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Topics for future editions may include:

- SECURE 2.0
- Taxation of High-Income Individuals

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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

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The field of taxation is the most dynamic area of accounting. Practitioners are constantly being confronted by changes with decisions from the various courts, issuances from the IRS, and sometimes Congressional legislation. While not all changes affect all practitioners or their clients, it is important to have an awareness of the changes that occur. This segment highlights many of the recent changes and issues.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze current issues in taxation, including analyzing a partnership's need to file Forms K-2 and K-3 and provide them to the partners, assessing any loss caused by investing through FTX, and assessing the use of equitable tolling in regard to filing in the Tax Court. [*Running time 39:57*]

PART 2. INDIVIDUAL TAXATION

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

Learning Objectives: Upon completion of this segment, the user should be able to analyze issues related to §734(b) partnership adjustments, including assessing whether an election should be made, determining how and when to make an election, and applying the rules for adjustments on distributions. [*Running time 33:20*]

PART 3. BUSINESS TAXATION

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F reorganizations have started to gain in popularity for structuring private equity purchases of S corporations. They are also used as businesses locate in different states. Since S corporation rules have many limitations on stock, the F reorganization may provide an answer. However, practitioners must be careful to meet all appropriate timing requirements for the various steps. F reorganizations may be more efficient than other available options.

Learning Objectives:

Upon completion of this segment, the user should be able to analyze issues related to private equity and F reorganizations, including determining how to use an F reorganization to change the domicile of an S corporation, assessing the rules of §338(h)(10) and §336(e); and assessing the general use of an F reorganization to effect a private equity sale. [*Running time 30:08*]

ABOUT THE SPEAKERS

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PART 1. CURRENT DEVELOPMENTS

Experts' Forum

Experts' Forum is a popular feature in which we review recent developments in taxation. This month, we begin with a discussion about draft instructions that have been revised and issued by the IRS as of December 12, 2022. Revised draft instructions are now available to partners and partnerships relative to Schedules K-2 and K-3, Form 1065.

Let's join Ian.

A. Revised Draft Instructions

Form 1065, Schedules K-2 and K-3

Mr. Redpath

Hi everybody. Welcome to the program. This is the place where we go over things that have happened with the IRS, the courts, announcements, pronouncements, rulings, an update, and some interesting things that have occurred and may affect your practice.

So, let's jump right in with really some good news. The revised draft instructions for the 2022 Schedules K-2 and K-3 of the 1065 are out. This is the second set. The first set was issued in October, and the October set was questionable as to what the deadlines were for filing. And it appeared that we would have a rush deadline in January to have to work with. But the new instructions that came out in December, the revised instructions, they expand the scope of domestic filing exception. So, they expand the scope of those who don't have to file. And so, it's much easier. The December draft added the exception.

Now again, if you're not familiar with the K-2 or K-3, for those of you who have partnerships that have any international transactions or have international owners, you know that the K-2 and the K-3 have become important schedules from the IRS's perspective, even though they came out in 2021. But they report items of international tax relevance. So, the K-2, that's the partner's distributive share of items that are international. And then, the K-3 is the partner's share of income, credits, deductions, etc. for international. So, the instructions and the partners' instructions on the K-3, they expand the exception for filing by adding two new categories—S corporation with only one shareholder and a single member LLC that is disregarded, whose sole member is either a U.S. citizen, resident alien, a domestic decedent estate with only U.S. citizen or resident alien beneficiaries, domestic grantor trust with only a U.S. citizen or resident alien as grantors and beneficiaries, or a domestic non-grantor trust, again, with only U.S. citizen or non-resident beneficiaries.

It also significantly extends the deadline to notify of the qualification under the exceptions. So, the draft instructions, the new draft instructions, they extend the date in which the partnership, to qualify for the exception, has to notify the partners that they're not going to receive a K-3 unless they request it. So, the October said it would have to be filed no later than two months before the due date of the partnership return. So, more than two [months] before the filing of the partnership return, basically January. But the December revision simply says that the partner must receive notification at least when the partnership furnishes the K-1 to the partner. And that, by the way, includes extensions. So, if the 1065 was on extension, then this would not be required until August 15th of 2023. So, the exceptions—if you're not familiar with the other exceptions—a partnership has an exception from filing if the partnership has no foreign activity, no income taxes paid or accrued, foreign-sourced income, foreign-sourced loss, or an ownership interest in a foreign partnership, corporation, foreign branch, disregarded entity, or the foreign activity is very limited. It's limited to the passive category of foreign income, and it generates no more than $300 of taxes subject to the foreign tax credit. And that would be amounts shown on a payee statement. Also, all of the partners are U.S. citizens, resident aliens, and the individuals which I mentioned previously. The partners receive notification from the partnership no later than, and as we said, this would be when they receive the K-1, a change in the

instructions, in the new revised instructions; and the partnership must receive a request from a partner for a K-3 at least one month before the date the partnership files its 1065. So, watch out for the final instructions; let's see what they say. But that's the latest on it.

B. *FTX Trading Ltd.*

Bankruptcy Court for the District of Delaware, Case No. 22-11068

Now, crypto, why cryptocurrency? Well, really, we need to talk to our clients about this. As you probably are well aware, FTX trading, which consists of West Realm Shires Services, and Alameda Research, and there's about 130 other affiliates, filed for Chapter 11 in Delaware. And again, collectively, they're just referred to as the FTX Group. This is creating all sorts of issues because there were some earlier filings, not to this degree, but Celsius Network, Voyager Digital also filed bankruptcy. But there's really no precedent for such a large-scale bankruptcy in this particular industry. And what are the tax consequences to the investors, the other stakeholders? What is the nature of cryptocurrency for this purpose? And we know that it's generally classified as property. So, what are the tax consequences here? The cryptocurrency owners, those who have cryptocurrency with them, what is their position in bankruptcy? Are they going to be considered retail consumers? Are they going to be considered sophisticated businesses? Are they going to be general creditors? And this obviously becomes important because this is a Chapter 11. Essentially, they're seeking not to liquidate and pay off their creditors; but they're seeking a reorganization. Well, that reorganization under chapter 11, the general creditors tend not to do well; and this can be forced down, a plan can be forced down onto them. And then, what's the value? In other words, if your clients get anything, what's the value? Well, is it going to be a snapshot saying, okay, when we finally determine what it is, this is the value that we're using and that's the value that your client gets? Now, your client may have a loss. Is that going to be a capital loss? Probably, if it's property, investment, it would have to be a capital loss. Some people, some commentators are saying, oh no, it should be an ordinary loss. But the IRS says that this is property. So, is it just a loss on your investment? But when would it be recognized? And you're probably going to have clients that are going to come in and say, Hey, they're in bankruptcy. I'm losing a lot of money. What do I do? Well, when it's in bankruptcy, it's a nonbusiness loss. And so, therefore, it has to be determined to be completely worthless. In other words, this is all you're going to get. That doesn't mean you're getting nothing; but it means this is all you're going to be able to get. Well, the amount you're going to get and the value can't be calculated until this bankruptcy is concluded. They have until March to submit a plan to the court, March of 2023. That plan may not be fully executed or agreed to. There could be lots of arguments, and this could extend into 2024, for example. So, the loss is certainly not going to be in 2022. It may be in 2023, depending on the outcome of the bankruptcy. So, clients are going to come in with a lot of questions on this Chapter 11 bankruptcy of FTX if they have. There's a lot of issues here. They certainly aren't going to get a loss in 2022. They may get a loss in 2023 if it's finally determined exactly what they're going to get. There's also an issue as to what are these people. Are they consumer customers? When they filed, there was an issue; because in the agreement with FTX, it specifically says that all digital assets are held in your account on the following basis. And basically, it says at all times, it's yours; it's not ours. You have ownership. You control the assets in your account. And you take the responsibility for any outages, downtime, applicable policies. You may withdraw the digital assets, sending them to different blockchains, trading. FTX is under no obligation to issue any replacement assets in the event that your password or private key is lost, stolen, there's malfunctioning, it's destroyed, or otherwise inaccessible. So, the terms in there are what are you, and what is your position? And this will all have to be sorted out by the bankruptcy court in this Chapter 11. We know there's an automatic stay, so your clients can't bring a separate action.

Reuters has reported that they believe that the number of creditors of FTX could exceed one million. It could exceed a million potential creditors. And remember that it takes two thirds in amount and more than one half in number of the allowed claims in a class held by creditors to accept or reject the plan. Regardless, the court can always accept a plan or reject it if they so

choose. Now, basically, this should be, again, a nonbusiness bad debt. But we have to determine first are they considered unsecured creditors? And if so, what's the plan? What will they get? And then, of course, how is this going to be valued? Is it going to be a snapshot? Again, there's really little or no precedent for certainly something on this particular scale. It would be good to talk to your clients and discuss this with them because there's also the Celsius and the Voyager bankruptcy issues also. But definitely nothing until next year [2023] at the very earliest. And it's going to be hard right now to even tell the client exactly what their position is going to be. One thing to make sure you notify them is anything they get from the bankruptcy courts or from the attorneys representing FTX, they need to respond to those. They certainly should try to get them to you. And then, if you need, get to a lawyer to decide what they should do.

With that in mind, another thing you need to talk to your clients about because it's here, is the Infrastructure Investment and Jobs Act that was back in November of 2021. That put into effect this reporting requirement, similar to a brokerage statement. Exactly what that number will be, it's unclear. They've talked about a new form; that'll be a 1099-DA, digital assets. And it's an attempt, again, to make it harder to conceal activities from the IRS. Again, this may or may not make it easy because it's going to be very difficult to determine the basis. So, I'm not sure we can rely on any basis reporting that is in there. Again, we have to remind our clients that, even if they don't get a 1099-B, they still need to report that income in 2023. So, again, this all begins in 2023. And also, exchanges currently have a problem to report capital gains or losses because the brokers can't see an accurate cost basis. So, when crypto moves between exchanges and wallets without any neutral third party tracking the transaction, then an accurate cost basis gets lost. So, compiling it on the tax return is not going to be an easy thing beginning in 2023. So, clients should not be under the false assumption that this new reporting means they don't have to do anything to track their basis or keep records of it; because who knows what this is actually going to look like when we finally get the notifications? And, of course, we won't get those until 2024 and we see what's on there. So, keep this in mind. Talk to your clients about it. Also, of course, the $10,000 rule kicks in for crypto. So, that's just a different issue, but something to keep track of.

So, a lot of things to talk to our clients about at the year-end regarding first, if they were trading in FTX, how they're going to be handled. And again, there's over a million potential creditors that would have claims. I'm sure a lot of you out there have clients who invested through that. And then, the reporting, to talk to them about the fact that this is not going to necessarily be a reliable way to keep information.

C. IRS Notice 2022-41

All right, we have a notice from the IRS, Notice 2022-41. For those of you who have clients who have cafeteria plans under Section 125 of the code, and that's great, you could offer different types of benefits. You can also offer potentially cash. One spouse has certain benefits with their employer, and another spouse has benefits with their employer. Why should you double up when the one's benefits will never be used, because the benefits from the other are much better? So, this allows you to do that and even have an option of cash without making and busting all of your plans by saying, well, you can take an option of cash. So, 125 plans are great. The 125, this notice says that an employee is able now to prospectively elect out of family coverage into self only, or family coverage, including one or more already covered related individuals under group health plans or other than a flexible spending arrangement. And there's certain conditions, but it's very flexible for making those movements. And the IRS says that you can rely on this notice for any changes after 1/1 of 2023. So, if you're thinking about making changes in your cafeteria plan, you may want to look at this notice in regard to what can be done with health insurance plans.

D. IR-2022-201

Reminder to IRA Owners 70-1/2

The IRS, IR-2022-201, has just reminded everyone—and it's really something to look at with our clients, especially those who like to make charitable contributions but are now 70-1/2 and have to start taking distributions from their IRAs—that they can transfer up to $100,000 tax free by a qualified charitable distribution by the end of the year. And again, this is something that hopefully you discussed it with your clients. If they missed that, well certainly it's something you may want to talk to them about, and when you're planning for 2023, something to pay close attention to. Again, obviously they've missed the deadline for 2022, but again, something to think about going forward.

E. IRS Announcement 2022-26

Announcement 2022-26 is really interesting because there are—and a lot of people are not aware of this—but there are cost-sharing payments for environmental protection. And essentially, payments made to protect the environment under certain plans described in Section 126 of the code, they're excludable. What the IRS said here is that the Septic Improvement Program that Suffolk County, New York had—if you're in Suffolk County, this is important—that were intended to encourage residents to upgrade their cesspools and septic systems to reduce nitrogen contamination affecting the watershed in the county. Those are excludable from gross income. Now, this particular notice is geared to these SIP payments in Suffolk County. However, this is something to really look at, and look at Section 126. And the information, the types of programs that they are considered to be excludable income. Also, they said the county has no reporting requirements. They also said that anyone who picked up these payments in prior returns should file amended returns because it is excludable income. File a 1040X and get a refund. So, I would again say, look at the code section because there's a lot of different types of payments that a taxpayer may receive that are under programs that are considered cost-sharing conservation payments, and therefore are excludable as income.

F. *Intan S. Ismail, et ux. v. Commissioner*

TC Memo 2022-113

All right. We have an interesting case coming out of the tax court, Intan S. Ismail and Mohd Razi Abd Rahim v. the Commissioner. Basically, they're married taxpayers. There's a Malaysian business that was set up by the parents of the husband. The husband actually lives in Malaysia and works for the business. And his father and another individual set this up under Malaysian law. The wife lives and works in the U.S. Well, what they tried to do was say that this LLC that was set up in Malaysia, that they were able to take the deductions against their U.S. tax return, claiming that both the husband and wife had an interest. And first off, the court said, "Look, you provided no evidence to show that you really had an interest in it." Okay, that's a factual thing. They didn't have the evidence to show that they really did have an interest. But more importantly, if you have businesses that have international and have set up an LLC, you really need to look at it because there are a lot of differences in the election. So, the election, even if they were, let's assume that they were partners in the LLC, that they in fact were members of the LLC, that they had ownership interest in the LLC. That really becomes somewhat irrelevant because the election has a default. And for foreign LLCs, if they didn't elect to be a partnership, the default is a corporation. So, even though it's a multiple-member entity, the default isn't to a partnership. The default is to a foreign corporation. So, therefore, they weren't entitled to any losses anyway. I've seen a few LLCs. Actually, in the last two months, I've seen several LLCs that were foreign LLCs. You really need to be careful to make sure that there's the proper elections that were made to determine what the tax treatment of that is going to be.

G. Private Letter Ruling 202248017

We have Private Letter Ruling 202248017. If you happen to represent and do any not-for-profit, this is a charity. They received a grant from an individual to support, to set up an endowment, to support fellowships, to encourage emerging scholars to pursue research on topics related to the financial history. In the public charity, in doing the support test, this grant skews it. They're not going to be a public charity under this rule. They sought a private letter ruling. The IRS said, "Look, there's a few tests that we're going to look at." No single test is that relevant. But the regulations basically say look at things like was the contribution made by a person who created it or previously contributed substantial part of the support or endowment, was in a position of authority with respect to the entity, directly or indirectly exercised control over the organization, or is related to someone within those points that I just mentioned? And they said, looking at the factors, this is just a one-time thing and we're not going to affect the test by a one-time grant. It's an unusual grant. So, you get to exclude it from the public charity support test. Look at this if you do not-for-profit work and you have someone who's going to make a donation that might skew that report. So, look very closely at this.

H. *Donoghue v. Reddig*

CA 1

Now, we have a circuit court case, Donoghue v. Reddig. Obviously, Reddig is the former commissioner. This was a horse breeding. It's just another one of these 183 cases. But in this, they used a time-honored [argument], which is—and I've used this a number of times—well, we're still in the startup phase. And how do I know? Well, I've got industry data to show that we're in the startup phase. Well, they said, we're in an extended startup phase on this horse racing; and we've passed through millions in deductions. Obviously, very little income. And the court said no, just because... And they said the global financial crisis, the decline in the horse racing industry were all areas that should be looked at as to why this wasn't being successful. But what they really looked at is the court looked at it and said, you know what? You've put money in here, yes, but you've done very little. You've lost a million dollars, wrote off a million dollars flowing through. But looking at the hobby loss rules, essentially, you really haven't done anything to show it's a trade or business. So again, another case where the IRS has been successful, primarily because they had no real records to keep that they were a trade or business. They didn't act like a trade or business. And they had very little activity actually in race horsing.

