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CPE NETWORK
TAX REPORT
MARCH 2023 VOLUME 36, ISSUE 3

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Topics for future editions may include:

- Taxation of High-Income Individuals
- C Corporation Taxation

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EXECUTIVE SUMMARY

ABOUT THE SPEAKERS

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

Shannon Jemiolo, CPA, PhD is an Assistant Accounting Professor at Canisius College in Buffalo, New York, where she also maintains an active tax consulting business. She holds a Bachelor's degree from West Virginia University and a Ph.D. from the University of Oklahoma. Prior to receiving her Ph.D., Shannon worked at in the tax division of PricewaterhouseCoopers and specialized in corporate tax, mergers and acquisition, and corporate restructuring. Shannon has written numerous articles on personal/corporate tax compliance and corporate social responsibility and has presented her tax research at national conferences around the country.

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

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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 a case that was decided by the Supreme Court. The case concerns protected documents related to grand jury subpoenas.

Let's join Ian.

A. *In re Grand Jury*

598 U.S. ____ (2023)

Mr. Redpath

Hi, I'm Ian Redpath. Welcome to the program. This is the segment where we go over a number of things that have happened with the Internal Revenue Service, with the courts, Congress, all sorts of different aspects of taxation. Hopefully, you are getting through tax season. We are in the middle of tax season right now and, hopefully, it hasn't been too stressful as you move into the heavy, individual tax part of the season.

Let's start right in with a court case. This is one that we talked about before in another program because the Supreme Court had granted *certiorari*—meaning, for those of you not up with the legal terms—*certiorari* is simply leave to appeal. And in almost all tax cases, there is no right to appeal to the Supreme Court of the United States. You have to go and ask for permission, and that is called *certiorari* if they grant it.

Well, they granted *certiorari*, and this is the *In re Grand Jury*. Now, kind of a strange name, right? *In re Grand Jury*. Why would a case be named *In re Grand Jury*? Well, the reason is that there was a grand jury subpoena of a law firm. Most of the communications that they are trying to get were communications among lawyers, but also communication with accountants—and this becomes a huge issue. If you are dealing with an attorney, and you are talking to the attorney about a client's tax situation, what can the IRS come in and get? Even with the attorney, we know that you don't have the same level (as accountants) of protection as lawyers do, but what about those communications? Can they fall under work-product protection, or can the attorney bring you in under their attorney-client privilege under the idea that this is legal advice in nature?

The Ninth Circuit Court of Appeals—and this was an international tax [case]; they refused to produce documents that were so-called *dual-purpose* communications. This was a criminal investigation of a corporate client. The Circuit Court, they followed the longstanding primary purpose test and said the attorney-client privilege for dual communications; and it was held that there was no privilege because they were unable to show that the primary purpose was legal. So, this was appealed to the Supreme Court; and, again, both the Circuit Court and the Ninth Circuit Court of Appeals had held that the privilege was not available because this was not primarily (the primary purpose was not) legal. So, the government said, "No, this is correct." Any communication between a client—so, for example, the client, the attorney, and a non-lawyer accountant—cannot fall under attorney-client privilege.

Again, a lot of the communications, some of it was simply tax preparation advice. And they said, "That didn't require a lawyer's expertise. It wasn't really legal advice." So, anything related simply to tax preparation advice would not be protected, and that had to be provided to the grand jury. The law firm here, they argued that the primary purpose test is flawed; and they proposed a significant purpose test, which said, really, shouldn't the issue here be when you have multiple potential reasons for a communication? And think about it, many times when you are talking to a client and maybe you are structuring a transaction, or you are talking to their attorney about how to structure it, there are legal aspects of it, there are accounting aspects of it, there are tax aspects of it—it has multiple purposes. So they said, you should apply the significant purpose test and that way is more reliable so that when an attorney and an accountant (in this case, it's accountants) but when an attorney and non-attorney are talking, they have a better idea upfront as to whether this is going to be protected or not, or whether the courts might come back later and say, "Oh, no, the primary purpose was *not* that."

Shockingly, the Supreme Court, suddenly, after hearing oral arguments, jumped in and said, "Oh, well, we changed our mind—sorry," and they denied. They remanded the case, they dismissed the case within the Supreme Court by saying it was not right. "It really wasn't right that we granted *certiorari* in the beginning so, oh well, forget it." Okay, so we are going back now to the Ninth Circuit; and there (and the law predominantly throughout the United States), [they use] the primary purpose test for these communications.

You always have to be careful when you have communications with an attorney. To what extent are you under either their work-product protection (there are cases out there like Deloitte and Textron) and this dual-purpose idea? So, to what extent is that communication with the lawyer? I would always, if you are talking to a lawyer about client information, I would make sure that the lawyer assures you that this would be considered under attorney-client privilege. It is really a difficult situation, not made any better by the Supreme Court just suddenly changing their mind. Literally, that is exactly what they did; they just changed their mind. It is rare that they would do that, especially after oral arguments—not make a decision, just, "Oh, sorry, we are not going to hear it."

B. *Cory H. Smith v. Commissioner*

(2023) TC Memo 2023-6

We have a case that is a little more certain, but something to pay attention to, the *Corey H. Smith* case. It is a Tax Court Memo case, and the IRS sought summary judgment. The taxpayer was an Air Force veteran engineer, worked on military defense facilities in Australia, and they claimed he wasn't entitled to the §119 exclusion for the value of lodging his employer provided. Now, the lodging failed because the general rule is it must be (1) a condition of employment, and (2) it must be on the premises. Well, this was miles—the place that they were providing for the housing—was miles away from the work site. Again, they tried to argue, and this is an argument that has been made before, but they tried to argue that the facility where the lodging was located was an integral part of the employer's business activities. And they said, "No, sorry. There wasn't a significant amount of work performed at the place where the lodging was being provided; therefore, sorry, no exclusion."

C. *Hrach Shilgevorkyan v. Commissioner*

(2023) TC Memo 2023-12

Interesting case. It is even better if you can pronounce it—*Hrach Shilgevorkyan*—I think I have it right there, *Shilgevorkyan*. It is a Tax Court case, and it deals with interest. So, what you have is, you have a family and a couple of brothers who are engaged in certain activities related to property. And there is this property in Arizona—Paradise Valley, Arizona. It was purchased for $1.525 million, and there was a little over a $1.43 million loan from Wells Fargo. One brother and his wife were the borrowers. About the same time that was taking place, the brother, wife, and another brother took out a $1.2 million construction loan secured, again, by the Paradise Valley property; and the loan was to fund construction of a 5,300-square-foot house and a separate 1,700-square-foot guest house on the premises.

Well, the one brother, Edvard, no problem; his wife, Lusine, no problem. They had signed the notes, and they were on the deed. But the other brother who was part of the construction loan—that's Artur—Artur never contributed anything, no down payments, never lived on the property, and never paid any expenses for the property. Artur now executes a quitclaim deed to his brother, and that is the brother involved with this case. They never contacted Wells Fargo about the conveyance; Wells Fargo didn't approve the conveyance; there never was an assumption of the mortgage; and there was no payment made. Artur did not receive anything from Hrach on this (no payments), so you just have a deed transferred.

Now, Hrach tries to take a mortgage deduction. Well, there are three things [required]: it has to be an indebtedness—it has to be the person's obligation, it has to be either the legal or equitable owner of the property that is subject to the mortgage, and the residence is a qualified residence. Well, Hrach doesn't

live there, has never lived there, had listed other residences, and did not show that this was a principal or a secondary residence during the year. In fact, all the evidence presented was that [he] never resided there; there was no residence there. So, the Court said no. Just the quitclaim deed, even though it was, in essence, subject to all of the debts, that does not make you an owner of the property, number one, when the person you got it from never had an interest in the property but was a borrower on one of the loans. It certainly doesn't give you the right to write off the interest.

D. *Brown v. Commissioner*

CA 9, 131 AFTR 2d ¶2023-346

Now, we have another Tax Court case, *Brown v. Commissioner*. This is kind of an interesting case because Michael Brown owes $50 million to the IRS; but Michael Brown knows, "the IRS is settling for pennies on the dollar." So, Michael Brown submits an Offer in Compromise; and he offers to settle it for $400,000, based upon doubt as to collectibility. Now, within the requirement—and he signed off on it because you are required to sign off that and agree that (again, it is on the form, IRS Form 656)—you said that you understand that the 20% down which he had made (20% of the Offer in Compromise of $400,000), that 20% down will not be refunded if your Offer in Compromise is not accepted. So, he has $80,000 out there. Now, he says to the IRS, "I want my money back," because the IRS says, no, it is not appropriate to compromise your liability because there are ongoing audits of your business, and the overall amount that you owe is still uncertain. So, there is no certainty as to what you owe for sure; we are not going to compromise it yet. But what the IRS does is, the IRS says, "But we are keeping your $80,000."

Brown argues that §§6320 and 6330 give the Tax Court jurisdiction to order a refund. Well, the IRS says no, that's not true—I'm sorry, excuse me—the Tax Court says no. (The IRS said it, too, and the Tax Court agreed.) The Court doesn't have any jurisdiction; it doesn't have equitable jurisdiction in this case to do that. So, essentially, he is out of luck.

E. JCX-1-23

The Joint Tax Commission, if you are interested, is something I think you might want to look at. In JCX-1-23, it lists all of the expiring tax provisions; and *expiring* means that there is a date that it is going to terminate—it ends or it reverts back to the old law. Either way, it is considered to be terminated. So, you will get, "Yes, this ends," or "This reverts back on this date; it reverts back to the prior law." For example, much of the Tax Cuts and Jobs Act, we are going to revert back in 2026.

F. *Calvin A. Lim, et al. v. Commissioner*

(2023) TC Memo 2023-11

We have another case here. This is *Calvin A. Lim, et al. v. Commissioner*, another Tax Court case. Interestingly here, you have a charitable contribution. The IRS made a motion for partial summary judgment. Remember, summary judgment means there are no facts. If everything the taxpayer said is true, they haven't raised a legitimate cause. So, the Court [said], "There is no reason to go to trial; just end it now." And that is really what happened here. They said summary judgment, because the charitable deduction they claimed on the contribution of LLC units to a foundation was a tax evasion scheme promoted by their attorney.

So, the taxpayers relied on the foundation's purported acknowledgement letter to show that the corporation transferred the LLC units to a foundation—remember, this S corp that owned these different LLC units, they transferred the LLC units to the foundation in the year in question. But, the letter didn't even show who it was

addressed to (the corporation, the individuals). It was addressed to the wife at her residence, not the corporation. It bore no signature of an officer or an employee. It didn't describe the property. It failed; certainly, it wasn't a qualified appraisal, so that failed. The attorney fees they tried to claim, those were a part of the appraisal. Well, that attorney's fee was a prohibited appraisal fee based on the appraised value of the units. So, again, nothing here is going to allow that charitable contribution.

Now, whether their reliance on their professional tax advice, [on that part] the Court would not grant summary judgment. They said there is a legitimate question of fact as to whether they relied on, or had reasonable cause by relying on, information provided by their tax professional. So, that certainly was one that they had to hear; there is question of fact there.

G. https://waysandmeans.house.gov/irswhistleblower

There is a now whistleblower [assistance]. The House Ways and Means Committee has set up a whistleblower form within the IRS, so IRS people can now submit directly to the House Ways and Means Committee through this online, anonymous, confidential hotline. Again, it is an online thing. They can provide whistleblower information directly to the House Ways and Means committee.

H. Revenue Procedure 2023-9

2023-7 IRB

If you are involved with development, there is a new revenue procedure, Rev. Proc. 2023-9, which replaces Rev. Rul. 92-29 and many of the aspects now. Basically, this will tell you how to use what is called the *alternate cost method* for the common improvement costs; often, developers want to use that. Again, this is kind of an exception to the economic performance rules normally for deductions because, essentially, you are putting estimates in before the actual economic performance has occurred. So, this allows you to do it. Also the Rev. Proc. tells you how to make the change, because this was a change of an accounting method. You can use the short Form 3115, generally. So, you might want to look that over if you are involved with that.

I. *Microsoft Corp. v. IRS*

DC WA, 131 AFTR 2d ¶2023-330

This is a really interesting case, *Microsoft Corp. v. IRS*, DC in Washington State. The only reason I bring this up is it was a summary judgment request; and, essentially, the IRS got away with—*yes, okay, sorry; you don't have to provide anything*. This really goes through and details; it is very detailed as to the various exemptions under FOIA.

Now, just to give you some idea, here is what the Court said—the Tax Court—they said, talking about what the FOIA requests, "They concern an IRS audit that began in 2007 for the tax years 2004 through 2006. Put another way, this case has seen three presidential administrations, and the FOIA requests have been around for a decade. The ongoing audit will turn 16 this year—eligible for a driver's license. If Microsoft owes back taxes, the money is old enough to vote. Obviously, something has gone completely astray here; but today, the Court is only tasked with answering the relatively simple question of whether the IRS violated FOIA."

These FOIA requests relate to §482 adjustments covering—and there are two of them—one covering Asia, Southeast Asia, South Pacific, another one covering the Americas. So, again, it goes through many of the exemptions, like Exemption 2, items related to the internal personnel rules and practices of the IRS; Exemption 3, the right to withhold information specifically exempted from disclosure (Were these returns ones that had to be disclosed? Again, the *Church of Scientology v. IRS* is the case that kind of set those rules on that.); Exemption 4, trade secrets in

commercial or financial information obtained from another person; Exemption 5 protects disclosure from inter-agency or intra-agency memos and letters, which would not be available by law to a party other than someone within the agency, in a litigation with the agency, and some of the overall, like deliberative process privilege. Now, keep in mind, there are thousands, and thousands, and thousands of documents that we're talking about here; and some were attorney-client privilege, and then the work product.

Then, Exemptions 6 and 7, personnel, medical, and similar files where disclosure would constitute an unwarranted invasion of privacy. In Exemption 7(A), which is used a lot, records or information compiled for law enforcement purposes. Were these compiled by a law enforcement agency and compiled for a law enforcement purpose? So, if you ever have a FOIA issue, that is one you may definitely want to bring.

J. *Minemyer v. Commissioner*

CA10, 131 AFTR 2d ¶2023-328

The next one is a Court of Appeals [case] for the 10th Circuit: *Minemyer v. Comm*. The reason I bring this up is—and I don't know the extent to which any of you have, or will be [involved]—but there is a lot of confusion sometimes when there is a criminal case involved. Of course, you may be tangentially involved in the criminal case; maybe you are under a Kovel letter. (More likely, it is a client of yours; the IRS has gone after them for something. They are not [typically] going after you.)

What happens, and here is where the confusion is; in this case, the taxpayer had made a plea bargain. Now, one of the things they always make you do to accept a plea bargain—or even if you're found guilty, it is not going to matter—but in a plea bargain, they are always going to ask your client for what is called an *allocution.* The defendant, tell the judge; and the judge will say, "Did you defraud the government out of X number of dollars?" And, under oath, you are going to say that, and then the plea bargain is going have a number. Now, that number—and I have done a number of criminal cases and I have done a lot of civil cases and, in the criminal case, you are plea bargaining because the sentencing is going to be based on the loss to the government. You are plea bargaining. So, almost always, that is less than, because you are saying, "Yes, I cheated them out of $2 million." (You actually cheated them out of $5 million, but if you cheated them out of five, you did cheat him out of two, right?) So, in the plea bargain it is almost always, in the criminal case, less; and the Court will always order a restitution. And in the restitution, that will then apply against the tax that is due. Now, that is different than forfeiture; and I am not going to get into all the differences, but there are some crazy differences here between forfeiture and restitution.

Anyway, after you have a criminal case, there is almost always a civil case after it; and the civil case is quite often higher, because they are going for the full amount of the tax. Well, what [the taxpayer] was saying is, "No, you can't go after me for more because I pled guilty and paid restitution in the criminal case." Well, the court here basically said, "No, that's not what happens. The civil and criminal are different. Now, yes, the restitution from the criminal case will be applied to your civil liabilities, but the IRS is not prohibited from going after you for more in the civil case. They are also not prohibited from going after you for other—like a civil fraud penalty, things of that nature." Interestingly enough, in this particular case, the Court said, "No, that is not correct; now, it will be deducted from any civil judgment, but they have the right to go after you."

So we're deep in the tax season. I wish you all well, I hope you are saving a little bit of time for yourselves during this this crazy tax season. I want to thank you for joining me, and please be safe.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. *In re Grand Jury*

598 U.S. ____ (2023)

The Supreme Court previously granted *certiorari* to hear a case from the Ninth Circuit Court of Appeals that upheld the lower court's decision to hold a law firm in contempt for failing to provide documents subpoenaed by the Grand Jury. The unnamed law firm, which provides international tax services, claimed the documents were privileged or protected communications regarding its corporate client that was under criminal investigation. The firm alleged that the communications served a dual purpose and sought a new approach to that privilege by asking the court to apply a "significant purpose" inquiry rather than the longstanding "primary-purpose test used in assessing attorney-client privilege for dual-purpose communications."

