digital asset trading platforms, digital asset payment processors, and certain digital asset-hosted wallet providers, to report gross proceeds on a newly developed Form 1099-DA and to provide payee statements to customers in accordance with Proposed Regulations §1.6045-1. In certain circumstances, brokers would also be required to include gain or loss and basis information for sales that take place on or after January 1, 2026, on these information returns and statements so that customers have the information they need to prepare their tax returns.

The proposed regulations extend to real estate reporting persons, such as title companies, closing attorneys, mortgage lenders, and real estate brokers, who are treated as brokers for dispositions of digital assets. They must report the disposition of digital assets paid as consideration by real estate purchasers to acquire real estate in real estate transactions that close on or after January 1, 2025. These real estate reporting persons would also be required to include on Form 1099-S the fair market value of digital assets paid to sellers of real estate in real estate transactions that close on or after January 1, 2025.

Finally, the proposed regulations set forth the rules for allocating costs incurred in a digital asset transaction, determining the basis and amount realized, and identifying digital assets sold. Taxpayers may rely on the gain/loss computation rules for dispositions in tax years ending on or after August 29, 2023.

H. Notice 2023-62; IR-2023-155

To help transition in implementing recent law changes applicable to catch-up contributions made by higher-income wage-earners, the IRS will treat the first two tax years beginning after 2023 as an administrative transition period with respect to the requirement under Sec. 414(v)(7)(A) that catch-up contributions made on behalf of certain eligible participants be designated as Roth contributions. Additional guidance will be forthcoming.

Section 603(a) of the SECURE 2.0 Act amended Sec. 414 (v) of the Code to add Sec. 414(v)(7), which provides that, in the case of an eligible participant whose wages for the preceding calendar year from the employer sponsoring the plan exceed $145,000, as adjusted, it applies only if any catch-up contributions are designated Roth contributions made pursuant to an employee election. If a plan provides that an eligible participant who is subject to the requirements of Sec. 414(v)(7)(A) may make catch-up contributions as designated Roth contributions, then all eligible participants in the plan must be permitted to make catch-up contributions as designated Roth contributions.

Those catch-up contributions will be treated as satisfying the requirements of Sec. 414(v)(7)(A), even if the contributions are not designated as Roth contributions, and a plan that does not provide for designated Roth contributions will be treated as satisfying the requirements.

I. IR-2023-152

The IRS reminds us that employers that have educational assistance programs can use them to help pay student loan obligations for their employees. Though educational assistance programs have been available for many years, the option to use them to pay student loans has been available only for payments made after March 27, 2020, and under current law, will continue to be available until December 31, 2025. These programs can now also be used to pay principal and interest on an employee's qualified education loans. Payments made directly to the lender, as well as those made to the employee, qualify. Benefits under an educational assistance program are limited to $5,250 per employee per year.

GROUP STUDY MATERIALS

A. Discussion Problems

1) Your client, Xi Hu, has a fiscal year 2022 return that will require K-2 and K-3 reporting. There will be negative numbers to report. How should this be done?

2) You believe that Xi is entitled to an ERC that was not properly claimed. You recommended that he file amended Forms 941-X and also amend the corporate income tax return to adjust for newly claimed wages. Are there any concerns?

3) On October 3, 2023, another client, Talia, disposed of certain digital assets. You are concerned about the information she has available to determine her taxable gain or loss. Any considerations?

Required:

Address the issues fairly presented by the facts and questions presented above.

B. Suggested Answers to Discussion Problems

1) For the 2022 tax year, the current schema for electronic filing of Schedules K-2 and K-3 does not permit negative values for specific line items in Part II, Section 1, of Schedules K-2 and K-3. It should enter zero on the line items in Schedules K-2 and K-3, Part II, Section 1, for which the schema does not permit negative values. A pass-through entity must attach a General Dependency (XML) schema to the Schedule K-2 identifying the line items and the negative values for which the pass-through entity reported zero on Part II, Section 1. A pass-through entity should also attach a list of the impacted line items and the negative numbers, partner by partner. A pass-through entity should report to its partners or members any changes to the amounts reported on the original Schedules K-3 issued to the partners or members.

2) In general, the IRS has indicated that it is going to aggressively review ERC claims due to the belief that there is a significant amount of fraud involving the "ERC Mills." This was just upped when the IRS announced a moratorium on processing new claims for ERC refunds until at least December 31, 2023. To protect the client, the claim should be made if you believe it is valid; however, the client should be advised that there will be a significant delay and that the claim will most likely undergo intensive review.

3) The IRS issued reliance regulations that would apply to this transaction. This provides guidance on the determination of amounts realized, basis, cost allocations, identification, determination of FMV, and other related issues. This should help determine the gain or loss to be recognized by the client.

PART 2. INDIVIDUAL TAXATION

Disclosure and Use of Taxpayer Information

On July 11, 2023, a Senate investigative committee issued a report titled, "Attacks on Tax Privacy." The committee's findings support previous reports that major tax return preparation services have been quietly transmitting sensitive financial information to Meta, formerly known as Facebook, when Americans file their returns online. There are key issues to consider regarding the sharing of taxpayer data, including preparers' professional responsibilities, taxpayer expectations of privacy, and the disclosures required to share data. Ian Redpath and Karen Davis discuss key issues related to the disclosure and use of taxpayer information.

Let's join Ian and Karen.

Mr. Redpath

Karen, welcome to the program.

Ms. Davis

Thanks for having me, Ian. It's a big topic today.

Mr. Redpath

Boy, you know, you don't think about it. I don't think it's something that's always at the top of our minds; we're so busy doing work for our clients. This becomes a real big issue when the client, all of a sudden, says, "Hey, would you send my tax returns over to XYZ Bank?" or, "Hey, I've got this company that's looking to invest in my firm. Could you send my tax returns over?"

Also, what shocking information coming out of the Senate, which really follows up a previous investigative report. I'm just going to quote from the Senate. This is a report to the Senate—I believe it was six senators and one member of the House—on July 11th, and here's what they wrote: "We write to inform you of the results of our investigation revealing outrageous and potentially illegal sharing of taxpayer's sensitive personal and financial information with Meta…" Who is Meta? I think there [are] some pretty big names attached to Meta. "…by online [tax] preparation companies." And this takes on added [significance] when you think that at least one of these companies was engaged in the free online [tax filing] with the IRS in prior years.

Wow. Sharing this information with Meta. I was shocked when I saw that. This goes back—*The Markup*... Tax-filing websites have been sending users' financial information to Facebook. This was a story concerning that, and that engaged the Senate. In November, they got involved last year when they saw this. "Okay, what's going on here?" Specifically, they refer to TaxSlayer, H&R Block, and TaxAct as sharing specific data of taxpayers with Meta, and I don't think—I could be wrong here—but I don't think they're doing it for free. So, what's going on here?

Ms. Davis

Ian, just to be clear, Meta is the new name for the parent company of Facebook. So, Meta is Facebook, and Meta Pixels are this—it's like cookies. We all know that you go to a website, they say, "Here's a cookie. We're going to embed our cookie in your user experience to enhance your user experience." You're like, "Whatever." You hit accept, and you don't really know what you've accepted. Meta Pixel is similar. In this case, it's the business that allows this bit of code to send information from the user interaction with the data to Facebook, and, in this case, also Google Analytics was getting some over a different method. To do what? I mean, that's the question: to do what? Including targeting ads. So, for instance, if I'm preparing my tax return at TaxAct.com, and I click on the pages for the American Opportunity Tax Credit. Now, Facebook knows I have kids in college, so they might pitch me student loan information. They would know my home mortgage. They know my AGI. They know a lot about my dependents. So, it turns out the amount of information being shared—and the amount of personal information shared—is a lot. And you mentioned at the outset…

Mr. Redpath

By the way, Karen, they said they've been doing it with Meta for a couple of years, but all three companies said that they've been sharing with Google Analytics for even longer than that.

Ms. Davis

Right.

Mr. Redpath

And they say, "Don't point fingers at us because guess what? It's industry standard to do this. It's an industry practice. Yes, we were in that article, but everybody's doing it." You know, it's kind of the kid, right? The kid that gets in trouble and says, "But Mom, Dad, everybody's doing it." That doesn't excuse it.

Ms. Davis

Yes, I know. Catching a student cheating on an exam and then being told by the student, "All of your students are cheating." It's like, now what? Right? So, you mentioned at the outset the letter that these senators and the one congresswoman wrote to reveal, "Okay, here's our report. Please take our report." They're writing to the [U.S.] Department of Justice, the FTC (the Federal Trade Commission), to TIGTA (the [U.S. Treasury Inspector General for Tax Administration]), and to the IRS. The question is, were laws broken? The focus of our program today—aside from the mind-blowing news that broke—is what are our responsibilities as preparers for the use and disclosure.

So, for instance, it's interesting, Ian, because cyber security has evolved, and our own security processes have evolved. It used to be when a client says, "My bank needs my tax return for the whatever," I could get them to fill out the form, as instructed by Rev. Proc. 2013-14—consent to disclose. "Sign this. I need it written; then I can disclose it." Or what we would do is just say, "I'm going to send you a copy. If you want to forward it to the bank, you can do that." But even that's gotten a little squirrely because now we have security things to send things securely. "I'm going to send it to your email, but only you can open it. So, if you forward the thing I sent you, they can't open it." Suddenly, we all have to be IT professionals on how you even get a paperless document to its destination. Whereas if it's, "I need a Xerox copy," fine. So, our jobs are extremely important. Our jobs are to secure the taxpayer information of our clients, and nobody in cyberspace at these platforms—either the Meta platform or the TaxAct, H&R Block, self-help platform—was paying attention to these really basic requirements.

Mr. Redpath

Also, Karen, one of the firms said that they employ 11 different types of Pixels on their website, and the way they operate, they said it potentially shared the data of every single user of their website. Now, if you take that over—I don't know how many we're talking about. We know three, but they're claiming everybody is doing it. I mean, we're talking about potentially the data being shared of millions of people.

Ms. Davis

Oh, millions!

Mr. Redpath

Yet every day, we read, "Security Summit. Here's what you need to do, preparer, to protect your clients' information." You know, and we all have—we're coming up with internal policies. What do we do? What do we do if there's a breach? All of these things that we're being required to do by the IRS. We're trying to protect, and we know that it's a constant barrage of fraudsters trying to get our clients' information. Just last year, one of the big frauds was where people—they were calling, but they would call staff people. "I'm calling from XYZ payroll company. We're looking at this. Can you verify this for us?" Often that [would lead to], "Oh yes, I'll verify that for you." Well, they got enough information from the websites of the accounting firm and of the company to kind of sound legitimate, and people were getting data. We know that, constantly, the IRS is warning us about these frauds attempting to get client data. Yet here we have client data being openly shared. Now, they claim that the personal information was not being shared. However, the Senate report says that Meta Pixel and other Meta tools used by TaxAct collected far more information—filing status, approximate AGI, approximate refund, and names of dependents, as you mentioned. Pixel collected the approximate federal tax owed, and certain buttons were clicked and the names of tax entry forms that the taxpayer navigated to. As you mentioned, oh, you're looking for the American Opportunity Credit or the Lifetime Learning Credit. Oh, American opportunity—you must have kids in college. We're going to gear things to that. So yes, tremendous information. But Pixel, according to the Senate report, shared the full names, emails, country, state, city, zip codes, phone numbers, and genders as hashed values. They claim that the data was shared anonymously, but the FTC and experts have indicated that the data could easily be used to identify the individuals and create, essentially, dossiers for targeted advertising.

Ms. Davis

That's right. So, our obligations consent to the disclosure of tax return information, but also the use of tax return information. If, for instance, our accounting firm wants to sort of go into a side business of helping people prepare the FAFSA forms for college aid, we would need permission from our clients to sort of trawl their information to look for internal marketing opportunities for things we might want to market to them. So, we take our responsibility seriously, but that's exactly what's happening here. People are getting targeted Facebook ads based on personal information gleaned from their tax return.

Mr. Redpath

And Meta says some of what they're using this for is to train their AI algorithms. So, they're using it for that purpose. Well, still. Again, the Senate report, the Senate says that these firms were—and I'm going to use their words—"shockingly careless in the treatment of taxpayer data." The tax prep companies indicated that they were not fully aware of exactly what they were sharing and what it was being used for.

Ms. Davis

Right. Also, Meta and Google want to wash their hands of it and say, "Oh, we have very, very clear privacy standards, and we relate this to our users and have instructed them to not share X, Y, and Z." But, of course, X, Y, and Z were shared, including, in some cases, without the vendor knowing really all that's being shared because Meta is taking what they want for their marketing purposes. What's interesting to me, also, is *The Markup* is the online investigative resource that broke this story back in November. So, they had something called Pixel Hunt, which is to crowdsource the discovery of how Meta Pixel works. They invited anybody—crowdsourcing it—to go ahead and load our attachment to track what Meta Pixel is sending and send it to us so that we can shadow their work and learn what they're doing. That's how, as part of this Pixel Hunt, *The Markup* learned about it and wrote it up, and that's what piqued the interest of these senators who then hauled the tax prep companies and the platforms in for a good questioning.

Now, the letter ends on a hopeful note. It says, "We couldn't be more happy than to know that the IRS is going to launch a pilot program where you can prepare your tax return at the IRS website without it being farmed out to private industry because private industry, in this case, did not prove trustworthy." But you were led into their arms by the IRS with the Free File program. So, it's a bad thing.

But again, what I keep coming back to is, Ian, what are our responsibilities? What do we tell our clients? Among the things we tell them is that, "You are safe. I care about you, and I have a very strong firewall. I don't fall for phishing things. I train my staff to not fall for phishing things. We secure your data as required by law and regulation and because we care about you, and that's why you come to us."

Mr. Redpath

Basically, a preparer cannot disclose or use any taxpayer information without getting the written consent of the taxpayer, and it is actually criminal to do so. Potentially, it's a criminal violation—penalties up to $1,000 per instance of doing it and up to a year [in jail]. Now, you can provide data for what are called auxiliary service providers, who you may use in connection with the preparation of a return. But clearly, Meta and Google don't meet that definition. They're using it for advertising, not in connection with the preparation of the return. So, let's do a brief review here of the law for our viewers so they know exactly where we stand, and let's start with [IRC] Section 7216.