I. *Hallmark Research Collective v. Commissioner*, 159 TC No. 6

Now, we have an interesting case, *Hallmark Research Collective v. the Commissioner*. Why is this an interesting case? Because on prior programs, we've talked about the *Boechler* case, *Boechler PC*. In April of 2022—so, last year—the Supreme Court issued an opinion in *Boechler*, which held that the 30-day time limit to file a petition to review a collection due process determination is an ordinary nonjurisdictional deadline, which would be subject to equitable tolling. In other words, we missed the deadline; but we had a good reason for missing the deadline. The IRS's position, and the tax court has always agreed, that these deadlines to file are jurisdictional. Well, now *Boechler* comes in and says, the 30-day time limit to review a collection due process determination, a CDP, is not jurisdictional. It's subject to equitable tolling. There could be a reason for being late.

Well, I had several cases where I had a CPA contact me and said, "I've got this case. Can we set up an appointment to review it?" Okay, no problem. Well, what she didn't tell me was that they had a 90-day letter. So, when she brought it in, they were a week past the 90 days. There is no maybe. In another case… If you've seen the 90-day letter, you know that there's a stamp, that the IRS puts a date on there and says, "You must file by this date in the tax court." Well, that date was not correct. The tax court held, "Sorry, you should know the law, CPA, attorney. You know when the 90-day period starts. The fact, that's just giving you some

notice. Sorry, you might have all the equitable arguments you want, but 90 days is 90 days. It's not 91 days. We don't have equitable tolling of that 90-day period to file in the tax court." So, remember when you get a notice, when you get the actual assessment, the so-called 90-day letter, it says you have 90 days to file in the tax court, pay the tax, or we'll begin collection. If you want to go to tax court, you don't have to pay the tax as a precondition. If you go to district court or claims court, you have to pay the tax, file a claim for refund. They're going to deny it, and then you sue them. You sue the government. That's why you'll always see versus the United States.

So, in this case they e-file using the tax court's website; and they file at 9:36 PM, September 2nd, 2021. On the petition, they say, "My CPA contracted COVID Delta over the last 40 days. We kindly request additional time to respond." So, clearly, Hallmark wasn't to blame for the late filing. And equitable—the idea of equitable tolling—equitable issues should be addressed by the court. Is it inequitable to deny them a hearing in the tax court under these conditions? It was one day late, one day. The tax court said—and this is after *Boechler*—the tax court said that 90 days is 90 days. It's not 91 days, it's not 90-1/2 days. It's not 100 days. They said there is no equitable tolling of the 90-day requirement. It's 90 days. They said, we don't have to follow the Supreme Court's argument because they made a distinction between Code Section 6213, which is the 90-day, and Code Section 6330, which is the 30-day period for CDP, for collection due process petitions. They said under 6330, the Supreme Court said it's not jurisdictional. The Supreme Court didn't discuss 6213. Practitioners have been hoping that will be the case, that equitable tolling would apply there. The tax court is saying no. They're saying that these are different statutes to be treated differently. So, this *Hallmark* case, we'll see what happens. We'll see if it gets appealed, and if it gets appealed, where it goes, because if equitable tolling applies; and certainly, this is a case where you could argue that equity should allow for an additional amount of time.

J. *Moore v. United States*

CA 9

We have another case out of the Ninth Circuit, *Moore v. the United States*. This case is denying a rehearing. But why might this case be important? It's very interesting because for subpart F income, you're actually paying tax on undistributed earnings of a corporation, unrealized earnings. For the taxpayer, it's unrealized. They haven't received them. The court, the majority of the court, of course, they just said, all right, no, we're not going to rehear this because your arguments. The law says undistributed income.

There's a really interesting dissent here. And the dissent goes into the historical of the constitution and says, you know what? There has to be a realization event. We can't eliminate realization event from taxation; or the government can start taxing without realization events. You might say, well why would they do that? Well, all you have to do is look back at President Biden's, the green book, proposals that his administration had. And one of them was to tax the unrealized gains in the portfolios of those making more than $400,000 a year. If your income was more than $400,000, you were going to be taxed—on the proposal—on unrealized gains in your portfolio. Now, again, it was only a proposal, didn't get anywhere; but the thought process was out there to tax unrealized gains. So, this is not coming from outer space. There was actually a proposal to do that. Several states actually have had at various times taxing unrealized gains in your portfolios, some intangibles type taxes. So, again, for some of you, you may say, well, why? That's ridiculous. There has to be a realization event. That's what this court dissent is trying to say. Look, just because it doesn't say it in the constitution, that doesn't say realized income, doesn't mean you can eliminate that type of a concept. It would give far too much power to the government. So, match that with the Biden administration saying, “Hey, we want to tax unrealized gains in portfolios of those making more than [$400,000]”—I believe it was [$400,000]. So, again, that thought process has been out there.

K. IRS Notice 2022-61

Notice 2022-61—if you are having a situation relative to what is prevailing wage and apprenticeship guidance under Section 45, this details what is prevailing wage, what is the apprenticeship requirements. And one thing to note is it does talk about a good faith effort. And it said if you requested in good faith, you requested qualified apprentices from a registered program, and they were not available, then you've met this particular provision. So, something to look at here.

L. *U.S. v. Parks*

DC MI

And lastly, the *U.S. v. Parks*, district court in Michigan. Interesting case because what happened here is that the return was filed, the estate tax return was filed five years late. Five, five years late. The taxpayer then elected the special use valuation election under 2032A. Of course, the IRS rejected it and said it was not filed within the filing time for filing, the normal requirement. The court here said, well, wait a second, that's not what it says. The election rules say on the first-filed 706 return. And that's under Reg. 22.0. And they said this was the first return filed. So, therefore, they're entitled to the special use valuation even though they filed it five years late.

M. Department of Labor Regulation

29 CFR Part 2550

And I guess one last one, I think this may be important. This is a DOL rule, but the Department of Labor has changed, if you represent any plan fiduciaries, the Department of Labor has a new regulation, 29 CFR 2550. And they now allow for plan fiduciaries to consider climate change and other environmental social governance factors, or so-called ESG that's becoming so popular, when they select retirement investments and exercise shareholder rights. So, if you have clients involved with that, you may want to look at that.

Well, again, I want to thank you for joining me. We have a lot of interesting things this month to go over. As you're heading into tax season, please try to stay calm. Like usual, the IRS and the government have left us a lot of changes to deal with, with our clients for 2022. So, good luck this tax season and please stay safe.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. Revised Draft Instructions

Form 1065, Schedules K-2 and K-3

The December draft instructions to Form 1065 expand the scope of the "domestic filing exception" introduced in October 2022 and make it easier for partnerships to take advantage of the exception. Beginning with their 2021 tax years, partnerships with "items of international tax relevance" must file Schedules K-2 and K-3. The draft partnership instructions and partner's instructions released October 25 added the domestic filing exception for a partnership meeting four requirements for its 2022 tax year. The December 2 draft instructions add two categories of partners that the partnership can have and still fall within the exception.

Therefore, under the December draft instructions, a partnership will qualify for the domestic filing exception if:

- The partnership has—
    - no foreign activity, defined as foreign income taxes paid or accrued, foreign source income or loss, or an ownership interest in a foreign partnership, corporation, foreign branch, or foreign disregarded entity, or
    - foreign activity that is limited to passive category foreign income generating no more than $300 of taxes subject to the foreign tax credit (and shown on a payee statement);
- All of the partners are U.S. citizens or resident aliens, domestic decedent's estates with only U.S.-citizen or resident-alien beneficiaries, domestic grantor trusts with only U.S.-citizen or resident-alien grantors and beneficiaries, domestic non-grantor trusts with only U.S.-citizen resident-alien beneficiaries, S corporations with a sole shareholder, or single-member LLCs that are disregarded entities and have as their sole member any of the other eligible categories of partners;
- The partners receive a notification from the partnership no later than the time the partnership furnishes Schedules K-1 that the partners will not receive Schedules K-3 unless they request them; and
- The partnership does not receive a request from any partner for Schedule K-3 at least one month before the date the partnership files its Form 1065.

The revised draft instructions also extend the date on which a partnership, to qualify for the exception, must notify the partners that they will not receive Schedules K-3 unless they request the schedules. The October draft instructions would have required the notification to be dated no later than two months before the due date of the partnership's return. However, the December revision simply states that a partner must receive notification "at the latest when the partnership furnishes the Schedule K-1 to the partner." It also clarifies that when a partner has been notified that the partnership will not provide Schedule K-3, that partner has until one month before the partnership files its Form 1065, *including extensions*, to request a Schedule K-3. Thus, if a calendar-year partnership files an extension of time to file its Form 1065 for tax year 2022, the partner has until August 15, 2023 (that is, one month before the due date of the Form 1065 as extended) to request a Schedule K-3.

B. *FTX Trading Ltd.*

Bankruptcy Court for the District of Delaware, Case No. 22-11068

The cryptocurrency markets took another major blow with the bankruptcy filing by a major trading platform, FTX Trading Ltd. This, and the potential criminal filings against its founder and other top executives has sent shockwaves through the markets. It is likely that you may have a client that invested in this exchange and will have questions concerning the deduction of any losses.

FTX Trading Ltd. is an offshore trading platform that consists of West Realm Shire Services Inc. (FTX US) and Alameda Research Ltd., as well as roughly 130 other affiliates. They filed for Chapter 11 bankruptcy (a reorganization) in the District of Delaware. The group is known as the FTX Group. Sam Bankman-Fried was its founder and CEO. At this point, it is unclear what if any assets FTX has remaining. This follows the bankruptcy filings for Celsius Network and Voyager Digital. There is little to no precedent for this; and the tax consequences for investors and other stakeholders are unclear due the nature of the technologies surrounding cryptocurrency and their classification as property. A significant question is whether investors are simply unsecured creditors. If so, the investors may get little or nothing back. If they do get something back, will it be in cash or cryptocurrency? Also, how will the interests be valued—a snapshot based on a specific time or an average value (over what period)?

Even though investors may not withdraw from the exchange, the issue is when, if ever, the loss would be incurred. Most likely the loss will not be incurred until the amount of any payout to the unsecured creditors is finally determined by an order of the court. Clearly, this will not be until 2023 at the earliest. It is not until that point that the actual loss can be determined. These will not be considered business losses so cannot be treated like a business bad debt and written off when partially worthless.

If you have any affected clients, you should review FTX's terms of service. It should be noted that there is a section regarding digital assets and to whom assets belong, as well as risk. The following is of significance:

- *8.2.6 All Digital Assets are held in your Account on the following basis:*

  (A) *Title to your Digital Assets shall at all times remain with you and shall not transfer to FTX Trading. As the owner of Digital Assets in your Account, you shall bear all risk of loss of such Digital Assets. FTX Trading shall have no liability for fluctuations in the fiat currency value of Digital Assets held in your Account.*

  (B) *None of the Digital Assets in your Account are the property of, or shall or may be loaned to, FTX Trading; FTX Trading does not represent or treat Digital Assets in User's Accounts as belonging to FTX Trading.*

  (C) *You control the Digital Assets held in your Account. At any time, subject to outages, downtime, and other applicable policies (including the Terms), you may withdraw your Digital Assets by sending them to a different blockchain address controlled by you or a third party.*

- *8.2.7 FTX Trading is under no obligation to issue any replacement Digital Asset in the event that any Digital Asset, password or private key is lost, stolen, malfunctioning, destroyed or otherwise inaccessible.*

Remember that there is an automatic stay that suspends most collection activity against FTX. It will remain until either the bankruptcy court lifts it or most likely when the bankruptcy case is closed and the debtor receives a discharge. FTX has until early March to submit a proposed plan for reorganization, subject to an approval vote by creditors and a subsequent court ruling.

1. The reporting requirements for crypto reporting under the Infrastructure and Investment Jobs Act, enacted November 2021, go into effect for 2023. The Infrastructure Act mandates that crypto exchanges send Form 1099-B, commonly used for traditional brokerages, to report a yearly profit or loss of a given crypto asset. There has also been talk about introducing a new tax information reporting form, Form 1099-DA, Digital Assets. Exchanges currently struggle to report capital gains or losses because brokers cannot see the accurate cost basis for a given asset when crypto moves between exchanges and wallets. Without a neutral third party tracking transactions, accurate cost basis is lost, even when compiled on tax information forms like the 1099-B. Even if investors don't receive Form 1099-B, they are still responsible for reporting and paying their crypto tax liability. The Act also extends reporting requirements for transactions involving over $10,000 in cash to transactions involving a new category, that is, digital assets.

C. Notice 2022-41, 2022-43 IRB 304

The IRS is expanding application of permitted change-in-status rules under §125 cafeteria plans. Specifically, employees will be able to prospectively elect out of family coverage and into self-only coverage, or family coverage including one or more already-covered related individuals, under group health plan other than flexible spending arrangements, provided specific conditions are satisfied. The IRS intends to modify the regulations to reflect this, but taxpayers can rely on this guidance for plan amendments allowing elections effective on or after January 1, 2023. Notice 2014-55, 2014-41 IRB 672 is amplified.

D. IR-2022-201

Reminder to IRA Owners 70-1/2

The IRS has reminded taxpayers who are aged 70½ or older that they can transfer up to $100,000 tax-free to a charity via QCDs by the end of the tax year. Such distributions may be excluded from gross income to the extent not exceeding $100,000, subject to certain conditions and provided they are paid directly from an IRA to an eligible charity (distributions paid first/directly to taxpayers themselves will not qualify). While it is too late for 2022, it may be a planning point with a client for 2023.

E. IRS Announcement 2022-26, 2022-51 IRB

Payments made to taxpayers under a program to protect the environment may be regarded excluded from income under §126(a)(8). This involved Suffolk County, NY under the county's Septic Improvement (SIP) Program that was intended to encourage residents to upgrade existing cesspools and septic systems, thereby reducing nitrogen contamination affecting the county's watershed. Payments from the SIP program are not includable in the gross income of recipients. The county has no information reporting, according to the IRS. Generally, Section 126(a)(8) provides an exclusion from gross income for payments under any state or local government program for conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife. In this case, affected taxpayers could amend prior returns reporting the income to the extent the year is still open.

F. *Intan N. Ismail and Mohd Razi Abd Rahim v. Commissioner*

TC Memo 2022-113

Married taxpayers were not entitled to deduct on their personal returns the business expenses of a Malaysian LLC. The husband lived in Malaysia and worked with or for the LLC; and he provided no evidence that either he or his wife was an actual owner. It was organized by his father and another individual. Even if he and/or his wife held interests in the LLC, they still would not be entitled to use the losses because the LLC didn't qualify as a pass-through entity for federal tax purposes under §7701. Although the LLC was a "foreign eligible entity" under Reg. §301.7701-2(b)(8)(ii)(3) that could have elected a different entity classification, it didn't make the appropriate elections and was, therefore, a corporation for U.S. tax purposes.

G. Private Letter Ruling 202248017

A proposed grant for the purpose of creating an endowment to support fellowships to encourage emerging scholars to pursue research on topics related to financial history constituted an "unusual grant" under Reg. §1.170A-9(f)(6)(ii) and related provisions. (PLR 202248017) The organization was a §501(c)(3) organization; and the grant was large enough to affect its public support calculations. As an unusual grant, the proposed grant does not come into play in that analysis. This is not expected to be made on a regular basis. Reg.

§1.509(a)-3(c)(4) provides that all pertinent facts and circumstances will be taken into consideration to determine whether a particular contribution may be excluded. No single factor will necessarily be determinative. Factors include: Whether the contribution was made by a person who; a. created the organization; b. previously contributed a substantial part of its support or endowment; c. stood in a position of authority with respect to the organization, such as a foundation manager within the meaning of §4946(b); d. directly or indirectly exercised control over the organization, or; e. was in a relationship described in §§4946(a)(1)(C) through 4946(a)(1) (G) with someone listed above.

H. *Donoghue v. Rettig*, CA 1, 130 AFTR 2d 2022-6614

The appeals court upheld a Tax Court decision that a married couple's ostensible farm/horse racing and breeding activity was not engaged in for profit under §183 and was thus a hobby. While taxpayers claimed that the farm's alleged startup period was prolonged and then, the farm was unable to earn profit due to the global financial crisis and fatal decline of horse racing industry in their area, they did not provide evidence of a clear error in the Court's findings and evaluation of relevant §183 factors.

I. *Hallmark Research Collective v. Commissioner*, 159 TC No. 6

On April 21, 2022, the Supreme Court issued its opinion in *Boechler*, holding that the 30-day time limit to file a petition for review of a collection due process determination (CDP) is an ordinary, nonjurisdictional deadline subject to equitable tolling. In this case, the petitioner's attorney e-filed a petition one day late. Hallmark noted: "My CPA… contracted COVID/DELTA over the last 40 days and kindly requests additional time to respond." Even if they are correct, the court rejected equitable tolling and said the 90-day period, unlike the 30-day period after a CDP, is jurisdictional.