The Supreme Court not only granted *certiorari* on October 3, but it held oral arguments on January 9. On January 23rd, the Court issued a *per curiam* (all justices in agreement) stating, "The writ of certiorari is dismissed as improvidently granted."

The government's position was that these communications sought tax preparation advice that did not require a lawyer's expertise. The primary purpose was not legal, but tax preparation.

The firm argued that the primary purpose test should be rejected. They proposed an alternative test of a "significant purpose test" to determine if privilege applies to dual- or multi-purpose communications. In other words, was there a bona fide legal purpose, not trying to determine the primary purpose? The government noted that this could establish a new "accountant-client" privilege if a taxpayer retained an attorney, rather than an accountant, to prepare their taxes.

B. *Cory H. Smith v. Commissioner*

(2023) TC Memo 2023-6

The IRS was granted partial summary judgment regarding a taxpayer's claim of an income exclusion under §119 for lodging provided by an employer. The taxpayer worked at a military defense facility in Australia and was provided lodging by the employer at a related facility several miles away. The argument that the premises should be considered the employer's business premises because it bore an "integral relationship" to employer's business activities was not persuasive. The taxpayer did not perform significant work from his lodging, it was not necessary for performance of his duties, and it did not serve an important function for the business.

C. *Hrach Shilgevorkyan v. Commissioner*

(2023) TC Memo 2023-12

The Tax Court upheld the denial of the taxpayer's mortgage interest deduction. The property secured by the mortgage was originally purchased by a brother, Edvard, and his wife. Later, a second mortgage was taken out to build two other houses on the premises. The second loan was also co-signed by the taxpayer's other brother, Artur. Hrach obtained a quitclaim deed from Artur for the property. There is no evidence that there was any consideration for the deed. The lender never approved the transfer nor substituted Hrach on the note. As a result, the taxpayer did not have legal or equitable title to the property. He also did not provide evidence that the property was either his principal or a secondary residence. In fact, for the year at issue, he stayed at and listed another property as his residence.

D. *Brown v. Commissioner*

CA 9, 131 AFTR 2d ¶2023-346

The Tax Court did not have jurisdiction to order a refund of the required upfront 20% payment made by the taxpayer in requesting an Offer in Compromise (OIC). The court found that §§6320 and 6330 did not give refund authority in collection due process (CDP) cases.

In 2016, the IRS placed a lien on properties owned by taxpayer, Michael D. Brown, for approximately $50,000,000 in unpaid federal taxes for various years between 2001 and 2011. Brown submitted Form 656 OIC and offered to pay $400,000, based on doubt as to collectibility. He included the required 20% down and signed the acknowledgement that he understands that the 20% will not be refunded if the OIC is rejected or returned. The IRS returned the OIC, alleging that it was inappropriate to compromise his tax liability when there were ongoing audits of Brown's businesses that made the overall amount of his liability still in question. In a previous appeal, the Ninth Circuit held that the IRS's decision not to return Brown's OIC deposit was proper, but remanded to allow the Tax Court to determine if it had jurisdiction to refund Brown's $80,000. On remand, the Tax Court held that it did not have jurisdiction to refund the payment because the power to do so had not been specifically granted to it by any statute. The Appeals Court upheld the Tax Court that it is a court of limited jurisdiction and possesses no general equitable powers.

E. JCX-1-23

The Joint Committee on Taxation (JCT) has published a "List of Expiring Federal Tax Provisions 2022–2034." It considers a provision to be expiring if, on a statutorily specified date, the provision terminates or reverts to the law in effect before the current version of the provision. Certain provisions cited in the document terminate by reference not to a specific date, but to a taxpayer's taxable year.

F. *Calvin A. Lim, et al. v. Commissioner*

(2023) TC Memo 2023-11

The IRS's motion for summary judgment was granted in part and denied in part. It was granted in denying the married taxpayers, who owned an S corporation, a charitable deduction for the donation of charitable LLC units to a foundation by the S corporation—pursuant to a tax evasion scheme promoted by their attorney. The taxpayers relied on the foundation's acknowledgement letter to show that the corporation transferred the LLC units to the foundation. However, the letter was addressed to the wife at her residence, rather than to the corporation, and was unsigned. It also failed to describe the property.

In addition, the donation failed §170(f)(11) and Reg. §1.170A-13(c)(6)(i)'s qualified appraisal requirements in that the attorney's fee was a prohibited appraisal fee based on appraised value of the LLC units. The taxpayers' claim that the attorney's fee was not prohibited because it was based on appraised value of promissory notes transferred to the LLC, rather than appraisal of the LLC units, was unsupported or otherwise unavailing in that the LLC had no assets apart from those notes. Thus, even if the attorney had appraised the notes, he would have, in effect, been determining the value of the LLC units. The court denied summary judgment to the government as to whether a reasonable cause defense related to penalties was available for reliance on the tax professional's advice, since that is a question of fact to be determined after a hearing.

G. https://waysandmeans.house.gov/irswhistleblower

The House Ways and Means Committee has established an online whistleblower form to assist IRS personnel who wish to submit information confidentially to the Committee regarding any inappropriate behavior or mishandling of taxpayer information at the agency. All submissions will allow for anonymity, and any confidential taxpayer information will be protected under §6103 governing whistleblower disclosures.

H. Revenue Procedure 2023-9

2023-7 IRB

The IRS has provided new rules and conditions for implementing an optional safe harbor method of accounting for real estate developers to determine when common improvement costs may be included in the basis of individual units of real property in a real property development project held for sale, to establish gain or loss from sales of those units. Rev. Rul. 92-29, 1992-1 CB 748 is declared obsolete.

Developers that want to use the alternative cost method generally will be required to apply the method to all qualifying projects in a trade or business instead of on a per-project basis as required under Rev. Proc. 92-29. Additionally, it provides the exclusive procedures for taxpayers who want to change their method of accounting to apply the alternative cost method. To ease the administrative burden faced by taxpayers to comply with the change to the alternative cost method for the first taxable year beginning after December 31, 2022, this revenue procedure (1) permits certain taxpayers to use a short Form 3115, Application for Change in Accounting Method, to make accounting method changes to apply the alternative cost method if each change results in a §481(a) adjustment of zero, and (2) waives the eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13, 2015-5 I.R.B. 419, which prohibits taxpayers from filing an automatic method change if the taxpayer has made or requested a change for the same item during the five taxable years ending with the year of change.

Under the alternative cost method, a developer includes the share of the estimated cost of common improvements allocable to the units sold in the basis of such units regardless of whether the costs have been incurred under §461(h), subject to the alternative cost limitations set forth in the revenue procedure.

I. *Microsoft Corp. v. IRS*

DC WA, 131 AFTR 2d ¶2023-330

The court granted the IRS summary judgment that it properly withheld, pursuant to various exemptions or privileges, a variety of information responsive to a Freedom of Information Act (FOIA) request regarding §482 and cost-sharing arrangements with foreign affiliates. Exemptions involved here included Exemption 2, for "security-related forms and communications used when hiring employees or contractors" and other employee forms and records; Exemption 3, in conjunction with Code §6103, for thousands of tax-related documents; and Exemption 7A, for thousands more records, in respect to which disclosure could reasonably be expected to interfere with enforcement proceedings. Although the IRS applied boilerplate language to support that exemption, such was deemed sufficient here. Other exemptions and protections/privileges, including attorney-client privilege, were also addressed. The court noted:

> "They concern an IRS audit that began in 2007 for the tax years of 2004 through 2006. Put another way, this case has seen three presidential administrations and the FOIA requests have been around for a decade. The ongoing audit will turn 16 this year—eligible for a driver's license. If Microsoft owes back taxes, the money is old enough to vote. Obviously, something has gone completely astray here, but today the Court is only tasked with answering the relatively simple question of whether the IRS violated FOIA."

The case provides an excellent analysis of the various exemptions a practitioner may face in making a FOIA request to the IRS.

J. *Minemyer v. Commissioner*

CA10, 131 AFTR 2d ¶2023-328

The taxpayer attempted to limit the ability to assess additional tax and penalties after he had pled guilty to tax evasion. He argued that his restitution order in the criminal case should be considered payment of all amounts owed to the government. The IRS found this argument to be without merit. Taxpayer also argued that they could not seek post-conviction-year civil fraud penalties because the IRS violated the supervisory approval requirements of §6751(b). The court found that §6751(b) did not require that supervisory approval be obtained before proposed penalties were communicated to the taxpayer; instead, it required only that said approval be obtained on or before the date that the IRS issued the deficiency notice, which it did here. The case was remanded.

A. Discussion Problems

1) Your client has approached you about the possibility of filing an offer in compromise (OIC) for liabilities he owes the IRS. He owes over $5,000,000 and suggests offering $1,000,000. You have done an analysis and believe the IRS will not accept it based on doubt as to collectibility. There is no doubt as to the liability. The client is insistent that you file the OIC, even if the IRS does not accept it. What concerns might you have about the required deposit?

2) Your office was retained by an individual to handle a matter in Appeals. You did not represent the taxpayer in the audit. The IRS Appeals officer indicates that your client did not cooperate and respond to IRS document requests. You have no record of this, and the client and prior accountant deny it. You are considering a FOIA request for this and other information you think may be helpful, because you are convinced that the IRS is also after another person and has information from that person that is affecting your client's case. Are there considerations with the FOIA request?

3) Your client was convicted of tax fraud. In the plea bargain, he admitted to owing the government $2,000,000 in taxes. He was ordered to pay and has paid restitution of that amount. The IRS is now seeking an additional $1,000,000 in taxes for the same years.

Required:

Discuss the issues raised above.

B. Suggested Answers to Discussion Problems

1) The client needs to be made aware that, in filing the request at $1,000,000, the OIC request must be accompanied by a nonrefundable 20% deposit, or $200,000. The client must understand that he will be required to acknowledge and agree that, if the OIC is rejected or returned, the IRS will retain the 20%. The client should consider your analysis that it will most likely be rejected because he does not qualify.

2) In this situation, a FOIA request is most likely in order. However, there are numerous exemptions and privileges that apply to the information that can allow the IRS to withhold it. The *Microsoft* case is a good analysis of those exemptions and privileges.

3) The plea bargain does not prevent the IRS from pursuing additional taxes that it deems due for the same period. While the plea bargain is an acknowledgement that $2,000,000 is owed, it does not say that is all that is owed. In most cases, a civil case follows the criminal case. Any restitution paid in the criminal case will be applied to the tax determined in the civil case to be owed by the taxpayer.

PART 2. INDIVIDUAL TAXATION

Digital Assets

A question on the front of the 2022 Form 1040 refers to digital assets. The term "digital assets" comes from the Infrastructure Act. The Form 1040 and its instructions make substantial changes to the reporting and types of assets without providing much guidance. As a result, there is significant confusion on what is included in digital assets. The lack of guidance means that practitioners must take care in obtaining the right information from clients and make professional judgments as to what is reportable. Ian Redpath and Shannon Jemiolo discuss some of the key issues related to digital asset reporting for 2022.

Let's join Ian and Shannon.

Mr. Redpath

Shannon, welcome to the program.

Ms. Jemiolo

Hi, Ian. Thank you so much for having me.

Mr. Redpath

Well, always great to have you. We've got something that's really interesting, and some of our viewers may have actually read an article or two that you and I have written on a similar topic, but something that's really changed. Didn't we just publish that article not too long ago?

Ms. Jemiolo

We did, and already it's out of date, and new stuff's coming.

Mr. Redpath

I mean, it is amazing. To set the tone here, we need a little history. We're going to put up a couple of slides for our viewers to follow, but let's start way, way back, in 2019. That far back, if anybody can remember, we had a question that suddenly appeared, but to show that the IRS didn't really care that much—I mean, they cared, but not making a huge thing—it was on Schedule 1. Viewers can see here from the 2019 Schedule 1, "At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire [any] financial interest in [any] virtual currency?" And that's the term we've been dealing with; that's the term everyone is familiar with.

Then, in 2020, they said, "Oh no, this is really important. We're going to put it on the first page right up under the heading." But yes, it's there, and it says, "At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire [any] financial interest in [any] virtual currency?" Yes or no? And the instructions provided some guidance.

Then, in 2021, they went to, "At any time during 2021, did you receive, sell, exchange, or otherwise dispose of…" So now, all of a sudden, they changed the idea. It's "dispose of."

So, now we get to 2022, and we had two things that came out in 2022. We had a change in the language; and also, we had a change in the terminology. So, not just the language they use there, but also in the terminology. For 2022—and here is our 2022 form—so fill us in here at this point. What do we have here, Shannon? What's the big change?

Ms. Jemiolo

That big change in language that you're referring to? I'm pretty sure you're talking about the change from *virtual currency* to *digital assets*. The expanse of digital assets compared to what was [a] big, but relatively narrow set of virtual currency. Now they're talking all digital assets—anything that has the characteristics of digital assets—and pulling it all in this year.

Mr. Redpath

We knew what virtual currency was, kind of. The IRS in the FAQs and in the instructions said, "a unit of account, a store of value, or a medium of exchange." And it said, "If anything has those characteristics, it's virtual currency for federal tax." Now, we changed this to digital assets, but also changed that language because it's getting really expansive. As our viewers can see from the 2022 form, "Did you (a) receive (as a reward, an award, or payment for property or services); or (b)

sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?"

Ms. Jemiolo

They're trying to [cast] that large net.

Mr. Redpath

To me, the problem, as we're in tax season right now, is have we gotten the appropriate information from our clients? Did we properly change our client organizer or input sheets to capture what could potentially be in there?

What are they trying to get to? We know they changed digital assets, and we're going to get to a discussion on that—virtual to digital. But they changed that language significantly within the question. What are they trying to get at here?

Ms. Jemiolo

What they're really trying to get at, ultimately, is, "Do you have something that constitutes a taxable transaction?" I think this is where they've been making the change gradually since we first saw this question back in 2019. [For] 2019 and 2020, on the tax return, they were asking about acquiring, and it seems like they decided, "That's not really what we're getting at. That's not the taxable event we're looking for." So, we've seen this shift over the past two years—especially this year—where it seems like they are really trying to hone in on, "Did you have some kind of taxable transaction that we need to know about?"

Mr. Redpath

Yes, and broadly, because they talk about a gift. And the taxable transaction there is did you file a 709? Did you file a gift tax return? It's not just, "Did you pick it up into income, or did you report a capital gain?" Maybe there's some other income or other tax, like a gift tax, that would have to be included on this.

So, what's a digital asset? We mentioned the characteristics of what would be virtual currency, but what now are these "digital assets."

Ms. Jemiolo

Right now, the definition that we have to go on [is that] *digital assets* are any kind of digital representation of value. They're going to be recorded [in a] cryptographically secured ledger—some kind of similar technology like that. Again, that's the best definition we have thus far.

Mr. Redpath

Yes, well, that's the problem. We have a definition from the Infrastructure Act, and that's on the brokerage reporting. They use this broad terminology; they put no characteristics. Yet the instructions say, "If it has the characteristics of a digital asset, it's a digital asset." But nowhere—not in the FAQs, not in the instructions, and not in any prior guidance—do they ever tell us what the characteristics of digital assets are. They tell us what the characteristics of virtual currency are, as we mentioned. So that creates, I think, a real problem when you talk about [whether] it has the characteristics, but, oh, guess what? We don't know what the characteristics are.

Ms. Jemiolo

Absolutely.

Mr. Redpath

And, by the way, that provision says in it that the secretary is supposed to issue regulations telling us what digital assets are, but, by the way, report it this year for your client, for the [2022] return.

Ms. Jemiolo

Yes. Like you were saying, we don't have instruction yet from the IRS about what exactly are these characteristics of digital assets. You mentioned that we do have some definition of characteristics of virtual currency; but even that is a little bit shaky right now, isn't it?

Mr. Redpath

Yes, absolutely. We have different definitions even from the IRS. So, the IRS definition—and again, it said, "Virtual currency: a unit of account, a store of value, or a medium of exchange." Well, that comes off of the IRS instructions. In the Notice back in 2014, it says, "and/or a medium of exchange." In the Rev. Proc. in 2019, it says, "and." Well, "and" means you have to have all three. "Or" [means] any of them—any of the three. I think the crucial point here are those—I hate to use the word. I'll use the term *NFTs* because, Shannon, I'm going to throw it to you to tell us what NFTs are.

Ms. Jemiolo

Oh, goodness. Okay. NFTs stands for nonfungible tokens. These are the things we've been hearing a lot about in the past couple of years. These are the

artworks, digital—I can't even call them a trademark, really. These are digital ownerships of virtual artwork, or, oh goodness. Dorsey, the founder of Twitter, sold his first tweet as an NFT, a nonfungible token.