Ms. Davis

[Section] 7216 was enacted in 1971, and it prohibits preparers of tax returns from knowingly or recklessly disclosing or using tax return information. And that's where you mentioned there could be a $1,000 per violation fine, and there could be a year in jail for each violation. Well, I'm looking at the millions of years in jail for everybody who just had their privacy violated. But also, the users themselves had signed arbitration agreements, so can they really get together and sue? Maybe not. But this is a serious law. It's a statutory law. It's IRC Section 7216. And then the regulations under [Section] 7216 were to help implement it, including revisions to the regulations as we get more complicated ways of interacting with the clients. You know, we're not doing returns by hand. We're not delivering them on paper. We're delivering things electronically, so we need the cybersecurity, the firewalls, the encryption, the masking of taxpayer social security numbers. One of the things I love is when I get a new client, and I say, "I need last year's tax return," but the social security numbers are masked. I'm like, "Okay, I can't put this in my software until you tell me your social." But they're masked for a good reason. So, you know, we follow these rules.

Mr. Redpath

And when you look at the regs, they basically were around for 30 years without changing, but technology changed. What we're doing changed, as you said. At one time, it wasn't totally unusual to have something that was just filled out by hand and sent in. Hardly the case today. But as the technology has changed, the regulations didn't really keep up with it. They were updated, but I think they're still a little out of date. They were updated in 2009, but here we are in 2023, and technology isn't what it was four years ago. So, that's a big difference. And what about Section 6713?

Ms. Davis

[Section] 6713 is not the criminal penalty. It's a civil penalty of $250 on someone who's engaged in the business of preparing or providing services in connection with the preparation of the return, who discloses the information or uses the information without the consent. We're not recklessly disregarding, but there is a penalty where you don't rise to that level. It's a civil penalty for disclosure and the failure to furnish the consent to disclose.

Mr. Redpath

And because [Section] 7216 is criminal, it requires knowing. It requires intent because it's a criminal act. Whereas this, if you do it, you don't have to know. It doesn't have to be a knowing disclosure, and it doesn't have to be reckless. So, your liability here is essentially, pretty much, if it got disclosed, you got the penalty. And again, the criminal act requires much more. So, from a criminal standpoint, from [Section] 7216, who are preparers? Who's going to be considered a *tax return preparer*?

Ms. Davis

There again, Ian, things have evolved over time. The *preparer* is the paid tax return preparer—people who hold themselves out as preparers—but also casual preparers. Volunteers through VITA [(Volunteer Income Tax Assistance)] or Tax [Counseling] for the Elderly [(TCE)]—they would be considered preparers for this reason, so they have these privacy and security needs as well. But now, there's the e-file providers—the Electronic Return Originator [(ERO)]. Maybe you didn't prepare the return, but you're transmitting the return to the IRS as the ERO. It's the intermediate service providers, the software developers, the reporting agents—people who are handling the return in the new technology age. That's why the regulations needed to be updated; because in 1971, we didn't have Electronic Return Originators, not that I'm aware of.

Mr. Redpath

No, and that would be an example of an auxiliary service. I'm providing you with the return to file it electronically as an auxiliary service to the preparation of the return. Meta, using it for advertising, is not an auxiliary service for that purpose.

Ms. Davis

Yes, and that's the thing, right? I was just wondering, when the story broke in mid-July, what does Meta say to this? Like, "Well, no, actually, I'm not a tax return preparer. I'm going to wash my hands of it because these businesses are the ones who are responsible. They were just sharing stuff with me and clearly violating the standards that I told them to follow." I mean, that just sounds like crocodile tears to me. I do think that Meta knew what it was doing, and it knew how to translate taxpayer tax return information into targeted Facebook ads. That's what was occurring. One of the things that's dangerous about this, Ian—I had a client who had some FBAR complications, and then she saw something on the internet that had targeted her. She's like, "This is like from Heaven. It's as if the universe delivered to me exactly what I need, so I'm going to take advantage of this opportunity that came up. It must be Heaven sent." Well, no. It was algorithm sent, right? Someone knows your browsing habits, or they got ahold of tax return information. They're targeting you. But if you don't know you're being targeted, and you just think it's manna from Heaven that arrives at exactly the right time in your hour of need, and you take it, you probably are being exploited. That's what worries me, and it worries everybody, about big data knowing so much about our lives.

Mr. Redpath

Well, like you said, privacy is important. And who knows? Are we supposed to operate under the concept that Meta is always going to operate in good faith and in the best interest of the individual taxpayer? For some reason, I don't think that's what they look at when they're looking at this. You mentioned Meta is saying, "Hey, it's not our job. They're giving us the information. We're going to use it." To me, that kind of sounds like they're engaged in a—well, they may not be specifically under that provision, but they're certainly conspiring to violate that with whoever's providing them the information. They know why they're going to use it. They know what the purpose is. They know they're getting disclosed information that essentially violates the law, so aren't they engaged in a conspiracy? I don't think they're going to get away with just washing their hands of it, although whether anybody's ever going to bring an action, that remains to be seen. What is *tax return information* for this purpose?

Ms. Davis

That's a good question. *Tax return information* is all the information that preparers obtain from the client, from the taxpayer, for preparation of the return and used in the preparation of the return. So, it's not just the [Form] 1099-INT and the [Form] W-2. It's also the taxpayer's summary of their real estate taxes paid or their charitable contributions. All of that becomes tax return information because it goes into our work. It includes our own computations and worksheets; printouts; correspondence from the IRS during preparation, filing, and the correction of the return; [and] statistical compilation of tax return information. [It's] also tax-return-preparation software registration information, so it's a pretty large category. Everything you have to wrap your arms around to do a tax return is *tax return information*.

Mr. Redpath

And disclosing it is basically—anyway, I mean, there's not like a limit as to the way it was disclosed. It really can be about pretty much anything unless you have that written consent from the client. The client has to know what you're using it [for], and normally, the situation is [that] they've asked you to provide it. "Would you provide it to the bank? Would you provide it?" But they have to know, and I think you have to at least explain to them that there's confidential information that they're being provided. I don't think they can come in and go, "Well, the bank said they want a copy of this." "Oh, Okay." I think you do have to do a little more disclosure to them when they sign that consent form. And I say sign the consent form. I mean, can we just say, "Here. Sign this that says, 'Send this to the bank?'" Or do we have to do a little more about that? And by the way, generally, the consent's only good for one year from the date they signed it. You can't say, "Well, you gave me one three years ago. It's still valid." No, it's one year. There is Rev. Proc. 2013-14 out there. How does that impact us, and why do our viewers have to go look at it?

Ms. Davis

That gave us the exact text, the exact font size, [and] the exact format of what the consent to disclose tax return information needs to be. The exception to this consent is, if you're sharing the information with a fellow tax return preparer who's assisting in the preparation, you don't need to get the consent to do that. But what's interesting under this rev. proc., if you're using a tax return shop that's not in the U.S. [and] you have some help desk over in India that's going to be feeding in your tax preparer information, then you need to disclose to the client, "Oh, by the way, I'm sending some of this abroad because the labor is cheaper, and they're really good at learning the U.S. tax code, and they're going to help me with it." So, if you have assistant preparers here in the U.S., that's fine. But if you're using assistant preparers abroad, you need specific consent for that, and you need to mask the social security numbers going abroad. There was a period ten years ago where we thought, “Oh my gosh, all our jobs are getting shipped abroad.” Well, I think Rev. Proc. 2013-14 put the kibosh on that because if you want to ship it abroad, you have to say to the client that you’re doing that, and that's just not going to go over well with your client.

Mr. Redpath

Yes, as you pointed out, at one time, people were talking about the 24-7 office—that I can send the information to India, and the next day it's done. I've got it all done the next day, and it's cheaper labor. I'm getting it back the next day—efficiency. And there were a lot of concerns about that, and what that information, what protections of information as it was going over there. I think, as you've pointed out, I've heard less and less about that. And I know even the large firms, the large national firms, were talking about, “Hey, this is great. We can just ship it over.” Still, there are larger firms that actually subcontract with smaller firms to do smaller returns that, for whatever reason, they're going to do, but they would not normally be doing those. And that still happens. Well, they’re preparers also. That would not necessarily require it. Although I still believe it's best practice if you're having someone else outside the firm working on the return, I think it's best practice from a legal perspective to protect yourself and make sure the client knows it and consents to it.

Ms. Davis

Yes, you know, it's interesting because Rev. Proc. 2013-14, at the time, I drafted a form that we could use in-house; and it's very burdensome to get that signature before you send it to the bank. And so, like I said, you just send it to the client and say, “You send it to the bank.” And that's pretty much what we do. And we don't do internal marketing, so the consent to use is not something I've studied deeply. But this rev. proc., even though it's ten years old, is suddenly relevant today. Because if you want to ask yourself what laws were broken, if any, during this whole Meta and Google Analytics thing with TaxSlayer and whatnot, this is a starting point to remind us, what are our obligations. And that's what I keep coming back to. We can't control what other preparers do; but when clients come to us, they come to us for a trusted relationship. And this is where it starts is our compliance with these regulatory requirements.

Mr. Redpath

Not to sound facetious, but I literally can see at some point, you're going to have, not the ads, “Hurt in a car? Call me!” We're going to say, “You think your information was disclosed on Facebook? Contact me!” I really can see that, and I'd be very surprised. We have all of these class action, late-night ads from lawyers. You know, “We're looking to have people set up a class action.” I can see that happening where suddenly people are, “Well, let's do a class action against Meta.” And the firms that are disclosing this—because they don't have the forms, and they're disclosing it to non-preparers. So, I see potential lawsuits out there about this. Again, we can think of these big companies that were doing it, but we need to be careful anytime we disclose information to anyone. Even at the request of the taxpayer, our own client, make sure you’ve got it signed.

I always go back. I’ve used this before. The first day I was in practice, my senior partner said to me, “Ian, your clients are not your friends. They may be acquaintances. They’re not your friends. Screw up one time, [and] see how good a friend they are.” And I've always kept that in mind. So, you may think, “Oh, I'll just send that over for you.” Make sure you've got that signed, even though you think that Sally and John are your best friends. Make sure you've got that signed because if something goes awry, you’ve got a target on you.

I think today's really something for our viewers to really keep in mind and to review their internal practices and make sure they're following best practices and the rev. proc. Karen, thank you for bringing this to our attention. Certainly, it’s an important issue and one that we don't always think about. We’re so busy doing all of our tax work that we forget some of these little detail things that could have some real exposure. Karen Davis, thank you for joining us; and to our viewers, thank you for being here and be safe.

Ms. Davis

Thanks, Ian.

Consent to the Disclosure of Taxpayer Information

By Ian J. Redpath, JD, LLM

A. Introduction

Protection of taxpayer data has come front and center in the consciousness of the government and the entire tax profession. Recent revelations have shocked all involved, especially considering the large numbers of electronically filed individual returns which generally use e-filing services that utilize Meta Pixel code. This has become a major area of concern, starting with a November 22, 2022, article in *The Markup,* which reported that major tax filing services, such as H&R Block, TaxAct, and TaxSlayer, have been transmitting, via Meta Pixel, sensitive financial information to Facebook. This includes names, email addresses, and often detailed information, including data on users' income, filing status, refund amounts, and dependents' college scholarship amounts. This information could be used to power advertising algorithms and will be available even if the taxpayer does not have a Facebook account or any other account on a Meta platform. The Senate conducted an independent investigation that upheld the conclusions reached in the article.

Protecting clients' sensitive data is and should be a matter of high importance for all tax professionals. This material addresses many of the concerns.

B. The Senate Report

In a scathing 54-page report, a Senate committee headed by Elizabeth Warren supported the findings detailed in the article. In a letter summarizing the findings, the committee noted: "We write to inform you of the results of our investigation revealing an outrageous and potentially illegal sharing of taxpayers' sensitive personal and financial information with Meta by online tax preparation companies." The letter further noted that while most websites use pixels, "it is particularly reckless for online tax preparation websites to use them on webpages where tax return information is entered unless further steps are taken to ensure that the pixels do not access sensitive information." The tax prep companies described this as a "ubiquitous" and "common industry practice." TaxAct, TaxSlayer, and H&R Block indicated that they have been using Google Analytics (GA) for even longer. One tax prep company revealed it had additional pixels on its website and that they potentially shared data for every single user of the company's websites. While all the companies indicated the shared data was anonymous, experts have warned that the data could easily be used to identify individuals or to create a dossier on them that could be used for targeted advertising or other purposes. Meta admitted that it used the data to target ads to taxpayers, including for companies other than the tax prep companies themselves, and to train Meta's own AI algorithms. The report notes that under the law, "a tax return preparer may not disclose or use a taxpayer's tax return information prior to obtaining a written consent from the taxpayer." These companies failed to do so when it came to the information that was turned over to Meta and Google. Violating the law can result in criminal penalties of up to $1,000 per instance and up to a year in prison. In IRS Tax Tip 2018-54, the IRS notes that, "[T]axpayers have the right to expect appropriate action will be taken against employees, return preparers, and others who wrongfully use or disclose taxpayer return information."

C. IRC Sections 6103 and 7216

IRC Section 6103 provides a general prohibition related to the release of tax information by an IRS employee. However, there are important exceptions:

- §6103(d) provides that return information may be shared with state agencies responsible for tax administration;
- §6103(i)(1) allows disclosure, pursuant to court order, with law enforcement agencies for investigation and prosecution of non-tax criminal laws;

- §6103(k)(6) allows limited disclosures of return information in the course of official tax administration investigations to third parties if necessary to obtain information that is not otherwise reasonably available;

- §6103(l)(1) provides that return information related to taxes imposed under chapters 2, 21, and 24 may be disclosed to the Social Security Administration (SSA) as needed to carry out its responsibilities under the Social Security Act.

- §6103(e)(6) & (c) provide for disclosures to powers of attorney and other designees.