J. *Moore v. U.S.*, CA 9, 130 AFTR 2d 2022-6534

The Ninth Circuit denied rehearing petition in CFC shareholders' refund action seeking to invalidate the Mandatory Repatriation Tax. The panel affirmed the district court's dismissal of an action seeking to invalidate the Mandatory Repatriation Tax. There is a strong dissent claiming that by taxing income that has yet to be recognized by the taxpayer, the tax is unconstitutional because it fails to incorporate the "realization" concept for recognition of income.

K. IRS Notice 2022-61

The IRS has provided some guidance on the terms "prevailing wage" and "apprenticeship programs" to reflect changes made by IRA "22. The guidance also begins the 60-day period for starting construction project requirement reflected in the IRA "22.

L. *U.S. v. Parks*

DC MI, 130 AFTR 2d 2022-6492

The government filed to collect taxes allegedly owed by an estate whose return was filed over 5 years late. The taxpayers claimed that the §2032A special use valuation election was timely filed because the election was made on the "first-filed Form 706 tax return" as required under Reg. §22.0(b)T. The election was valid so long as it was made on the first filed return, even if such return wasn't timely, remained in force, and wasn't superseded by Reg. §301.9100-2"s limited extension provision or otherwise.

M. Department of Labor Regulation

29 CFR Part 2550

The DOL has issued final regulations that allow plan fiduciaries to consider climate change and other environmental, social, and governance factors (ESG) when they select retirement investments and exercise shareholder rights. The DOL said that it concluded that two rules issued in 2020 unnecessarily restrained plan fiduciaries" ability to weigh ESG factors when choosing investments, even when those factors would benefit plan participants financially.

A. Discussion Problems

- Your client, CBD, LLC, is taxed as a partnership and has limited foreign activity. All partners are U.S. citizens. The partnership wants to know if they must file Forms K-2 and K-3 and provide such forms to the partners.

- Another client, Mazi, informs you that she purchased cryptocurrency through the FTX platform. She wants to know if she can take a loss in 2022 since FTX filed bankruptcy.

- Jesse is a new client. She brings in a 90-day letter and, in your opinion, has a high probability of success in the Tax Court. She does not have the assets to pay the tax or a substantial portion of it at this time. You note that the time for filing has passed by 10 days. Jesse explains that her CPA, a sole practitioner, passed away, and she thought this had been taken care of. She asks you what to do to file with the Tax Court.

Required:

Discuss issues raised in the above fact patterns.

B. Suggested Answers to Discussion Problems

1) The instructions for the Form 1065 contain a domestic filing exception to the requirements for Form 1065 K-2 and K-3. A determination must be made if the exception applies. Regardless, the client should be told that a partner can request that a K-3 be provided.

2) The situation with FTX is still muddled. It is clear that no deductions will be allowed until at least 2023. Since the client will most likely be a general unsecured creditor, it is possible the client will get little or nothing. You should review the terms of service. Most likely, this will be a non-business loss and probably capital; but that cannot be determined until the plan has been filed and action taken by the Court, which will be 2023 at the earliest.

3) Based on the *Hallmark* case, the Tax Court will not apply equitable tolling of the 90-day period. While this is a clear case of hardship from something beyond the control of the client, the Court maintains this is jurisdictional.

PART 2. INDIVIDUAL TAXATION

Section 754 Election and Section 734 Adjustments

Taxation and reporting can be quite complicated for both partners and partnerships. This segment involves IRC Section 754 and basis adjustments under Section 734. The basis of partnership property is not adjusted as the result of a distribution of property to a partner unless a Section 754 election relating to optional adjustment to basis of partnership property is in effect with that partnership or unless there is a substantial basis reduction with respect to such distribution. Ian Redpath and Bob Lickwar discuss key factors regarding a Section 754 election and Section 734 basis adjustments.

Let's join Ian and Bob as they discuss Sections 754 and 734.

Mr. Redpath

Bob, welcome to the program.

Mr. Lickwar

Thanks, Ian, how are you? Great to be here.

Mr. Redpath

You're the guru of partnership tax, so I always defer to you. We've got an area that's complex, highly complex, as a lot of partnership tax is, a lot of misunderstanding here, and this is one. We did another program on the 754 election and the 743(b) adjustments. And even partnerships that I know where they're doing that one, they're not making this one. They're not making the adjustments under this provision. So, could you just decide which one you want to take? I mean, oh, I want 743(b) adjustment, but I don't want 734(b) adjustment.

Mr. Lickwar

Unfortunately, Ian, no, you can't do that. You're kind of locked into both of them once you make the 754 election. But it's a great point that you raise because 743 only applies to certain transactions—sales exchanges or the death of a partner. 734(b), which is the cousin to 743, is only going to apply to partnership distributions of property, including cash. So, that's the only thing here. If there's a sale or exchange, you'll do 743; a death, 743; otherwise, you're under 734.

Mr. Redpath

Let's go back to the beginning a little bit and kind of recap. You've got three accounts in a partnership that we deal with, and I think this gets confusing. And I'm not sure about the way the IRS handled the changeover to tax basis capital account reporting. I think they messed it up; but they made it even more complicated how they got into it and changed their minds several times on this. But we know now, the capital account is to be kept on a tax basis. So, we've got capital account, inside basis, outside basis. So, we talked, with 743(b), we're really talking about the outside basis, inside basis, trying to make those two the same for a partner. So, what is the capital account? What is inside basis? What is outside basis?

Mr. Lickwar

The capital account, Ian, is basically a measure of economic activity, which could include things like contributions, distributions, whether it be property or cash, and the transactional effects of the partnership operations through the year.

Mr. Redpath

Bob, this is really something that… I'm glad you said it because that's an excellent way to put it. I always learned, I don't know if you did, but I always learned that the capital account was to reflect the economic relationship of the parties. And, therefore, when 704(b) using essentially, similar to GAAP, but basically using fair market value accounting, made sense when you said the economic relationship. But you just put it, I thought very, very good to think about this; because if you've heard that, because that's a constant thing, economic relationship is the capital account. And what you said, I thought, was really interesting. You said no, it's really the transaction; it's to keep account of the economic transactions. And I think that makes sense when you think now about tax basis capital account reporting. It's not the economic relationship of the parties. It's the transactions that are taking place. Do I have that right?

Mr. Lickwar

Yes, you have that right, Ian. And there is certainly a place for the economics between the parties; and that's

handled under 704(b). And sometimes, when there are special allocations, 704(b) will spill over into the tax world, whether you're talking about allocations, traditional allocations, curative allocations, etc., etc. But, yes, the capital account is going to maintain that. I agree with you, Ian, that the IRS, for whatever reason, they decided to go with the tax basis capital accounts, eliminated some things that, in my opinion, really weren't causing any harm and are going to get into basis eventually anyway. For example, if I purchased your interest for $100,000 and there's a 754 adjustment, but your capital account shows zero, well my K-1 shows zero too, even though you and I both know that I paid you $100,000 for your interest. Why would you eliminate that 743(b) adjustment? I don't know because in the context of a 734 adjustment, Ian, rather than being a partner-specific adjustment, the 734(b) adjustment is a common partnership basis adjustment. And there's no separate reporting, and it can hit the capital account. So, as if they couldn't make it any more confusing, they did by drawing the line there. I wish the whole world was a 734(b) adjustment, Ian. But unfortunately, it's not.

Mr. Redpath

So, what is the inside basis?

Mr. Lickwar

The inside basis, Ian, and people get really confused by inside and outside basis. My outside basis is generally what's my basis in my partnership interest. I put in 100,000 bucks on day one for my interest. That's my outside basis. Inside basis is the partnership's basis in its assets. The partnership takes my $100,000, plus another [$100,000] from you, and they buy a piece of land for $200,000. The $200,000 basis in the land is the partnership's inside basis in its assets.

Mr. Redpath

And lastly, what is outside basis?

Mr. Lickwar

Back to our example, Ian, the $100,000 that you and I each put in, that would be our outside basis. It's what's our basis outside of the partnership's tax basis balance sheet.

Mr. Redpath

So, does outside basis have any real impact on this adjustment under 734 if you have the election in effect?

Mr. Lickwar

It certainly does, Ian. And it can apply in a situation where there is a distribution that results in gain recognition or loss recognition. It also can apply in a situation where there's a property distribution where the basis in the property from the partnership is different from the outside basis of the partner. So, I think before we go even a little bit further on 734(b), I think it's going to be pretty important to understand the general distribution rules of partnerships under Section 731. There's really two types of distributions, current and liquidating distributions. And that's a pretty easy concept I think to understand; although again, it causes a lot of confusion and I understand why. A current distribution is any distribution which doesn't liquidate your entire interest. So, even though your interest was 25%, you get a distribution, now you own 5%; that's still a current distribution because you still have an ownership interest in the partnership.

If you receive a distribution of only cash, and your basis after the distribution is greater than zero, that's a tax-free distribution. And remember that your basis includes your capital account, your investment plus your share of the partnership liabilities. If you receive a distribution of cash that exceeds your basis in the partnership interest, there's the potential for gain recognition, whether it be ordinary income because you have a disproportionate distribution or capital gain under Section 741. And when that gain is triggered, Ian, that potentially triggers an adjustment under 734.

If we're talking about a liquidating distribution, the general rule is gain is recognized to the extent cash exceeds basis, and no loss is recognized unless only three types of property are received—cash, inventory, receivables. If anything else comes into play, like land—or I was going to say securities, but that's not a good example, because marketable securities are treated as cash. But say it's land or a building; that will result in the nonrecognition of a potential loss, and there will be potential for basis. I call it skewing, a difference between the partnership's basis and my new basis in the property received.

Mr. Redpath

And that gain or loss on that property, that's basically postponing some of your gain or loss from the distribution in the partnership. So, it's not being recognized now; but it's going to be recognized when you've disposed of that property. And one of the

reasons that rule exists is that you can't… So, you take cash out first. Then, whatever's left in basis, you shift it over and put it on the property that you receive. But you can't put any more on receivables or inventory than the partnership's basis. So, if it's a cash basis, it has zero on the receivables. The bottom line is you can end up with a basis left over on a liquidating distribution, and you have nothing to put it on because you didn't get any other property. And so, therefore, they say okay, well you can take a loss at that point. But you can make that 734 adjustment or the partnership for that potential gain or loss, the gain or loss that will be recognized in the future, correct?

Mr. Lickwar

That's absolutely correct, Ian; so, you've got a basis disparity there. Let's put some numbers to it. Let's assume that my interest is worth $10,000. I'm going to get a share of the partnership assets, which is $3,500 in cash, $3,500 in receivables, and $3,000 in inventory. And I'll assume that we're a cash-basis law practice. From my perspective, Ian, as the partner, the $3,500 in cash I receive reduces my basis to $6,500. The inventory I receive reduces my basis down to $3,500. But as you said, I can't assign any basis to the receivables. When I collect them, I'll pay ordinary income, so the code allows me a $3,500 loss. What will happen in that case, Ian, is to close my capital account out, the other partners will increase their basis in the accounts receivable under the premise that I took them with me; and, therefore, there should be no gain or loss recognized or some other ordinary income property.

Mr. Redpath

Well, if we don't make that adjustment, you are going to recognize $3,500 of gain on the receivables. But the partnership still has the receivables; they're going to recognize the gain too.

Mr. Lickwar

Correct.

Mr. Redpath

You're both going to; the gain's going to be recognized twice. But also, it works to the opposite. The loss could be recognized twice. So, if there was distributed property that had a loss, that loss is going to be recognized when you sell the property. But wait, that loss was in the property as the partnership held it; so now that loss is being recognized twice when you dispose of the property. And the partnership, well, you've got to make an adjustment to the property, to the other assets that are there.

Mr. Lickwar

Yes, you're exactly right.

Mr. Redpath

So, 754 is the election. How do we make this election? Is it just automatic? What is the 754 election?

Mr. Lickwar

Well, Ian, it's a one-time election; because once you make a 754 election, you are in. You make it by attaching the election to a timely filed tax return. There are also some rules which say if you miss the election, you have up to a year to make a late election under the late election regs under 9100. So, you can get 9100 relief; and you should—best practices would say—keep a copy of that election in your permanent file. The general partner or tax matters partner that used to have to sign the election—that is not the case anymore. To facilitate e-filing, there's no requirement to sign it; you just attach it to the return. I would say, Ian, that many partnerships probably have not maintained the election in their permanent file. If they're unsure as to whether the election is in place, or they're wondering if the IRS will challenge it, will it hurt you to make the election again? The answer is probably not. If there's a downward basis adjustment, the partnership would not like to make it. But that's not going to do anything. It doesn't matter, it goes up or down. It's to your advantage or your disadvantage; you have to ride it both ways.

Mr. Redpath

One of the things—we've talked about this in a lot of different situations, a lot of programs—but the 754, we always think of the positives of 754. We always think of the step up in basis or the positive things we can get out of it; but there's also negative things that we can get out of it. You can't recognize the loss twice. An incoming partner who buys out another partner's interest may get a step down in basis if that happens. And once you made that election, the IRS is not jumping up and down saying, oh yes, fine. It's wacky Wednesday. Everybody gets out of their 754 election. It's not easy to get out of a 754; because the IRS knows that most people that want to get out, it's only because they don't want the negative effects of the 754. I really

think if you don't have one in effect, I think it's something you need to think of because that election may be good today. But is it going to be good five years from now, 10 years from now? And you've really got to be looking at projections of where you think things are going to really make that decision. Whether or not it's good for one transaction, is it going to be something we want to have? Because once you make it, very difficult to get out of.

Mr. Lickwar

Yes, you've got to have a really good reason, Ian. It can't be just that you're making a downward basis adjustment and you don't want to do that. But I would say that from a practical perspective, what I've seen in practice is historically an increase in basis under 754 elections in most cases. I deal with a lot of real estate. I deal with a lot of professional partnerships. And because of depreciation deductions, mostly you're seeing that the increases are positive, especially for properties that are 30 to 35 years old, and we see many of those. What's unique here, Ian, and I think what's unique about partnerships in general is assume a situation where instead of me buying your partnership interest and there being a basis adjustment. Or since we're talking about 734 adjustments, let's assume that your basis is zero, your interest is worth 100,000 bucks. So, we give you $100,000. You recognize gain; we get to increase the basis of our partnership property. Think of this in the similar context of an S corporation where I buy out your stock for [$100,000], and you pay tax on the gain because you have all capital gain and a zero basis. There's no adjustment inside of the S corporation to those assets, Ian, so it's very unique. And while I agree with you that you have to consider the good with the bad, my thinking is in most cases that I've seen, the adjustment has always been a positive adjustment. That doesn't mean it's always going to work that way, but that's what I've seen. And that's really the discussion that you need to have with your clients. You have a unique opportunity. Administratively, it can be difficult because as more partners come in, the election is on, and you're going to have to track it until you get permission from the IRS to take it off.

Mr. Redpath

And that's one of the problems is that, and I've mentioned before that one of the ways I got out of a 754 for a client was they had so many changes, so many adjustments. It became an administrative nightmare because there were partners coming in and out. And every time a new partner came in, boom, there you had to because they were buying the interest from the other partners, it became a nightmare. And the other one, which is not unusual, is different partners. The original partners that elected it weren't even around anymore and the business was totally different. Totally different type of business, totally different dynamics. As you said, certain businesses, it works really well, different dynamics with the business. So, the IRS, they're not unwilling to let you out. You've got to have a business reason to get out. And one thing I did want to mention, keep in mind, and a lot of practitioners forget this. When we talk about a distribution of cash, that includes any reduction in your liabilities. So, if you're relieved of any liabilities as part of anything, that is considered to be a distribution of cash. So, the liabilities are paid off during the year. You got a distribution of cash equal to that. You might say, well I didn't get any cash. I didn't get a cash distribution. Oh yes, you did because the liabilities went down. So, keep in mind that those are always considered deemed distributions of cash.

So, 734, this is the partnership adjusting the assets for all the partners, right? Not like 743.

Mr. Lickwar

That's correct. This is common basis. And therefore, Ian, there's no special reporting. Last time, we talked about 743 adjustments and reporting depreciation deductions on code V and code F. You won't see that with 734 adjustments; and you also won't see the basis reporting with 734 telling the partner what their share of the building cost is, and the accumulated, etc. You're not going to see that. So, it's a completely different regime because this is going to affect the common basis of the partnership property. And a very unique aspect of Section 734(b) is adjustments can actually at times be suspended. There's four circumstances, Ian, where a 734(b) adjustment can arise. We talked about two of them. Cash distribution exceeds outside basis. Partner recognizes gain, 734 adjustments. Distribution results of cash results in a loss to the partner, 734(b) adjustment. The other two situations are distributions of non-cash property.