Mr. Redpath

It could be an artwork. I don't own my Picasso. I own a digital representation of this Picasso. Or, the most recent—and this, lots of people have heard about them—the former President Trump came out with his Trump Superheroes. He called them trading cards, but those were NFTs. Those were nonfungible tokens that you can buy and sell through the cryptographic blockchain. You can buy and sell those, but that is exactly what a nonfungible token or an NFT is. We have a classic example right now. We don't even have to go back to things like gifs and all of that. There's the classic case that just happened recently. That's what those were. A lot of people didn't understand what they were. "Trading cards? What are they?" Nope, they were nonfungible tokens.

Ms. Jemiolo

And there are big dollar amounts associated.

Mr. Redpath

It's a unit of account, it's a store of value, but it's not a medium of exchange. Therefore, it's maybe a virtual currency, depending on which definition you want to [use] from the IRS. But what has the IRS really said in the instructions? And, by the way, they added this to the FAQs. What are they saying about this?

Ms. Jemiolo

They are specifically including the NFTs. They are making it unambiguous. Whether or not these are virtual currencies, we can ignore that for now. They put directly in the instructions for the 1040 that NFTs are included in that line.

Mr. Redpath

Yes. And, for our viewers here, this comes from the instructions. We have some of the changes here. Answer, "Yes." The red is the 2021, and the black is the 2022. Some of it's relatively simple, but, even in that first line—yes, we're always going to see the change to digital assets—but if you look in that first line, the difference between property, which is a broad concept, and goods. They used to just say goods, and we can put a narrow definition on that, but property, that's pretty inclusive of a lot of things.

So, a number of these things struck me. The bullet point here, "The transfer of digital assets for free without providing consideration as a bona fide gift." You've got to check that box. But the other one here is "otherwise disposed of a financial interest." Okay. What does a financial interest mean? What does that mean to have a financial interest in a digital asset?

Ms. Jemiolo

It's fairly broad. If you have a financial interest in a digital asset, it's saying that you are the owner of record or you have an ownership stake in an account that maybe holds one or more of these digital assets.

Mr. Redpath

It's kind of odd that you have all these terminologies—that they're leaving so much open-ended, which allows, for them, a broad opportunity to come in and audit later. Right?

Ms. Jemiolo

Especially, they've given these broad things to include now with very, very little guidance at this point.

Mr. Redpath

I think what's interesting is that they say, "Don't leave this question blank." I mean, you want to get an audit, leave that question blank. So, if it's no, check "no;" but make sure you're getting the correct information from your client. I always tell people, "Better that you know before the IRS comes after them." Because the IRS is getting more and more and more information and ability to find out what's going on with digital assets. Even though the reporting for brokers has been postponed—recent announcement, they're postponing it—I thought what was interesting is, in the instructions, the IRS [says], "For more information, go to the IRS website." But it says [irs.gov/en/articles/virtual-currency-taxes-faqs]. So, they change it to digital assets, and then the instructions tell us to go to virtual currency on their website to get the answers.

It's a huge problem. And again, this cryptographically secure distributed ledger or similar technology specified by the secretary—yes, we're going to have some upcoming regulations.

I mentioned Notice 2014-21, and I mentioned Rev. Rul.—I think I said Rev. Proc., excuse me—Rev. Rul. 2019-24. So, what did those—that's our guidance on at least virtual currency because that's the only guidance we have—what's the problem with those?

Ms. Jemiolo

The problem with those is Notice 2014-21, for the characteristics of what would be a virtual currency. When we went back and we talked about the three different functions—a unit of account, a store of value, or a medium of exchange—2014 said "and/or," right? So, you only had to meet one of those three functions to be included here. But Revenue Ruling 2019-24 says "and." Big difference, right, between only needing to meet one of those functions or needing to meet all three of those functions?

Mr. Redpath

And, by the way, the prior FAQs, at one time, used the revenue ruling and said "and." Then, that disappeared.

Ms. Jemiolo

And that's a big difference.

Mr. Redpath

Nonfungible tokens are the classic example because they're a unit of account, a store of value, but they're certainly not a medium of exchange. They wouldn't be a virtual currency, but we know the IRS is saying specifically… it's right out there. The first thing they say: "For example, nonfungible tokens; those are digital assets." We have, I think, a serious problem, because then they go on and they say, "Well, if it has the characteristics of a digital asset."

Ms. Jemiolo

Which are not defined, but yes.

Mr. Redpath

So, what exactly does that mean?

We have the Infrastructure Act, and I think we have to take a reference to that in Section 6045. Can you just fill us in briefly about the Infrastructure Act and where that stands now?

Ms. Jemiolo

Oh, yes, absolutely. So, the Infrastructure Act—that 6045 section—they want information essentially from brokers. These are going to become things that brokers have to share information about buyers and prices [with] the IRS, much like if you sell stock through a broker. So, 6045 was going to require brokers—and then they expanded the definition of what a broker was—but a broker who transferred a covered security over into the hands of another broker, meaning virtual currency or the like. Essentially, what happened was—this was a lot. There's a lot of transactions that happen when we're dealing with virtual currency [for which] we may not have all the information the IRS is going to want from us. The brokers and CPAs got together, and they raised these issues. And so, right now, where this is standing is that the IRS has gone ahead and taken a little bit of a step back. They've said, "We're not going to require these reports yet. We'll let you wait until we finally come out with our final guidance."

Mr. Redpath

And that's Announcement 2023-2, for our viewers, where they said it. That's also the $10,000 rule. It applies to brokers here.

Ms. Jemiolo

That $10,000 rule, that's a big one, because that comes with a felony charge.

Mr. Redpath

Yes, that's a pretty big one. I think that the problem is that, even in the Infrastructure Act—and we've talked about the definition—it uses the term broker. It extends it to anyone who regularly effectuates transfers of any digital assets recorded cryptographically, secured distribution, or similar technology. It uses the same language, but it defines a digital asset as "except as provided by the IRS." Well, we have nothing. We have no guidance. We have nothing out there. One of the reasons they're extending the reporting requirement—and it still could come in 2024, but we just don't know. It doesn't sound like the IRS is planning on coming out with regulations very soon. It'll be interesting to see what they do.

Another aspect that we're going to be hit with every year for other reasons, but now this becomes important—the FBAR requirements. This has been going back and forth, and people say, "Should I? Should I not? Do I have to do FBARs?" I guess, after the recent bankruptcy, we might wonder where offshore, onshore, or even exist any of our digital assets. That being said, what is the issue with FBARs right now because we've got to answer that question?

Ms. Jemiolo

Yes, absolutely. It's funny, you mentioned, at the beginning of this program, the paper that we had published about this, and this was a concern even when we wrote that paper. So, that concern's not gone away at this point. The concern is, right now, FBAR regulations don't define a foreign account holding this virtual currency as being a reportable account. Right now, it's not being included there; but we've been hearing rumblings. This has been in the works for a while. There is an intention to go ahead and propose an amendment that's going to bring virtual currency in as that same type of reportable account. So, we could end up seeing it come into play here. We just don't yet.

Mr. Redpath

It will be interesting because, again, the FBAR reporting is not an IRS reporting. FinCEN reporting is under the Bank Secrecy Act. They've, again, continued to be talking about virtual currency. Holding virtual currency. Do you have virtual currency? Virtual currency. So, it would take a change, and not just the IRS changing that question and changing what they call [it]. Under the Bank Secrecy Act, there's going to have to be a determination that—and not by the Internal Revenue Service—there's going to have to be a determination that it's digital assets.

So, if you have a nonfungible token, for example, does that require reporting if it's held where? And how do we know what's offshore? How are we going to know what's being held and where? I think that's why they kind of stay away, but now they've added this other complexity with the IRS flopping that language on us at the last minute.

Now, one of the things that we've seen, too—and I think this is interesting—is that when we talk about virtual currency, actually, some countries have adopted it, and some central banks are actually issuing their own virtual currency. What's the status of that? Because that's fiat currency. That's actual currency.

Ms. Jemiolo

At this point, what we've got [is] El Salvador—they adopted Bitcoin as legal tender. We've got the Central African Republic; [they] also adopted Bitcoin as legal tender. So, two countries who are—and then, not a country, but more locally, was it Colorado who just back in September of last year is accepting virtual currency as tax payment?

Mr. Redpath

Yes.

Ms. Jemiolo

And then, talking about banks. Right now, the central bank digital currency—it's money backed and issued by a central bank. So, we've been seeing that come out and become a little bit more popular. Right now, our Federal Reserve hasn't decided to go one way or the other in terms of pursuing or putting in some kind of a central bank digital currency. But we have seen it come up a lot, particularly in The Bahamas, Nigeria, Grenada, Dominica, Saint Lucia. All of them have their own bank-backed virtual currencies happening.

Mr. Redpath

Yes, it's interesting because you have Nigeria, but then the rest of it—The Bahamas, Grenada, Dominica, Saint Lucia. The sand dollar, which is what it's called in The Bahamas, was the first one. The terminology is new. We have cryptocurrencies, but there's also this thing called a stablecoin. What's a stablecoin? Why is it called a stablecoin, and how does that conflict with normal non-stablecoins?

Ms. Jemiolo

Let me first address the non-stablecoins. The non-stablecoins are the ones—Bitcoin, Ethereum—the ones that are traded on the market. So, the price for those—we've seen the volatility in Bitcoin over the past few years. It was trading way up—sixties. And, I think, right now, it's trading significantly lower than that. It hit down in [the] twenty thousands not long ago. But it's very volatile. It's not pegged to anything. It's purely supply and demand.

Whereas stablecoins, they get their name because they're a bit more stable than that. They're going to be pegged or referenced in some way to something real. Really common things are being pegged to the U.S. dollar. So, coins being worth an equivalent number of dollars, and that being a stable amount. So, you don't see the amount of volatility you see with the other virtual currencies.

Mr. Redpath

And we assume they are because they say they are. So, for example, Tether and the USD coin say they're pegged to the U.S. dollar. Some people have said—in fact, the government has, at times, alleged that's not really true.

So, how does an NFT fit in here? That's really not stable. It's [worth] whatever somebody's willing to pay. If you want to look at the superhero, those—and, by the way, you can take any side you want on that argument, but they raised $11 million. They raised a lot of money, $11 million. But now, they're just [worth] whatever somebody's willing to pay. And now they're trading; but the trading is really selling, right? So, I'm assuming you have a transaction in property that you're going to have to report as a—at this point, it would be a short-term capital gain. Schedule D, right? I'm assuming, if you were to sell your Donald Trump superhero digital card, you would have to do that.

Now we've seen a movement, especially among athletes, who have wanted to get paid at least partially in Bitcoin. What does that mean? What happens there?

Ms. Jemiolo

Well, let's see. We've had a couple of big names—Trevor Lawrence is the one I can think of off the top of my head.

Mr. Redpath

Yes. And that's a good stepping off point to discuss, so everyone really is aware, Notice 2014-21. It says virtual currency, but we're going to substitute digital assets in there. How does that tell us to treat, in general, a transaction in digital assets?

Ms. Jemiolo

In general, it should be treated as, again, what it is that it's standing in place for. If we're using this to pay employees, it's going to be viewed as wages to them. If we're buying this as property, it's going to be viewed as property. Although I think the general rule right now is that it is property.

Mr. Redpath

Yes, it's property. If you get it for services, well then, it's… Trevor Lawrence's bonus, it doesn't matter what is paid in dollars. Bitcoin, I'm sorry, it's property. But property for services is considered to be taxable at the fair market value at the time you got it, as you mentioned.

Also, another issue that's been coming up is people donating digital assets to a charity and then trying to write off the full amount, which may or may not—but it's not a cash donation, is it?

Ms. Jemiolo

That's right. You're right, it's not a cash donation. It raises a lot of headaches for people who are coming into this, maybe less knowledgeable than they should be, trying to do something—maybe do something good with donating it. Maybe trying to get a tax break off of it. But it's been a not pleasant surprise for many of them.

Mr. Redpath

Yes, it's property donation. You get this 50% of adjusted gross income. During the increase to 60%, the COVID rules—sorry, this was not cash. Then we had Chief Counsel Advice 202035011, which basically dealt with crowdsourcing and said, "Hey, if you get paid, it doesn't matter how you get paid. And, by the way, it's also subject to self-employment tax, so put it on your Schedule C and pay self-employment tax on what you got." So, I think that's something that a lot of people are going to miss.

Ms. Jemiolo

Getting back to the donation piece, I think a lot of clients may not be aware that for crypto, if it's been held for a year or less, the deduction's going to be the lesser of their basis in that virtual currency or the virtual currency's fair market value at the time of that donation. So, they view this big gain, and they're like, "Oh, I can donate the whole amount." And that's not how that deduction's going to work.

Mr. Redpath

They may be able to get the full amount if—and that's the big if—they reduce to 30% of AGI. Now the reality is, most of my clients are not donating 30% of adjusted gross income to charities, so they're able to take it. But there certainly are people who do. Especially if you have a year, for example, where you had a conservation easement, for example, where you had a large donation for a conservation easement.

One thing the IRS has said, which I think is good, is that these coins that you get in a game that stay within the game. They can't be cashed out. It allows you to play the game, and keep playing the game, and play more of the game. Those are not considered digital assets.

Ms. Jemiolo

Right. I think I heard myself and all the other parents in the country have a big collective sigh of relief at that

because it's popular games that really became the sticking point. It's, what, Roblox and their [Robux], right? These are things that 10-year-olds, 14-year-olds—they're acquiring a lot of to play the game; and then, all of a sudden, as a parent, for a time, these were included. And so, as a parent, trying to think through, "How am I going to monitor this?" But no, thankfully, like you said, those have been kicked off the table. If they can't be pulled back out of the game, they're not going to be part of this taxable issue.

Mr. Redpath

One of the terms that people hear a lot—and I think it's worth at least talking about—is *mining*. You know, mining. When I think of mining, I think of somebody that's got a hard hat and a light on it, but that's not what we're talking about here. But understanding what mining is, because that's a term you hear all the time about people who are mining digital assets. There's three ways to mine, but really, you're getting compensated for mining. If you're a miner in digital assets, you're getting compensated for doing this, which means you got income.

So, what are the three main ways? There's proof of work, proof of stake, and proof of capacity, [which] is the newer one that's coming out. Not every platform uses proof of capacity, so it's relatively new. But what are those? What is proof of work?

Ms. Jemiolo

Proof of work is using an algorithm to solve very complex mathematical problems. This is going to take some very high-powered computers. It's going to take a lot of trial and error and a lot of computing space, which equates to a lot of energy. You've heard a lot of complaints about crypto mining centers; that's a big reason why. Essentially, what happens here is you have a bunch of different miners who are trying to solve this puzzle or the equation. The first one who gets it is the one who gets to add the block to the blockchain, do the mine, and receive compensation.

Mr. Redpath

But that's really mine—that's for me, right? I mean, you're kind of doing it for me to verify that I have currency. I have this Bitcoin; we've added a new block, and that's my Bitcoin. But you're verifying that that's what it is—that there is a block there.

Ms. Jemiolo

Right. Now, the proof of stake makes the miners put a little bit more skin in the game. Proof of stake is going to require the miner to pledge an investment in digital currency before they're allowed to validate any transactions. It takes a little bit more from them on the front end.

Mr. Redpath

So basically, if I screw up, and I verify something, I'm going to lose. I'm going to lose what I've put up.

Ms. Jemiolo

Right.

Mr. Redpath

So, before the miner verifies a block that's added to the chain, they're going to get the fee because that's validating the addition to the chain.

Now, proof of capacity. That's kind of the new one. Not everyone is allowing it. What are you doing with that? How does that differ?

Ms. Jemiolo

Proof of capacity is where we're going to be using spare space on the device's hard drive itself to store solutions to the problems. It's more efficient compared to the proof of work or the proof of stake systems, which is why it's been taking hold lately. But having the space to dedicate to it on the computer's hard drive is a fairly big deal. That computer's going have to dedicate the memory and the hard drive space to keep mining. So, we'll see what the next one coming is, but those are the three that are out right now.

Mr. Redpath

And again, when you hear *mining*, that's what it means. I know I've had a lot of clients ask me this question. "I've heard about mining. What does that mean? What does that mean, mining?" And so, that's what it means. And if people are mining—I do know some people that are engaged in mining—that's a business thing. They're literally in the business of mining and making some good money on it. I was going to say some good coin, but it's digital coin. But that's all income to them. I had that conversation recently with someone. "That's all income to you. You're not getting around this."

Wow—a lot of changes here, Shannon. What—because you're seeing it, and I'm seeing it—what do we need to do? What should we be telling our viewers they really need to focus with the clients on? Because, this hit us out of the blue when they threw that into the change in the instructions and then went on the FAQs and made a couple of minor changes, like adding in NFTs. What advice do you have for our viewers out there?

Ms. Jemiolo

My biggest advice when it comes to these NFTs and virtual currencies—document, document, document. Keep records. Right now, whether or not brokers are doing it, we'll find out, but keep records of what you bought it at. If you sold it, what did you sell it for? What's the market price? Dates. Keep track of everything because, like you said earlier, the IRS is going to find out. It's best that we find out first.