Section 7216 prohibits preparers of tax returns from knowingly or recklessly disclosing or using tax return information. Violations provide for penalties of a fine up to $1,000, or imprisonment for not more than one year, or both, for each violation. The IRS, on its website, has exhaustive FAQs on this topic.

Section 6713 imposes a civil penalty of $250 per occurrence up to $10,000 maximum per calendar year on any person who is engaged in the business of preparing or providing services in connection with the preparation of returns of tax, or any person who for compensation prepares a return for another person, and who—

- Discloses any information furnished to him for, or in connection with, the preparation of any such return, or

- Uses any such information for any purpose other than to prepare, or assist in preparing, any such return.

Unlike §7216, §6713 does not require that the disclosure be knowing or reckless.

For these purposes, a tax return preparer is a person that participates in the preparation of tax returns for taxpayers, including but not limited to:

- Preparers:
    1. Paid return preparers, and those that hold themselves out as preparers, and
    2. Casual preparers that are compensated, and volunteers through VITA, TCE, etc.

- E-File providers:
    1. Electronic return originators,
    2. Electronic return transmitters,
    3. Intermediate service providers,
    4. Software developers, and
    5. Reporting agents. (Revenue Procedure 2007-40)

- Those that assist others in preparing returns or performing auxiliary services in connection with preparing returns. Contractors receiving tax return information from tax return preparers are considered tax return preparers subject to the same provisions and penalties. The regulations provide that tax return preparers that engage contractors and disclose tax return information to them are required to inform contractors of the rules and consequences in a written notice. (See IRS FAQ #3.)

Tax return information is all the information that a tax return preparer obtains from taxpayers and/or other sources, regardless of the form or manner of obtaining it, if it is for the purposes of preparing or in connection with the preparation of tax returns. This is very broad and includes all computations, worksheets, and printouts preparers create; correspondence from the IRS during the preparation, filing, and correction of returns; statistical compilations of tax return information; and tax return preparation software registration information. (See FAQ #5.)

Disclosure of tax return information is the act of making tax return information known to any person in any manner whatsoever. The regulations authorize two types of disclosures:

- Certain permissible disclosures without taxpayer consent, and
- Disclosures requiring taxpayer consent.

There are exceptions for disclosure without a taxpayer's prior written consent. (Reg. §301.7216-2)

D. Taxpayer Consents

A client may request that tax returns be sent to a bank to assist in obtaining a loan, to a potential investor, a potential buyer, or for other purposes. A tax professional may think that having an email from the client authorizing the practitioner to disclose the return information to a specific person would be sufficient; unfortunately, this often-held belief is wrong. Of course, nothing matters until something bad happens and the practitioner finds himself/herself unprotected for failure to follow the consent rules. An email will be of little avail in this situation. The rules for obtaining consent to disclose tax return information are found in Reg. §301.7216-3 and Revenue Procedure 2013-14. Clearly, a valid consent must be voluntary and knowingly provided by the taxpayer. Thus, the IRS has provided detailed rules on what is a valid consent to eliminate as much confusion as possible.

The disclosure must contain certain specific information, including:

- the name of the tax return preparer,
- the name of the taxpayer,
- specify the nature of the disclosure(s),
- specify to whom the disclosure(s) will be made,
- details on the data to be disclosed.

Further, consents must be signed and dated by the taxpayer by handwritten signature or specific electronic signatures. The revenue procedure provides that electronic signatures may be created using the following methods:

- Assign a personal identification number (PIN) that is at least five characters long to the taxpayer.
- Have the taxpayer type in the taxpayer's name and then hit "enter" to authorize the consent. (The software must not automatically furnish the taxpayer's name so that the taxpayer only has to click a button to consent.)
- Any other manner in which the taxpayer affirmatively enters five or more characters unique to the taxpayer that the tax return preparer uses to verify the taxpayer's identity.

The consent may specify the period of time it will be in force. If nothing is set forth, then it will be effective for a period of one year from the date the taxpayer signed the consent. [Reg. §301.7216-3(b)(5)] There is no universal or global consent. Each separate consent must be on a separate written document, either paper or electronic. It may be set out as an attachment to an engagement letter as long it complies with the rules and is separately signed.

Rev. Proc. 2013-14 contains the required formatting and mandatory language of a consent to disclose or use tax return information, including paper and font size for paper consents. For electronic consent, it requires the consent to appear on its own screen and, not only sets forth the text size, but requires that there must be a sufficient contrast between the text and background colors.

The Revenue Procedure provides mandatory statements that must be included for different purposes, including:

- Consent to disclose tax return information in a context other than tax return preparation or auxiliary services;
- Consent to disclose tax return information in the context of tax return preparation or auxiliary services;

- Consent to use tax return information; and
- Consent to disclose tax return information to a tax return preparer located outside the United States.

All consents must also contain the following statement:

> If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1-800-366-4484, or by email at complaints@tigta.treas.gov.

All consents require the taxpayer's affirmative consent to disclosure or use of tax return information. There cannot be an opt-out type of consent—consent unless opted out by the client. Electronic consents must be furnished in a manner that ensures the taxpayer's affirmative, knowing consent to each disclosure or use.

For any disclosure outside the United States, including any U.S. territory or possession, both parties must maintain an "adequate data protection safeguard" both at the time the taxpayer's consent is obtained and when making the disclosure. The revenue procedure describes an adequate data protection safeguard as a management-approved and implemented security program, policy, and practice that includes administrative, technical, and physical safeguards to protect tax return information from misuse, unauthorized access, or disclosure, and that meets or conforms to one of the data security frameworks described in the revenue procedure.

It should be noted that a tax return preparer may use tax return information for the purpose of identifying a suspicious or potentially fraudulent return from the taxpayer or a related party. [§7216(a)(2)] In addition, return information may be analyzed to produce statistical compilations that identify potentially fraudulent behavior or patterns of conduct. (Reg. §301.7216-2)

E. Conclusion

Practitioners should take great care in making sure the policies of the firm and any consent documents comply with the detailed rules established by the IRS. Failure to comply will result in the consent being invalid and potential liability for the practitioner. It is a good policy to review and regularly update the consents and policies as a matter of best practice.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, Alexander, has a small business operated as an S corporation. He is seeking a loan from a bank and has identified a potential investor. He sent you an email requesting that you provide the bank and the investor with his last two tax returns. He supplies their names and addresses.

Required:

1) What general information is needed for a proper consent?

2) What is needed for a valid handwritten consent?

3) Can the email constitute a proper electronic consent?

B. Suggested Answers to Discussion Problems

1) Tax return information is all the information that a tax return preparer obtains from taxpayers and other sources, regardless of the form or manner of obtaining it, if it is for the purposes of preparing or in connection with the preparation of tax returns. Disclosure of tax return information is the act of making tax return information known to any person in any manner whatsoever. The regulations authorize two types of disclosures:

- Certain permissible disclosures without taxpayer consent, and
- Disclosures requiring taxpayer consent.

The rules for obtaining consent to disclose tax return information are found in Reg. §301.7216-3 and Revenue Procedure 2013-14. Clearly, a valid consent must be voluntary and knowingly provided by the taxpayer. To eliminate as much confusion as possible, the IRS has provided detailed rules on what is a valid consent.

The disclosure must contain certain specific information, including:

- the name of the tax return preparer,
- the name of the taxpayer,
- the nature of the disclosure(s),
- to whom the disclosures will be made, and
- details on the data to be disclosed.

Further, consents must be signed and dated by the taxpayer by handwritten signature or by electronic signature. All consents must also contain the following statement:

> If you believe your tax return information has been disclosed or used improperly in a manner unauthorized by law or without your permission, you may contact the Treasury Inspector General for Tax Administration (TIGTA) by telephone at 1(800)366-4484, or by email at complaints@tigta.treas.gov.

2) In addition to the above, Rev. Proc. 2013-14 contains the required formatting and mandatory language of a consent to disclose or use tax return information, including paper and font size for paper consents. The Revenue Procedure provides mandatory statements that must be included for different purposes, including:

- Consent to disclose tax return information in a context other than tax return preparation or auxiliary services;
- Consent to disclose tax return information in the context of tax return preparation or auxiliary services;
- Consent to use tax return information; and
- Consent to disclose tax return information to a tax return preparer located outside the United States.

3) A client may request that tax returns be sent to a bank to assist in obtaining a loan, to a potential investor, a potential buyer, or for other purposes. A tax professional may think that having an email from the client authorizing the practitioner to disclose the return information to a specific person would be sufficient—unfortunately, this often-held belief is wrong. Of course, nothing matters until something bad happens and the practitioner finds himself/herself unprotected for failure to follow the consent rules. An email will be of little avail in this situation.

PART 3. BUSINESS TAXATION

Section 338

Section 338 of the Internal Revenue Code should be considered when determining how to structure a transaction that involves buying, selling, or combining different companies. If various conditions are met, an election under Section 338(h)(10) allows the parties in a sale of corporate stock to treat the transaction for federal income tax purposes as if it had been an asset sale. All things being equal, buyers generally prefer an asset sale, while sellers prefer a stock sale. Ian Redpath and Greg Urban discuss the pros and cons of Section 338 and Section 338(h)(10) for buyers and sellers.

Let's join Ian and Greg.

Mr. Redpath

Greg, welcome to the program.

Mr. Urban

Hey Ian, nice to be back with you.

Mr. Redpath

It is always great to have you, always great to get your insight. The last time, I believe it was the last time we were together, we had a really interesting topic, and that topic related to S corps and F reorgs, which are a very popular thing. And in doing some reading for our topic today, some people are saying, "Well, maybe this is a substitute for that F reorg." So, maybe our viewers should go and look at that one when we talk about this one today. We are talking about [Sections] 338 and 338(h)(10). Now, some of our viewers are like me. They're old guys. Some of our viewers remember 338 and they said, "When they changed the rules and made it taxable, it has kind of gone away." Or "Yes, I know there is this (h)(10), but that deals with consolidated returns; I don't really see the use of it."

Basically, I think we have to start with the idea of, okay, you have a buyer and a seller, and there are multiple ways. Most of my clients—I don't know about yours, Greg—they have a mantra; it comes from *Jerry Maguire*, I believe, and it is "Show me the money." And I can come up and say, "Hey, I have this great corporate reorganization for you," and they are going to say, "I want to see the money." So, I see that as a major issue with a lot of people who say, "Okay, you can come up with all the fancy corporate reorganization stuff you want. I want to see the money." So, is a transaction then going to be a stock sale or an asset sale? There are other issues like, do we have 1202 stock or 1244 issues? Maybe we can reinvest in an Opportunity Zone. There are all these other things that we can look at. Can you just tell us what would be the difference? What is the driver for the seller? If you're representing the seller, what are you wanting to sell, assets or stock?

Mr. Urban

When you are the seller, in almost all circumstances, we see sellers wanting to sell stock. Oftentimes, it's the cleanest transaction from their perspective. It is eligible for capital gain rates and a very simple transaction usually to effectuate. Very rarely is a seller overly enthused with an asset sale; there is just more work involved, and there is usually a higher tax rate that is going to apply, at least to some of the assets that are involved in the transaction. Maybe we should build out on that a little bit, but that would be from the perspective of a seller. You are almost always saying, "Let's sell stock."

Mr. Redpath

Yes, like you mentioned, if they are selling the assets, you often have double tax. They will sell the assets, and then they have recapture of depreciation, ordinary income, their inventory; if it's a cash basis, then they have receivables. They have all this ordinary income taxed at 21 percent. But then, your corporation sold its assets, but that money now is sitting in the corporation; it's not in my hands. Now, you have the double tax on the liquidation. You have the tax on the sale, and then you have the tax on the liquidation, and you're sitting there thinking, wait a second, I'm getting double taxed here. I got taxed on the sale, and that was a lot of ordinary income. And now, when they distribute out the cash, I'm going to get taxed again as if I sold my stock for the value of what I got. So, I'm getting double taxed. Why would I want to sell my assets?

Mr. Urban

And even in the circumstance where you're not double taxed, with a pass-through entity, you think about a seller's perspective where they would always like to sell stock. In a typical pass-through transaction, you're going to have some assets that are going to generate ordinary income. Even if you are outside of the realm of C corporations—which, I would say, you see fewer and fewer of today, although maybe with some of the 2017 tax changes, there were some companies that went back to the C corporation structure—but when you have pass-through entities now, even if you look at your typical S corporation or partnership, you said it perfectly—oftentimes, you might sell cash basis receivables; they might be an included part of the transaction.

Our firm does a lot of valuation work and, almost always, even in an area such as inventory, you will see some step-up in the value of the inventory. It doesn't even have to be manufactured inventory. You could have inventory that is just purchased for resale, and somebody will come in and say, "Okay, for financial reporting purposes, I need to do a purchase price allocation, and I need to open my opening balance sheet." And a lot of times, maybe for financial statement purposes, they will want to set those assets at fair market value. And maybe with inventory that is acquired for resale, the purchasing function has already taken place, so there is maybe some profit that should be built into that purchase—just the fact that the inventory has been acquired. Oftentimes, that in and of itself will require a step-up from historical cost where you will see some ordinary income component in it.

Obviously, the other area where we see it is to the extent purchase price is allocated to fixed assets, particularly assets where there is ordinary income depreciation recapture. That's something that is almost always prevalent in an asset sale that you wouldn't even have to deal with in a stock sale. Sometimes, there are intangibles that can generate ordinary income treatment, so not all intangibles would have capital gain treatment associated with them.

Those are typically some of the issues that we would run into and why you would prefer a stock sale, to the point that you are making.

Mr. Redpath

Even with an S corp, if you happen to have built-in gain and you sell the assets, you have the built-in gains tax that's going to kick in. And when you have an asset sale, both the buyer and the seller have to report. There is a requirement under Section 1060 that you are going to have to allocate to the seven classes on a residual method, so you can't just arbitrarily say where this payment goes. I always make sure that I get to see it, but I put in, essentially, the allocation into the contract of sale. That way, if the other side has different numbers they report to the IRS, I have my numbers, and it is part of the contract.