So, let's assume, Ian, that you and I are going to part ways. You want to retire, head up into the woods, and do nothing but fishing and camping. But the only thing you want, Ian, is that 1984 Ford Econoline van. I don't know what it is about the van, but you really want the van. Your basis in the partnership interest is $5,000. But because of the listed property rules, Ian, that van still

has a basis 25 years later of $25,000. And it's worth five grand, but the partnership basis is [$25,000]. You're going to take that van. What's going to happen to you under Section 731? Well, first, no gain or loss is recognized. And second, since the basis to the partnership in the van exceeds your basis, you're going to take a basis in the van of $5,000. The partnership has just had $25,000 removed from its books, and it's wondering what happens. Well, what happens is that if the partnership has other types of 1245 property, they can make an adjustment. If there is no other 1245 property, that adjustment is held in abeyance. So, what we're looking for is…

Mr. Redpath

Held in abeyance until what? You said held in abeyance.

Mr. Lickwar

Until I acquire similar property.

Mr. Redpath

Okay. And of course, we're going to remember to do that. That number's going to be there somewhere in the future when we get it.

Mr. Lickwar

Yes, I actually like to keep it on the books; and I call it other pending adjustments or something like that. But those are the rules you need to deal with. And 734 will kick in in any of those situations. So, cash distributions with gain or loss, property distributions where either the partnership or the partner has a differing basis in the property. That could be quite the converse, Ian, where your capital account has a $25,000 basis and the van has a $5,000 basis, but you think it's worth 25 grand. The same thing could happen, the converse. You'll take a $25,000 basis in the van. The partnership got rid of something worth $5,000. Now, there's a negative adjustment to apply to other 1245 property, or if we don't have any, when we finally get some.

Mr. Redpath

Yes. And again, the adjustments can be positive or negative. And as you're pointing out, the first adjustment is to similar property, right? I mean, what created the gain, what created the loss. And Bob, I'm going to let you in on a little secret about that Econoline van. Do you recall a movie, and some of our viewers are not, but look it up, Google it. Goldfinger?

Mr. Lickwar

I do.

Mr. Redpath

That Econoline van is made of gold. I just painted it over. Where do you think I've been hiding all our profit all these years?

Mr. Lickwar

Sure. Okay, that's good. That's good.

Mr. Redpath

So, I know that there's this thing called substantial built-in loss. Does that apply to a 734 adjustment?

Mr. Lickwar

Yes, potentially it does, Ian. So many partnerships have made a conscious decision that they just don't want to deal with 754 adjustments and all of the nuances and the recordkeeping. And there's a part of me that says I really can't blame them. But the IRS came up with a rule in Congress back in 2004. Partnerships are extremely flexible. In other words, admitting new partners is a lot easier than admitting them into a C or an S corporation. And you can play around with distributions by following the letter of the law; that's why we have the disguised sale rules. In this case, Ian, if a partnership has a substantial built-in loss, which means that the basis of the assets exceeds the value of the assets by more than a quarter million dollars, or there is a special allocation that would result in a more than $250,000 loss going to one partner, even if I don't have a substantial built-in loss, I have to apply these rules mandatorily. That second law came in as part of the Tax Cuts and Jobs Act in 2017.

Mr. Redpath

Now, there are some questions. Question 10 on the 1065 that deals with 754 adjustments, 10a, b, and c. What are these questions really asking us, and what are they alerting the Service to?

Mr. Lickwar

Well, they're asking us if there's been a transfer of a partnership interest or a distribution of property that potentially results in a 754 adjustment, if the partnership has previously made the election, or if they're going to do so this year. It also asks in item 10c about substantial built-in losses. And if there is in fact

an adjustment calculated for the current year, they're going to want to know the details. How did you come up with it? What was the previously taxed capital? How was the adjustment being allocated? Which partner is being affected?

Mr. Redpath

Now, you mentioned before and in our program on 743, about the fact that 743 has to be eliminated. It's not in the capital account. Even though it's a tax adjustment, you don't account for it in the capital account. What about this adjustment? Is the 734(b) adjustment in the capital account?

Mr. Lickwar

Yes, it's certainly in the tax-basis capital account, Ian. You don't have to eliminate the 734 adjustments. It's kind of the kookiest thing I've ever seen. I'm still trying to get over and I'm finally getting used to not having the 743(b) adjustments in there. And I'm doing that by keeping track separately on an Excel worksheet of the capital account with the 743(b) adjustment in it. But since this is common basis, there's no need to remove it from the capital accounts.

Mr. Redpath

I think one of the things about the capital account today, and we've kind of alluded to it a lot, is man, I mean we got more off the book capital accounts now. I mean, for certain things in tax, you have to have 704(b). I mean, when subchapter K refers to book, it means 704(b) book. And so, when you have things like minimum gain, debt allocation, when you do the constructive liquidation scenario, it hits the capital account. Well, what capital account? Well, your 704(b). You did special allocations; 704(b) says the first requirement, capital account maintenance, you have to keep them according to the regulations, which is 704(b). So, I think one of the problems with that capital account is a lot of practitioners look at it and they go, well, this is the capital account, and I do everything to this capital account. And the answer is no, not necessarily. If everything is plain vanilla, yes, it'll probably work. But no, you've got this other thing out there. So, by putting in this tax basis and not eliminating other things, then, they've just added more complexity to really what the capital account is, and how you have to look at it, and what you have to make adjustments for different things, different capital accounts. So, as you said, you could have different accounts that you're keeping for different purposes today. I think they may have overly complicated it and certainly didn't make it easier.

Mr. Lickwar

It's always actually been there, Ian; but they've codified the complication, I think, is what they did. But what they really got us to do is think about it. And we see the end game, because the IRS recently announced that they're going to start looking at losses taken in excess of basis; and they're also going to start looking at distributions that could result in taxable gain. And how are they going to do that? They're going to do that and look at the K-1s and the tax-basis capital accounts. And if you're negative and there's no share of liabilities allocated to you, guess what? I think you're going to be in the crosshairs.

Mr. Redpath

Yes, and I think one of the things that's happened over the years is there's been a lot of changes. For example, the capital account—you and I are both old enough to remember when we had the boxes. You put a number. How did you keep this? How did you get this number? GAAP, 704(b) book, tax, and then the infamous "other." And then there was a line to put in, hybrid, as per books and records. There was no correlation here. And so, really now, with all of this reporting, in an attempt to—I'm going to hate to use the word standardize—but to some degree standardize the information. They put in do you have any pre-contribution gain still remaining? Anything sold that has pre-contribution gain? All of this is now being reported on the K-1. That 743 adjustment clearly has to be designated on the K-1. So, I think what's happening is that with AI, they're saying, well, we have the ability to do a lot more in targeting returns that may have issues or we may be able to get more money from and not waste our time with other areas. And then, you add the centralized partnership audit rules where they can actually, the BBAs, where they can just go to the partnership and make the audit. I think it really is, as you said, we're going to see more and more and more audits in these areas; and they're getting more and more information just off of the reporting requirements, especially on the K-1.

Mr. Lickwar

And clearly, Ian, these 754 adjustments are partnership-level items, in my opinion. So, they will be subject to the BBA rules. And if you need to make a change,

you're going to have to do it, and a lot of times, rather than amend a return, through an administrative adjustment request, which is a very time-consuming project. So, yes, it's getting more complicated by the day. But you can see the end game here; and the end game here is more information for the IRS to see where people are missing things. And I think the IRS knows that people are taking losses where they don't have basis; and if they do, maybe that basis is not at risk. And also, they're taking distributions where there have been no liabilities reported. I have to tell you, Ian, if I get a K-1 and there's no share of liabilities reported, the first thing I usually do is call the accounting firm that prepared the K-1 to say, hey, aren't there any liabilities allocated here? Because this is a perfect red flag for the IRS.

Mr. Redpath

Yes, absolutely. We have Form 15254, a relatively new form. What is that for?

Mr. Lickwar

That's to ask the IRS, Ian, to ask for their permission to get out of the 754 election. It's not going to be because my property values declined, although given what we went through with the pandemic, one would question whether they may be lenient even in a case like that. But more or less, Ian, you're going to have to have a really good reason. As you had mentioned previously, a lot of changes in partners' interest, the change in the nature of the business with a lot of assets, etc. So, something other than generally the value of my assets went down and my adjustment is negative.

Mr. Redpath

And I think that, the example, shifts and change in retirement, a lot of retirements and/or other shifts of ownership. Yes. Okay. So, the situation I mentioned we had, there were 350 partnership interests. But for example, in one year, there were 1,200 partners. It was being transferred regularly. If you have Ma and Pa; and okay, now the kid's in there; and well, the kid sold out to his sister; and the sister, well the sister made a gift. That's not what we're talking about here, about substantial changes. I mean, it really has to be something like that where it's quite large. But substantial changes in the business, substantial changes in the assets, the nature of the business is totally different, where 754 may not make as much sense. But I think a lot of it is really administrative nightmare. The IRS does understand that this can get just out of hand, the books and records that you would have to keep for everyone to make those adjustments.

Mr. Lickwar

But remember, Ian, even if you can get out under this provision, you still have to consider the substantial built-in loss rules, which may just drag you back in.

Mr. Redpath

Right. Yes, you're still not out. You've got to wait about two years, right?

Mr. Lickwar

That's correct. So, if those substantial built-in loss rules come into play, it's really not going to do you much good.

Mr. Redpath

Right, not at all. All right, Bob, thanks a lot. I again appreciate all of your insight into here. Partnership tax is highly complicated, but you're certainly the guru and making it easier. So, Bob Lickwar, thank you for joining me. We'll have you on our program soon.

Mr. Lickwar

Thanks. Great to see you. Have a good day.

Section 754 and Section 734(b)

By Ian J. Redpath, JD, LLM

A. Introduction

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

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

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

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

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

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

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

B. Making and Revoking the Election

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

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

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

The written statement must:

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

For example, the Election could be as follows:

Election Pursuant to I.R.C. §754

TIN: XX-XXXXXXX

Smithson, a general partnership, hereby elects under I.R.C. §754 and Regs. §1.754–1(b)(1) to apply the provisions of I.R.C. §§734(b) and 743(b), beginning with the taxable year ending December 31, 20XX.

Date: _____

Smithson Partnership
251 Main Ave.
Somewhere, NY 00000

The IRS has eliminated the need for a signature to allow easier e-filing of the election. This is effective for tax years ending after August 5, 2022 [TD9963].

If more than 12 months have passed, late relief can still be requested under Reg. §301.9100-3(a). Generally, relief will be granted if the taxpayer provides evidence that establishes to the satisfaction of the IRS that the taxpayer acted reasonably and in good faith and that granting the extension will not prejudice the interests of the Government. The taxpayer must submit a detailed sworn affidavit:

(1) describing the events that led to the failure to make a valid election and to the discovery of the failure;

(2) indicating the existence of grounds for the extension, along with sworn affidavits by others that support these grounds; and

(3) stating whether the taxpayer's return or returns for the taxable year(s) in which the election should have been made [or any taxable year(s) that would have been affected by the election had it been timely made] are either being examined by the IRS or being considered by an appeals office or a federal court.

Additionally, the taxpayer must also submit a copy of any documents referring to the election and, upon request, submit a copy of the taxpayer's tax return (and any tax return of other taxpayers affected by the election) for any taxable year for which an extension to make the Section 754 election has been requested.

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

To revoke the election, a partnership must file a revocation request on Form 15254, *Request for Section 754 Revocation*, no later than 30 days after the close of the partnership year for which the revocation is intended to take effect. The request must be signed by one of the partners. The request must state the reason(s) for requesting the revocation. The IRS is not very liberal at granting a revocation and will not do so if the reason is simply that it is no longer beneficial to the partners, such as a situation where the value of the partnership has declined and there would be negative adjustments to basis. Examples of possible reasons acceptable to the IRS include:

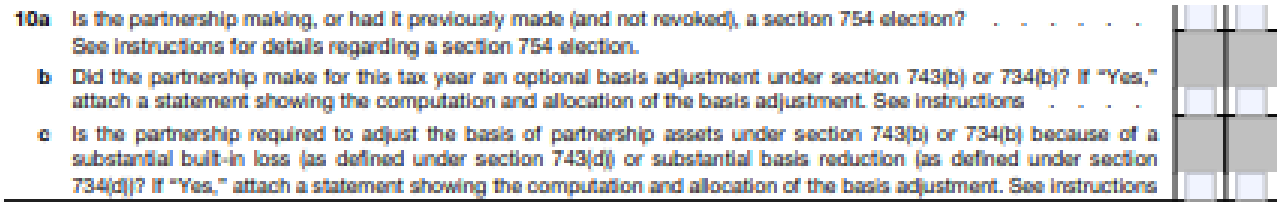
- a change in the nature of the partnership business,
- a substantial increase in partnership assets,
- a change in the character of partnership assets,
- an increased frequency of retirements, or
- shifts of partnership interests that would result in an increased administrative burden from the election.

The partnership must file Form 15254 at following address: Department of the Treasury; Internal Revenue Service Center; Ogden, UT 84201-0011.

The IRS will send a letter to the partnership approving or denying the request to revoke the election.

C. Form 1065 Questions and Statements

If the election is in effect, then Form 1065, Schedule B, Question 10a, should be answered YES. If the election is in effect and an adjustment was made for the year under either section, then Question 10b should be answered YES and an **attachment** included with the return showing the computation and the allocation of basis. If no election is in effect, but there is a "substantial built-in loss," then Question 10a would be answered NO and Question 10c answered YES with an **attachment** to the return showing the computation and allocation of the adjustment.


10a Is the partnership making, or had it previously made (and not revoked), a section 754 election? . . . . . See instructions for details regarding a section 754 election.

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

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

D. Adjustments on Distributions

In order to avoid the possible double taxation, or duplicate loss, a partnership with a §754 adjustment will adjust the basis of the partnership property (inside basis of assets) to reflect gain or loss recognized or postponed on a distribution if there is a §754 election in effect. The basis that applies to all partners is commonly called the "common basis" as it applies to all partners. Recall that the §743(b) adjustment on a sale or exchange or at death will apply only to the incoming partner. In that situation, the incoming partner will have their share of inside basis be the common basis and the adjustment under §743. The adjustment will be considered a "new" asset and, if depreciable or amortizable, it will be written off based on the same class life as the asset it attached to; for example, if it attached to a 7-year asset, it is a new 7-year asset for cost recovery purposes and even qualifies for bonus depreciation. Make sure your software is tracking it as one asset with a bifurcated basis for the incoming partner. This will be important upon disposition. The §734(b) adjustment applies to all partners in the partnership and adjusts the basis for all partners in the common basis. The §734(b) adjustment is allocated in accordance with the rules in §755.

The §734(b) adjustment will apply in the following situations:

1. The distributee partner recognizes gain under §731(a)(1);
2. The distributee partner recognizes loss under §731(a)(2);
3. The distributee partner's adjusted basis in the distributed property is less than the partnership's adjusted basis in the property immediately preceding the distribution; or
4. The distributee partner's adjusted basis in the distributed property is greater than the partnership's adjusted basis in the property immediately preceding the distribution.

If a partnership makes an adjustment to the basis of partnership property under §734(b), it must attach a statement to the partnership return for the year in which the distribution occurs setting forth the computation of the adjustment and the partnership properties to which the adjustment has been allocated.

Thus, the §734(b) has a relationship to the partner's basis on a distribution. The amount of gain or loss is based on the distributee partner's outside basis in the partnership, which may differ from his or her proportionate share of the inside basis on the assets that were distributed out to him or her—the gain or loss that may be currently recognized or postponed.

To allocate the adjustment to the partnership's assets:

1. Divide the partnership assets into two asset classes—ordinary income assets and capital assets;

2. Next, allocate to the various assets within each class—although usually, the allocation is only within one class (that created the gain/loss).

With respect to an intra-class allocation, an upward allocation is allocated as follows:

1. First, allocate to properties with unrealized appreciation in proportion to the amount of unrealized appreciation in each item of property in that class before the adjustment is taken into account (note that this allocation may not exceed the property's unrealized appreciation) and then,
2. Any adjustment remaining is allocated among items of property within the class in proportion to their fair market values.

If there are no items of property in the class to which the upward adjustment has been allocated, then the adjustment is made when the partnership subsequently acquires property belonging to that class.

A downward adjustment is first allocated to properties with unrealized depreciation in proportion to the amount of unrealized depreciation in each item of property in that class, before the adjustment is taken into account. The amount of adjustment allocated to an item of property cannot exceed the amount of unrealized depreciation in that item of property

The increase or decrease in basis of the entity's property depends on the distribution's effect on the distributee partner. In determining the basis of the distributed assets in the hands of the partnership and in the hands of the partner, other basis adjustments in the partnership's assets, such as adjustments under §743(b) or §732(b), are taken into account. [Reg. §1.734-1(b)(1)(ii); Reg. §1.734-1(b)(2)(ii)] The basis adjustment is allocated to property similar to the underlying property. If the partnership doesn't have any similar property, it will be held in abeyance to adjust the basis of later acquired property.