Mr. Redpath

If you didn't do it, make sure that you have a supplement from your client on your client organizer or input sheets because you've got to expand the questions that you were asking. This is not [the] same as last year. It is not the same as last year. It's very different than last year, so we have to add some additional questions that we really weren't expecting to have to. But when they change the instructions on us and, essentially, broadly change the definition, we've got to keep ahead of that. Our clients don't always like that, but, we have to remind them we're keeping ahead of the IRS on this one.

Ms. Jemiolo

Exactly.

Mr. Redpath

Shannon Jemiolo, thanks for joining me. Thanks for your insight on this. You know, all we can do is keep waiting for more guidance, but be conservative. Would you agree with that? Is that the best way to approach this right now?

Ms. Jemiolo

Oh, absolutely.

Mr. Redpath

Shannon Jemiolo, thank you very much for joining me.

Ms. Jemiolo

Thanks for having me.

Digital Assets/Virtual Currency

By Ian J. Redpath, JD, LLM

A. Introduction

The popularity and value of virtual currency, also called cryptocurrency or digital currency, has grown significantly in recent years. The urban myth is that this is not money and, thus, nothing to declare. Taxpayers often do not understand that virtual currency is not anonymous, and the IRS has the ability to track it. Beginning in 2014, the IRS began releasing guidance regarding virtual currency and, of course, the taxation of it. Without much guidance provided by the IRS, the 2022 Form 1040 and its instructions include substantial changes to the types of assets and how to report them.

B. What is Virtual Currency?

Virtual currency is a digital representation of value, other than a representation of the U.S. dollar or a foreign currency (real currency), that functions as a unit of account, a store of value, or a medium of exchange. Some virtual currencies are convertible, which means that they have an equivalent value in real currency or act as a substitute for real currency. The IRS uses the term *virtual currency* to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. Regardless of the label applied, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for federal income tax purposes. It is a digital representation of value that is stored and transacted only through designated software, mobile or computer applications, or through dedicated digital wallets. The transactions are conducted through secure, dedicated networks on the internet. It is convertible into traditional currency (fiat). It also can be used as payment for goods and services if the seller accepts it. Companies such as Microsoft, Overstock, and Tesla will allow payment in Bitcoin. While Amazon currently does not accept virtual currency, gift cards can be purchased from some vendors with virtual currency and can be used on Amazon.

Cryptography is used to secure transactions that are digitally recorded on a distributed ledger, such as a blockchain. Units of virtual currency are generally called coins or tokens. The distributed ledger technology uses independent digital systems to record, share, and synchronize transactions, the details of which are recorded in multiple places at the same time with no central data store or administration functionality.

To buy virtual currencies, a person will need a *digital wallet* to hold the currency. Generally, wallets are created through an account on an exchange. At that point, a person can transfer traditional currency to buy virtual currency such as Bitcoin or Ethereum.

C. Increased Scrutiny

In 2019, the IRS put a question regarding virtual currency on Schedule 1, Form 1040. For 2020, they moved that question to the header on the first page of Form 1040 and Form 1040-SR. In 2021, they revised this question and changed "acquire" an interest to "dispose" of an interest in virtual currency.

A transaction involving virtual currency includes, but is not limited to the following:

- The receipt of virtual currency as payment for goods or services provided.
- The receipt or transfer of virtual currency for free (without providing any consideration) that does not qualify as a bona fide gift.
- The receipt of new virtual currency as a result of mining and staking activities.
- The receipt of virtual currency as a result of a hard fork.

An exchange of virtual currency for property, goods, or services is—

- An exchange/trade of virtual currency for another virtual currency,
- A sale of virtual currency, or
- Any other disposition of a financial interest in virtual currency.

For 2022, the IRS has made some significant changes that add additional complexity and confusion to this matter. To demonstrate the importance of this area, they added a marginal heading to the question reading "Digital Assets." Next, and more importantly, the language of the question has been substantially revised. It now reads: "At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?"

Part (a) is clearly more complex because of the category being expanded to "digital assets." Next, the question asks if the digital assets are received whether by reward, award, or compensation (such as wages) rather than just asking whether they were acquired or disposed of as in prior years. This new terminology and form of questioning requires taxpayers to report what would be a taxable transaction. Part (b) is meant to capture nearly any relinquishment of a digital asset, whether by selling it (capital gain), exchanging it (various potential tax implications depending on the nature of the transaction), or gifting it (which could result in the need to file a Form 709). The intent is to determine if other reporting may be necessary. The Form 1040 instructions specify that, if a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for federal income tax purposes. This mirrors the prior language for virtual currency; but, unlike the past instructions for virtual currency, there is no further explanation to clarify the characteristics of digital assets.

D. Virtual Currency versus Digital Assets

In previous years, the IRS has asked specifically about virtual currency. Per the 2021 Form 1040 instructions, virtual currency is a "digital representation of value, other than a representation of the U.S. dollar or a foreign currency ("real currency"), that functions as a unit of account, a store of value, or a medium of exchange." The IRS uses the term *virtual currency* to describe the various types of convertible virtual currency that are used as a medium of exchange, such as digital currency and cryptocurrency. According to the IRS, if a particular asset has the characteristics of virtual currency, it will be treated as virtual currency for federal income tax purposes.

The term *digital assets* comes from the Infrastructure Act. Section 6045(g)(3)(D) defines a *digital asset* as "any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." Thus, for a more definitive explanation, we must await upcoming regulations. Despite this uncertainty regarding the Secretary's guidance and the possibility for the definition of *digital assets* to change with upcoming regulations, the question is on the 2022 Form 1040 and requires an answer.

The 2022 Form 1040 instructions refer to the "characteristics of digital assets" without a definition. Likewise, the IRS website does not provide any characteristics. While the IRS provides some guidance on the definition of virtual currency, the characteristics provided are conflicting. Notice 2014-21 states that virtual currency is a digital representation of value that functions as a medium of exchange, a unit of account, and/or a store of value. Thus, an asset need only satisfy one of those three criteria to qualify as virtual currency. In Rev. Rul. 2019-24, the IRS uses "and" rather than "and/or," meaning that all three criteria must be met for the asset to qualify as virtual currency. No characteristics are provided in the Form 1040 instructions or the updated website on digital assets for 2022.

The revised question also asks if the taxpayer, in addition to selling digital assets, disposed of a financial interest in any digital asset. This is another example of the IRS trying to get better insight into taxable events involving digital assets to which the taxpayer may have been party. Such a financial interest would include being the owner of record of a digital asset, but also holding "an ownership stake in an account that holds one or more digital assets, including the rights and

obligations to acquire a financial interest," per the Form 1040 instructions. While holding digital assets in a digital wallet/account, transferring digital assets from one wallet/account owned by the taxpayer to another owned by the taxpayer, or purchasing digital assets using real currency will not require the taxpayer to check "Yes" on the digital asset question, the receipt or disposition of any digital asset will. If "Yes" is checked, the taxpayer must report the receipt or disposition on the relevant form. (For example, if the digital asset disposed of was held as a capital asset, the disposition would be reported on Form 8949 and Schedule D.)

In Notice 2014-21, 2014-IRB 938, the IRS indicated that "virtual/crypto currency was a form of property and general tax principles apply." If received as payment for goods or services, virtual currency is considered income when received based on its fair market value (FMV) at that time. Taxpayers recognize a gain or loss on the sale or disposition of virtual currency based on the value received. The character of the gain or loss is dependent on how the taxpayer holds the property. The emphasis is on the time the taxpayer has *dominion and control* over the currency. A taxpayer has dominion and control over the virtual currency when the taxpayer has the ability to transfer, sell, exchange, or otherwise dispose of the virtual/crypto currency. The tax basis is established based on the fair market value at that time. If the taxpayer cannot exercise dominion and control over the newly created virtual currency, then the taxpayer does not recognize gross income until it is actually or constructively received. Once the taxpayer can exercise dominion and control (typically when the cryptocurrency exchange credits the taxpayer's account with the new virtual currency) then the taxpayer must recognize income on the date it was constructively received based on the fair market value of the cryptocurrency at that time.

In December 2019, the IRS stated on its website that Robux and V-Bucks were examples of convertible virtual currencies subject to the new disclosure requirement; however, in February 2020, the IRS softened its position stating that transacting in virtual currencies as part of a game that do not leave the game environment (i.e., are not convertible into traditional currency) would not be income nor require taxpayers to indicate this on their tax returns.

Many digital platforms allow individuals or entities to "*crowdsource*" jobs by using the internet to outsource assignments to an undefined and often large group of other individuals or entities. This facilitates *microtasking* or subdividing larger tasks into smaller tasks and distributing the tasks via online crowdwork platforms. In Chief Council Advice 202035011, the IRS took the position that if the taxpayer receives *convertible* virtual currency for performing the task, then the taxpayer has been compensated with property. The convertible virtual currency received must be reported on the taxpayer's income tax return as ordinary income and may be subject to self-employment tax.

In Information Letter 2016-0036 (June 24, 2016), the IRS attempted to address whether the receipts from crowdfunding are taxable as income. Section 61(a) provides that all accessions to wealth are in fact income unless Congress has provided a specific exclusion. Reg. §1.451-2 sets out the constructive receipt doctrine, which provides that when a taxpayer obtains dominion and/or control of an asset, he has in fact ascended to wealth. Only when the wealth is not under the taxpayer's control is it not considered income; however, the moment the taxpayer has control of the wealth, it will become income unless §61 provides a specific exemption. The IRS indicated that "generally, money received without an offsetting liability (such as a repayment obligation), that is neither a capital contribution to an entity in exchange for a capital interest in the entity or a gift, is includable in income." An equity interest of the venture is received in return for the contribution. To further define what is taxable and what is not, the IRS indicated the following will never be taxable:

- loans that must be repaid,
- capital contributed to an entity in exchange for an equity interest in the entity, or
- gifts made out of a detached generosity and without a *quid pro quo.*

However, the IRS went on to say that not all voluntary transfers without a *quid pro quo* are in fact gifts for federal income tax purposes. This leaves the door open for a significant amount of post-transactional second guessing in the absence of a clear indication of the intention of the parties. The IRS closed with a statement that each crowdfunding effort's taxable status would be a facts and circumstances test controlled by statutory requirements.

E. Nonfungible Tokens (NFTs)

On April 28, the Joint Chiefs of Global Tax Enforcement (J5) issued an intelligence bulletin containing best practices for taxpayers who have, or are planning to buy, NFTs. NFTs can be anything digital, including drawings, music, or other items that can be considered art. They have been described as an evolution of fine-art collecting, only digital.

While money and virtual currencies/cryptocurrencies are *fungible*—meaning they can be traded or exchanged for one another—NFTs cannot. Because they hold a value primarily set by the market and demand, they can be bought and sold just like other physical types of art. NFTs' unique data makes it easy to verify and validate their ownership and the transfer of tokens between owners. They are unique cryptographic tokens that exist on a blockchain and cannot be replicated. NFTs can represent real-world items like artwork and real estate. "*Tokenizing*" these real-world tangible assets makes buying, selling, and trading them more efficient while reducing the probability of fraud.

An NFT is created, or *minted*, from digital objects that represent both tangible and intangible items, including the following:

- Graphic art
- GIFs
- Videos and sports highlights
- Collectibles
- Virtual avatars and video game skins
- Designer sneakers
- Music

Instead of getting an actual oil painting to hang on the wall, the buyer gets a digital file. Artists no longer have to rely on galleries or auction houses; instead, artists can sell their art directly to consumers as NFTs, which also lets them keep more of the profits. In addition, artists can program in royalties, so they'll receive a percentage of sales whenever their art is sold to a new owner. Brands like Charmin and Taco Bell have auctioned off themed NFT art to raise funds for charity. Twitter co-founder, Jack Dorsey, sold his first tweet as an NFT for more than $2.9 million.

While NFTs do not appear to be a unit of account or medium of exchange, they are a store of value. If Rev. Rul. 2019-24's definition of virtual currency is applied rather than Notice 2014-21's definition, NFTs would have previously been excluded from the IRS's virtual currency question. The IRS has taken the ambiguity out of this, though, by specifying in the Form 1040 instructions that NFTs are considered digital assets; thus, the updated wording of the question applies to them.

F. Other Reporting

A growing question is whether those currencies are reportable for Form 114, Report of Foreign Bank and Financial Accounts (FBAR). Financial Crimes Enforcement Network (FinCEN) Notice 2020-2 stated that FBAR regulations do not define a foreign account holding virtual currency as a type of reportable account. [See 31 CFR §1010.350(c).] Thus, a foreign account holding virtual currency is not reportable on the FBAR unless it is a reportable account under 31 C.F.R. §1010.350 because it holds reportable assets besides virtual currency. However, FinCEN intends to propose an amendment to the regulations implementing the Bank Secrecy Act (BSA) to include virtual currency as a type of reportable account. At this time, these changes have not been implemented.

While transactions in virtual currency will generally be reported on Form 8949 and Schedule D, if a person received any virtual currency as compensation for services or disposed of any virtual currency that was held for sale to customers in a trade or business, it must be reported the same as any other income of the same type (for example, W-2 wages on Form 1040 or 1040-SR, line 1, or inventory or services from Schedule C on Schedule 1). The Bi-Partisan Infrastructure Investment and Jobs Act of 2021 (IIJA) expanded cryptocurrency reporting requirements to stop the perceived underreporting of cryptocurrency transactions.

The IIJA expanded the definition of *brokers* to include persons responsible for regularly effectuating transfers

of any digital asset which is recorded on a cryptographically secured distributed ledger or any similar technology. It defines *digital asset* as "any digital representation of value which is recorded on a cryptographically secured distributed ledger or any similar technology as specified by the Secretary." As a result of this change, brokers will have increased reporting requirements for cryptocurrency transactions effective for transactions entered into after December 31, 2022. Cryptocurrency brokers will be required to record transactions, tracking them for customers and the IRS, similar to the way stock and bond brokers currently do via tax form 1099-B. They will be required to disclose the names, addresses, and phone numbers of their customers; the gross proceeds from sales; and any capital gains or losses. Thus, a digital asset acquired on or after January 1, 2023, would be a covered security and brokers would have to report a customer's basis and gain or loss when the customer sells or exchanges the digital asset. This has been further delayed by the government.

Section 6050I requires that any person engaged in a trade or business that receives cash in excess of $10,000 in a single transaction or in related transactions must file Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business. The IIJA expands the scope of this section to include required reporting of digital assets. As a result, individuals engaged in a trade or business will be required to report cryptocurrency transactions over $10,000 using Form 8300. The reporting requirements are effective for transactions entered into as of January 1, 2023, or later.

G. Conclusion

Beginning in 2027, the Saver's Credit becomes a Saver's Match. It creates one credit rate of 50% and makes it refundable. The refund credit amount will be deposited directly into an individual's retirement account or IRA.

A. Discussion Problems

Your client, Carla Springs, is a famous professional soccer player living and playing soccer in the United States. She had heard that she can avoid paying tax on part of her salary by being paid in virtual currency/cryptocurrency. As a result, for 2022, she had her employer pay two-thirds of her salary in Bitcoin. Each pay period, her employer diverted two-thirds of her check to purchase a Bitcoin that was then put into her virtual wallet.

Carla also invested in Lionel Messi superhero cards. They were issued virtually as nonfungible tokens. She invested in five of them at $5,000 per token. Later in 2022, she made a gift of three tokens to her best friend and teammate, Pippa. The value at the time of the gift was $7,000 per token. On December 31, Carla sold one token for $1,000.

Required:

1) Address the tax treatment of the salary diverted into Bitcoin.

2) Address the tax treatment of the NFTs.

3) Address the reporting requirements for the above matters.

B. Suggested Answers to Discussion Problems

1) The fact that Carla is receiving compensation for services makes the value of the Bitcoin taxable as ordinary income. The form of payment is not relevant. Digital assets would include virtual currency/cryptocurrency, so the Bitcoin she received is considered property received for services. The fair market value of the property (it would equal what was paid for the Bitcoin) is taxable. In addition, as wages, it would be subject to FICA.

2) There has been a controversy as to whether NFTs are virtual currency. For the 2022 tax year, the IRS makes it clear that NFTs are digital assets subject to answering "Yes" to the question on Form 1040. While there is an arguable position that NFTs are not virtual currency under IRS guidance, the Instructions for Form 1040 and the revised IRS website specifically list them as digital assets. The transfer to Carla's teammate is a gift, and the sale is considered the sale of property.

3) Having the digital asset requires Carla to answer "Yes" to the question on page 1 of the Form 1040. The amounts received as compensation would be reported as salary. A discussion should be had with the employer about FICA. In any event, she is still responsible for paying her portion of the FICA. The sale should be reported on Form 8949 and Schedule D. Carla will also have to file a gift tax return.

PART 3. BUSINESS TAXATION

Revenue Procedure 2022-19

An S corporation is a very popular form of entity for small businesses in America. There are several rules that must be followed to obtain and maintain S corporation status. Failure to comply with these rules may result in an invalid election or a termination event. In the past, numerous requests for inadvertent termination relief were submitted to the IRS through a time-consuming and costly private letter ruling process. Revenue Procedure 2022-19 provides self-correction for many common termination and invalid election matters. This relief is not available once the IRS discovers the error. Ian Redpath and Greg Urban discuss the relief provided in Revenue Procedure 2022-19.