Mr. Urban

You know, Ian, one of the few times I have seen the buyer and the seller take a different approach relative to the 1060 allocation—and it gets done on the Form 8594—the return got pulled for audit very quickly. No exaggeration.

Mr. Redpath

By the way, for our viewers, both sides have to file it. It's not just one side; both sides file the form.

Mr. Urban

That's right. What we do—and this is maybe what you just said is valuable for the audience because oftentimes, in agreements, it would be best if the purchase price allocation was detailed. But a lot of times, that valuation work isn't done at the time of closing. A lot of people are still working through working capital adjustments at that time.

What we have seen is some language, and there are iterations of this in an agreement, that would say, within 30 days, one party, and it is usually the buyer (my experience has been the buyer) usually has a requirement to set an opening balance sheet for financial reporting purposes so, oftentimes, they take the first stab. I get there is a difference between fair value and fair market value, but oftentimes, there is a lot of synergy with using the purchase price allocation for the opening balance sheet.

Maybe, then, the seller has (say that it is due 90 days after closing) the seller has a period of time to rebut. Worst case scenario, if they can't agree, then it goes to some independent third party. But that is a really good feel for how I think the allocation process typically plays out.

Mr. Redpath

But a lot of times—and I have seen this many, many times—where a client has come in, and the parties have an agreement, and I'm going to call it at this point, loosely, an "agreement in principle," but it has probably been a handshake, maybe a handshake over a beer, and they said, "Would you take two and a half million?" "Yes." "Oh, great." And they come in, and they say, "I'm selling my business for two and a half million." Now we start the work. They think, two and a half million, everything is set. No, we're just starting. As you said, now we have to look at [Section] 1060. Where is that two-and-a-half million going? It may be very favorable to one side, depending on what categories you're putting things in and how you're valuing within those seven classes. You certainly don't want to have a lot left over in the residual because that goes to goodwill.

Mr. Urban

Yes, the seller would probably like a lot in the seventh category because, generally, most assets in that category are probably going to generate capital gain treatment. But the buyer is going to look at it, and they are going to say, "These are things that we have to recover"—over 15 years, typically. I will say it has been my experience, and I think most of the literature in the area will note, that you are dealing with adverse parties here. And generally, to the extent the parties can agree on the allocation, I think the Service respects that. It doesn't mean they're bound to go along with it, but it is an important factor. And that is one thing that maybe you would tell the audience is to agree to have some provision where they agree to the purchase price allocation and file the 8594 uniformly.

Mr. Redpath

Yes. I think it's important that you do, and that is part of the negotiation and should be part of the contract that, somehow, you have the number, the allocation that you have come up with. As you said, you don't always have it initially; you have to work on that, and maybe that is subsequent. We have kind of gone around a little bit, but if you are the buyer, we want the assets, right? Why do we want the assets?

Mr. Urban

If you're the buyer, the number one reason you want it is because you're going to recover your basis while you hold and operate the business, as opposed to having the basis sit in the stock and maybe only available on a disposition of that stock. And sometimes, people don't intend to sell businesses. Maybe they will acquire a business and leave it in the family; and with the way the estate tax rules are now, the value of the business will get stepped up. So, having the purchase price sit in the stock can oftentimes not yield tax deductions, maybe for a very long period of time until the business is disposed of.

By acquiring the assets, you have the opportunity to depreciate assets with bonus depreciation (even though it is being scaled back, that is still an important consideration) and the ability to have basis in the inventory. Sometimes, that is actually something that buyers don't really like because the inventory gets stepped up, so the profit margin is a little bit lower. But certainly, I think the step-up in basis in not only the tangible assets, but also the intangibles, and being able to amortize those, is a very valuable benefit to the buyer.

Mr. Redpath

Well, and I think the thing is that there is no such thing in corporate tax as a "754 election." While you can buy an interest in a partnership and perhaps step up your basis so you can take a higher basis and recover your costs, there's no such equivalent in corporate tax.

Now, you are arguing. I say, "Okay, you will only sell me the stock, but I want the assets." If I buy the stock, now I have a parent-sub situation; I have a subsidiary. Well, I know I can do a tax-free liquidation under Section 332, but that is just going to carry over the basis. Let's say I paid $5 million, but the inside basis of the assets is $1 million. I haven't helped myself at all by buying the stock and then doing a 332. Yes, I got the assets, but so what? This is where 338 comes in, right?

Mr. Urban

That is where 338 comes in. And the other thing that you have to be a little careful with there, too, is even if you have an S corporation making an acquisition, sometimes you can have a situation where there is outside basis that disappears if you make a QSub election, things like that. So, there are definitely some things to watch for in the pure stock acquisition context which, yes, that is where the 338 comes in. It basically says, let's say there is a situation where just buying the stock is necessary. Maybe there are contracts or agreements or something in place that can't be transferred as an asset sale, or it would be very difficult to transfer. Here, we can sell the stock but still have the benefits of that asset sale. The 338 election would really facilitate a situation like that, where maybe you have to sell stock for whatever reason, but you still want to enjoy the benefits to the buyer like we were just talking about.

Mr. Redpath

But the problem is—and this is why I said some people remember 338 as being great because, at one time, there was no tax consequence to a 338—but now, if you make an election under 338, you have to pay tax. So, it is kind of looked at this way: you have a "NewCo" (which is a hypothetical corporation) that purchases all of the assets from that target, the subsidiary—remember, it is a subsidiary now—and then, NewCo is liquidated in that 332. Well, it bought it for $5 million; its basis is $5 million. The only problem is that the subsidiary (the former target, now subsidiary) has to pay the tax on, in our example, $4 million of gain. It is a present value, right? What is the present value of the future deductions I'm getting with the step-up versus the 21-percent tax cost of making that election?

Mr. Urban

That is really the analysis in the 338 situation. The other thing would be if there is something somewhere in the structure, maybe an NOL, that would allow for the sheltering of that gain on the deemed asset sale. That is what we would be looking to eliminate. In situations, maybe, where there are NOLs that have been built up, maybe a 338 election has some utility because we can avoid paying tax. Maybe a buyer is willing to pay a little bit more, like you say, for the present value of the deductions. The other area where we see a 338 election pop up in practice deals with the sale of non-CFC foreign subsidiaries. There, you can treat the stock acquisition as an asset acquisition, but that's for U.S. tax purposes. The advantage of doing that is the 338 election provides larger depreciation and amortization deductions which offset things like GILTI and maybe Subpart F income, if it exists.

I would say, in our practice, those are the two situations where we see the straight 338 elections typically applying: in a situation where, maybe, we have NOLs, or we can shelter that corporate-level tax on the asset sale, or you have a situation with a foreign subsidiary where foreign jurisdiction is still going to view it as a stock sale. For the U.S. purposes, we have an asset sale. Maybe you don't wind up with the tax consequence that is so detrimental that you were talking about. However, that is definitely facts and circumstances, and that is something you have got to look at. But those are the two situations where we see the 338 election apply.

Mr. Redpath

I think the last one you mentioned is probably one of the more common—the international situation—and it is certainly something that, if you are involved with that, that is one of the things you absolutely want to look at. Is that something that we could do with 338? We have kind of not really said it, but it is a stock sale treated as an asset sale. That is essentially what we are looking at here because you are getting the results. But remember, with the straight 338, you are having double tax. The transaction is double taxed. The seller pays capital gain on the sale of their stock—it's a stock sale for them. Then, the buyer is going to pay tax on that hypothetical transfer to NewCo under 338, so the transaction is getting double taxed in order to get that step-up in basis that you are looking for.

It may or may not [be a benefit]. It is an analysis. You have to look at it and say, “Yes, we are going to benefit.” For the most part, that analysis of present value doesn’t usually seem to favor wanting to do a 338—unless there is an NOL. A great example, Greg, that you gave was, if there is an NOL there, why not just use it and get your step-up in basis?

The 338 is an election. You use Form 8023 to make the election, and you have to have a qualified stock purchase. What is a qualified stock purchase for this purpose?

Mr. Urban

You are looking at acquiring 80 percent of stock in the target, and that is generally done within a 12-month period.

Mr. Redpath

And the thing is, the 80 percent has to be within the 12-month period. It doesn’t look at prior ownership. It says in that 12-month period, you got the 80 percent. It’s not like a 351 where you can use prior ownership and say, “We are in control. We have 80-percent control.” No, prior ownership doesn’t go. You have to get the 80 percent in that 12-month [period]—and not a year, not a tax year, a 12-month calendar-year acquisition period, and that is 80 percent of the total voting power *and* value. It is voting power and value. And again, you use Form 8023 to make the election.

Now, we have kind of hinted around at it a little bit in the beginning, but 338 has some viability, especially with S corps, but also, historically, it was in the consolidated return. The seller had a consolidated group, and the seller is selling one of their subsidiaries to the buyer, and 338(h)(10) comes in with some hypotheticals, but really ends up with a stock sale that is treated like an asset sale.

One thing for our viewers, remember that the actual transaction in a regular 338 is a stock sale. So, even though we treat it like an asset sale, you have to get the lawyers to get rid of the target because you have a parent-sub; they own the stock of the subsidiary. In the paperwork, the legal paperwork—not the tax work but the legal paperwork—you have a parent sub, and you have to get rid of that sub. Here, parent, sub, the sub is the target. What does a general 338(h)(10) look like?

Mr. Urban

It is really quite similar in a lot of ways to the 338. It is actually 338(g), which is the first election we were talking about. Here, you have a very similar situation where you have got a hypothetical sale from the target to a NewCo, and that target, of which you are acquiring the stock, is deemed to sell its assets. There is an asset sale that takes place on the sale from the target to the hypothetical new corporation, and then you are deemed to have a distribution of the proceeds back up to the shareholder. So, you essentially are back to the situation where you have a similar situation, but you see this with an S corporation, like you said, probably most frequently, particularly with the number of S corporations that are out there. That target is deemed to sell their assets for all the reasons that we talked about before, and then you have a deemed distribution of those proceeds.

Mr. Redpath

And that distribution is tax-free because that is a 332 liquidation. For a 332 liquidation, how do I know it’s going to qualify as a 332? Because 332 says you have to have the 80-percent control. Well, you have to sell 80 percent within that 12-month period to have a 338 election, so you know you’re qualified for 332. Now the parent liquidates—under 332—the sub, and it is really doing the same thing, but you’re doing it under the second-tier subsidiary and then doing the 332. You’re getting the same result, except the tax burden is all borne by the seller, not the buyer. The buyer is getting the step-up in basis. And the seller is paying the tax (ordinary income on the recapture items), so they are paying it as an asset sale. For their purposes, it is treated like an asset sale; and the buyer is getting the step-up in basis. In a consolidated group, why would a seller want to do that? Why are they going to say, “I’m going to pick up all the tax”?

Mr. Urban

Again, I think in the practical sense, they have some attribute at the parent level that allows them to shelter the gain on the deemed asset sale. That would be the typical result.

Mr. Redpath

Well, consolidated losses, they probably are sheltering some, but I have also seen this discussion—and I have had this discussion. Okay, $5 million is the fair market value, but for you to get a step-up for $5 million, it is going to cost you 21 percent on that $4 million gain. I'm picking up an asset sale. I'm not getting all capital gain. I am paying more tax, so we are going to negotiate a number that is more than $5 million. I'm not going to pay more than what I would have had to pay if I just bought the stock and did a 338. There's a number in there that we both can work with. There is a premium on the sale.

Mr. Urban

Yes, or in the S corp context—not to bounce off of the consolidated context, but you just see more with the S corporations today, based upon the sheer number of S corporations that exist. Oftentimes, you might have a seller with a capital loss (the ultimate S corporation shareholder I'm talking about here), and those types of attributes oftentimes can reduce the burden. But you are right; it comes down to a present value analysis. The seller isn't going to give up all of the extra tax, but there is usually a midpoint where the seller and the buyer can agree: the buyer is obtaining these benefits, but the seller is incurring some additional level of tax. That is just the way that it happens.

Mr. Redpath

Yes, it is just some kind of a premium that we can agree on. What people have to remember is that if you are going to make a 338(h)(10) election, you also have to make a 338. You have to elect both. You can't just elect 338(h)(10); you have to elect 338(h) and 338(h)(10). There are cases out there where they haven't elected both and the courts have said, "Sorry," and the IRS has said, "Sorry, you don't get the benefits."

So, we have been talking about S corps. Conceptually, it wasn't there; S corps were not in the consideration, it was a consolidated group. Then, practitioners—because practitioners try to stay a couple of steps ahead of the IRS—said, "Well, isn't an S corp like a consolidated return? Everything is being taxed at one level. That is pretty consolidated. It's consolidated with the shareholders, just like a consolidated return in a consolidated affiliated group." A pretty good argument. And the IRS said, "You know what? That is a good argument." They didn't make too much of a fuss about it, and they actually went in and changed the regs. In 1.338(h)(10)-1(c), they said, "A qualified stock purchase, it can be an S corp, so you can use it in the S." As you said, for most practitioners who don't have a lot of consolidated groups they are dealing with, this is where 338 and 338(h)(10) really get their life, is with the S corp.

So, what happens in the S corp scenario? You talked a little bit about it. What really happens if you have an S corp situation where the target is the S corp, the buyers are individuals, and they are saying, "No, you have to buy the stock. You have to buy the stock." And you are saying, "No." Then, Greg, you as the expert are going to come in and say, "Hey, I have a way around this, guys. I have this little toy I call 338 and 338(h)(10)." So, what is the magic you are going to work for them, Greg?

Mr. Urban

I think maybe the easiest way to say it is the target S corporation is deemed to sell its assets to a NewCo, so you have an entity-level gain that is based upon the sale of those assets. And then, those proceeds are basically deemed to be distributed to the shareholder in that scenario. So, you have a situation where you have the asset sale that occurs at the lower level, but then you have got a distribution of proceeds to the shareholder. Now, the shareholder will get a step-up in basis for the asset sale. So, the delta (the thing that typically gets modeled in this scenario) would be to look at: if the shareholder sold their stock, it would be a capital gain transaction; if they elect the (h)(10), there is still really one layer of tax, that being on the asset sale—however, that asset sale may have different character of gain, capital versus ordinary, and that is where the modeling and the analysis come in.