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

Example: Jane has a basis of $10,000 for her one-third interest in partnership JBC. The partnership has no liabilities and has assets consisting of cash of $11,000 and property with a partnership basis of $19,000 and a value of $22,000. Jane receives $11,000 in cash in liquidation of her entire interest in the partnership. She has a gain of $1,000 under §731(a)(1). If the election under §754 is in effect, the partnership basis for the property becomes $20,000 ($19,000 plus $1,000).

Example: Harry has a basis of $10,000 for his one-third interest in partnership DEH. The partnership balance sheet before the distribution shows the following:

Assets	Adjusted Basis	FMV
Cash	$ 4,000	$ 4,000
Property A	11,000	11,000
Property B	15,000	18,000
Total	$30,000	$33,000
Liabilities and Capital		
Liabilities	$ 0	$ 0
Capital		
Darlene	$10,000	$10,000
Eli	10,000	10,000
Harry	10,000	10,000
Total	30,000	33,000

In liquidation of his entire interest in the partnership, Harry received property A with a partnership basis of $11,000. Harry's basis for property A is $10,000 under §732(b). Where the election under §754 is in effect, the excess of $1,000 (the partnership basis before the distribution less Harry's basis for the property after distribution) is added to the basis of property B. The basis of property B becomes $16,000 ($15,000 plus $1,000).

Example: Greta has a basis of $11,000 for her one-third interest in partnership GHT. Partnership assets consist of cash of $10,000 and property with a basis of $23,000 and a value of $20,000. There are no partnership liabilities. In liquidation of her entire interest in the partnership, Greta receives $10,000 in cash. She has a loss of $1,000 under §731(a)(2). If the election under §754 is in effect, the partnership basis for the property becomes $22,000 ($23,000 less $1,000).

Example: Jenny has a basis of $11,000 for her one-third interest in partnership JKM. The partnership balance sheet before the distribution shows the following:

Assets	Adjusted Basis	FMV
Cash	$ 5,000	$ 5,000
Property A	10,000	10,000
Property B	18,000	15,000
Total	$33,000	$30,000
Liabilities and Capital		
Liabilities	$ 0	$ 0
Capital		
Jenny	$11,000	$10,000
Kenny	11,000	10,000
Lenny	11,000	10,000
Total	33,000	30,000

In liquidation of her entire interest in the partnership, Jenny receives property A with a partnership basis of $10,000. Jenny's basis for property A under §732(b) is $11,000. Where the election under §754 is in effect, the excess of $1,000 ($11,000 basis of property A to Jenny, less its $10,000 adjusted basis to the partnership immediately before the distribution) decreases the basis of property B in the partnership. Thus, the basis of property B becomes $17,000 ($18,000 less $1,000).

E. Substantial Built-in Loss

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

The §734(b) adjustment is mandatory where a distribution in liquidation of a partner's interest would give rise to a "substantial basis reduction" if a §754 election were in effect. The partnership has a "substantial built-in loss" when:

- The partnership's adjusted basis in partnership property exceeds the fair market value of such property by more than $250,000, or
- The transferee partner would be allocated a loss of more than $250,000 if the partnership sold assets for cash equal to their fair market value immediately after such transfer.

Example: Peter, Carla and Sven, each contribute $1.5 million to equal Partnership PCS. PCS purchases two parcels of land, parcel A for $3.6 million and parcel B for $900,000. Parcel A declines in value to $1.2 million and parcel B declines to $600,000. Assume there is no §754 election in effect. The partnership redeems Peter's interest by distributing parcel B. The basis of parcel B in the hands of the partnership immediately before the transfer was $900,000. Under §732, Peter takes a basis in the land equal to his basis in his partnership interest immediately before the distribution, or $1.5 million. If a §754 election were in effect, PCS would be required to make a reduction to the basis of parcel A by the difference, or $600,000. Because the basis reduction exceeds $250,000, there is a substantial basis reduction, and the adjustment is required under §734(d).

F. Conclusion

In any partnership, consideration of a §754 election is often presented to the practitioner. Of course, the client is usually unaware that such elections are available. It is important to be aware of the rules and their highly complex nature to properly advise a client. This is especially important with the need for IRS approval to revoke the election. Generally, practitioners think of the positive aspects of an election; however, there can be negative consequences in the future. It is equally important to understand the basics of both of the adjustments as well as the potential "substantial built-in loss" or "substantial basis adjustment" rules.

A. Discussion Problems

Your client, CBA, LLC, is taxed as a partnership. Jane, a partner, had a basis of $50,000 in her partnership interest and received a building with a fair market value to the partnership of $100,000 in termination of her interest. Under the general rules of liquidation, Jane took a substituted basis of $50,000 under the proportionate liquidating distribution rules.

Required:

1) What considerations should be made regarding the §754 election?

2) If the §754 election is to be made, what must be done?

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

B. Suggested Answers to Discussion Problems

1) The first thing to do is determine if the partnership has an existing §754 election in effect. If so, the partnership is bound to it unless revoked. There are a number of advantages to making a §754 election. If it is made, then the adjustments under both §743(b) on sale or exchange or death and §734(b) on distributions both apply. While the adjustments can be an advantage in an inflationary period, they may also be a negative if the value of the partnership and/or its property decreases. It can also become an administrative burden for compliance purposes, especially if there are a large number of partner interest changes. It must always be remembered that once an election is made, it remains in effect until revoked with IRS approval, which is not easily obtained.

2) If a §754 election has been made and not terminated, then there is nothing to do. If it has not been made, and the decision is made to elect it, the election may be made by filing a written statement with the partnership's return for the tax year in which the transfer occurs. It must be filed by the due date, including extensions, for such year for filing the partnership return. There is an extension that is available.

3) If an optional adjustment-to-basis election is in effect, the partnership increases the basis of its remaining property by $50,000. The adjustment will increase the basis of similar property if available or is otherwise held until similar property is obtained.

PART 3. BUSINESS TAXATION

Private Equity and F Reorganizations of S Corporations

S corporations continue to be the predominant type of corporation for closely held businesses. Therefore, many of the closely held businesses that private equity firms wish to acquire are S corporations. An F reorganization is a change in identity, form, or place of organization of one corporation, and the F reorganization strategy has become popular within private equity transactions involving S corporations. While it sounds simple enough, the specific requirements can be complex and ambiguous. Ian Redpath and Greg Urban discuss key factors regarding private equity and F reorganizations of S corporations.

Let's join Ian and Greg.

Mr. Redpath

Greg, welcome to the program.

Mr. Urban

Hey, Ian, good to be with you today.

Mr. Redpath

Our topic today, it's maybe a little in the weeds for some people. But it's becoming so common now that I really think it's important to at least understand what people are doing. Because you may have an S corporation where someone's looking for equity, and they talk to private equity investors. Or you have someone coming in that wants to cherry pick some assets, and they want an interest in the business; but you don't want a second class of stock, or you've got some type of angel investors. There's all sorts of different alternatives where this could apply. We're talking about essentially reorganizing an S corp. And one of the things you always have to worry about are the types of shareholders. Also, the number of shareholders isn't as big an issue anymore, but the types of shareholders certainly and second class of stock. You have second class of stock issues. Those are things you really need to worry about. And there's this thing out there—that I think we do it a lot and don't even think about what we really did—which is an F reorg, a change in form. And essentially, I'm changing my form. Maybe I'm a New York corporation, or I'm an S corp in New York. I want to become an S corp in Delaware. I just simply do an F reorg. Now, I may have done a merger between those two, but it's still an F reorg. If it ends up with the same owners, it's considered under an F, which has very loose rules, essentially. I guess the issue is, there's really no rules as long as you're just doing it, and you just change the form, and basically everything is the same.

And so, all these other things that we would talk about in a reorg. You talk about the judicial doctrines that are out there, and business purpose, and continuity of shareholder enterprise, and continuity of business. We don't worry about those because it's just a change in form. You were this form; now you're this form. And the simplest is, you want to take your S corp and you want to now be a Florida S corp because you don't want to be a New York S corp because the shareholders just all moved down to Florida. So, okay, that's simple. And that is technically an F reorganization as far as the code is concerned.

This is a little different where you're looking for, maybe you have private equity coming in. Now, if people remember, you have the ability under Section 338 to have, essentially, what is a stock purchase treated as an asset purchase, but at a heck of a tax cost. And there's all sorts of rules. 80% control—when did you get the 80%? There's all these rules that are in there that have to be followed; and they have to be followed precisely. There's no close enough in order to get the benefits of it. And it can get really into the weeds there doing it. This is becoming really popular, this use of an F reorg. Can you lay out to us where this is heading and where you're seeing it in practice?

Mr. Urban

S corps, I would say when you look out at our historical client base, many of our clients are S corporations. But nowadays, when companies are formed, you tend to see more LLCs. I think that is, generally speaking, the preferred ownership structure. So, with a lot of legacy S corporations, you see a couple things happening. Where we first experienced this in our practice was, we had some S corporations that would want maybe a key employee could come in. And they would say, geez, we

don't like the idea of that employee having a big taxable event when we grant them the ownership interest. Which, with an S corporation, you've got that. You've got to look at what's the fair market value of the interest, that's compensation. You've got to deal with taxes. A lot of times, people getting the interest aren't anticipating, or they can't come out of pocket to pay the income tax that's due to them. So, you have that challenge.

The F reorg, in that context, provides a solution in that, through some structuring that we'll talk about, you have the opportunity to change that S corporation maybe to an LLC. And maybe have somebody come in with a profits interest, which isn't a taxable event, and maybe you get the retention and the incentive, you meet that objective. That was really where we first experienced this. Then, more in the past maybe three or four years, you see some S corporation owners, they're getting older. And they maybe are looking to diversify. Some businesses figure maybe they've grown as much as they can organically and they need to have an investor come in. That investor is almost never an individual. That investor is going to be an investment fund, it's going to be a family office, it's going to be a partnership, something like that. As everybody knows, those are ineligible shareholders.

Mr. Redpath

And a lot of times, what I have found in practice is that a lot of times my clients who have a successful small business, they're out there looking for that equity investor. And the ones that are out there that are looking to invest, you don't go out and find the individual who says, "Hey, I'm just looking for a business to put my money in." They tend to be equity funds of some type.

Mr. Urban

Yes. And you're looking for a mechanism that you might have an S corporation that could have one or two objectives, typically. One is, while they're looking to grow, they need some capital. Maybe an equity fund brings a technology or an expertise, or some synergies with other businesses that are similar. And our clients are interested in an owner because it gives them some type of a strategic advantage. So, that you see. The other thing that you see with S corporations is maybe some owners are looking to take some funds off the table. Maybe they're looking to have somewhat of a liquidity event, which you mentioned the 338(h)(10) alternative earlier. You really don't have that option with a 338(h)(10). So, in a classic situation, which is something that we've dealt with probably twice in the past six months, it tells you how frequently you see these. And by the way, when you speak with most of the larger firms, including the big four firms, this is a really popular structuring technique that they go through. And they're very familiar with it. You mentioned the flexibility. There's not a lot of judicial doctrine restrictions that you need to follow with this. There's certainly some. But what we're seeing is mature S corporations have grown. Maybe they've built up a lot of AAA. Maybe the owners are conservative, or they believe that it needs capital within those companies to continue to operate, so they don't take distributions. Yet, for a variety of reasons, maybe an owner wants to hold onto an S corporation. Maybe they've got children coming in. Maybe they want to pass away and have it stepped up at the fair market value at the time of death. That's sometimes something that somebody's thinking about when they're talking about transferring their business. So, what you typically see is maybe this F reorg provides an opportunity for capital to come in and for the owner maybe to take a distribution just in advance of some of that capital coming in, get some of that AAA off of the table. And you've got those dynamics at work. So, it's a really useful and efficient way that you're seeing those objectives met.

Mr. Redpath

And you can also see it sometimes from the other side, Greg, where the buyer, the equity investors say, "Okay, but we want you around with some skin in this game. We don't want you out; we want you in. And we want you to have some skin in the game." So, as you mentioned, maybe you're going to cash out, get some cash off the table; but we still want you to have something in the game as we move forward.

Mr. Urban

The other thing that they want is they want tax basis, fair market value tax basis, in the business that they're acquiring. They're going to have it in the stock or the ownership interest; but they might not have it in the underlying assets like you would have in a 338(h)(10) for instance, necessarily. Or in some other type of a transaction. This gives you an opportunity to provide the buyer more certainty relative to the tax basis that they would have in their assets.

Mr. Redpath

And just so our viewers, who aren't really that familiar, just very quickly. The idea of the 338 elections. And

there's 338 and then 338(h)(10), which is used in S corps and consolidated groups. But the basic idea is you're buying the stock. The reality is you bought stock, but you get to treat it as if it were an asset purchase. So, if I spend $5 million to buy the stock, simplistically, but the basis in the assets is only a million, I've got $5 million of basis hung out there on stock. I'm not going to get that back until I dispose of it. Because I've only got a million dollars of basis in the assets. 338 and 338(h)(10) are going to allow you to step up the basis through these hypothetical transactions that take place. Again, a whole other course on those hypothetical transactions. But it allows you to basically treat it as if you bought the assets, but it's not done without a tax cost. So yes, you get a step up to $5 million in the assets, as you were mentioning the asset basis. You get a step up to $5 million, but that's not tax free. That's not going to come tax free. But maybe there's another way to get to the same ending.

Mr. Urban

Right. And that's where this F reorg comes in. Like I said, it's really popular in that context. And my experience is it also is popular with the admittance of a key employee into the structure. From those perspectives, this is a technique that maybe describing how it works, Ian, would be good for the audience to get a feel for just conceptually what's happening, and how does this take place.

Mr. Redpath

Just before we do that, Greg, I want to put up a screen here, a slide for our audience to look at what basically are the benefits.

Mr. Urban

Yes, great.

Mr. Redpath

For the seller, strategy allows them to defer the gain and recognition with respect to their rollover equity, to obtain the tax benefit related to the transaction cost, and to defer the gain recognition with respect to deferred payments. What is the buyer, the strategy we're going to talk about, the buyer? They obtain a step-up basis in the target's assets for what they paid for it. They avoid the dependency on the S status for that valid 338(h)(10) issue. And they avoid the need for all the cumbersome things that come with preserving the continued use of the target's EIN, the buyer's structure. It provides them with certainly less legal consequences and less work that becomes cumbersome in making all these elections, etc.

Mr. Urban

Right.

Mr. Redpath

What's the structure that we're talking about?

Mr. Urban

What you typically see, the first step is in most cases, you see a brand new corporation set up. Usually, it's fresh corporation, corporation really can only have a de minimis amount of cash. Very important that this is what we'd call a fresh corporation that is set up. And then, what typically happens is the old S corporation owner will just simply exchange his stock. So, 351 contribution, essentially, of stock into the new corporation in exchange for the stock of the new corporation. Now, if you think about it, you own stock in this new corporation; and the new corporation owns stock in the legacy old corporation.

Now, obviously, there's some elections that become really critical there. That new corporation, in our experience, you really want to be an S corporation from day one. There's a simplified mechanism where, upon the contribution of the old S corporation stock to the new corporation, you elect to treat that old S corporation as a QSub, as a qualified Subchapter S subsidiary. So, you file an 8869; that's the QSub election. On that QSub election, you have the opportunity to note that that contribution was part of an F reorganization.

Mr. Redpath

That's a line that was actually added. A couple of years ago, they added a line there so you could say, yes, this is part of an F reorg. We're doing an F reorg.

Mr. Urban

That's right. And what that saves you from having to do is file a 2553 then for that holding company. The Service, when they get the 8869, the qualified Subchapter S subsidiary election, they know to treat that holding company then as an S corporation. And you typically have that done from day one. Now, it could be that the corporation was set up maybe a couple days in advance of the contribution of the S corporation

stock. You've got to watch that, because you probably could have a situation where you've got a C corporation maybe for a couple of days. But that's generally the first couple of steps that you'd see would be the formation of the new company, the contribution of the stock to the new company, and then a qualified Subchapter S subsidiary election. Now, if you think what you got, is you've got a new company that owns an entity that's treated as a disregarded entity for federal income tax purposes.

Mr. Redpath

We've got the traditional now S corporation, which is your holding company that now has a QSub that's disregarded. So, basically the corporation, the S corp holding company owns all the assets and takes over all the tax attributes of the S corp QSub.