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

It's always great to have you. I always love to get your insight; and this is an interesting one because we are in tax season. During tax season, I have always been one of these people who has recommended that this is a good time to look at the documents—to look at the partnership agreements, the LLC operating agreements, even the corporate records—just to make sure that the clients are keeping everything up to date.

I mentioned once before in another program, I had a situation where they brought me the corporate records and I took the seal off. The place had been a corporation for 20 years; I knew who owned the building on Madison Avenue in Manhattan, so I knew who owned the building. They also had, by the way, a place on Park Avenue. I knew who owned them—the corporation. I just didn't know who owned the corporation. They had never issued stock, never had any minutes. So, you see all of these errors; you see language in there, especially with capital accounts. You and I did a program on that where it is very common just to have language that refers to the IRS rules, or 704(b), and that's not always being done. So, there are all sorts of things in there. You may not have time to look at them right now—but it is a good time to at least say, "Hey, this has to be looked at. Maybe we have to bring your attorney in. Maybe we have to change these." And this makes it even more important, I think, for S corps. What's your hit on this?

Mr. Urban

Yes, this is an area that—you're absolutely right—comes up during the compliance season when we're looking at documents, particularly this time of the year. But the other thing that strikes me when I read through this Rev. Proc. 2022-19 is that this is the type of thing that comes up when you least want it to. In other words, maybe there is a sale transaction going on, or maybe somebody is doing due diligence on the company, or maybe there is a federal or state examination that is going on. What you see—and I'm sure we will get into a lot of this—is particularly with LLCs having elected S status, there are a lot of unintentional items that may be in the documents that some practitioners maybe just don't think about all the time.

I think that this is welcome relief in terms of being able to get out of some of those situations, if you will. My experience has been, I don't think the IRS is looking to knock out S elections. I don't think that is the case at all. I think that this is probably a situation where they are getting a lot of volume and requests for relief and, in our practice, these are definitely things that pop up at the wrong time. When you think about a typical tax practitioner, I don't know that every year, [they] go back and reexamine the documents; they might have looked at it. Sometimes, you pick up a new client who has been filing S corporation returns; and I think the reality is that sometimes you just continue filing S corp returns, for instance. This is really a good reminder to go back and to look at some of the documentation, and to make sure that everything in the tax record book is in place.

Mr. Redpath

I think the change in capital accounts was a good reason to look at partnership agreements and LLCs taxed as a

partnership. I think this is a really good reason to go and look at what are you using—I'm going to use that as a broad term—as your legal form? You mentioned one of the real common things today is the LLC, and then electing S [status]. Also, you might say, "Well, I have a C corp and I'm going to elect QSub." So, those are issues where you have to look at the documents to see, really, what do we have? And, I'll say this as an attorney, often there are very fine attorneys, and they write the documents that are clearly legal; but the tax implications are significant. And, often, what looks good from the financial side—or legally, we can do this—creates havoc on the other side as to how it is going to be taxed.

This movement that we are seeing towards LLCs, then electing S—so much so that the IRS basically said, "Look, if you file the 2553, that is a default election to be a corporation; you don't even have to do the 8832." They want you to, but you don't even have to. We are just going to treat it as a default election to be a corporation and then elect S, and some people wonder why. I'll tell you, as a lawyer, there is a great argument that is being made that you actually get better legal protection in an LLC form than in a corporate form; because all they can get is a charging order if there is a divorce, for example, or creditors.

Then of course, the relationships among the members is very different than the relationship among shareholders, or the shareholders and the board of directors. So, that is a whole program in and of itself, but it is becoming a very common practice which is creating issues. The idea of a termination—you see these all the time; if you look at the dailies, you see all the time it will say, the IRS has granted inadvertent termination relief. So, until this Rev. Proc., what was the procedure? When you are looking at something and you go, "Wait a second, we have a termination event here. What do we do?" I know some people will say you ignore it; but assuming you're going do what you are really supposed to be doing, how [was] that handled prior to this Rev. Proc.?

Mr. Urban

Our experience was that you would request private letter ruling relief. The reality is that most practitioners probably have never had the experience to file a private letter ruling. They are very expensive; they are very time consuming. I think what you saw a lot of times was—I don't say it was easier to ignore it—but it is just such a difficult process and such a time-consuming and expensive process to go through the private letter ruling process that I think this particular revenue procedure offers some relief for some areas that otherwise would have required a very time-consuming and costly route to remediation.

Mr. Redpath

The IRS estimates that the cost of a private letter ruling is about $38,000 in user fees, a $20,000 preparer fee, and $50,000 due diligence fees. I mean, it can be very, very costly. They estimate that about 120 S corporations need guidance but elect not even to pursue assistance because of the cost. They take that position that I mentioned which is, "Well, let's correct it and hope we don't get caught."

Mr. Urban

Yes, and my guess is that the resources of the Service are so limited that to have these coming in for what are—I don't want to say repeat-type situations, but many of them are very similar—they probably looked at this and said this is a much more efficient way to go about dealing with things.

Mr. Redpath

Well, I agree with you. I think the fact that the resources are so stretched at the IRS—all you have to look at is how many returns are still not processed; that will tell you how stretched they are—and giving private letter rulings and going through the whole process on their side is really taking a lot of time, as you said, for things they see over, and over, and over, and over again. Most of the things that they are seeing for inadvertent termination relief are things that are consistent. They could have a blank letter waiting and just change the name.

Mr. Urban

Yes, the facts are so similar. You're right. You read the dailies and no matter what research software you use, you are right, they are very similar situations. These are situations that—like I say, my experience has been in a live transaction, maybe you have an S corp that is for sale—these are things that you would like some certainty that you can have resolved, and you would like it quickly.

Mr. Redpath

Yes, and the bottom line is that I'm doing my due diligence on a company that you are representing and

all of a sudden, I say, "Hey, wait a second. You have a second class of stock here." Now, you are talking about inadvertent termination relief. Well, guess what? I just knocked at least $100,000, if not more, off the price, because I'm going to say, "We have to get a private letter ruling. So, either you do it or we do it but, nonetheless, we are not paying the same amount."

Mr. Urban

Right, or a significant amount is going to go into escrow until maybe a three-year period passes, maybe more, maybe there is going to be a purchase price reduction. I think that these areas can be remediated really quickly. There are a few things in here that I think you can get by calling the tax practitioner hotline, if you will. You are able to get some of these documents before this, but this is nice in that it formalizes a solution to many very common problems.

Mr. Redpath

And it gives us a good reason to sit down with a client and say, "Hey, let's do an analysis to make sure. We have this opportunity sitting out there." Because you can't use this revenue procedure once you get caught. If you are in audit, you can't say, "Well, wait a second. We're going to self-correct." So, it is a good opportunity, I think, to sit down with the client and to review these things—and there is a reason to. You're not making work; you are doing something that there is a reason to do it. It is a value added, and value added equals billable time.

Mr. Urban

It also is an opportunity, I think, to let clients know you are thinking about their situation. When you and I were preparing for this, we started talking about doing this presentation in the late fall. Since then, we had an S corporation where a shareholder was just redeemed out, and they redid some of the documents. It was an LLC that had made an S election, and you think to yourself, "Well, wait a second. Did you just say that there is an operating agreement there? Maybe I should take a look at that operating agreement." Sure enough, there is language in there about special allocations, and liquidating based upon capital accounts, and all the things we are going to get to. But those are the types of things that, I think, give practitioners just a top-of-mind reminder that we can correct some of these things pretty efficiently.

Mr. Redpath

I think anytime you have an LLC that is operating as an S corp—and keep in mind for our viewers—that legally you are still an LLC, but for tax purposes, you are an S corp. Anytime you have that, or anytime that you have a conversion—you have a C corp that has converted, or you have a QSub election—I think you want to go back and say, "We had better look at those documents, just to make sure." Because now we can correct things that we may not have been paying attention to at the time that this happened.

So, there are six areas in the revenue procedure. I'm going to put up a slide for our viewers of the six areas. Greg, can you tell us the six areas here and go over this for our viewers?

Mr. Urban

Yes, so a lot of these six areas mirror principles that are in S corp taxation. One class of stock—S corporations can generally only have one class of stock; and we will get into what that means, but that is certainly addressed. It addresses situations where there are disproportionate distributions from the S corporation; it happens more often than you would expect. Is that something that will violate the S election and cause a termination? Maybe there are some inadvertent errors on the 2553 or the 8869 (the S election or the QSub election).

Mr. Redpath

How many times has that happened that you realize, "Geez, we missed a consent. We actually missed something here."

Mr. Urban

Yes. It was interesting when we prepared for this—and we can certainly talk about these in more detail—but we don't really see too much of that in the practice. When you make an S election, generally speaking, I think we are pretty diligent. Most practitioners are pretty diligent. They read the form, "Okay, these are the signatures we need, and then we need to file it by now." But I think you had made the point in some of the materials, as we were preparing about community property states, the need for a husband and a wife to sign. I found that interesting, and I think a lot of the viewers would find that point helpful as we go through today, definitely.

Mr. Redpath

The other thing, Greg, is that, as you know in practice, often—I know that you look at the election—but often, the attorney is going to make the election, or the accountant is going to make the election. Who made the election? Well, okay, so the attorney made the election. Does it contain all the proper signatures, et cetera? Often, in that confusion, things can slip through the cracks on that. Or, you have a trust that is in there. Was that properly signed and consented to, or elected? For example, an electing small business trust is an owner. Were the proper consents filed for that?

Mr. Urban

Yes, for sure. The other area, missing administrative acceptances of the S election, that is one where I like to think we have a pretty easy fix; we have been able to get letters pretty efficiently from the Service but, certainly, something that Revenue Procedure 2022-19 deals with. Filing federal income tax returns inconsistent with the S election—you talk about this communication between the accountants and the attorneys—I would say, again, from my experience, that is an area where sometimes an S election gets made and there isn't great communication around there, and maybe you file a partnership return. I have seen that happen before. That is purely a mistake, but it doesn't appear to impair the S selection. Then, non-identical governing procedures. We go through some examples of that later on.

Those six areas are really the key areas where I think this revenue procedure is designed to provide a little bit easier relief than going through the private letter ruling process.

Mr. Redpath

Let's start off with the—and two of these are kind of interrelated. One class of stock and non-identical governing provisions are kind of related, but we will separate them because that is the way they do it in the revenue procedure. So, one class of stock. You basically have one class of stock; but what does that mean, and what should we be looking for?

Mr. Urban

When we think of one class of stock, we think of identical rights to things like distributions, things like liquidating proceeds. I think those are the big ones. You can have differences in stock in terms of voting rights, so that is something that sometimes happens, particularly with intergenerational planning. I think, at its core, the single class of stock really is dealing with distributions and what a shareholder would receive on a liquidation of the corporation. Essentially, everybody should be entitled to their pro rata share.

Mr. Redpath

And the bottom line is, you are supposed to have identical rights. Identical rights on distribution, and identical rights that [are based on your] share—if I own 20%, I get 20% on distributions, and on liquidating distributions, on both. I think where you get into some trouble is where you have debt instruments that are not within safe-harbor debt. Then, the IRS comes in and goes, "You know what? Under debt equity, we are going to look at that; those are really equity." Well, once they say they are equity, then the interest payments you were making to that person created a second class of stock; because now they are treated as distributions, not as interest payments, and you have a second class of stock. Or, you have an "employment agreement," and for that employment agreement, they say, "No, it was a way to get this person more profit" (especially if it is unreasonable compensation). "You were trying to get them profit—more than their share." Again, if it is reasonable for the work they are doing, that is not an issue; but where it is not, [they say] "You are trying to get them more profit."

So, I look at it and say, if it would, under a C corp analysis, be a constructive dividend—renting something at more than fair rental—if it is that type of situation, it could be considered a second class of stock because there is that term, governing provisions. Well, if they reinterpret that loan, that rental agreement, that employment agreement, if they reinterpret that and they say, "You know what? That is providing a distribution that is not equal. Therefore, you have a second class of stock." I think what this revenue procedure does, which is really interesting, is it says, "As long as the principal purpose is not to circumvent—you didn't do this to circumvent; that was not the intent—then we are going to ignore it, and it is not going to be a termination. You can ignore it, and we are going to ignore it."

Mr. Urban

Yes, I would agree.

Mr. Redpath

I think that is interesting; principal purpose becomes the real main key element here. And again, buy-sell

agreements, transfer restrictions, debt instruments, short-term advances, all of those are things that that revenue procedure looked at and said probably we are not going to be looking at those as long as [you have] that principal purpose. There was a case out there where what they did was, they provided for preferred stock—well, [that is a] second class of stock—but they never made any distributions in relationship to it. They came to their accountant, and their accountant said, "Whoa, what did you do? You can't do that." Obviously, they never got advice earlier. So therefore, they just reversed it. They said, "The company is going to take back those preferred shares," and reversed it. The IRS said, "No harm, no foul. You made no distributions under it. You didn't give anybody anything under those. So, therefore, it is not a second class of stock." Remember, you can have voting differences. You can have differences in voting stock.

Mr. Urban

That is, really, the one we see that is most common. Particularly with a situation where an employee has some stock where you have, like I said, an inter-family, or maybe some generational wealth planning, those types of things, where somebody likes to hold onto the vote of the stock. So, we see those differences, and I don't think that is really what they are getting at with this particular provision.

Mr. Redpath

No, not at all. And by the way, for people who are looking at things like phantom stock or stock appreciation rights, the IRS has specifically said that those do not create a second class of stock; you can use those. So, the next thing, disproportionate distributions—you got more than your share this year.

Mr. Urban

Yes, so distributions can be different, and we do see this periodically, relative to timing. But generally speaking, I think when the smoke clears, if you will, all shareholders have to get their pro rata share when you look at the distributions in total.

Mr. Redpath

As long as the agreements don't show that you can have disproportionate distributions. It does happen, right? "Hey, I needed money for my kid's tuition, so I took out a little more this year," or "My spouse wanted to go on a vacation, so I took out a little more this year." I always look at it, and I think the IRS—at least in my experience—has [said] that as long as within a reasonable period of time after you discover it, you make equalizing distributions, you bring everything back into sync, the IRS is not going to say anything.

Mr. Urban

What we see a lot of times is maybe there is an estate and their last return, let's just say, is December 31st. Maybe there is a distribution that is made in the spring that relates to when a final determination of taxable income can be made. Maybe that party isn't a shareholder in the spring. You could still have distributions as long as they are to the shareholders that were in existence at that time. I think that is an important thing to point out, that those types of distributions do happen and they are provided for.

Mr. Redpath

Now, what about inadvertent errors on your Form 2553 or the 8869? What can we do with those without having to go through a rather lengthy process?

Mr. Urban

This is an error where, presumably, maybe you don't have the correct signatures. Maybe you didn't get all of the required parties to sign. I think what this is saying is, if you have always followed and treated yourself as an S corporation, and if this error was truly inadvertent, this revenue procedure will provide you a sense of relief in areas like that. Like I said at the outset—you were talking a little bit about community property states, and I think that is a really good point; yes, sometimes, it is easy to forget that a husband and a wife both need to sign a 2553 in situations like that. So, this is the type of provision, this Revenue Procedure 2022-19, that would correct a situation like that where you just inadvertently did not get the second signature.

Mr. Redpath

Yes, and you could also have things like you are missing a valid tax year on the form; you left something off on the form, and this allows you to easily correct that. But, also, it says if there are other areas of inadvertent [errors] or omissions, you simply can correct it by correcting it and sending in a written explanation to the IRS (either Ogden, Utah, or Kansas City). You just simply say, "Hey, we made a mistake. We have an error; here's what it is. Thank you." So, it is a real simple process.

The same thing, again, missing administrative acceptance letters. What about that? That could be from your S election or your QSub election.

Mr. Urban

Yes, and now a lot of practitioners out there might be listening to this and say, "Well, geez, we could get those even without this revenue procedure." The Practitioner Priority line was very good about issuing letters. But you are right, in the case that it is not in the file when somebody asks for it doesn't mean that you don't have a valid S election.

Mr. Redpath

It is a CP261 on a Form 2553 or a CP279 on the 8869. This makes it very easy to do that. And you also, again, have the tax line—the Practitioner Priority Service—to take care of that. Now, you mentioned earlier, maybe you didn't know that they were going to elect S and you filed a partnership return. Now you find out, "Hey, you guys elected S. That wasn't in the discussion." What about that? What does the Rev. Proc. say about that so you can file?

Mr. Urban

This is one that I think, other than the LLC operating agreement issue that we were talking about, I think this is the one we maybe see most frequently—a situation where you get an attorney who will make the S election. We, as an accounting firm, would see that it is an LLC. Maybe there is a fall down in the communication there and we file a partnership return instead of an S corp return. I think what they are saying here is look at if the S election was made (valid), and you have a reasonable cause to explain the filing, that type of a filing doesn't impair the S election.