Mr. Redpath

As you said, the gain is recognized by the S corp. It flows through on the K-1. The shareholders get a step-up in basis, so when they get the distribution of the proceeds, they're not going to be recognizing the gain twice. It is only going to be recognized once. It would be an odd situation where they would not. So, you have, really, a great benefit here. And as you said, maybe you have losses, and maybe there is something that can help offset that transaction as the S corp disappears. So, it kind of gives you the best of both worlds, and it is commonly used; it is very common.

Now, not to put you too much on the spot, but we did a program on F reorgs, which are becoming very popular in the S area. Can this be an alternative to that, or would it work with that?

Mr. Urban

I think this is an alternative to an F reorg. What we see in the F reorg—and we are seeing more and more of these—is some shareholder, sometimes it's a private equity fund, sometimes it's maybe an individual that is coming in that wants to own a part of the S corporation, or maybe there is an ineligible shareholder. But effectively, what happens in that F reorg is that we are changing, in my experience, an S corporation into an LLC, and you are usually doing that through one or two mechanisms under state law. You are merging it into the LLC in some states; or in some states, you can just change the form. In New York State, where we are, it is typically done through a merger. So, the corporation will merge into an LLC. Now, there is an intermediate step before that where a holding company is set up. A holding company is set up, an S corporation shareholder contributes their stock; immediately, there is a QSub election that is made, and the theory is that when that QSub election is made, that former S corporation now becomes a disregarded entity. Changing the disregarded entity from a corporation into a single-member LLC is going from a disregard to a disregard. So, under that line of thinking, you now have the ability to change what used to be a corporation into an LLC, and then you could admit new owners into that particular structure. We see that. I would say it is a very common structuring technique.

We don't see as many (h)(10)s because there usually is a higher level of tax that is paid. So, when you are thinking about how you can bring in an owner, the F reorg probably has more utility when you are not looking at a sale of an 80-percent interest. Maybe you want to bring in a minority owner, maybe you want to bring in a key employee, something along those lines, whereas the (h)(10) is, I'm selling 100 percent of my business (typically), and I'm going to use this mechanism to exit and to effectuate the sale.

Mr. Redpath

Greg Urban, thank you very much. A lot of great insight. I really appreciate you being on the program, and we are going to have you on the program again very soon. So, Greg, thanks a lot. To our viewers, I hope you have enjoyed the program, I hope it has been a lot of information, and please be safe.

SUPPLEMENTAL MATERIALS

Sections 338(g) and 338(h)(10)

By Ian J. Redpath, JD, LLM

A. Introduction

In the acquisition of a business, the buyer and seller will usually have adverse interests relative to each other. The tax treatment afforded the sale of stock and the sale of assets is generally significantly different for both the buyer and seller, so they will often differ on the desired form. Determining the ultimate transactional form is a matter of negotiation and may be driven by the party most motivated—seller to sell or buyer to buy. The price may be related to the form of the transaction, for example, if a premium is required.

B. Stock Acquisition

As a general rule, the seller would like to have a stock sale that will qualify for capital gain treatment and, if long-term, held a year and a day, will be considered residual long-term gain for rate purposes (0%, 15%, 20%). [§§1221, 1222, and 1223] If the seller is a corporation, there will be no special tax rates on long-term capital gains. A stock sale results in only one level of taxation based on the difference between the proceeds of the sale (less selling expenses) and the seller's basis in the shares sold. If the corporation is an S corporation, the determination of basis is more complex than that of a C corporation. This is an area of focus on audit, so care should be taken in that calculation. If the seller is in a consolidated group, the sale may trigger recognition of deferred intercompany transactions for the selling group.

One major non-tax consideration is that in a stock sale, the liabilities will generally stay with the company and not follow the former owner. On the other hand, the purchaser generally will want to purchase the assets to escape prior liabilities and obtain a step-up in asset bases for purposes of cost recovery. The buyer will also not be subject to any elections made by the seller as to accounting methods, etc. In these situations, the buyer will usually require the seller to provide full indemnification for tax liabilities associated with pre-acquisition periods, as well as a declaration that the seller is in full compliance with all filing obligations of type of tax and that all required tax returns have been filed or will be filed. There are usually additional representations contained in the contracts that deal with liability for issues that are outstanding and unresolved at the time of closing. This would include positions taken on tax returns and may include representations on listed transactions. Often, there is a "hold-back" in escrow for estimated amounts due. A bond obtained by the seller may cover this.

Another often underplayed or overlooked issue that is very important in a stock sale is the impact of state and local taxation. For example, some states and local governments assess real estate transfer taxes on a transfer of stock if the corporation owns certain real property. Likewise, some states apply sales tax on the transfer of stock holding certain assets subject to sales tax. This is sometimes missed because there is not a transfer of the property, only the entity owning the property. These cannot be ignored as the amounts can be significant.

A seller, other than a corporation, may be entitled to certain tax benefits in a stock sale. Under §1202, the seller may be allowed to exclude the gain realized on the sale of qualified small business stock (QSB stock) if the stock has been held for more than five years prior to sale. The amount of gain that may be excluded is limited, on a "per issuer" basis, to the greater of $10 million or ten times the taxpayer's basis in the stock. QSB stock is any stock in a domestic corporation that is originally issued after August 10, 1993, if:

- The corporation is a "qualified small business" (QSB) upon issuance of the stock, and
- The stock is acquired by the taxpayer at its original issue in exchange for money, other property (not including stock), or as compensation for services provided to the corporation.

Section 1045 permits a non-corporate seller who sells QSB stock after August 5, 1997, to defer gain on such sale by rolling over the gain into a new investment in QSB stock if:

- The taxpayer has held the original stock for more than six months, and
- The taxpayer makes a special election to claim §1045 treatment on the taxpayer's federal income tax return for the year of sale.

Deferral of gain is available only to the extent that the amount realized upon sale does not exceed:

- The cost of any new QSB stock purchased during the 60-day period beginning on the date of such sale; reduced by
- Any portion of the cost previously accounted for under this section.

Section 1244 provides a potential benefit if the stock is sold at a loss. Under this provision, an individual and certain partner sellers may deduct as an ordinary loss $50,000 or $100,000 (married filing jointly) of loss on §1244 stock. The balance of the loss is a capital loss. Section 1244 stock treatment applies to the first $1,000,000 of capitalization. The seller must be the original holder, and the consideration for the receipt of the stock may not be services or stock and/or securities of another corporation. The stock may be common or preferred stock issued after July 18, 1984. There is an active business requirement that for the five prior years ending before the date of sale, the corporation derived more than 50% of its gross receipts from nonpassive sources. It should be noted that cancellation of indebtedness owed to the shareholder is considered valid consideration. Book entries to additional paid-in capital or conversions of debt to equity via book entries will not qualify for §1244 treatment. New stock must be issued.

The buyer will generally want an asset sale in order to step-up the basis of the assets to reflect the price that was paid. If a corporation purchases the stock of a target corporation, it will then have a subsidiary. If the buyer wants the assets and owns at least 80% of the subsidiary, it may engage in a liquidation of the subsidiary. This liquidation will be tax-free under §332. The tax attributes of the subsidiary will carry over to the parent under §381. Under §334, the basis of the assets will carry over. As a result, the assets will retain the same basis as in the hands of the seller. A potential relief provision under §338 allows a stock purchase to be treated as an asset purchase under certain conditions.

C. Asset Sale

Asset purchases are generally advantageous for the buyer. The buyer can take the assets free of most liabilities of the seller. It can also purchase only the assets that it wants and not be burdened with unwanted assets. Of course, one of the greatest benefits for the buyer is the ability to get a basis in the assets based on the price paid. It is not burdened by any seller elections related to the assets. It may also avoid problems of minority shareholders of the target corporation that do not want to sell. Asset acquisitions are usually less complicated from the perspective of federal or state securities laws.

The seller recognizes gain/loss based upon the difference between the proceeds it received and the seller's basis in the assets sold. This often results in significant ordinary income due to the sale of inventory, receivables, and depreciation recapture under §§1245, 1250, and 291. The seller corporation will continue to exist, and its tax attributes remain with the seller. If the seller decides not to continue the corporation, then it will have potential additional tax on the liquidation of the corporation based upon the amount received less the seller's basis in the stock. It should be noted that the recognition of gain on the sale of the assets will generally eliminate a corporate-level gain on the liquidation. However, only net after-tax proceeds are available to be distributed to the seller's shareholders. In most situations, two levels of tax apply to the shareholders of the selling corporation. This will be mitigated if the seller is an S corporation. If it is, the two levels of tax will generally be avoided, absent possible built-in-gains tax issues. There are usually state and local tax issues, especially sales/use and transfer taxes.

Usually, the buyer and seller have adverse interests in determining the type of transaction and the allocation of the purchase price of assets sold. The seller may find it more advantageous to allocate the purchase price to assets that will generate capital gain, while the buyer may want a step-up in basis in assets like inventory or depreciable assets. While recognizing this inherent adversity in interests, the IRS is likely to accept an arms-length purchase price allocation between the parties. It is mandatory for both the buyer and seller to allocate the purchase price in accordance with §1060. This is referred to as the "residual method."

Section 1060 applies to any "applicable asset acquisition," defined as any transfer of assets constituting a trade or business if the purchaser's basis in the acquired assets is determined wholly by reference to the consideration paid for such assets. "Assets constituting a trade or business" consist of any group of assets:

- The use of which would constitute an active trade or business for purposes of §355, or
- To which goodwill or going concern value could under any circumstances attach.

For this purpose, FMV is the gross fair market value unreduced by mortgages, liens, pledges, or other liabilities; however, for determining the seller's gain or loss, the FMV of any property is treated as being not less than any nonrecourse debt to which the property is subject. Any liability incurred as a result of the acquisition of the property is disregarded to the extent it was not taken into account in determining the basis in such property.

The purchase price is allocated first to cash or cash-type items, then to the remaining classes, other than Class VII, based on the relative FMV of the assets in the class. If anything remains, then it must be for goodwill or going concern value and allocated to Class VII. Thus, the method is called the residual method as the residual is allocated to Class VII. Once the price has been allocated to a class, it is allocated on relative FMV to the assets within that class to determine the gain or loss on the assets.

The classes under IRC §1060 are as follows:

Class I assets are cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions.

Class II assets are actively traded personal property. In addition, Class II assets include certificates of deposit and foreign currency even if they are not actively traded personal property. Class II assets do not include stock of target affiliates, whether or not actively traded. Examples of Class II assets include U.S. securities and publicly traded stock.

Class III assets are assets that the taxpayer marks-to-market at least annually for federal income tax purposes and debt instruments (including accounts receivable).

Class IV assets are stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of a trade or business.

Class V assets are all assets other than Class I, II, III, IV, VI, and VII assets. Furniture and fixtures, buildings, land, vehicles, and equipment, which constitute all or part of a trade or business, are generally Class V assets.

Class VI assets are all §197 intangibles except goodwill and going concern value.

Class VII assets are goodwill and going concern value, whether or not the goodwill or going concern value qualifies as a §197 intangible.

Both the seller and the buyer must use Form 8594 to report the §1060 transaction. Form 8594 must also be filed if the purchaser or seller is amending an original or a previously filed supplemental Form 8594 because of an increase or decrease in the purchaser's cost of the assets or the amount realized by the seller. This applies whether the group of assets constitutes a trade or business in the hands of the seller, the purchaser, or both.

D. Section 338(g)

If the buying corporation makes a "qualified stock purchase" (QSP) of the stock, it can elect under §338(g) to have the stock purchase treated as a purchase of the target's assets. If the election is made, the target corporation is treated as having sold all its assets at the close of the "acquisition date" to "New Target" for a price that is generally what the purchasing corporation paid for the target's stock. The "old target" recognizes gain or loss on the sale of its assets on its final return. The new target is treated as a new corporation that purchased the assets on the date after the acquisition date. The result is usually a step-up in the basis of the target's assets in accordance with what the purchasing corporation paid for the target's stock. Generally, the parent will now engage in a §332 liquidation. The result is that the parent now owns the assets with a step-up in basis. It will also be able to make any appropriate election in relation to the property obtained. The downside is the cost. It must be determined if the step-up is worth the cost. On a present value basis, what is the benefit of the step-up in asset basis versus the tax cost on the "sale" by the old target? Generally, the tax cost makes this not financially advantageous for the buyer. The analysis can be favorable if the target has a favorable tax attribute such as an NOL or is not subject to U.S. tax, in which case the "deemed sale" tax can be mitigated. Note that in making the §338(g) election, the allocation of the "deemed sales price" to the assets requires the use of §1060.

Form 8023 is used to make elections under §338. A QSP is the purchase of at least 80% of the total voting power and value of the corporation by another corporation during a 12-month acquisition period. The acquisition period begins on the date of the first purchase of target stock and ends 12 months later. Note that the 80% must be purchased in the acquisition period; the 80% does not include any prior-owned stock.

Example:

Acquiring Corporation purchases 100% of the outstanding shares of Target Corporation for $5 million. Target Corporation has one asset with a basis of $1 million and a fair market value of $5 million. When a §338(g) election is made, Target recognizes a $4 million gain on the deemed sale of the asset to "NewCo." After the election, the asset's tax basis in the hands of "NewCo" is $5 million. NewCo is liquidated under §332, and Acquiring takes a basis in the asset of $5 million.

For purposes of determining the subsidiary's new basis in its assets, the deemed purchase price is equal to the price that the parent corporation paid for the subsidiary's stock. The price must be adjusted for the ownership of less than 100%, i.e., the stock not owned by the Parent Corporation, as well as liabilities of the subsidiary and other relevant items. The grossed-up basis is derived by multiplying the actual purchase price of the stock by a ratio; the numerator is 100%, and the denominator is equal to the percentage of the subsidiary stock owned by the parent. In increasing the purchase price of the stock for liabilities of the subsidiary, such liabilities include the tax liability attributable to income associated with the deemed asset sale.