Mr. Urban

AAA, E&P, those types of items. And then, with that QSub, qualified Subchapter S subsidiary, is disregarded for federal income tax purposes. And the whole concept and premise behind the F reorg, is that since it's a disregarded entity, changing its form from a corporation to an LLC, which also as a single member LLC is a disregarded entity, is disregarded for federal income tax purposes. So, that's the change in form that you were referring to, and hence, the F reorg provision. And if you think about what happened now is we still have an S corporation on top, if you will; but now it owns an LLC, a disregarded entity that's a single member LLC. And that's where the flexibility, in our view, begins.

Mr. Redpath

You're converting the QSub to an LLC.

Mr. Urban

That's right.

Mr. Redpath

There's no tax consequence to this.

Mr. Urban

No tax consequences because it's one disregarded entity to another disregarded entity. Now, it's interesting; some states will allow you to just merely change the form. I guess you would apply to the Secretary of State, I'd like this corporation to become an LLC. And they allow for that. You and I are in New York; New York doesn't quite effectuate it that way. What they say is, okay, you need to merge the corporation into an LLC. So, that's what you see in quite a few states, actually. You actually have a merger of the corporation into the LLC; and you're left with the disregarded entity, the single member LLC. But you're merging a disregard in a disregard. So, federal income tax purposes, that's really a non-event. So mechanically, it's important to know that this can happen one or two ways. Just merely a change in form under state law, or it can happen under an actual merger, which are the situations that I'm more familiar with. But in either event, you're left with a single member LLC then with all of the opportunities that you articulated, and we articulated before, relative to step-up in basis and things like that.

Then, usually what we see, now is when the flexibility tends to begin. If you think about it, now I've got an LLC. I could admit a key employee with a partner profits interest, and now it becomes a partnership. But I've gotten the key employee in with the ability to be a partner, with the ability to share in future operating profits of the entity. So, that's typically an objective. The other thing is this private equity and capital objective that we've been talking about. And that, in my experience, happens one of two ways. Maybe that LLC interest, a portion of it will be distributed out of the S corporation to the S corporation owner. And then, he or she would sell that interest to a third party, say a private equity firm. So, that would make that underlying LLC a partnership now, because you have the S corporation and a new owner. So, that's something you see. Or what we've seen more recently is just a third party make a capital contribution to that underlying LLC. And on a capital contribution, now you've got multiple owners; and that makes that entity a partnership. So, flexible in terms of the way that you can do it; but yet, it's an efficient way to achieve some of these results we're talking about.

Mr. Redpath

But you could make then, with your LLC, when you've converted it to an LLC, you could make a 754 election before the buyer, the private equity group, comes in and buys the interest, which would allow them to get a step-up in basis, which is what they were looking for.

Mr. Urban

That's right. Now, one of the other advantages to doing this, and this is something that was critical in a

transaction that I just worked on over the summer. If you go back to the ordering, we had a new company that was set up that owns a disregarded entity; that's typically initially a qualified Subchapter S subsidiary. Maybe that entity has contracts; those contracts are oftentimes referred to by reference to the EIN of that entity. Maybe there's a lot of other things that entity has got going on. So, a big benefit of this to a lot of taxpayers is the subsidiary entity is allowed to retain the historical federal identification number. This is a way to go through all this, move from an S corporation to an LLC in the manner that we're talking about, yet retain that EIN at the lower-tier level, which is really important to a lot of taxpayers.

Mr. Redpath

Yes. This is an interesting provision, because you're really avoiding a lot of steps and complexity. It sounds complex. But it's actually less complex than it could be if you did it through a number of different steps, and a lot better tax consequence.

Mr. Urban

And a lot of benefits. Now, there's some nuances. The upper-tier entity needs a new employer identification number. And interestingly enough, when you file the tax return for this initial year, your old S corporation doesn't even file a return. That filing is made by the entity, that new holding company that sits at the top. A little bit confusing, but that's the mechanic of the way that the compliance works. So, there's a few nuances, but that maintaining the EIN at the lower-tier level is a big benefit too in many of these transactions.

Mr. Redpath

Oh, yes. No, that certainly would be. And again, you don't even have to file the 2553. You just say, yes, this is part of an F reorg; and you've skipped another step in the transaction. And then with the carryover of the attributes, and then the ability to do that 754 election if you have a private equity group coming in that may be buying an interest. Because as you mentioned, the person wants to get some money off the table. It sounds like a great deal. As we said, this is something that's becoming more and more popular. Now, the different steps here I think can be done. It doesn't have to be done all of the steps, for example, the conversion and everything. You could literally just do it with the first steps without having the secondary steps if you're not, for example, bringing private equity in. There's a number of reasons you might want to do it and stop just with the QSub election. That's another possibility. Especially if you're just changing the form, where you were doing business. Well, that might be another thing to look at, which would then give you the possibility of making the LLC conversion at some future point and still getting the benefits of it. Are there any other things that you need to look at in this context?

Mr. Urban

I would say that those are the big things. Sometimes, this question of sales tax comes up. Which entity have you done anything relative to sales tax registrations? We believe that sales tax is determined by reference to the federal identification number. So, a lot of times, there's consistency that way. There's another question that comes up. Sometimes, people ask a practical question of, okay, if you think about maybe one of the scenarios that we were talking about where we merged a corporation into an LLC. That's just the way that the change of form had to occur. Does that merger do anything to the EIN? And it shouldn't do anything to the EIN. So, you get some practical questions when you start to draw up the transaction. But those are the big things.

Mr. Redpath

Let me give you a basis question, okay? I've got my S corp, I have converted it to an LLC. Now, in my S corp, my shareholders have paid-in capital. Maybe they have additional paid-in capital. But now, I've got a capital account. What's my beginning capital account from that LLC, in the LLC, when there was no capital account, there was no concept of a capital account in the S corp?

Mr. Urban

You're talking about tax or book capital account?

Mr. Redpath

That's another program we did on that. But how do you account for that?

Mr. Urban

Typically, what you would do is you'd restart the capital account computation; and you would start with the capital accounts with the fair market value of what was contributed. So, what you see oftentimes is take the simpler example, cash comes in for say a 20% ownership interest. That to me implies that the rest of the assets contributed by the old S corporation are 80%

of the value. What we do is we start the capital accounts by reference to the fair market value of the property that was contributed to this new partnership.

Mr. Redpath

So, on the conversion, you look at the fair market value of the assets and say that's the capital account?

Mr. Urban

That would be your 704(b) capital account when the partnership forms, yes.

Mr. Redpath

And what about your tax capital account? What do we do with paid-in capital, for example? Or what do we do with AAA or E&P?

Mr. Urban

A lot of those concepts will still reside at the holding company level. But your tax basis in the structure, it's just a carryover tax basis from when you were an S corporation. The point you're making is you need to have a handle on the outside basis of your S corporation, but that should carry over into this new structure. But if you have a partnership, obviously you've got to follow those 704(b) rules and probably establish a capital account on that basis.

Mr. Redpath

Yes. And this comes up a lot when people just do one… Here we had another step, we had a QSub. Basically, all the tax attributes went up. But when you don't have that QSub and you just have an S corp converting to a partnership or an LLC taxed as a partnership. All of a sudden, okay, well, what is your capital account? I was an S corp. I had paid-in capital. I have a AAA account and I have E&P. What is your capital account? And that's a real confusing issue on a conversion. And I don't think the IRS has given us a lot of guidance on that.

Mr. Urban

Right.

Mr. Redpath

But this is a little easier because you've got that QSub election to go up. Greg, this is really interesting. Again, as you said, it's very popular. Anybody out there where you've got these types of situations with some of your S corporation clients, this is something really to look at, this F reorg. I think this is a great topic. And Greg, thanks for your insight. I know you've been doing a lot of these. As you said, you've had two in the last six months; so, obviously, it's a popular thing. I don't think it's just popular with you. It's got some real benefits out there for all of our viewers to look at. Greg, I really want to thank you for being here. Thank you for your insight. Great program today. Thanks again, Greg.

Mr. Urban

Thanks, Ian. Nice to be with you.

F Reorganizations and S Corporations

By Ian J. Redpath, JD, LLM

A. Introduction

S corporations generally pay no taxes; and the tax items for the year pass through to the shareholders and are taxed at the owner level. This is similar to a partnership, except the S corporation has a number of limitations that are not applicable to a partnership. For closely held corporate businesses, the choice is generally an S corporation for tax purposes. Additionally, many small businesses utilize the S corporation to limit the amount of FICA/SE taxes. In most partnerships, the partners pay self-employment taxes on all of their income; while in an S structure, the W-2 wage of an employee/owner is subject to FICA, and distributions are not subject to S/E taxes. The planning is to reduce the "wages" to an amount that is not "unreasonably" low and then take as much as possible out as a distribution. This is a frequent area of audit in S corporations.

One significant limitation of S corporations is the inability to have a second class of stock. There may be voting differences but not differences in rights on distributions or liquidations. Thus, a corporation may not have voting common stock and voting preferred stock with a preference on dividends or liquidations. It should be noted that this only applies to issued and outstanding shares. Also, unexercised stock options, warrants, and convertible debt are not usually considered a second class of stock. The IRS may attempt to find debt and/or an employment arrangement as actually disguised stock; and, thus, the corporation's S status is terminated.

An S corporation cannot have more than 100 shareholders. This can be expanded as a group of family members is treated as one shareholder for this purpose. This includes any common ancestor, the lineal descendants of the common ancestor, and the spouses (or former spouses) of the lineal descendants or common ancestor.

A third important limitation is that an S corporation's shares may be held only by U.S. citizens or residents, estates, certain trusts, charities, and certain other tax-exempt organizations. Qualified retirement plans other than IRAs, and one-person LLCs, can also qualify as shareholders of an S corporation. Note that partnerships, corporations, limited liability partnerships, and most LLCs cannot own S corporation stock.

An F reorganization under §368(a)(1)(F) is somewhat commonplace, often without being considered one, is a mere change in identity, form, or place of organization of one corporation. This is regardless of however it is effected. There are certain steps that must be followed to avoid the potential of gain recognition and a busted reorganization. Reg. §1.368-2(m) provides six requirements that must be met for a transaction that involves an actual or deemed transfer of property by a transferor corporation to a resulting corporation to be an F reorganization. The regulations are written to make sure that the transaction is truly an F reorganization and not an acquisitive or divisive transaction. The transferee or resulting corporation should be the essential equivalent of the transferor corporation.

The six requirements are:

- All of the stock of the transferee resulting corporation must have been distributed or deemed distributed in exchange for stock of the transferor corporation.
- The same person(s) must own all of the stock of the transferor corporation as determined immediately before the reorganization, and of the transferee resulting corporation immediately after the reorganization, in identical proportions. (Note that stockholders are permitted to exchange their shares of the transferor corporation for a different class of shares of the transferee resulting corporation, as long as they are of equivalent value. Also, the existing stockholders can receive a distribution of money or other property from either the transferor corporation or the transferee resulting corporation, whether or not in exchange for stock in the transferor corporation or the resulting corporation.)
- The transferee resulting corporation may not hold any property or have any tax attributes immediately before the reorganization, other than a de minimis

amount of assets as needed under local law to facilitate the incorporation or maintain its legal existence.

- The transferor corporation must completely liquidate, or be deemed to have liquidated, for federal tax purposes (for example, by a merger). To preserve its legal existence, it may retain a de minimis amount of assets rather than legally dissolve.
- The transferee resulting corporation must be the only acquiring corporation; and immediately after the reorganization, it must be the only corporation holding property that was held by the transferor corporation immediately before the reorganization.
- The transferor corporation must be the only corporation acquired by the transferee resulting corporation immediately after the reorganization. It may not hold property from a corporation other than the transferor corporation if it would succeed to the tax attributes of that other corporation under §381(c).

The third and fourth requirements are to ensure that, with minor exceptions, everything that the transferee resulting corporation owns after the F reorganization is from the transferor corporation and the transferor corporation will not retain assets and be terminated for tax purposes.

Reg. §1.368-2(m)(3)(ii) provides that transactions preceding or following a potential F reorganization generally will not cause a transaction to fail as an F reorganization. Rev. Ruls. 96-29, 79-250, 69-516, 64-250, and 61-156 all have provided that the step-transaction approach should not cause a failure of an F reorganization that is part of a larger transaction. This allows for pre-transaction F reorganization strategy followed by an acquisition.

In a sale, buyers usually want an asset purchase so as to obtain a step up in basis in assets for cost recovery purposes. On the other hand, sellers want to sell their stock to obtain favorable capital gain treatment, usually long term. If the buyer obtains the stock and liquidates the subsidiary, it will be a nontaxable transaction under §332. The basis and other tax attributes will carry over under §§334 and §381. Section 338 will allow a stock purchase to be treated as an asset purchase by the buyer, but at a cost. A corporation may elect the provisions of §338 if it acquires at least 80 percent of the stock (measured by voting and value) of another corporation within a 12-month period; a "qualified stock purchase." The stock must be acquired in a taxable transaction. An acquisition of stock by any member of an affiliated group that includes the parent corporation is considered to be an acquisition by the parent. The §338 election must be made by the fifteenth day of the ninth month beginning after the month in which a qualified stock purchase occurs. If made, the election is irrevocable. If §338 is elected, the subsidiary is treated as having sold its assets on the qualified stock purchase date for a value that is determined with reference to the parent's basis in the subsidiary stock plus any liabilities of the subsidiary ("aggregate deemed sale price"). The subsidiary is then treated as a new corporation that purchased those assets for a similarly computed amount ("adjusted grossed-up basis") on the day following the qualified stock purchase date. The deemed sale results in gain (or loss) recognition by the subsidiary, and the deemed purchase results in a stepped-up (or down) basis for the subsidiary's assets. The subsidiary may, but need not, be liquidated. If the subsidiary is liquidated, the parent will obtain a carryover of the stepped-up (or -down) basis of the subsidiary's assets.

A variation on §338 is §338(h)(10). The election must be to apply both sections. The most common use of this section is an S corporation target. The election allows, for tax purposes, an electing buyer and seller to treat the buyer as having purchased the target's assets. Of course, the reality is that the stock was purchased; so, the legal paperwork must be changed to reelect this end result. Essentially, the target S corporation sells all its assets to the buyer. The gain or loss flows through to the selling shareholder(s), and the corporation is deemed liquidated.

A §336(e) election is similar to the §338(h)(10) election. The major difference is that in a §338(h)(10) election, the purchaser must be a corporation, and the term "qualified stock purchase" (QSP) is used when all criteria for the election are met. For §336(e), a qualified stock disposition (QSD), the types of purchasers are not restricted. This means individuals, partnerships, or other noncorporate entities that could not use a §338(h)(10) election may still be able to qualify for the same treatment under §336(e). According to Reg. §1.336-1(b)(6)(ii)(A), a QSP takes precedent. For an S corporation stock disposition to qualify as a QSD, at least 80% of the vote and value of S corporation stock must be disposed of in a transaction or series of transactions within a 12-month period [Regs. Sec. 1.336-1(b)(6)(i))], which is the similar to §338(h)(10).

B. Reincorporation

The reincorporation of an S corporation from New York to Florida can be accomplished by forming a Florida corporation, followed by the merger of the New York corporation into the Florida corporation. [Rev. Rul. 64-250, 1964-2 CB 333] The New York corporation will be treated, for federal income tax purposes, as transferring all of its assets to the Florida corporation in exchange for stock of the Florida corporation and the assumption of any liabilities. This should constitute a tax-free exchange to which §§361(a) and 357(a) apply. The New York corporation then distributes the stock of the Florida corporation to its shareholders. Under §354, there is no gain or loss recognized. Also, the Florida corporation recognizes no gain or loss under §1032. This would be an F reorganization. The Florida corporation succeeds to the EIN and tax attributes of the New York corporation, including the S election.

C. Use of F Reorganizations and Private Equity Acquisitions

An election under §§338(h)(10) or 336(e) often requires coordination between the buyer and the seller with respect to the election and various other legal matters. Normally, in these transactions, the buyer wants the seller to have some form of continuing interest; this may not allow a tax deferral on any rollover portion of the transaction for the seller. Sellers may demand to participate in any future upside under private-equity ownership.

One concern is that there may be an inadvertent step that invalidates the S election, resulting in the sale of a C corporation. It is for this reason the use of an F reorganization has become a common technique in these types of transactions. This will allow:

(1) a step-up in tax basis of the target's assets for the purchase portion of the transaction (even if under 80%);

(2) the same treatment to sellers under a §338(h)(10) election but without the need for an 80% change and with the ability to achieve tax deferral on the rollover;

(3) the avoidance of cumbersome legal considerations common in an asset purchase; and

(4) continuation of the target's employer identification number (EIN), which is often an important consideration for a buyer.