Mr. Redpath

I had one, and it was interesting because they made a QSub election; then, they filed two S returns—one for the parent and one for the sub. And this had gone on for a couple of years where they were filing an S return, 1120-S, for the subsidiary. Well, that is just wrong; but they had a valid QSub election, so it was just being filed incorrectly. The accounting firm (not a CPA firm, by the way, but the accounting firm) that was filing it was filing two S returns. Wrong, but this will allow you to correct it.

Then, we have this other one that, as we said, fits with the second class of stock; but, as you mentioned, this is something you really need to look at, and that is the non-identical governing provisions.

Mr. Urban

Yes. This, to me, would be the LLC issue. This would be the situation where—and this happens when many LLCs get formed—an attorney may use a standard LLC operating agreement; and, maybe after the fact, somebody decides to make an S election. Well, all of the owners enter into the LLC operating agreement. That agreement will say capital accounts are going to be maintained, maybe special allocations will be made, maybe there are minimum gain chargebacks, maybe there are all sorts of provisions that relate to partnership taxation that probably would be inconsistent with the spirit of the requirements of being an S corporation. I think what this is saying is, "Look, as long as you always treated this as an S corporation, as long as you always followed the rules that would apply to an S corporation, the fact that you have this agreement in and of itself is not something that would impair the S election." In this particular area, the remedy for this is pretty simple. It is, basically, documentation in the file that would say, "We recognize that this is in place; but hey, look, we have always treated this consistent with the way an S corp would need to be treated."

Mr. Redpath

Yes, the IRS in the Rev. Proc.—and we are going to put up something here for our viewers to look at—this is what has to be satisfied to avoid needing a PLR. The corporation has or had (notice, past tense) because if you had a provision, and this is where you have to be careful, if you had a provision at any time while you were an S, you technically had a termination event. The fact that you changed it later, and because you didn't get caught, that doesn't mean you didn't have a termination event.

So you have, or had, one or more non-identical provisions. The corporation has not made a disproportionate distribution, actual or deemed, based upon that—that is not the one where [you] took out a little more this year and next year you evened it off. This is where we have made distributions pursuant to this. You filed the 1120-S for each year, beginning in the first year when those non-identical provisions were adopted; in other words, you have always filed an 1120-S. And then attached to—you mentioned a document—well, attached to this Rev. Proc., and this is something you need to look at, there are two statements: corporate governing provision statement, and shareholder

statement. Basically, here is the statement, fill out the statement, have it signed, have the corporation keep it with their corporate records, and you keep a copy in your permanent file. And if the IRS ever comes in and challenges it, you pull out those statements and say, "Here. We corrected it. We self-corrected. Thank you." Have you had an opportunity to look at those? I know a while ago when we talked, you had mentioned that you had one, you thought, that you have to do this with, to use those statements.

Mr. Urban

Yes, so we have had a few within the practice that we have seen that have been remedied in other ways. We knew that this was a potential issue. A lot of attorneys will say, "Well, we didn't want to draft another agreement;" or, for whatever reason, "The client didn't really see the importance of it." So, we would add a paragraph to the end of them that would oftentimes say, "This agreement is in place except for the fact when an S election is in place, under which time, we will file the provisions of Subchapter S." This, to me, is better. This, basically, maybe reinforces what had been done under those particular provisions.

Mr. Redpath

And by the way, you and I spoke about that; and as I recall, yes, I agreed with you that that would work. I think, also, doing this is just a slam dunk now.

Mr. Urban

Yes, it just makes the situation a lot cleaner.

Mr. Redpath

Obviously, "We followed the procedure; here it is, we have it," versus arguing whether or not that language works.

Mr. Urban

And it is really simple. I think all we need is documentation in the file that [shows] we read this revenue procedure; and we are asserting, if you will, that we followed the rules relative to an S corporation. But I will tell you, it is funny, you may miss a few of those, particularly if you have taken on work. Maybe they are LLCs that have filed for many years as S corporations. True story, like I said before, we had somebody that just got redeemed out of an S corporation, and they were talking about updating the operating agreement. You hear that terminology, and I think that this should raise a flag of saying, "Well, let's take a look at that operating agreement;" and maybe we use this as an opportunity just to, as you say, clean up the situation.

Mr. Redpath

Yes, and we know that a lot of people will use the term partner because they don't understand what the form is, so they [should, but] they don't say, "My fellow shareholder." They might say my partner—are you really a partner? Exactly what are we operating under?

Mr. Urban

Right, so in situations like that, we have used it as an opportunity to put something in the file. We have had clients take a look at it, kind of assert and sign off, if you will, on the fact that they have followed that. I just think it is a best practice that a lot of practitioners would benefit from.

Mr. Redpath

It is not often that we sit back and we [think], man, the IRS really did us a solid here. They really said, "Look, we understand that there are all these screwups. We understand that the rules can get a little convoluted, or the attorney did it, or the accountant thought they were doing it, and all of these things that can happen. You are still operating as an S corp, and that is really the bottom line here. You have been an S corp, but technically something is wrong or something was done inadvertently, like you took out more this year, but you guys made up for it the next year. So that type of thing, the IRS has finally just said, "We are not going to make you go through all of that cost, plus we don't have the time to waste with these things. Just take care of it. Here are the statements. Put them in your file, and you are fine. There is no termination."

Mr. Urban

Yes, and a lot of times many of these events happened years and years and years ago. Maybe you discover it off chance; and I think if you find these things, this gives an opportunity to put the issue behind you. Like I said, it particularly pops up in a situation where you have a transaction or you have a review where sometimes there is just no reason to look at these things on a regular basis. If it is something you become aware of, I think this is a really useful tool to maybe alleviate some stress that otherwise might be there.

Mr. Redpath

As you said, it's a good time to look at it. Because a lot of these things may have happened a long time ago, and we haven't been looking at this to make sure that it is up to date. We probably would know if there have been disproportionate distributions, and we can say, "You have to pick up those." But a lot of these other things, we just don't know. We are not going back and looking at the documents and trying to go through them. We just [know], okay, it is an S corp. I know it is an S corp; we have been filing as an S corp. Same as last year, we are going to file as an S corp.

Mr. Urban

That is the truth. That is what really happens. You pick up a return and you file, and you look back and you say, "Okay, maybe I want three years' worth of returns." And they all come through as S corp returns. Maybe there are not many shareholders, and it is easy to understand the capital structure and you carry on. But lo and behold, you find out five years ago that somebody had passed away, and when it transferred into an estate, or went from an estate to a trust, that something went afoul. Those are the types of situations that can make your heart sink when you discover them.

Mr. Redpath

The thing is, it's a good opportunity—and I'm not saying that you are going to spend a hundred hours on this—but it is a good opportunity to look, to say, is there anything that pops out to me? Because now we can correct it. We can't correct it—none of this applies—if the IRS catches you. So, it is a good time, and it is a good time to say to the client, "Look, we have this revenue procedure that came out, and the IRS says we can self-correct any errors that might have happened in your legal documents primarily. So, let's just take a look at them and see if there is anything that pops up."

Mr. Urban

Yes, for sure.

Mr. Redpath

Greg, thanks for being here. Thanks for your insight on this. This is something that is not just one of these hypothetical things. As you said, you have already had a number of times where this issue has come up since the Rev. Proc. came out, so very practical, and the IRS is finally doing us a solid.

Mr. Urban

Yes, I think very timely and something [for] a lot of practitioners it is going to help. If anything else, just the awareness that it exists so that when these issues do pop up, I think it is worth reading through this document and understanding, okay, can I fit within one of these six areas?

Mr. Redpath

Greg, thanks again.

Mr. Urban

All right, Ian, nice being with you.

Rev. Proc. 2022-19

By Ian J. Redpath, JD, LLM

A. Introduction

S corporations are considered the most popular form of entity for small business in America. This is often driven by the ability to pass through more profit to the owners through distributions not subject to self-employment taxes. There is a national trend to having a limited liability company (LLC) as the legal form of business and electing to be taxed as a corporation, and then electing S status. The ability to operate as a conduit corporation comes with many rules as to the type of stock and shareholders allowed. To be a small business corporation eligible to elect S status, the following criteria must be met: [IRC §1361(b)]

- Be a domestic corporation.
- Have only allowable shareholders: individuals, certain trusts, and estates. Partnerships, corporations, or nonresident alien shareholders cannot be shareholders.
- Have no more than 100 shareholders.
- Have one class of stock.
- Not be an ineligible corporation, i.e., certain financial institutions, insurance companies, and domestic international sales corporations.

A corporation may voluntarily revoke its S election. However, in many cases, the termination is involuntary because if the corporation fails one or more of the above requirements, it is considered terminated effective on the date of the act violating any rule (i.e., issuing a second class of stock). After a termination, the corporation is not eligible to re-elect S status for five years. In the event of a termination, the corporation should attach to its return, for the tax year in which the termination occurs, a notification that a termination has occurred and the date of the termination. [Reg. §1.1362-2(b)(1)] It should be noted that the election itself may be invalid and, thus, the corporation was never eligible to be an S corporation.

B. Inadvertent Termination or Invalid Election Relief

If the event causing the termination or invalid election was "inadvertent," the IRS may allow the S status to continue, provided the issue causing the termination or invalid election is rectified. [IRC §1362(f)] The corporation has the burden of establishing that it was "inadvertent." A major factor is if the event was reasonably within the control of the corporation and, for terminations, not part of a plan to terminate the election. If the corporation was unaware of the event despite its due diligence to safeguard against such an event or circumstance, such as a nonresident alien becoming a shareholder, this will generally be considered "inadvertent." [Reg. §1.1362-4(b)]

The IRS may provide relief to corporations both retroactively and for continuing S status if the corporation satisfies the following: [See Reg. §1.1362-4(a).]

- The corporation previously made a valid S election and that election terminated;
- The S election qualification loss was triggered by an inadvertent act;
- The IRS determines that the termination was inadvertent;
- Steps are taken within a reasonable period to correct the condition that rendered the corporation ineligible to be an S corporation; and
- The corporation and persons who were shareholders during the period of the termination agree to make any adjustments the IRS requires that are consistent with the treatment of the corporation as an S corporation.

While, in general, the IRS has been very liberal in granting "inadvertent" termination relief, this required a private letter ruling (PLR). Often, the IRS sees the same issues and similar events creating terminations or invalid elections. The IRS receives many requests each

year; and it is believed that significantly more are either not discovered or ignored. PLR requests take up significant resources for the IRS and can be very costly for the corporations. As a result, the IRS issued Rev. Proc. 2022-19 that allows, in certain circumstances, for corporations to "self-correct" the issues giving rise to a termination or invalid election event. The IRS estimates that approximately 80 PLR requests are received each year, and another 120 S corporations need guidance but elect not to pursue assistance due to the costs in areas addressed by this Revenue Procedure. The IRS estimates that the total cost of a PLR is approximately $108,000 (a $38,000 user fee, a $20,000 preparer PLR fee, and a $50,000 preparer due diligence fee). [Rev. Proc. 2022-19]

C. Revenue Procedure 2022-19

Revenue Procedure 2022-19 addresses six areas where taxpayers may self-correct rather than seek a PLR:

1. One class of stock requirement;
2. Disproportionate distributions;
3. Certain inadvertent errors on Form 2553 or Form 8869;
4. Missing administrative acceptance letter for S election or QSub election;
5. Filing a federal income tax filing inconsistent with an S election or QSub election; and
6. Non-identical governing provisions.

For areas not covered by the Revenue Procedure, the traditional PLR may be sought. Additionally, if an area is covered by the Revenue Procedure but the corporation seeks the added assurance of a PLR from the IRS, it may still follow that process—this could be the case in a reorganization or purchase transaction and the added assurance is required by the acquirer. It should be noted that there are areas in which the IRS will not issue rulings.

D. One Class of Stock Requirement

An S corporation may have only one class of stock issued and outstanding. While differences in voting rights will be ignored for this purpose, the corporation may not allow for differences in distribution or liquidation rights. [§1361(b)(1)(D) and Reg. §1.1361-1(l)(1)] While the corporation may have different classes of common stock, voting and nonvoting, it cannot have preferred shares that have preferences on distributions and liquidations. This is regardless of whether they are voting or nonvoting shares. The IRS has issued a number of PLRs allowing phantom stock, stock appreciation rights, and some other forms of deferred compensation arrangements to not be considered a second class of stock. Of course, care must be taken to meet the requirements set forth to avoid being considered a second class of stock.

In determining whether a document or agreement creates a second class of stock, it is not determinative what the corporation designates it as—for example, it does not have to be labeled as "stock" to be considered a second class of stock. Determining identical rights to distributions and liquidation proceeds is determined based on, among other things, the "governing provisions." These include the corporate charter, articles of incorporation, bylaws, applicable state law, and other binding agreements relating to distribution and liquidation proceeds. [Reg. §1.1361-1(l)(2)(i)] In addition to these, other arrangements may be considered a second class of stock if the principal purpose of the arrangement is to circumvent the second class of stock rules.

Parties may try to circumvent the second class of stock rules with other arrangements such as buy-sell agreements, employment agreements, loans, leases, and others that are really meant to provide additional profit to a shareholder or former shareholder. Other agreements or arrangements may be considered to create a second class of stock, as well, if a principal purpose is to avoid the single class of stock requirement. [Reg. §§1.1361-1(l)(2)(ii)(A), (4)(ii)(A), (ii)(B)(1), (B)(2)] If the principal purpose is not to circumvent the second class of stock rules, Rev. Proc.

2022-19 provides that the IRS will not treat the S corporation as having a second class of stock. The IRS will not issue PLRs on these.

E. Disproportionate Distributions

Regardless of the governing provisions or other arrangements, a corporation may still make disproportionate distributions. Many times, these are not meant to be permanent and/or circumvent the second class of stock rules. They are often circumstantially made, based on events and needs of a particular shareholder that year. PLR 200944018 illustrates a typical scenario:

> ABC Corp. is a corporation that elects S status on formation. In year 1, it made disproportionate distributions to its shareholders by failing to make distributions to all of its shareholders. During the following year, when the accountant was preparing the tax return for year 1, she discovered the error and had the corporation make equalizing distributions. The IRS determined that the S election may have terminated because disproportionate distributions could create a second class of stock for those getting a distribution in year 1. It concluded that if the S election had been terminated, the termination was inadvertent and the corporation took corrective action within a reasonable time of discovery. Thus, the IRS ruled that the corporation is to be treated as continuing to be an S corporation from its election and thereafter, provided that ABC's S election otherwise was not terminated.

Reg. §1.1361-1(2)(i) provides that "Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances." According to Rev. Proc. 2022-19, "be given appropriate tax effect" means that disproportionate distributions will not cause a termination as long as the governing provisions provide for identical distribution and liquidation rights. The IRS will not issue rulings in these situations.

F. Certain Inadvertent Errors on Form 2553 or Form 8869

A corporation must affirmatively elect to be taxed under the provisions of Subchapter S by filing Form 2553. An S corporation may not own another S corporation, but it may own stock in a C corporation. If an election is made on Form 8869 by the parent owning 100% of the stock of the C corporation subsidiary, the subsidiary can be treated as a disregarded entity, similar to a single member entity LLC. Some errors in those forms are not simply *de minimis* and can cause the election to be considered invalid—so the corporation is never an S or QSub. These errors include obtaining shareholder consent or designating a proper tax year. [IRC §1362(a)(2) and Reg. §1.1378-1]

If the error is the result of missing shareholder consent, Rev. Proc. 2022-19 allows the error to be corrected by either: (a) submitting the missing signature(s) within the time during which an extension of time for filing would be allowed [see Reg. §1.1362-6(b)(3)(iii)]; (b) obtaining simplified late filing relief under Rev. Proc. 2013-30; or (c) for late consents in community property states, obtaining automatic relief under Rev. Proc. 2004-35.

Rev. Proc. 2022-19 states that if the error is the lack of providing a valid tax year or missing the signature of an authorized officer, then the error should be corrected by following the simplified relief procedures under Rev. Proc. 2013-30. If none of these procedures apply, the taxpayer still may be required to obtain a PLR to correct the error.

Other inadvertent errors or omissions may be corrected by submission of a written explanation to the IRS service center in Ogden, UT, or Kansas City, MO. For these errors or omissions, the IRS will not issue a PLR.

G. Missing Administrative Acceptance Letter for S Election or QSub Election

The IRS will notify corporations of acceptance of their elections. For Form 2553, acceptance is a CP261 Notice. For Form 8869, it is a CP279 Notice to the parent corporation and a CP249A Notice to the subsidiary. If the notice is never received or it is lost and the corporation needs to have the Notice (for example for a lender), prior to the Revenue Procedure, the corporation would have needed to obtain a PLR to show acceptance by the IRS. Rev. Proc. 2022-19 provides procedures to obtain a replacement letter. The replacement may be obtained by the S corporation or shareholders of the S corporation by contacting the IRS Business and Specialty Tax Line at (800)829-4933. For tax practitioners, the replacement letter may be obtained by contacting the IRS Practitioner Priority Service at (866)860-4259.