E. Section 338(h)(10)

If the target's stock was purchased from a group filing consolidated returns or from an affiliated group filing separate returns, or if the target is an S corporation, it may be more advantageous. Another election is allowed under §338(h)(10). In this situation, the target is deemed to have sold its assets in a taxable transaction and then distributed the proceeds in a deemed liquidation under §332; this may, however, depending on the circumstances, be treated for tax purposes as a reorganization, liquidation, or other transaction, while a member of the selling consolidated group, or while owned by the selling affiliates or S corporation shareholders. The effect is that the sale of the target's stock will be ignored and that the distribution of the sales proceeds will usually be treated as a complete liquidation subject to §§336 and 337. [Reg. §1.338-1 through Reg. §1.338(h)(10)-1]

If a parent corporation sells at least 80% of the target corporation's stock and an election is made under §338(h)(10), the parent does not recognize any gain or loss on the sale of the stock. Rather, the target recognizes gain or loss as if it sold its assets, and the basis of its assets to the acquiring corporation is the purchase price of the stock. Thus, if a §338(h)(10) election is made, a regular §338 election is made for the target, and the old target is treated as selling all of its assets to the new target for their fair market value. Thus, you must elect both. The old target recognizes all gain and loss realized on the deemed sale. The parent reports the gain or loss from the target's deemed sale of its assets on its return. If the parent and the target file consolidated tax returns, the gain or loss is included on the consolidated return and, therefore, may be offset by any NOLs of the group. The selling parent inherits the target's attributes, including any NOLs that the parent could use in the consolidated return of the selling group.

The acquiring corporation's aggregate basis of the assets is generally equal to the price it paid for the target's stock adjusted for liabilities. The aggregate basis is allocated among the target's assets, as seen earlier for a regular §338 election. The selling and buying corporations have joint and several liability for the tax on the deemed sale—hence, both must make the election.

If the target is an S corporation and a stock purchase is desired for non-tax reasons, but an asset purchase is desired for tax reasons, the target S corporation's shareholders and the acquiring corporation must agree to make an election under Section 338(h)(10). The company's income or losses are distributed to its shareholders who, in turn, report income or losses on their individual income tax returns. This fact can potentially complicate the sale of an S corporation. However, Reg. §1.338(h)(10)-1(c) permits corporations making a QSP of a target S corporation to make an election under §338(h)(10) jointly with the S corporation shareholders. All shareholders of the target S corporation (selling and non-selling) must consent to the election. When this election is made, for tax purposes, the sale of the stock by the selling shareholders is ignored. Further, the regulation enables a stock sale of an S corporation to be taxed as if the transaction were an asset sale. Asset sales offer several advantages. For one, the buyer can take a "stepped-up" tax basis, which means it can significantly raise the stated value of the seller's assets. Greater asset value, in turn, enables a buyer to claim more depreciation on its to-be-acquired assets and, therefore, to take a larger, current tax deduction.

F. Conclusion

The buyer and seller of a business or its assets have many options in how to structure the transaction. The tax consequences for the buyer and seller can vary dramatically, depending on the form chosen. Since the law generally does not provide a "win-win" for both sides, it requires significant negotiation. It is important that practitioners advise clients, either buyer or seller, on the wide range of options and possible tax implications associated with each. It is also important that the parties make sure there is an agreement and consistency in what is reported by the other party on Form 8594 in order to mitigate potential audit issues. The use of §338(g) and 338(h)(10) may be beneficial in moving a transaction to a favorable conclusion for both parties.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, Jane Smith, is the President and CEO of ABC Corp. She has identified a company, JonesCo, Inc., that ABC is interested in taking over. She indicates that the seller is offering to sell the stock for $6 million and believes it is an appropriate fair market value of the assets. JonesCo is a cash-basis corporation whose assets are primarily inventory, equipment, and §197 intangibles. JonesCo's basis in its assets is $1million. Its shareholders' stock basis is $750,000.

Jane indicates that JonesCo has some significant potential product liability exposure from a product it has now ceased producing. ABC is most interested in getting certain assets of JonesCo, which are state-of-the-art in the industry. JonesCo's shareholders are demanding a stock sale. ABC wants the step-up in basis, if at all possible.

Required:

1) Explain the implications to Jane of a stock purchase of JonesCo, Inc.

2) Could ABC still obtain the assets within ABC with a stepped-up basis?

3) Is there any other option if JonesCo is a subsidiary in an affiliated group or an S corporation?

B. Suggested Answers to Discussion Problems

1) JonesCo's shareholders would prefer a stock sale as it would remove them from the company and potential liabilities, and they would have a capital gain of $4,250,000. Assuming it is long-term gain, it would be subject to the 0%, 15%, or 20% rate. Unfortunately, there is little advantage for ABC. The liabilities will remain with JonesCo. At a minimum, ABC will want to address these liabilities with a hold-back or bond; they need to be addressed in the purchase price.

   ABC will have a subsidiary corporation in JonesCo, Inc. It will have a $6 million basis in the stock, and JonesCo will carry over all its tax attributes, including the $1 million basis. The additional $5 million of basis will not be recovered until ABC disposes of JonesCo.

2) ABC could do a §332 tax-free liquidation, but this would not result in a step-up in basis. As a result, ABC will have the assets within ABC but at a $1 million basis. This would not have a tax effect on the former JonesCo shareholders. It could look into IRC §338(g), "a deemed asset sale." This would allow a step-up in basis for the assets coming from JonesCo. However, JonesCo would have to recognize a gain on the sale of its assets in the hypothetical transaction equal to $5 million. This would have to be compared to the present value of the step-up in asset value to determine if it would be advisable or viable.

3) If JonesCo is an S corporation or if it is in an affiliated group, whether or not filing consolidated, then it may be able to negotiate the use of §338(h)(10). This will treat the purchase of the stock of JonesCo as the purchase of its assets. Thus, a step-up in basis. JonesCo will treat it as an asset purchase for tax purposes and then liquidate.

GLOSSARY OF KEY TERMS

Applicable Asset Acquisition—Any transfer of assets constituting a trade or business if the purchaser's basis in the acquired assets is determined wholly by reference to the consideration paid for such assets.

Electronic Return Originator (ERO)—An Electronic Return Originator (ERO) begins the process of electronic submission of returns it either prepares or collects from taxpayers who want to e-file their returns. An ERO starts the electronic submission of a return after the taxpayer authorizes the filing of the return via IRS e-file. The ERO must have either prepared the return or collected it from a taxpayer or another authorized ERO.

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

Form 8023—Elections Under Section 338 for Corporations Making Qualified Stock Purchases

Form 8300—Report of Cash Payments Over $10,000 Received in a Trade or Business

Form 8508—Application for a Waiver from Electronic Filing of Information Returns

Form 8594—Asset Acquisition Statement Under Section 1060

Meta Pixel—The Meta Pixel is a piece of code that is put on a website and allows one to measure the effectiveness of advertising by understanding the actions people take on the website.

Tax Cuts and Jobs Act (TCJA)—Public Law No. 115-97, an act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, was signed into law by President Trump on December 22, 2017. Although not the official name for the new legislation, it is most commonly referred to as the Tax Cuts and Jobs Act (TCJA).

CUMULATIVE INDEX 2023

BY TOPIC

BY CITATION

BY SPEAKER

CPE Network®
Tax Report
Volume 36, Issue 9 **October 2023**

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

1. According to Ian Redpath, which of the following is correct regarding reporting of negative amounts on electronically filed Schedules K-2 and K-3?

   A. Although reported as zero on the schedules, negative amounts are reported in attachments.
   B. Negative amounts must be reported in Part II, Section 1, of Schedules K-2 and K-3.
   C. The current schema for filing these schedules electronically does not allow for negative amounts, so they cannot be reported.
   D. The IRS confirms in FS-2023-20 that it is appropriate to report negative amounts on both schedules.

2. According to Ian Redpath, which of the following changes is effective on January 1, 2024, under IR-2023-157?

   A. The filing deadline for claiming the Employee Retention Credit (ERC) is being pulled back from April 15, 2025, to December 31, 2024.
   B. Taxpayers with any amount of adjusted gross income will be able to claim the Clean Vehicle Credit if the seller provides them with a specific report verifying the vehicle's status.
   C. Pass-through entities must attach a General Dependency (XML) schema to their Schedule K-2 that identifies changes to specific line items.
   D. Businesses that file Form 8300 (Report of Cash Payments Over $10,000 in a Trade or Business) must do so electronically if they have to file at least ten other information returns.

3. According to Ian Redpath, what happens to net operating losses (NOLs) passed through from an S corporation to an electing small business trust (ESBT) under CCA 202335014?

   A. After covering the S portion of the ESBT's income, the NOL is applied against the trust portion of the ESBT's income for the year.
   B. If the ESBT does not have enough income in its S portion, any unused NOL amounts disappear.
   C. After covering the S portion of the ESBT's income, the NOL flows through to the beneficiaries of the trust.
   D. The NOL is carried over by the ESBT and can be claimed against future income from the ESBT's S portion.

4. According to Ian Redpath, how are transferable development rights (TDRs) treated under Private Letter Ruling 202335002?

   A. Taxpayers can choose whether to treat the transfer of TDRs as an involuntary conversion or a like-kind exchange.
   B. TDRs are not considered real property for the purposes of IRC Section 1031.
   C. TDRs qualify for treatment as a like-kind exchange if they were intended as replacement property.
   D. When TDRs are transferred, they trigger the involuntary conversion rules and all inherent limitations.

Continued on next page

5. According to Ian Redpath, which of the following occurs under the proposed regulations for digital assets outlined in IR-2023-153?

   A. When digital assets are sold, taxpayers can specifically identify each unit disposed of in their books and records, or they can default to the first-in, first-out (FIFO) method.
   B. Taxpayers should not rely on these regulations until they are finalized in 2025 in case the IRS changes its mind on the treatment of digital assets.
   C. Going from one digital asset to another is never accounted for as a sale, even if the new digital asset is materially different, because the assets stay in digital form.
   D. Fees paid for transferring digital assets from one digital wallet to another are not considered a disposition of digital assets subject to gain or loss treatment.

6. According to Ian Redpath and Karen Davis, what is the purpose of Meta Pixels?

   A. Meta Pixels are considered cookies, so users must click to agree before a website can use them.
   B. Meta Pixels are benign code that helps businesses process data more efficiently on their websites and provide a better user experience.
   C. Businesses use Meta Pixels to encrypt personal user information for secure transactions.
   D. Businesses allow Meta Pixels to send users' personal information to Meta where it can be used to target Facebook ads.

7. According to Ian Redpath and Karen Davis, what does the Senate's investigative committee say in its July 11, 2023, report, "Attacks on Privacy"?

   A. It is an industry standard for businesses to share information with Meta, Google Analytics, etc., so the recent sharing of electronic tax return information did not break any rules.
   B. The third-party tax providers shared the tax return information, so they are culpable, not Meta, Google Analytics, or others.
   C. There has been shockingly careless treatment of taxpayer data by private industry electronic tax return filing services.
   D. Taxpayer data such as name, filing status, approximate AGI, approximate tax refund or tax due amount, and tax forms were never shared.

8. According to Ian Redpath and Karen Davis, what is the penalty for a criminal violation of IRC Section 7216 (i.e., knowingly and recklessly disclosing or using tax return information)?

   A. Up to $250 per violation and no jail time
   B. Up to $1,000 and one year in jail per violation
   C. Up to $1,500 and six months in jail per violation
   D. A maximum of $10,000 and five years in jail

9. According to Ian Redpath and Karen Davis, what is considered *tax return information* for purposes of the penalties under IRC Sections 6713 and 7216?

   A. It is a small category of information focused specifically on data included on tax returns and information returns.
   B. It is a small category of information focused specifically on data sent to the IRS (e.g., on forms) and data received from the IRS (e.g., correspondence).
   C. It is a large category of information covering all information related to the tax return and the practitioner's work through the date that the tax return is submitted to the IRS.
   D. It is a large category of information encompassing everything practitioners touch to complete a tax return: software registration, forms, practitioner's computations, corrections of the return in later years, and more.

Continued on next page

10. According to Ian Redpath and Karen Davis, when practitioners obtain consent to disclose their clients' tax return information, how long is it valid?

    A. One year from the date it was signed
    B. Three years from the date it was signed
    C. Five years from the date it was signed
    D. Indefinitely, unless specifically revoked by the client

11. According to Ian Redpath and Greg Urban, a seller will typically prefer to structure a sale as which of the following?

    A. An asset sale because assets usually have a higher value than stock
    B. An asset sale because sales of stock are often subject to double taxation
    C. A stock sale because it is considered ordinary income instead of capital gain
    D. A stock sale because it is typically a clean, simple transaction

12. According to Ian Redpath and Greg Urban, a buyer will typically prefer to structure a sale as which of the following?

    A. An asset sale because delaying tax deductions is more beneficial when it is time to dispose of the business
    B. An asset sale because of bonus deprecation and the ability to have basis in inventory
    C. A stock sale because the purchase price will generally be lower
    D. A stock sale because the value of the basis is more stable over time

13. According to Ian Redpath and Greg Urban, which of the following is an advantage of using the Section 338 election to treat a stock sale as an asset for tax purposes?

    A. There are no tax consequences to making the election.
    B. The seller will receive more benefits from the sale than the buyer.
    C. NOLs can be used to offset gain on the sale.
    D. Depreciation deductions are minimized when foreign subsidiaries are involved.

14. According to Ian Redpath and Greg Urban, which of the following is a qualified stock purchase for the Section 338 election?

    A. The buyer acquires 80% of the stock in the target within a 12-month period.
    B. The buyer acquires 50% of the stock in the target within a 12-month period.
    C. The buyer increases ownership of the target to 80% of the stock.
    D. The buyer increases ownership of the target to 50% of the stock.

15. According to Ian Redpath and Greg Urban, can a stock sale using the Section 338 election qualify as a Section 332 liquidation?