There is no 80% or more purchase requirement nor the taxation of 100% of the gain in a partial rollover transaction. It does not have to meet the qualified stock purchase requirements. As a result, it is often a better solution if a tax-deferred rollover is inherent in the transaction and if the buyer wishes to obtain a step-up on the corporate assets it acquired.

The use of this assumes there is a step-up in basis. It will generally not be used when a step-down is the result.

Example of Structure:

Step 1: The stock of the S corporation target (OldCo) is to be contributed by the shareholders to a new holding company (NewCo) in exchange for stock of NewCo. NewCo may make a valid S election and then make a QSub election for the OldCo. The result is that OldCo is deemed to be liquidated into NewCo. This is tax-free under §332 with the basis and other tax attributes carrying over with the assets. As a result, OldCo is not a wholly owned subsidiary of NewCo. This can be treated as an F reorganization. [PRLs 200542013; 200725012, and 200701017] The S election may not be necessary as the deemed liquidation of OldCo carries the S election to NewCo [Rev. Ruls. 2008-18 and 64-250]; however, it may be done. NewCo will have to obtain a new EIN as OldCo will retain the EIN. It should be noted that Form 8869 has a question to confirm whether the QSub election was being made in connection with an F reorganization described in Rev. Rul. 2008-18. The purpose is to alert the IRS that there will be no separate S corporation election for NewCo and OldCo's S corporation status continues in effect for NewCo. A Form 2553 is *not* required to be filed by OldCo as the parent; however, practitioners will often file it. The timing is critical; so, great care must be taken that proper timing is met.

Step 2: The next step is to convert the QSub into a single member LLC under appropriate state law. This will be tax-free since because both the QSub and the resulting single member LLC are disregarded entities for federal income tax purposes. The QSub election should have the same effective date as the contribution of stock to the holding company and S corporation election. The conversion into the LLC should be effective only after the effective date of the holding company S election and QSub election.

Step 3: The structure will allow a partial tax-free rollover exchange of part of NewCo's interest in the disregarded LLC in a tax-free §721 exchange for a partnership interest in the purchaser. This would be a multiple member LLC. NewCo will hold the rollover partnership interest received in the exchange. The remaining interest of NewCo in the disregarded LLC can be sold to the purchaser for cash. Because the LLC is a disregarded single member LLC, it should be treated as a partial asset sale for tax purposes, resulting in a step-up in basis for the purchaser. There still may be some liability issues for the purchaser. Note that the §754 election should be made. NewCo will have to obtain a new EIN because OldCo will be required to retain its historic EIN even though it is a disregarded entity. This has avoided the issues and problems with a §338(h)(10) or §336(e) process. [See Rev. Rul. 99-5]

D. Conclusion

Since so many small businesses are formed as S corporations, it is not surprising that issues may arise relating to bringing in investors or possible sales of all or part of the business. Proper planning using an F reorganization has gained in popularity. Care must be taken to meet the strict compliance to the timing of the steps to assure F reorganization treatment. This can be done in a more efficient manner with less complications than utilizing §338(h)(10) or §336(e).

A. Discussion Problems

Your clients, James Smith and Carlita Jones, own an S corporation that is domiciled in New York.

- They are considering relocating to Texas.
- They have also been approached by a private equity group that would like to effectuate an asset sale but also want them to have some continuing interest. They would like to have capital gain treatment.

Required:

Discuss the following:

1) If they wish to relocate to Texas, how can the corporation be moved?

2) Since the buyer wants an asset purchase as well as having the seller maintain a continuing interest, can they utilize §338(h)(10) or §336(e)?

3) Why might an F reorganization be utilized for the private equity transaction?

B. Suggested Answers to Discussion Problems

1) This is a common use of an F reorganization. A Texas corporation will be organized and the two entities merged under state law. This is considered an F reorganization for federal income tax purposes.

2) Sections 338 and 338(h)(10) provide a solution by treating a stock purchase as an asset purchase. However, it has a number of requirements that often make it difficult to use in these situations. If the equity group is not a corporation, then §336(e) will get the same result.

3) Advantages to using an F reorganization are:

   - a step-up in tax basis of the target's assets for the purchase portion of the transaction (even if under 80%);
   - the same treatment to sellers under a §338(h)(10) election but without the need for an 80% change and with the ability to achieve tax deferral on the rollover;
   - the avoidance of cumbersome legal considerations common in an asset purchase; and
   - continuation of the target's employer identification number (EIN), which is often an important consideration for a buyer.

   There is neither an 80% or more purchase requirement nor the taxation of 100% of the gain in a partial rollover transaction. It does not have to meet the qualified stock purchase requirements. As a result, it is often a better solution if a tax-deferred rollover is inherent in the transaction and if the buyer wishes to obtain a step-up on the corporate assets it acquired. However, great care must be taken to effectuate each step in a timely manner.

GLOSSARY OF KEY TERMS

Angel Investor—A high-net-worth individual who provides financial backing for small businesses or entrepreneurs, typically in exchange for ownership equity in the company.

Cryptocurrency— Cryptocurrency is a type of unregulated digital currency that is only available in electronic form. It is stored and transacted only through designated software, mobile or computer applications, or through dedicated digital wallets, and the transactions occur over the internet through secure, dedicated networks.

F Reorganization—An F reorganization under §368(a)(1)(F) is a mere change in identity, form, or place of organization of one corporation, regardless of however it is effected.

IRS Form 2553—Form 2553, Election by a Small Business Corporation

IRS Form 8869—Form 8869, Qualified Subchapter S Subsidiary Election

IRS Form 15254—Form 15254, Request for Section 754 Revocation

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.

Private Equity—Private equity is an alternative investment class that invests in or acquires private companies that are not listed on a public stock exchange.

Qualified Subchapter S Subsidiary (QSub)—A domestic corporation that itself would be eligible to make an S corporation election and is 100 percent owned by an S corporation that makes the QSub election for its subsidiary. For federal income tax purposes, the QSub is not treated as a separate corporation.

CUMULATIVE INDEX 2023

BY TOPIC

BY CITATION

BY SPEAKER

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

1. According to Ian Redpath, which of the following cases involves a Chapter 11 bankruptcy?

   A. *Donoghue v. Reddig*
   B. *FTX Trading Ltd.*
   C. *Hallmark Research Collective v. Commissioner*
   D. *Intan S. Ismail, et ux. v. Commissioner*

2. According to Ian Redpath, which of the following is a reminder that it may be possible to transfer up to $100,000 tax free through a qualified charitable distribution?

   A. IRS Notice 2022-41
   B. IR-2022-201
   C. IRS Announcement 2022-26
   D. Private Letter Ruling 202248017

3. According to Ian Redpath, in which of the following cases did the court rule against the plaintiff because they failed to prove that they were a trade or business rather than a hobby?

   A. *Donoghue v. Reddig*
   B. *FTX Trading Ltd.*
   C. *Hallmark Research Collective v. Commissioner*
   D. *Intan S. Ismail, et ux. v. Commissioner*

4. According to Ian Redpath, which of the following cases may be appealed because of the argument for equitable tolling?

   A. *Donoghue v. Reddig*
   B. *Hallmark Research Collective v. Commissioner*
   C. *Intan S. Ismail, et ux. v. Commissioner*
   D. *Moore v. United States*

5. According to Ian Redpath, which of the following cases involved a dissent regarding whether the government can start taxing income without a realization event?

   A. *Donoghue v. Reddig*
   B. *Hallmark Research Collective v. Commissioner*
   C. *Intan S. Ismail, et ux. v. Commissioner*
   D. *Moore v. United States*

Continued on next page

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

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

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

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

8. According to Ian Redpath and Bob Lickwar, how long is a Section 754 election in effect once it has been elected?

   A. One year
   B. Five years
   C. Ten years
   D. Unless the IRS agrees to its revocation

9. According to Ian Redpath and Bob Lickwar, which of the following is ***always*** correct regarding a Section 754 election?

   A. It does not impact the basis of partnership assets.
   B. It results in a step-down in the basis of partnership assets.
   C. It results in a step-up in the basis of partnership assets.
   D. It can result in a step-down or a step-up in the basis of partnership assets.

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

    A. Schedule K-1
    B. Form 1065
    C. Form 8869
    D. Form 15254

Continued on next page

11. According to Ian Redpath and Greg Urban, which of the following describes an IRC Section 338(h)(10) transaction?

    A. Buying assets in an S corporation and treating it as an asset purchase
    B. Buying assets in an S corporation and treating it as a stock purchase
    C. Buying stock in an S corporation and treating it as an asset purchase
    D. Buying stock in an S corporation and treating it as a stock purchase

12. According to Ian Redpath and Greg Urban, which of the following is used to file a QSub election?

    A. Schedule K-1
    B. Form 1065
    C. Form 8869
    D. Form 15254

13. According to Ian Redpath and Greg Urban, which of the following is ***not*** a typical result of an F Reorganization?

    A. Change in identity, form, or place of organization
    B. Complicated legal paperwork
    C. Continuation of the target's assets
    D. Step-up in tax basis of the target's assets

14. According to Ian Redpath and Greg Urban, which of the following forms is often filed in an F Reorganization even though it may not be required?

    A. Schedule K-1
    B. Form 2553
    C. Form 8869
    D. Form 15254

15. According to Ian Redpath and Greg Urban, which of the following is correct for the initial year following an F Reorganization for an S corporation converted to an LLC?

    A. The LLC is not required to file a federal income tax return.
    B. The LLC is required to file two federal income tax returns.
    C. The S corporation is not required to file a federal income tax return.
    D. The S corporation is required to file two federal income tax returns.

CPE Network®
Tax Report
Volume 36, Issue 1 **January 2023**

Subscriber Survey

Evaluation Form

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

How would you rate the topics covered in the January 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	_____	_____	_____	_____	_____	_____
Section 754 Election and Section 734 Adjustments	_____	_____	_____	_____	_____	_____
Private Equity and F Reorganizations of S Corporations	_____	_____	_____	_____	_____	_____

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

Which segments of the January 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 January 2023 **CPE Network® Tax Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	**Knowledge of Topic**	**Presentation Skills**
Ian Redpath	_____	_____	_____
Robert Lickwar	_____	_____	_____
Greg Urban	_____	_____	_____

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

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

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

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

Were program materials accurate? Yes ☐ No ☐ _____

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

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

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

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

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

Specific Comments: _____

_____

Name/Company _____

Address _____

City/State/Zip _____

Email _____

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

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: _____

Account #: _____

Location: _____

Program Title: CPE Network Tax Report, January 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: _____

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

CPE Network/Webinar Delivery Tracking Report

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

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

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED SEPTEMBER 3, 2021

Welcome to CPE Network!

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

This User Guide has the following sections:

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

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

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

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

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

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

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

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

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

Requesting Participant CPE Certificates

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

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

Email: **CPLgrading@tr.com**

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance in a Webinar

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

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

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

Examples of polling questions:

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

Additional Notes on Monitoring Mechanisms:

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

Real Time Moderator During Program Presentation

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

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

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

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

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

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

Requesting Participant CPE Certificates

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

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

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Self-Study” Format

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

Self-Study—Print

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

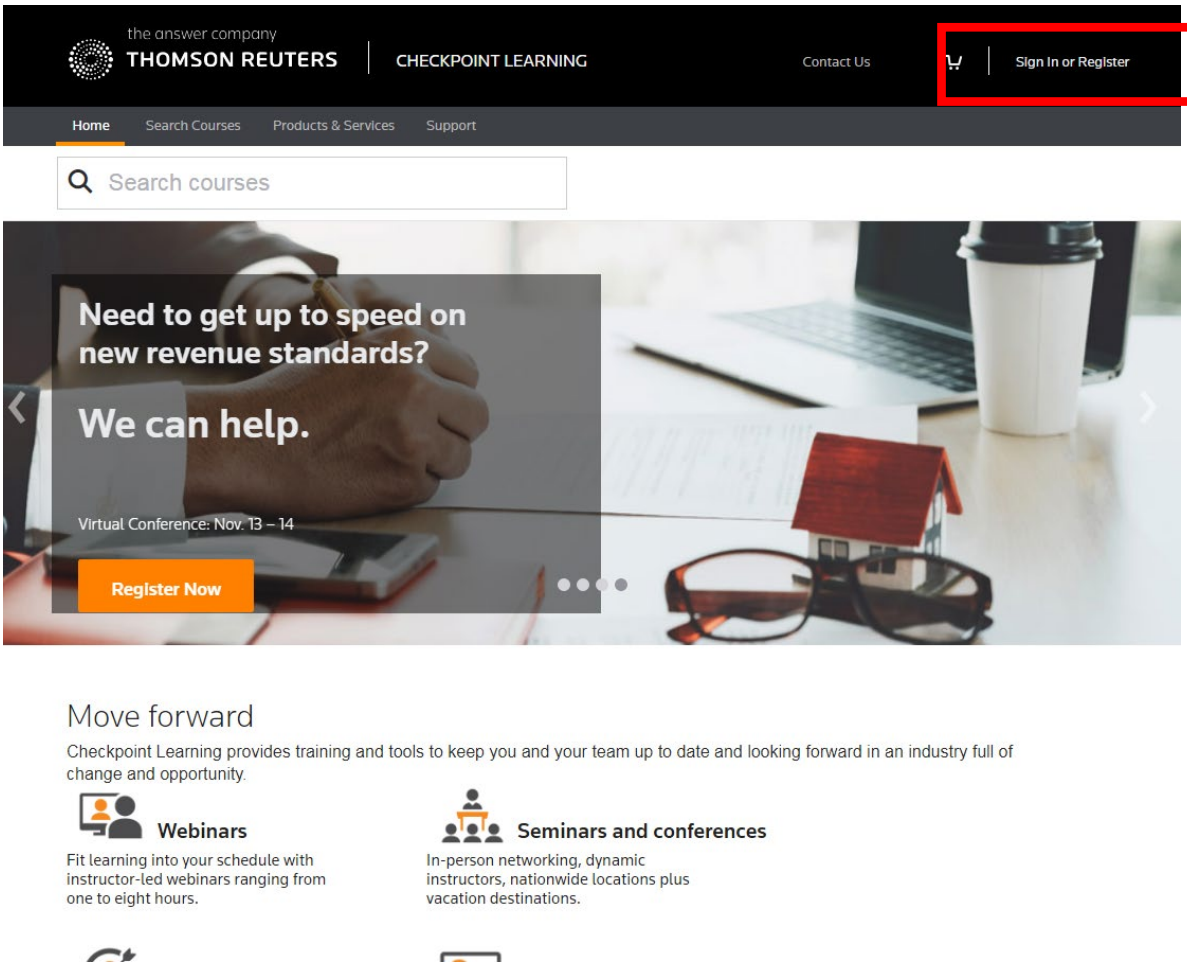
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

  Thomson Reuters
  PO Box 115008
  Carrollton, TX 75011-5008

Self-Study—Online

Follow these simple steps to use the online program:

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



Move forward

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

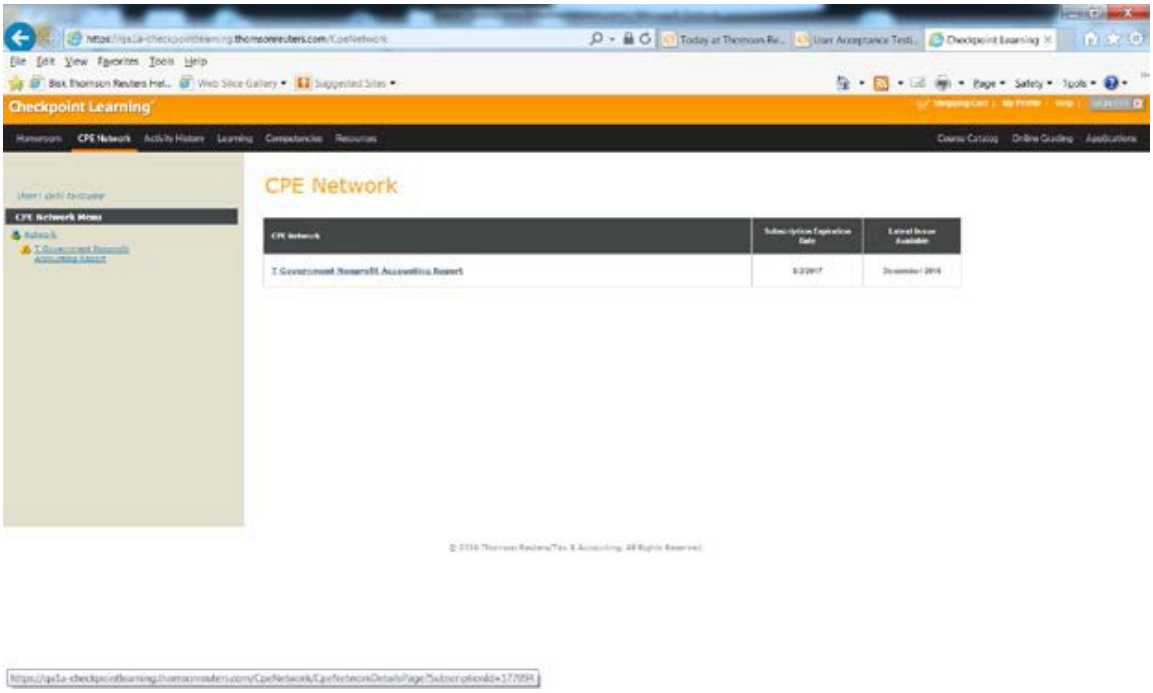
Webinars

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

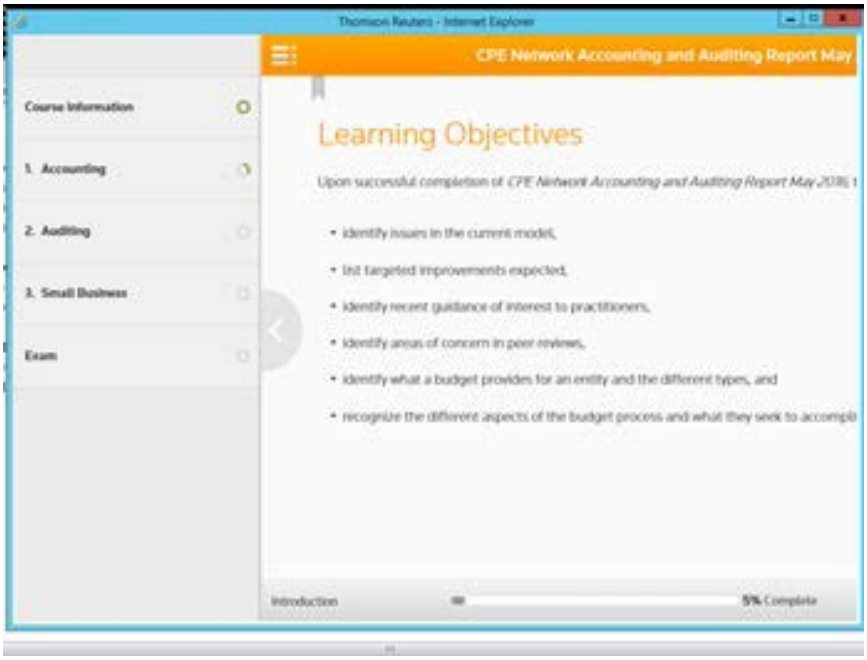
Seminars and conferences

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

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

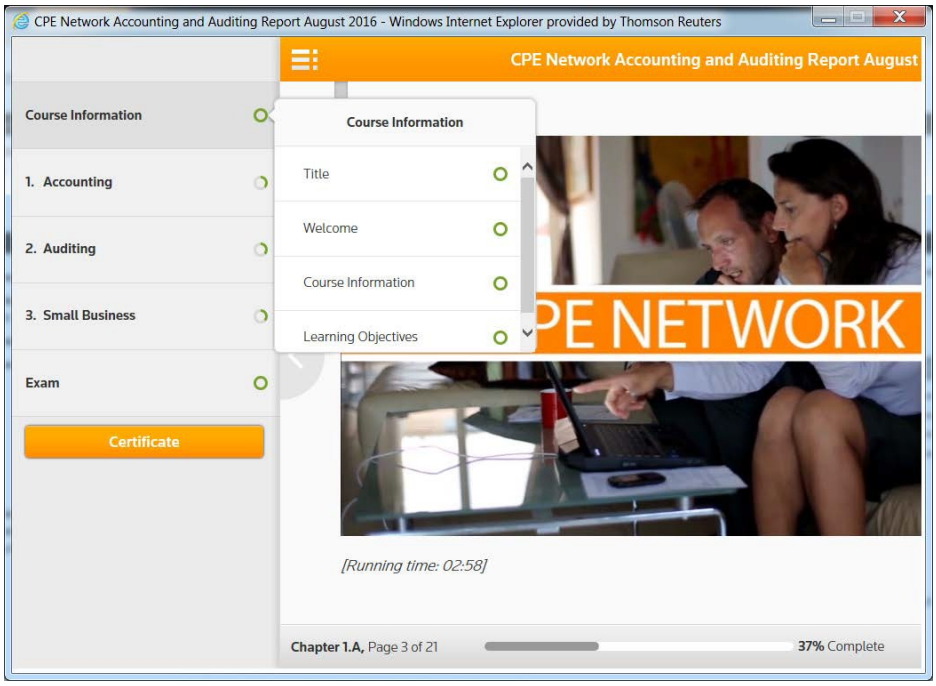


The Chapter Menu is in the gray bar at the left of your screen:



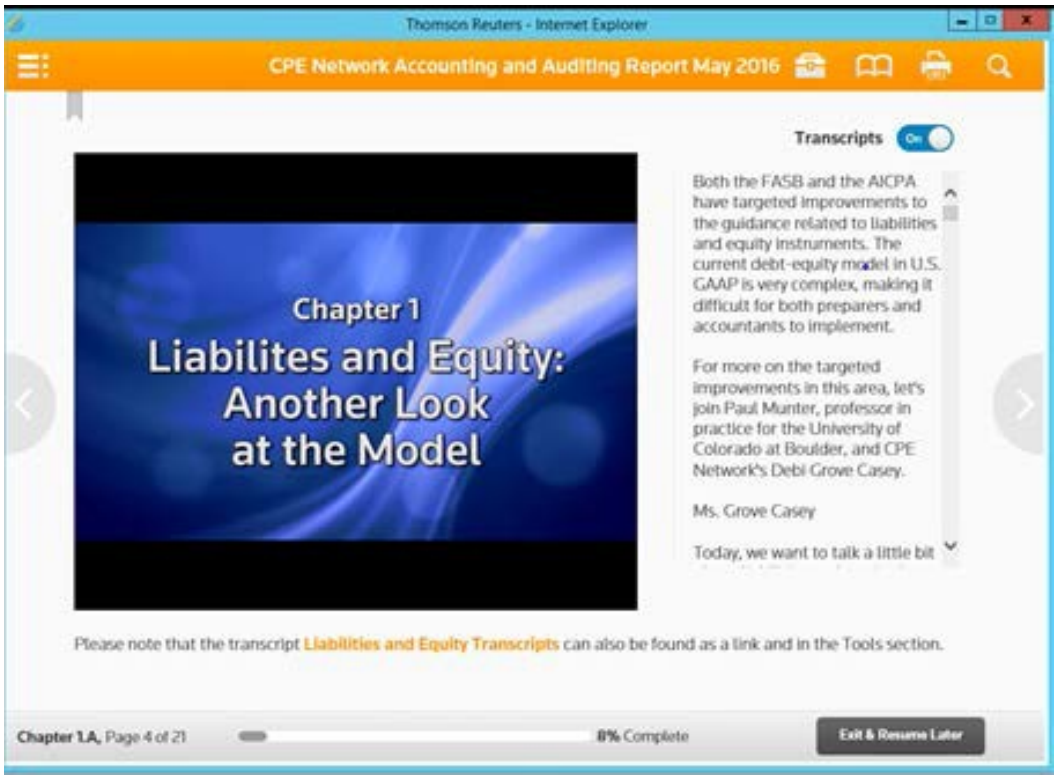
Click down to access the dropdown menu and move between the program Chapters.

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

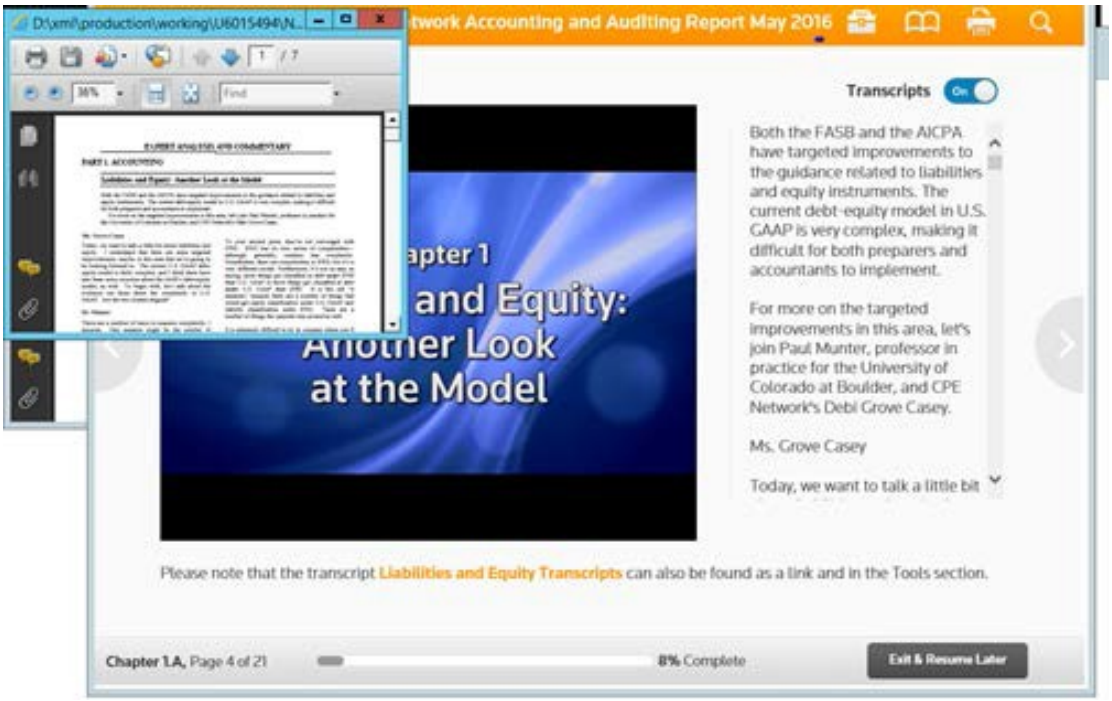


- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental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

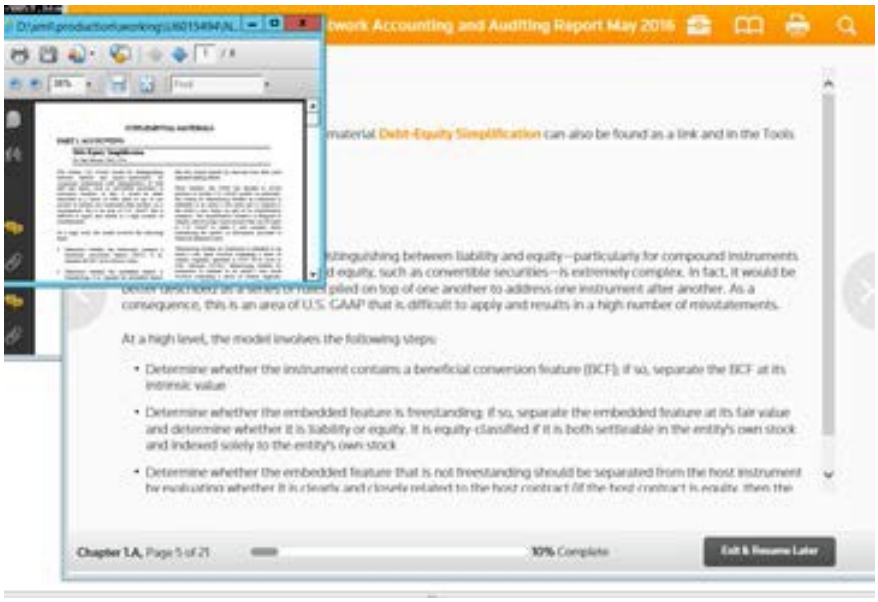
Video segments may be downloaded from the CPL player by clicking on the download button.



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

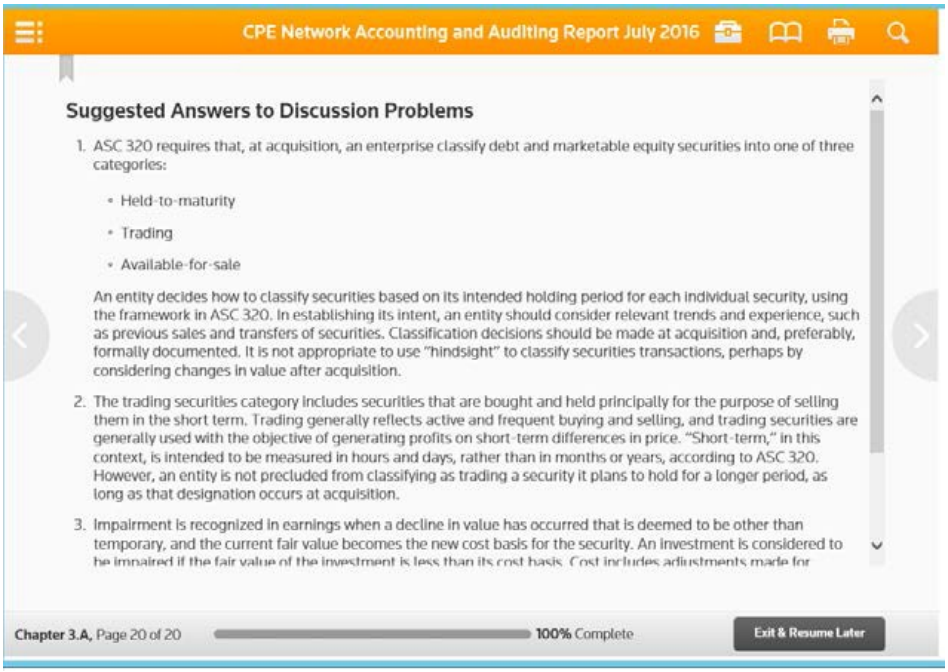


Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



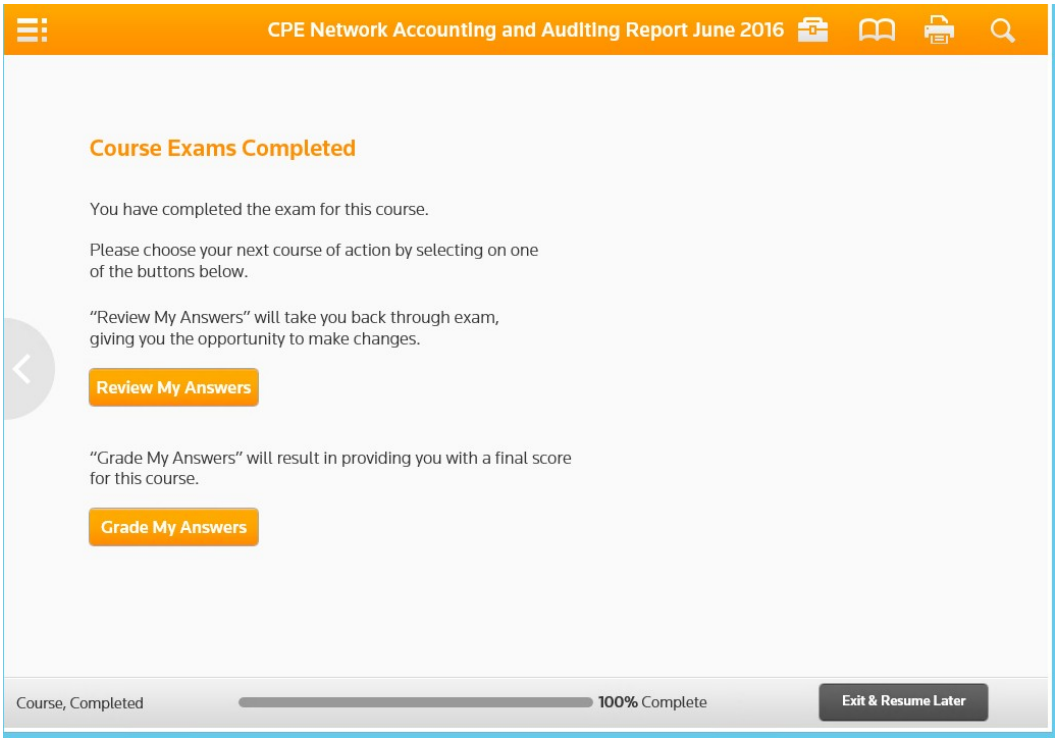
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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



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

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



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

Additional Features Search

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

Search Results are displayed with the number of hits.

Print

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

What Does It Mean to Be a CPE Sponsor?

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

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

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

CPE Sponsor Requirements

Determining CPE Credit Increments

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

Program Presentation

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

information available in advance:

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

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

signable format)

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

Appendix: Forms

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

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

Getting Help

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

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