H. Filing a Federal Income Tax Filing Inconsistent With an S Election or QSub Election

An S corporation files its annual income tax return by submitting a Form 1120-S. A QSub does not file a tax return since it is disregarded for tax purposes and all tax items are included in the parent's Form 1120-S. Sometimes, corporations file returns that are inconsistent with either election. For example, some practitioners have been known to file a Form 1120-S for the QSub and parent, or an S corporation files a Form 1120 for its initial year even though the election is in effect. While not considered a termination event under the regulations, the IRS has received many requests for PLRs to confirm the continuing acceptance of S status. Rev. Proc. 2022-19 provides that the S corporation or QSub parent must file a federal income tax return consistent with its tax status for any open tax years, whether that is as an S corporation, a QSub parent, or a QSub. The IRS will treat all transactions and distributions as being made by an S corporation or QSub, as reported on the correct form. The IRS will not issue rulings in these situations.

I. Non-identical Governing Provisions

This part of the Revenue Procedure is related to the second class of stock discussion. Many times, the governing provisions contain "non-identical provisions." This is often the case when an LLC is going to be taxed as an S corporation. Attorneys will, on many occasions, follow general forms, such as the operating agreement, for an LLC's legal existence and provide provisions that are totally legal but can create a second class of stock—such as the right to make special allocations. This can also be the case in standard articles or bylaws for a corporation that may provide for the ability to issue preferred stock. (If not issued and outstanding, it would not create a second class of stock, but best practice would be to not have it).

Rev. Proc. 2022-19 defines a "non-identical governing provision" as a governing provision, alone or as part of another governing provision, which results in the S corporation having more than one class of stock. These provisions would conflict with the requirement that the governing provisions of an S corporation provide for identical distribution and liquidation rights, and causes a termination or invalid election. Rev. Proc. 2022-19 allows them to be corrected without a PLR. In order to be eligible for this simplified correction procedure, the following must be satisfied: (a) the corporation has or had one or more non-identical governing provisions; (b) the corporation has not made a disproportionate distribution (actual or deemed); (c) the corporation files IRS Form 1120-S for each year beginning when the first non-identical governing provision was adopted and through the year immediately preceding the year in which the corporation requests relief; and (d) procedural requirements for requesting relief are satisfied.

With respect to procedural requirements, Rev. Proc. 2022-19 requires certain information to be provided and statements be confirmed by the corporation and each "applicable shareholder." Applicable shareholders are shareholders at any time when the non-identical governing provision existed. Samples of each are attached as an Appendix to the Revenue Procedure. The corporation is required to retain the Corporate Governing Provision Statement, the Shareholder Statement(s), and the revised governing provisions, in

accordance with §6001 of the Code. The Corporate Governing Provision Statement, the Shareholder Statement(s), and the revised governing provisions must be retained by the corporation for inspection by authorized Internal Revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any provision of the Code or the Income Tax Regulations. [Reg. §1.6001-1(e)] If these items cannot be satisfied, then a PLR may be requested.

J. Conclusion

The relief provided in Rev. Proc. 2022-19 to self-correct errors is not available once the IRS discovers the error. As a result, practitioners need to be proactive with their clients operating as S corporations, whether newly elected or having held long-term status. It is recommended that practitioners review the operating/governing documents of all S corporations to make sure there are no issues. This might include other documents like employment agreements with a shareholder/employee. It is certainly best to self-correct than to wait until the IRS might catch it in the future.

A. Discussion Problems

Your office acquires a new client during this year's tax season. In reviewing the client's tax information, you find the following:

The client is an LLC that elected to be taxed as a corporation and filed a Form 2553 and then elected S status effective for its first year of operation. It has always filed a Form 1120-S. Several years ago, it obtained a C corporation subsidiary and made a QSub election. They have an acceptance from the IRS in their records for the S election, but not for the QSub election. The prior accountant was filing a separate Form 1120-S for the subsidiary. In reviewing their operating agreement, you have found that it has a common provision for LLCs allowing for special allocations. It has never made special allocations, but you note that the distributions over the years have been somewhat disproportionate. The owners tell you that they just "take out" what they need for the year and know they will have to make it up later.

Required:

Discuss the following based on the above facts:

1) Is there an issue with any of the facts presented that might affect the validity of the S or QSub status?

2) Are there any issues for which you can utilize Rev. Proc. 2022-19?

3) What would be the advantage to using Rev. Proc. 2022-19?

B. Suggested Answers to Discussion Problems

1) The provisions in the operating agreement are governing provisions and non-identical provisions. The IRS could determine that they constitute a termination event. The allocations that have been made could, again, be considered a second class of stock as the distributions are not in conformity with the shareholder's ownership of the stock. These could be considered termination events, ending the S election when it occurred. Of course, if the parent is not an S corporation, then the subsidiary cannot quality as a QSub. A review should also be made of the elections for S and QSub status to make sure they comply with the law, or there could be an invalid election.

2) Rev. Proc. 2022-19 allows for self-correction of certain defects that will not require a PLR. Rev. Proc. 2022-19 addresses six areas where taxpayers may self-correct rather than seek a PLR:

   - One class of stock requirement;
   - Disproportionate distributions;
   - Certain inadvertent errors on Form 2553 or Form 8869;
   - Missing administrative acceptance letter for S election or QSub election;
   - Filing a federal income tax filing inconsistent with an S election or QSub election; and
   - Non-identical governing provisions.

   The facts indicate that the client can make use of Revenue Procedure 2022-19.

3) The IRS may provide inadvertent termination relief to corporations both retroactively and for continuing S status if the corporation satisfies the following [see Reg. §1.1362-4(a)]:

   - The corporation previously made a valid S election and that election terminated;
   - The S election qualification loss was triggered by an inadvertent act;
   - The IRS determines that the termination was inadvertent;
   - Steps are taken within a reasonable period to correct the condition that rendered the corporation ineligible to be an S corporation; and
   - The corporation and persons who were shareholders during the period of the termination agree to make any adjustments the IRS requires that are consistent with the treatment of the corporation as an S corporation.

   The private letter ruling (PLR) process is costly and time-consuming. Rev. Proc. 2022-19 allows for self-correction of many common inadvertent termination/invalid election events without the need for a PLR.

Cryptocurrency/Virtual Currency— 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.

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.

Nonfungible Token (NFT)— Nonfungible tokens are unique cryptographic tokens that exist on a blockchain and cannot be replicated. They can be anything digital such as artwork, music, and tweets.

Offer in Compromise—The IRS has the ability to "compromise" a civil or criminal tax liability after assessment and before referral to the Department of Justice. The taxpayer may seek a compromise based on doubt as to collectibility, doubt as to liability, or to promote effective tax administration. The process is known as offer in compromise (OIC) and constitutes an agreement between a taxpayer and the IRS to accept less than full payment.

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

Stablecoins—Stablecoins are cryptocurrencies designed to have a relatively stable price and whose value is pegged or tied to that of another currency, commodity, or financial instrument. Stablecoins aim to provide an alternative to the high volatility of the most popular cryptocurrencies.

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

Virtual Currency—Virtual currency 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.

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, what is the meaning of the term *certiorari*?

   A. Attorney-client privilege is disallowed for certain dual-purpose communications.
   B. A case is remanded from the Supreme Court back to a lower court.
   C. The primary purpose test is replaced by a significant purpose test.
   D. Someone is granted the right to appeal, such as to the Supreme Court.

2. According to Ian Redpath, based on the *Hrach Shilgevorkyan v Commissioner* case, all ***except*** which of the following are required for taking a mortgage deduction?

   A. A quitclaim deed on the property
   B. Residency in a qualified residence subject to the mortgage
   C. An obligation to pay back the mortgage
   D. Legal or equitable ownership of the property

3. According to Ian Redpath, per JCX-1-23, many of the provisions of the Tax Cuts and Jobs Act will revert back to their original status in what year?

   A. 2023
   B. 2024
   C. 2025
   D. 2026

4. According to Ian Redpath, use of a new form allows whistleblowers within the IRS to report directly to whom?

   A. The House Ways and Means Committee
   B. The U.S. Securities and Exchange Commission
   C. The Ninth Circuit Court of Appeals
   D. The Supreme Court

5. According to Ian Redpath, what type of information does Exemption 4 cover related to requests under the Freedom of Information Act (FOIA)?

   A. Internal personnel rules and practices of the IRS
   B. Trade secrets in commercial or financial information obtained from another person
   C. Inter-agency or intra-agency memos and letters which would not be available by law to someone outside the agency
   D. Personnel, medical, and similar files, the disclosure of which constitutes an unwarranted invasion of privacy

Continued on next page

6. According to Ian Redpath and Shannon Jemiolo, a question on the 2021 Form 1040 referred to virtual currency. In lieu of the term virtual currency, the question on the 2022 Form 1040 refers to which of the following?

   A. Cryptocurrency
   B. Digital assets
   C. Nonfungible tokens
   D. Stablecoins

7. According to Ian Redpath and Shannon Jemiolo, what is one example of a nonfungible token?

   A. Former President Trump's superhero cards
   B. Robux from the game Roblox
   C. The Sand Dollar from The Bahamas
   D. Trevor Lawrence's bonus paid in Bitcoin

8. According to Ian Redpath and Shannon Jemiolo, which state accepted virtual currency for tax payments in 2022?

   A. Alabama
   B. Colorado
   C. New Hampshire
   D. Texas

9. According to Ian Redpath and Shannon Jemiolo, which of the following is considered *stablecoin*?

   A. Bitcoin
   B. Nonfungible tokens
   C. The Sand Dollar
   D. Tether

10. According to Ian Redpath and Shannon Jemiolo, what is *proof of stake* when mining digital assets?

    A. Using an algorithm to solve complex mathematical problems
    B. Adding blocks to the block chain after the mathematical problem is solved
    C. Pledging an investment in digital currency before validating transactions
    D. Using spare space on a computer's hard drive to store solutions to the mathematical problems

Continued on next page

11. According to Ian Redpath and Greg Urban, what is the purpose of Revenue Procedure 2022-19?

    A. It allows S corporations to request relief from inadvertent termination after the error is discovered by the IRS.
    B. It allows S corporations to self-correct for many common termination and invalid election matters prior to IRS involvement.
    C. It allows small businesses to obtain and maintain S corporation status.
    D. It requires S corporations to determine whether they are fulfilling the stipulations in their governing documents.

12. According to Ian Redpath and Greg Urban, which of the following terms best describes the private letter ruling process used prior to Revenue Procedure 2022-19?

    A. Quick
    B. Simple
    C. Costly
    D. Efficient

13. According to Ian Redpath and Greg Urban, how many key areas are addressed by Revenue Procedure 2022-19?

    A. Three
    B. Six
    C. Ten
    D. Twelve

14. According to Ian Redpath and Greg Urban, at its core, what is the main consideration for determining whether an S corporation has a single class of stock?

    A. The use of debt instruments and the related safe harbor
    B. Distribution rights ensuring shareholders receive their pro rata share
    C. Whether an employment agreement exists
    D. Intergenerational differences in voting rights

15. According to Ian Redpath and Greg Urban, can you use Revenue Procedure 2022-19 to address issues that occurred in the past?

    A. Yes, this revenue procedure provides a good opportunity to fix issues from many years ago.
    B. Yes, but there is a limit and only issues from one to three years ago can be fixed.
    C. No, only current-year issues can be resolved using the guidance in this revenue procedure.
    D. No, a private letter ruling is the only way to address issues that occur more than two years in the past.

CPE Network®
Tax Report
Volume 36, Issue 3 **March 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 March 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	_____	_____	_____	_____	_____	_____
Digital Assets	_____	_____	_____	_____	_____	_____
Revenue Procedure 2022-19	_____	_____	_____	_____	_____	_____

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

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

	Overall	Knowledge of Topic	Presentation Skills
Ian Redpath	_____	_____	_____
Shannon Jemiolo	_____	_____	_____
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, March 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!

“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:

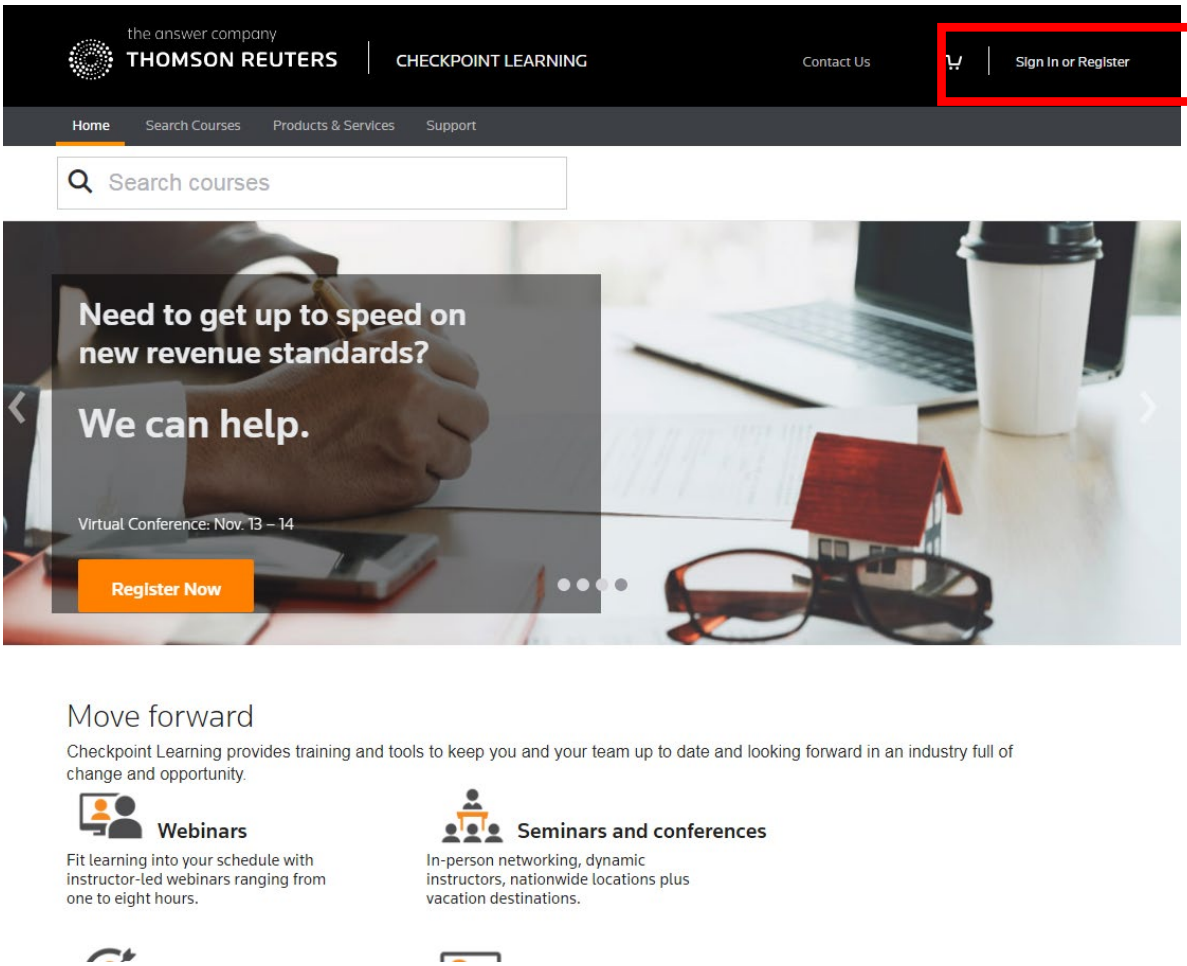
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