    A. Yes, because IRC Sections 332 and 338 both require the buyer to have control of 80% of the stock.
    B. Yes, if an attribute is available at the parent level to shelter gain from a deemed asset sale.
    C. Yes, if the buyer is willing to bear the tax burden instead of the seller.
    D. No, use of a Section 338 election and a Section 332 liquidation are mutually exclusive.

CPE Network®
Tax Report
Volume 36, Issue 9 **October 2023**

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 October 2023 **CPE Network® Tax Report**? Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Experts' Forum	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Disclosure and Use of Taxpayer Information	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Sections 338 and 338(h)(10)	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|

Which segments of the October 2023 issue of **CPE Network® Tax Report** did you like the most, and why?

Which segments of the October 2023 issue of **CPE Network® Tax Report** did you like the least, and why?

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

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

How would you rate the effectiveness of the speakers in the October 2023 **CPE Network® Tax Report**? Rate each speaker on a scale of 1–5 (5=highest):

	Overall	**Knowledge of Topic**	**Presentation Skills**
Ian Redpath	|______|	|______|	|______|
Karen Davis	|______|	|______|	|______|
Greg Urban	|______|	|______|	|______|

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

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

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

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

Were program materials accurate? Yes ☐ No ☐ ______________________

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

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

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

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

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

Specific Comments: ____

____

Name/Company ____

Address ____

City/State/Zip ____

Email ____

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

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: ______________________________

Account #: ______________________________

Location: ______________________________

Program Title: CPE Network Tax Report, October 2023 Date: __________

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

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

Instructor Name: ______________________ Date: __________

E-mail address: ______________________

License State and Number: ______________________

CPLgrading@cerifi.com

CPE Network/Webinar Delivery Tracking Report

Course Title	
Course Date:	
Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of <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.

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

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED August 29, 2023

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.
- **Transitioning From DVDs:** For groups playing the video from the online platform, we suggest downloading the video from the Checkpoint Learning player to the desktop before projecting.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

Note: DVDs no longer ship with this product effective 3/1/2023.

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

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

The entire transcript is also available as a pdf in the Checkpoint Learning player in the resource toolbox at the top of the screen, or 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.

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

Examples of polling questions:

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

Additional Notes on Monitoring Mechanisms:

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

Real Time Moderator During Program Presentation

"Group internet based" programs must have a **qualified, real time moderator while the program is being presented.** Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

Note: DVDs are no longer shipped effective 3/1/2023

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

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

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

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group internet based” session should be sent to Checkpoint Learning Network by 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—Print

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

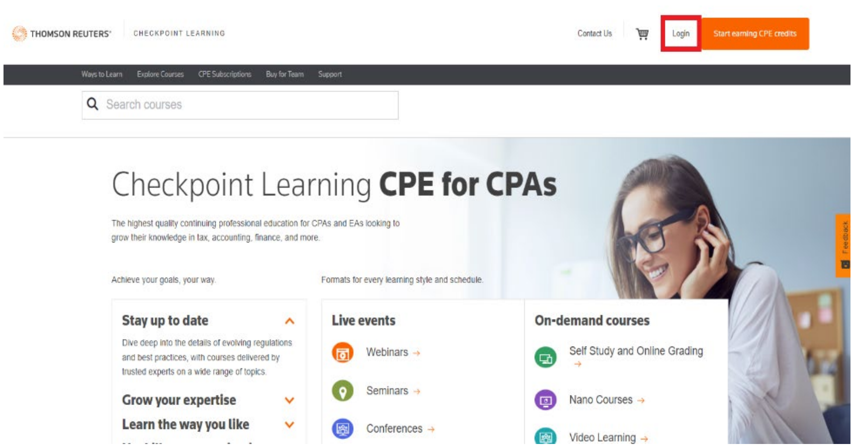
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.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

  CPLgrading@cerifi.com

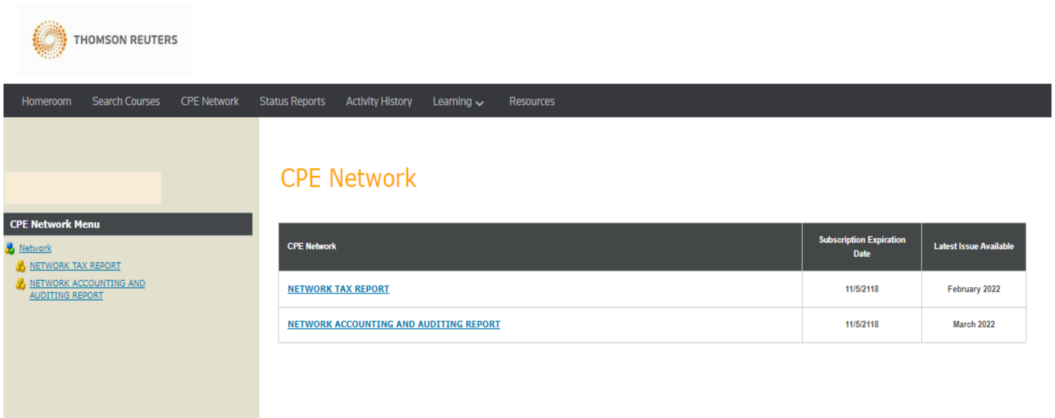
Self-Study—Online

Follow these simple steps to use the online program:

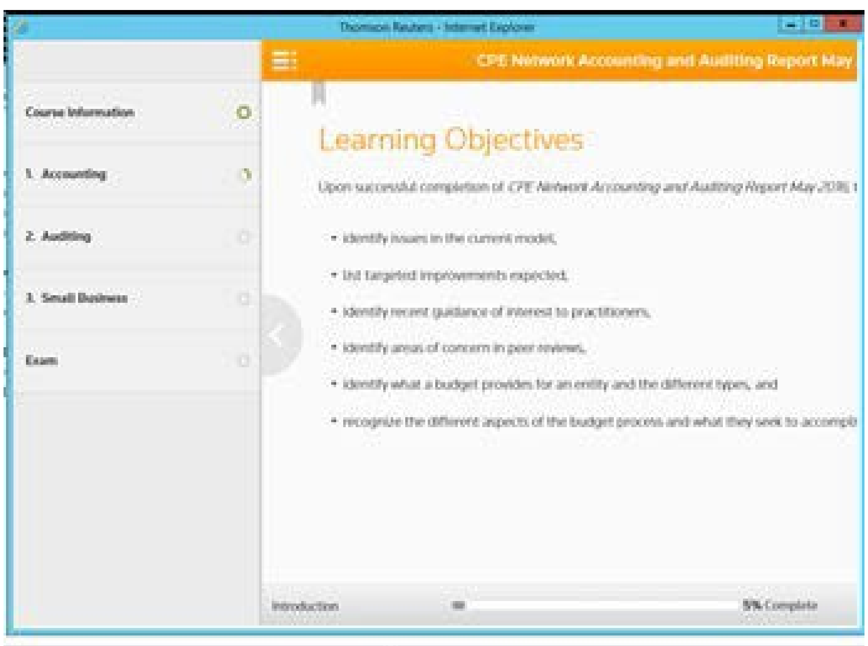
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



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

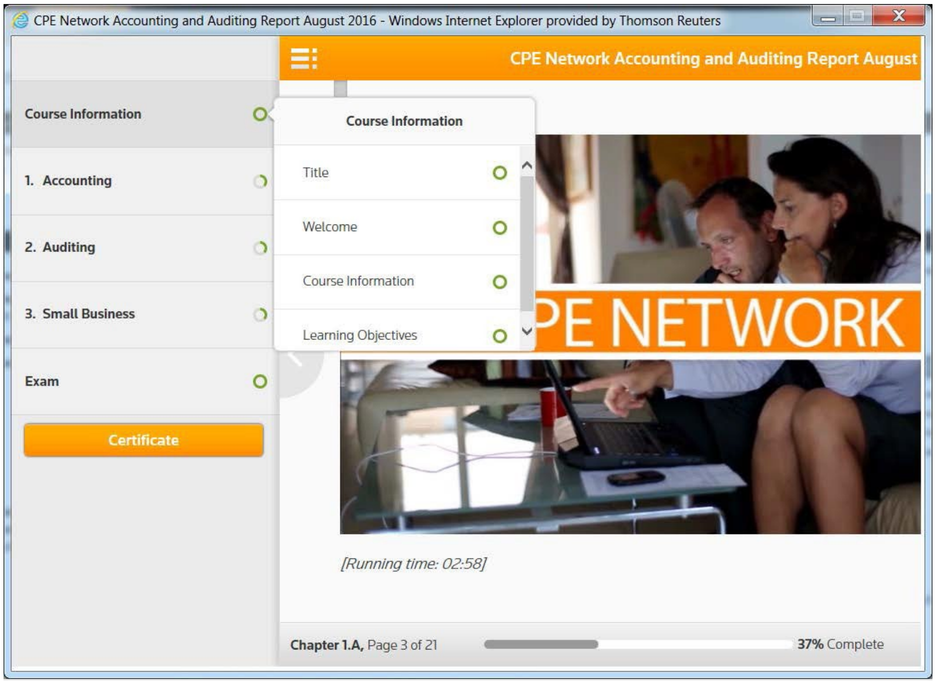


The Chapter Menu is in the gray bar at the left of your screen:

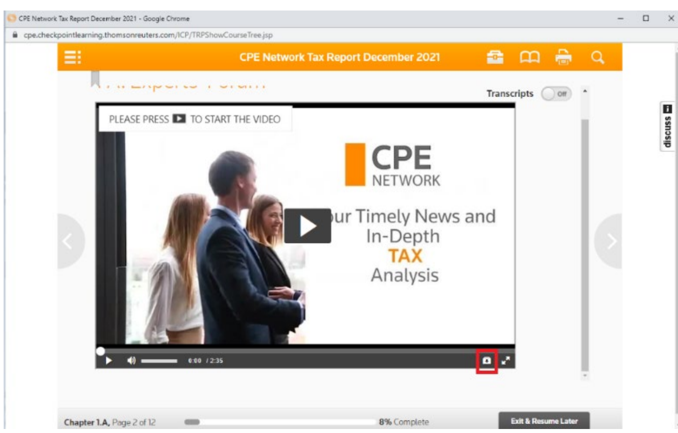


Click down to access the dropdown menu and move between the program Chapters.

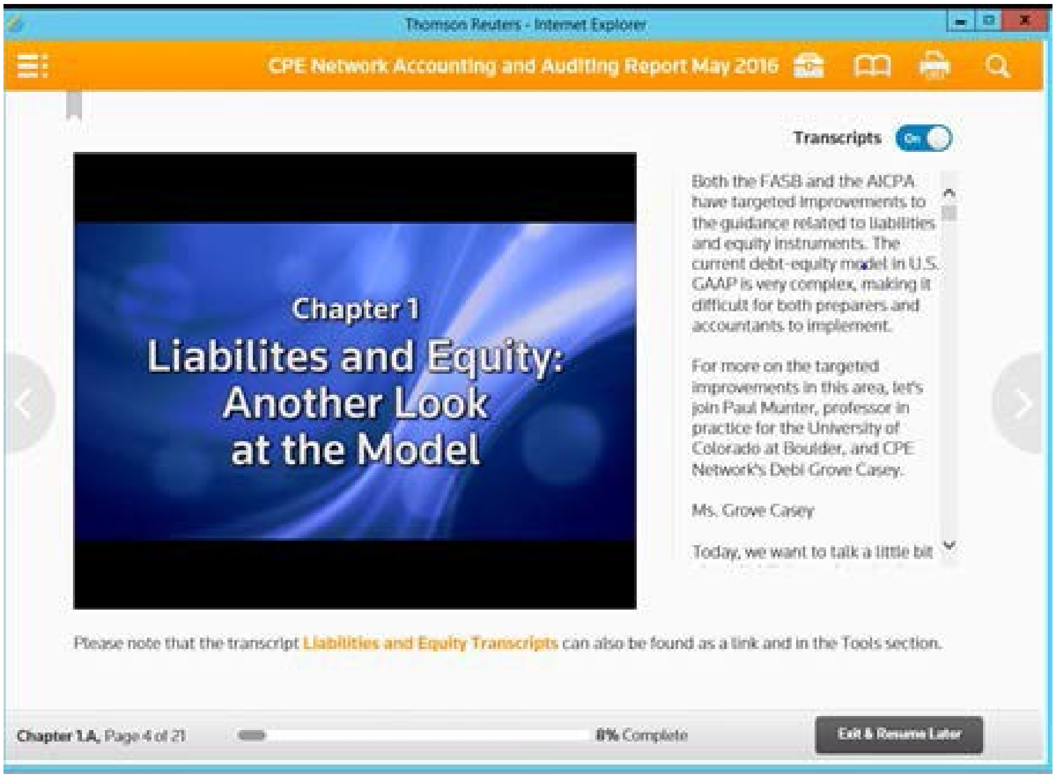
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



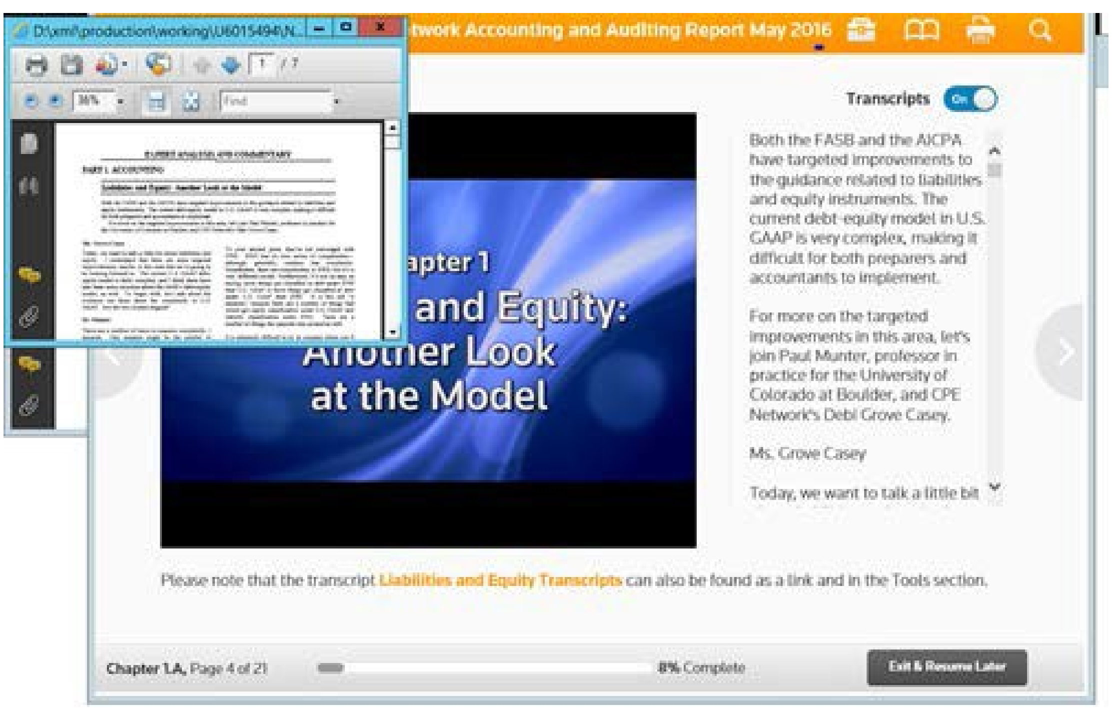
- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access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