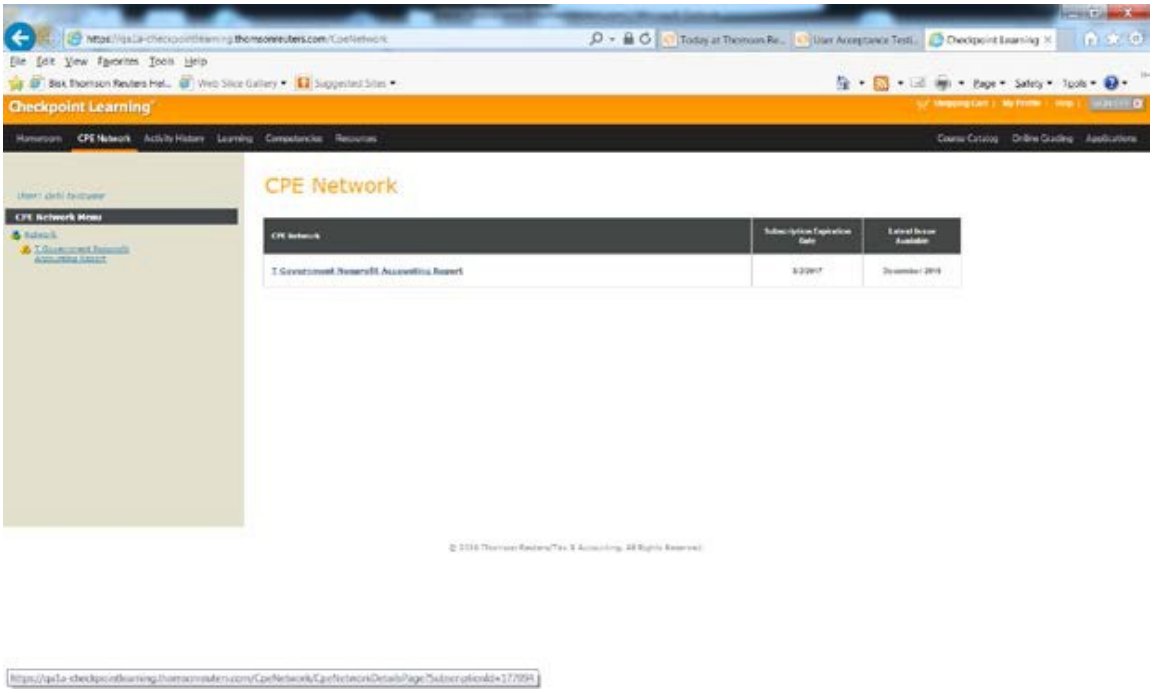
Webinars

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

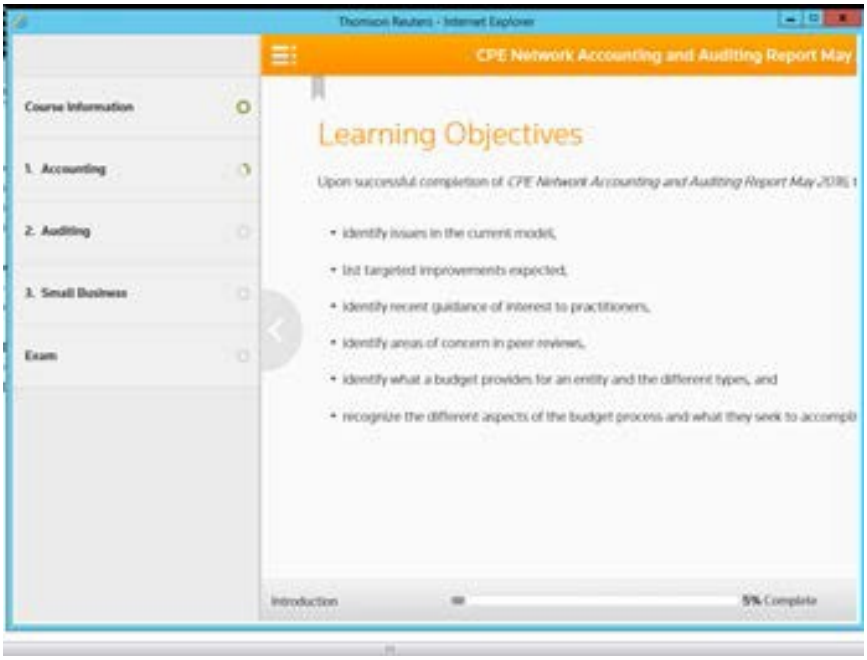
Seminars and conferences

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

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

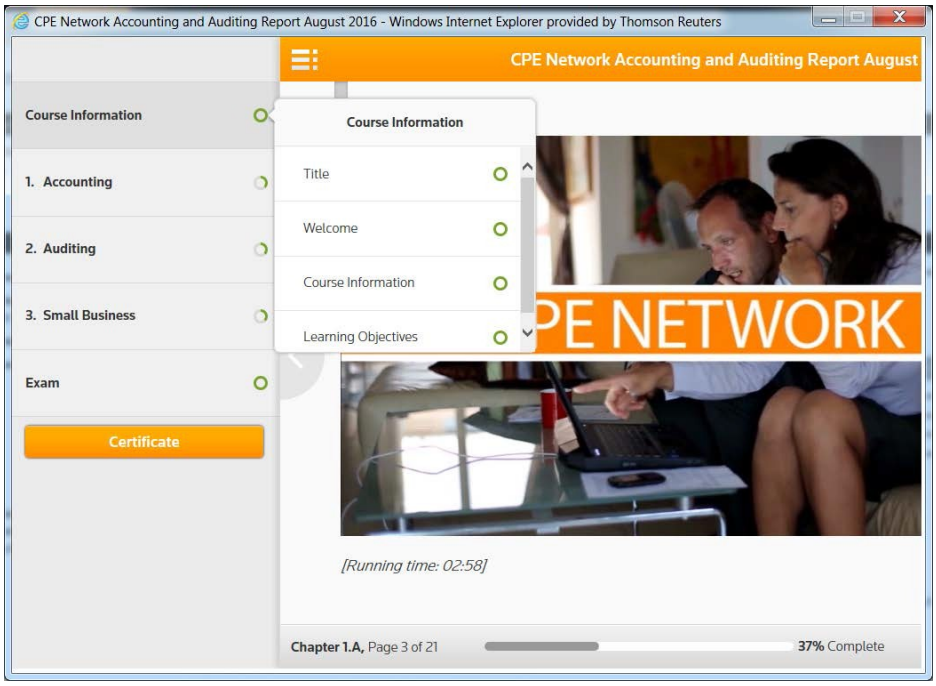


The Chapter Menu is in the gray bar at the left of your screen:



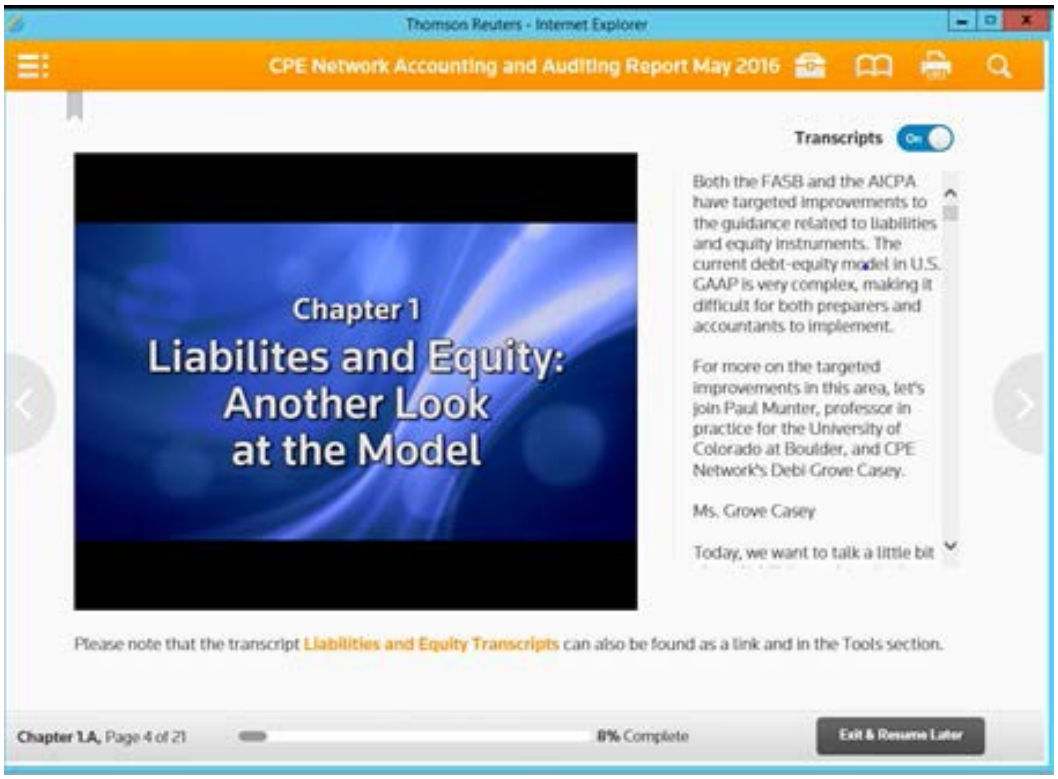
Click down to access the dropdown menu and move between the program Chapters.

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

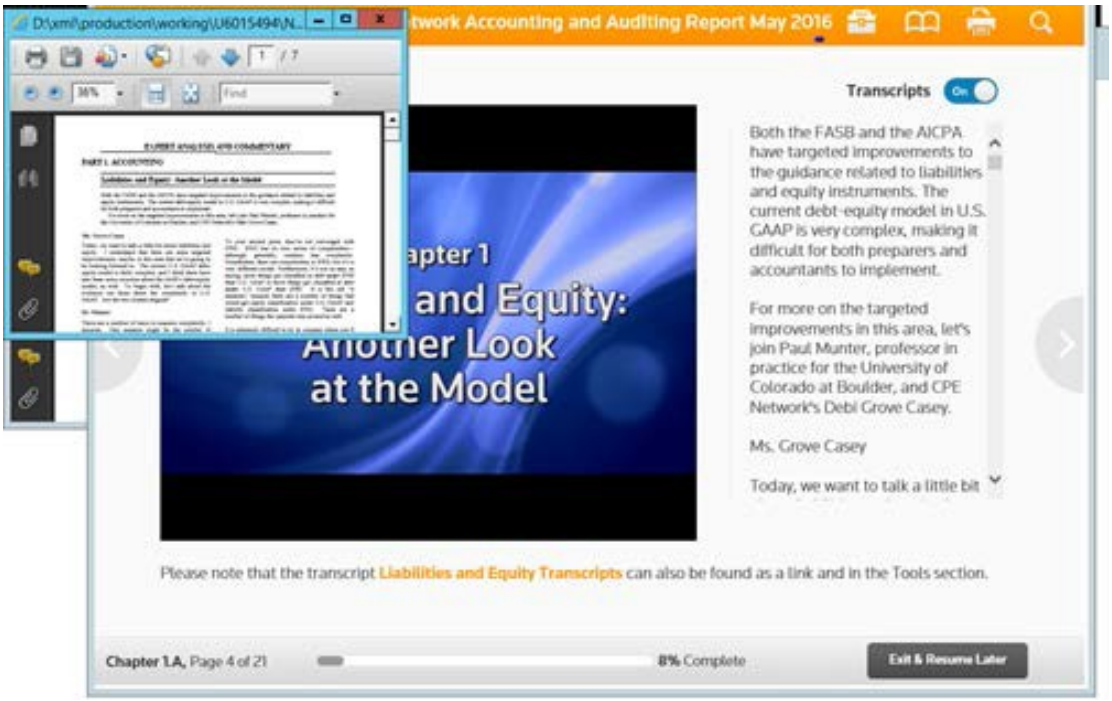


- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental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

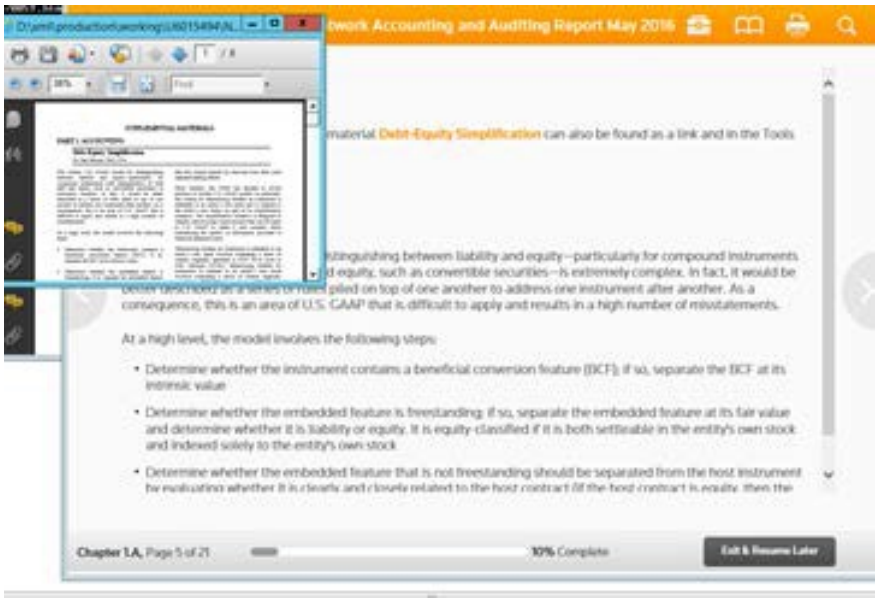
Video segments may be downloaded from the CPL player by clicking on the download button.



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.

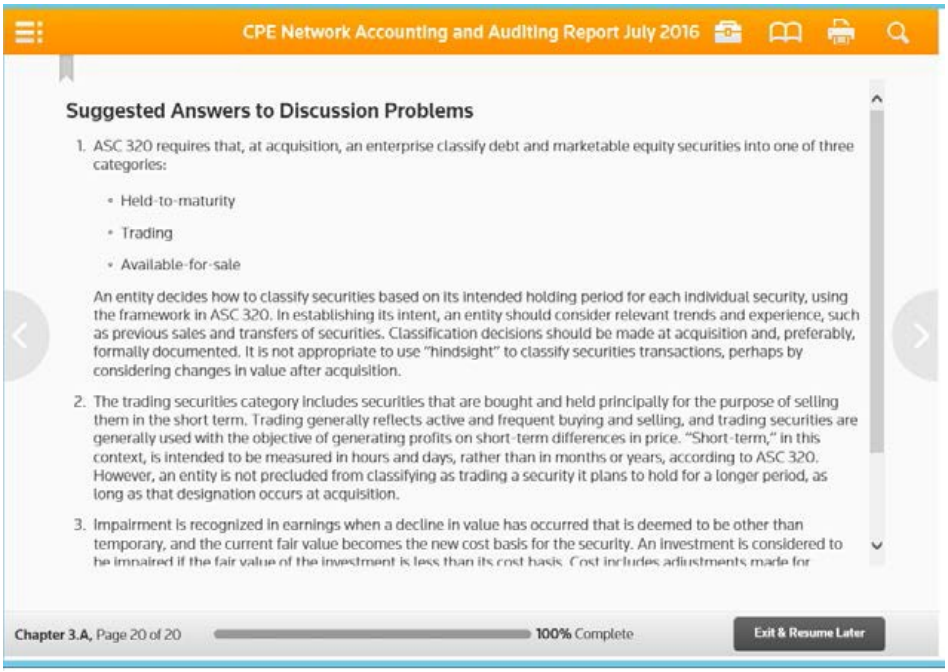


Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



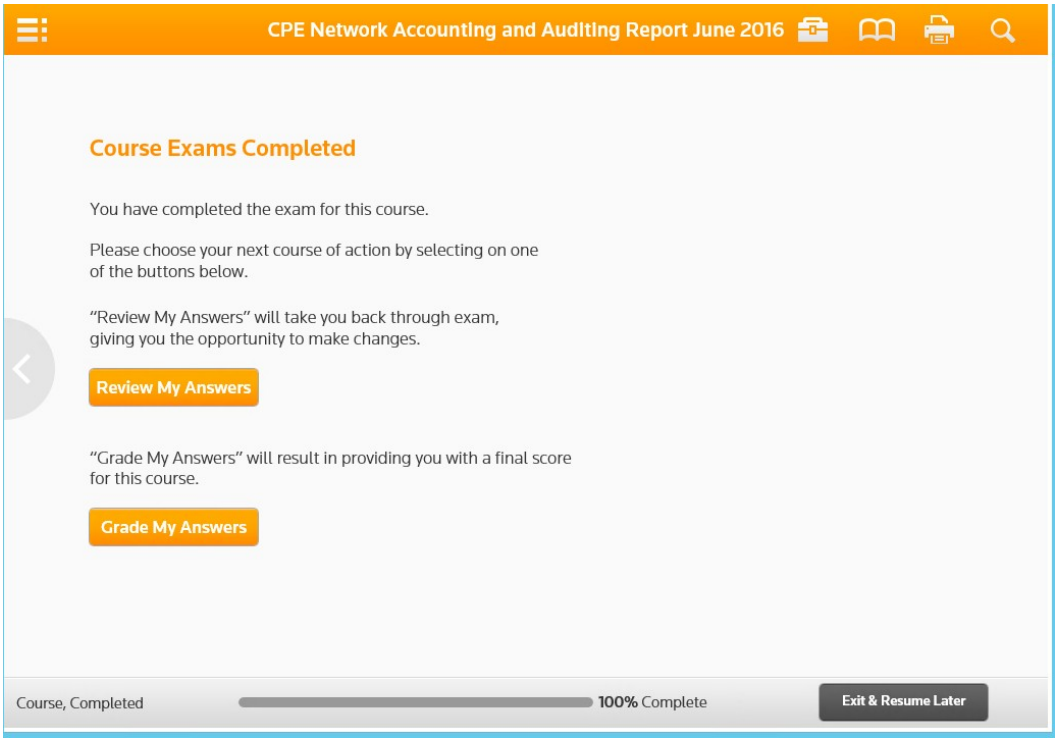
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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