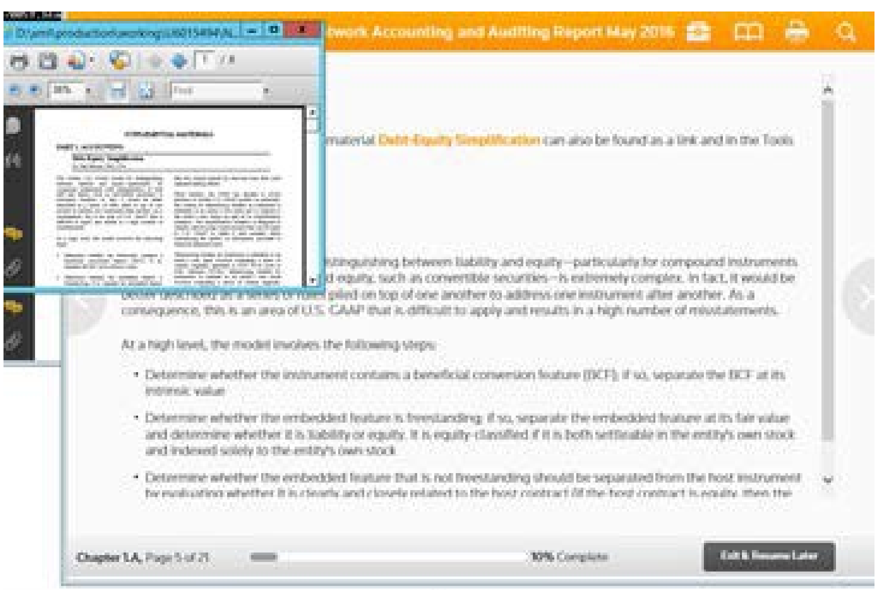
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.



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



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



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

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

Suggested Answers to Discussion Problems

1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:

   - Held-to-maturity
   - Trading
   - Available-for-sale

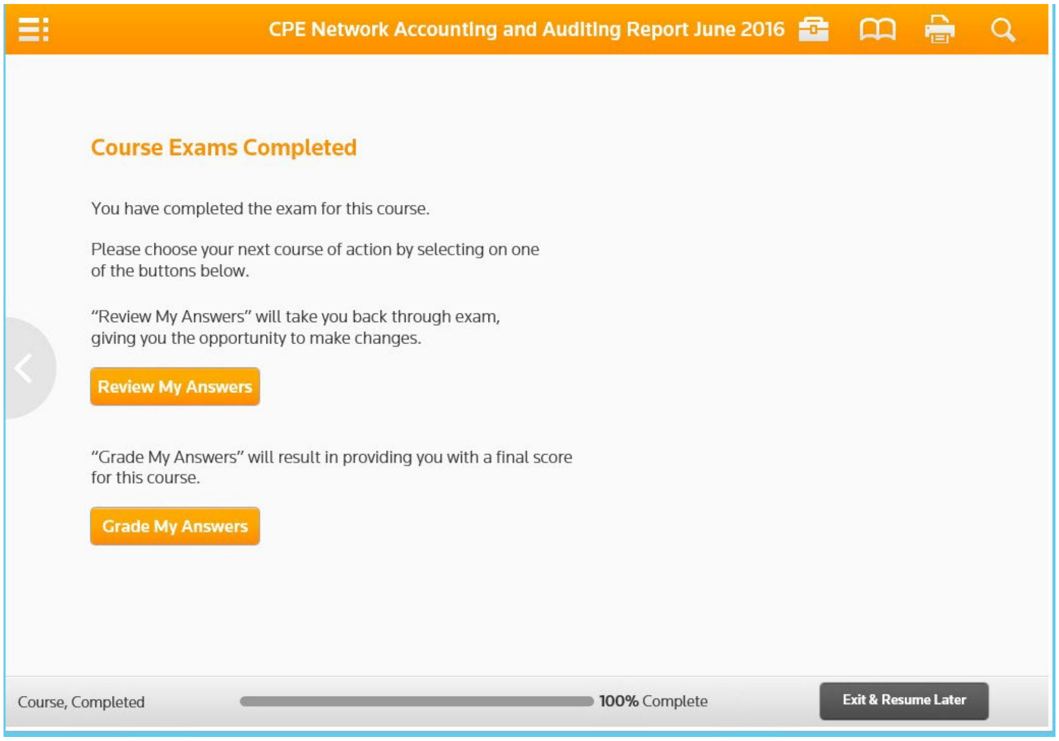
   An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.

2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.

3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

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.

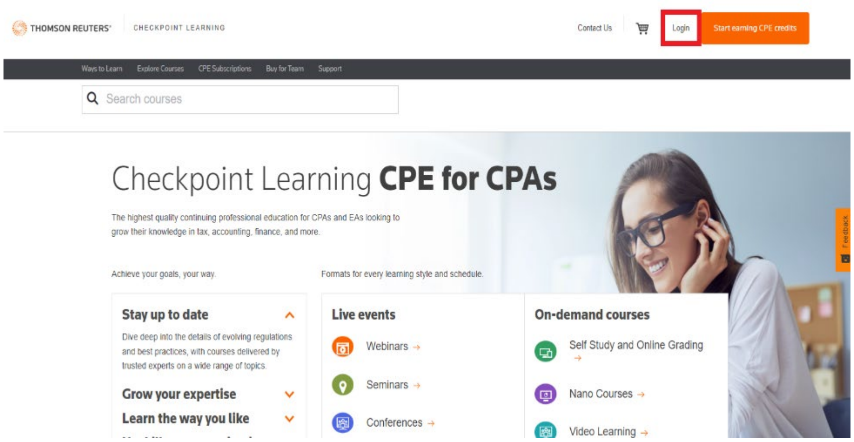
Print

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**.

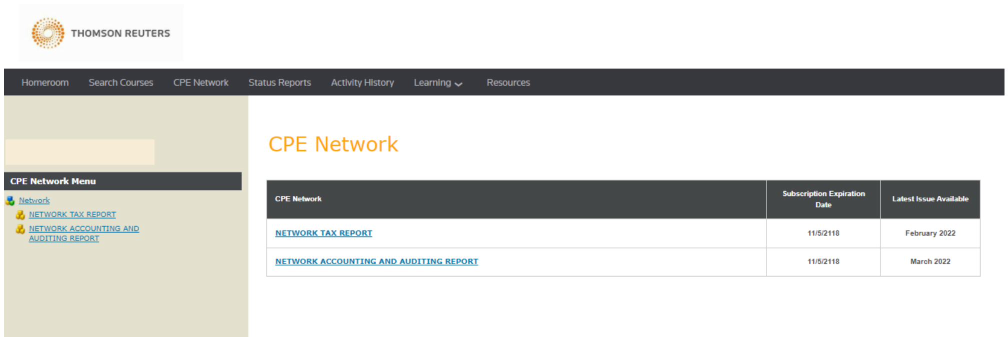
Transitioning From DVDs

Follow these simple steps to access the video and pdf for download from the online platform:

- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



- In the CPE **Network** tab, select the desired Network Report by clicking on the title, then select the appropriate edition.



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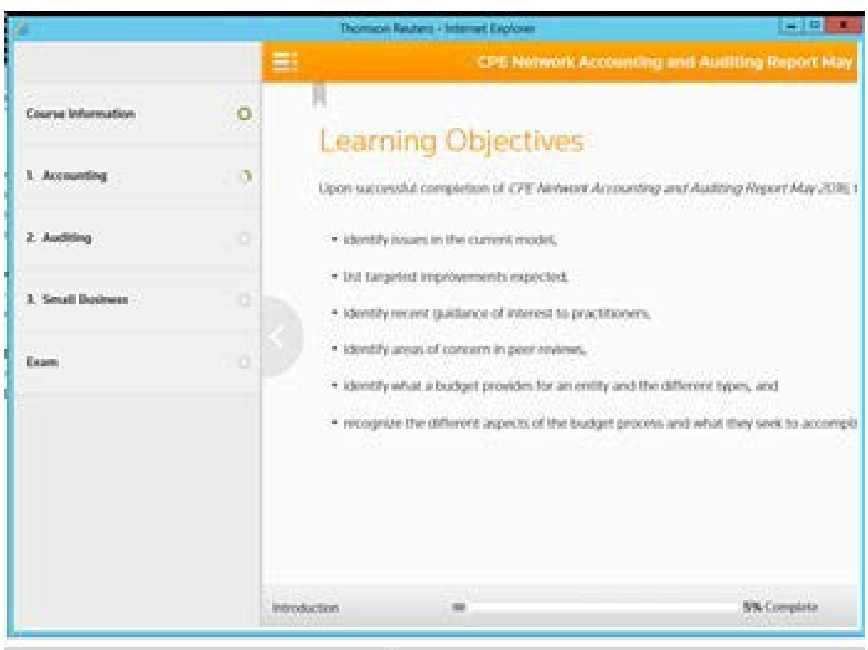

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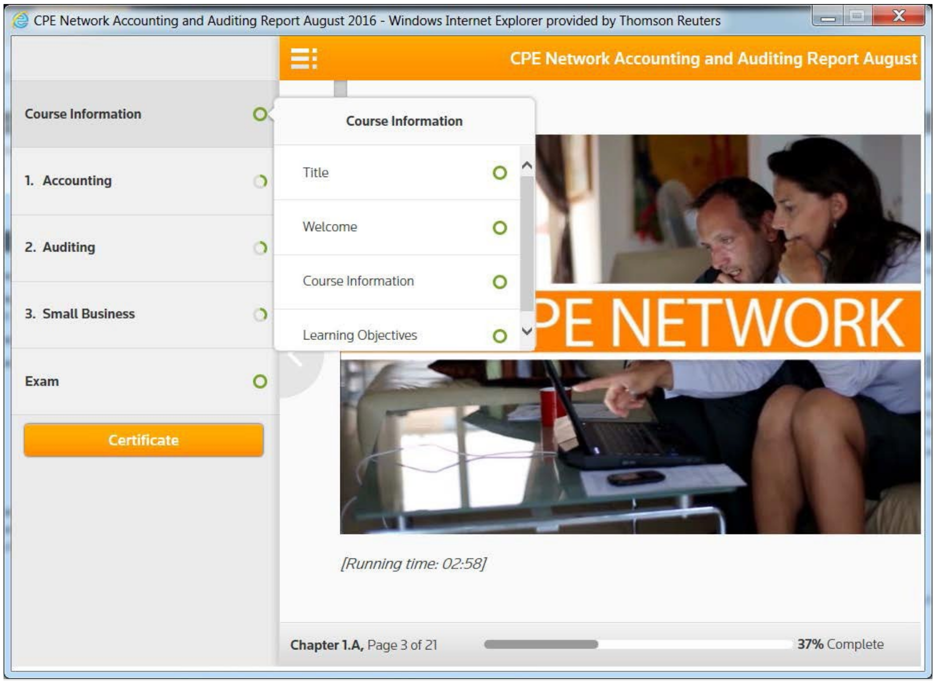

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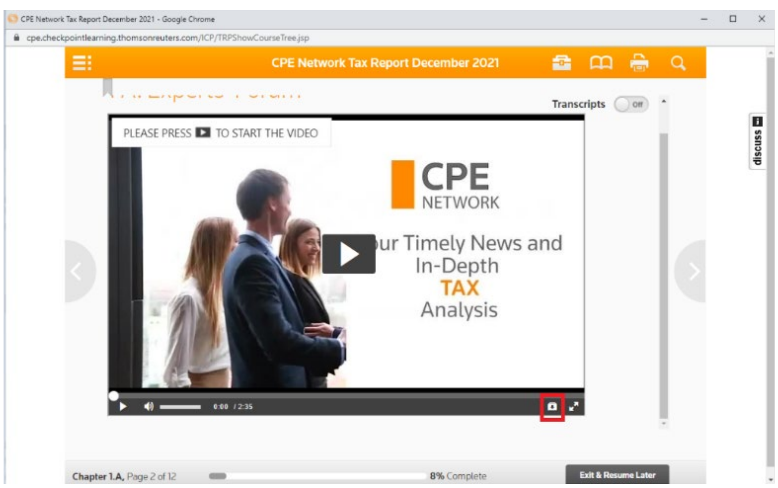

Video segments may be downloaded from the CPL player by clicking on the download button noted above. You may need to use the scroll bar to the right of the video to see the download button. **Tip: You may need to use the scroll bar to the right of the video to see the download button.**

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent to administrators with each release.

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

<u>Determining CPE Credit Increments</u>

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

Program Presentation

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

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

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

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

Getting Help

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

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	844.245.5970	Cplsupport@cerifi.com	• Browser-based • Certificate discrepancies • Accessing courses • Migration questions • Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	• Functionality (how to use, where to find) • Content questions • Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	• Billing • Existing orders • Cancellations • Webinars • Certificates