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CPE NETWORK TAX REPORT

SEPTEMBER 2022 VOLUME 35, ISSUE 8

Note: Beginning with the March 2023 edition of the Network programs, DVDs will no longer be shipped by Thomson Reuters. Videos will be available for download or streaming only. For customers wishing to adopt an online only format sooner, please contact your customer representative.

Note: During the current COVID-19 crisis, direct person-to-person contact can be reduced by forwarding this to participants and reminding others that the video is also available online through the CPL player. Additionally, video/discussion/Q&A may be shared via Teams, Zoom, or other conferencing-type software. Participants may submit the quiz for self-study credit, or Group Internet Based credit (similar to a webinar) is now available. Consult the user guide at the end of the newsletter for instructions on how to earn credit in this manner.

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Topics for future editions may include:

- Debt Basis in an S Corporation
- Reasonable Compensation

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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

The Inflation Reduction Act of 2022 was signed into law on August 16, 2022. It is predicted to have a negligible effect on inflation. The Act includes provisions related to health care, numerous climate credits, and some revenue raising taxes. While most of the provisions take effect in the future practitioners must be cognizant of the rules to properly advise clients.

Learning Objectives:

Upon completion of this segment, the user should be able to identify a number of recent changes/updates to the tax laws including: (1) the predicted impact of the Act on inflation, (2) the enacted corporate alternative minimum tax in addition to the tax on the repurchase of corporate stock, and (3) the increase or extension of various credits. [*Running time 41:03*]

PART 2. INDIVIDUAL TAXATION

Despite the hoopla surrounding Limited Liability Companies (LLC), corporations electing to be taxed under Subchapter S of the Internal Revenue Coder (S corporations.), continue to be a very popular entity of choice for small businesses. Perhaps the most important concept in S corporation taxation is that of basis. The proper calculation of basis is essential for the proper treatment of distributions and losses. It is a common area of audit by the Service.

Learning Objectives: Upon completion of this segment, the user should be able to identify a number of aspects of stock basis in S corporations including: (1) the forms used to track stock basis, calculate at-risk limitations, and report passive activity loss limitations and (2) the computation of stock basis.
[*Running time 30:42*]

PART 3. BUSINESS TAXATION

The federal rehabilitation tax credit is a financial incentive to invest in historic buildings and creates benefits to investors and property owners. The credit is equal to 20% of qualified rehabilitation expenditures and is claimed in five equal annual installments beginning on the date on which the rehabilitated building is placed in service. Practitioners should be cognizant of the requirements to properly advise clients of its availability. [*Running time 39:49*]

Learning Objectives:

Upon completion of this segment, the user should be able to discuss a number of aspects of the rehabilitation credit including: (1) evaluate who can take the credit; (2) assess qualified rehabilitation expenses and (3) determine when a building is substantially rehabilitated.

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.

Robert Lickwar, CPA is a tax partner with the accounting firm of Del Conte, Hyde, Annello and Schuch, P.C. in Farmington, Connecticut. Mr. Lickwar has more than 30 years' experience in public practice and generally serves small businesses and their owners with tax planning and compliance services. He is also a nationally recognized presenter on many federal, state, and local tax issues.

Jonathan Tretter, CPA is a director with Freed Maxick CPAs in Batavia, NY. Jonathan is a graduate of Canisius College, and a member of the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants. His focus is on taxation and planning for C corporations, S corporations, Partnerships and LLCs, and high-net worth individuals. He also has extensive knowledge of federal and state tax credits and incentives, methods of accounting, UNICAP 263A, estate and business succession planning, along with tangible property and cost recovery.

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

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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 join Ian Redpath and Bob Lickwar for a discussion regarding recent legislation, the Inflation Reduction Act of 2022.

Let's join Ian and Bob.

Mr. Redpath

Bob. Welcome to the program.

Mr. Lickwar

Thanks, Ian. It's great to be here.

Mr. Redpath

You know, this is going to take us back because the Experts Forum we used to do together; many times, we've done that. This is one where you hear the television or the radio, and they say we're going to interrupt our regularly scheduled program. So, we're going to interrupt our regularly scheduled program on the Experts Forum to go over the new Inflation Reduction Act—and I'm shortening it, Inflation Reduction, Climate, on and on and on and Tax Act. So, the acronym is IRA. Bob, I said welcome to the program. I'm not sure that I should say welcome when it comes to the Act. We've heard a lot of things about it, and there's been a lot in the press about this Act; and it starts with inflation. What are they projecting is really going to be the impact, if any, on inflation by this Act?

Mr. Lickwar

Well, if you read some of the reports, Ian, there have been reports put out by the congressional budget office or the CBO; there have also been studies put out by the Wharton School of Business from the University of Pennsylvania, and they both predict that if everything hits, the impact on inflation will be relatively minimal, maybe 0.1% or a quarter percent on inflation over the next five years. Hopefully, we'll be out of an inflationary period by then. I think what you're really seeing here with this bill is the commitment of the Democratic party to climate change and incentives that they believe will get us to a zero emissions world, or at least country, by a certain date. And that's, of course, subject to anyone's speculation; but certainly, there are many provisions in this bill, Ian. As I read the bill, I'm going to need a geothermal engineer to help me figure out what some of the credits are here. My son-in-law is an electrical engineer; and he's trying to explain to me about how some of these things work—like changes to grids and things, which sound like they're good ideas, but it's really difficult from a tax practitioner's perspective, Ian, to know about all of the credits out there. And certainly there are some provisions, like certain appliances that are creditable, where the federal government has kicked that responsibility back to the states. So now, it's the states to come up with what they think is a budget and wait for government funding. There's going to be a lot going on here. It's going to be a long process. And really from a tax practitioner's perspective, depending on your type of clients, maybe there's not a lot of tax provisions that will affect you, but certainly, windows and things like that will affect most of your clientele.

Mr. Redpath

I think that what's important, Bob, is that a lot of the provisions in here—there's been a lot of hoopla about them, but they're going to tend to hit only a very narrow group. And yes, Bob, as you know, I have a very, very large clientele of corporations that have a billion dollars in income.…

Mr. Lickwar

So, you have part of the 150, Ian, because the estimate is of the 500 Fortune 500 companies, roughly 30% of them will be affected. So you're looking at 150 companies, Ian, bearing the burden of $445 billion in revenue raise. So, I'm glad you have those clients, Ian. I don't have those clients. I don't even think that my controlled groups under Sections 52 and 1563 quite get there; maybe a little short, Ian, maybe on the borderline, but they're just not there.

Mr. Redpath

Yes. And I think that's a good point, Bob; and the fact of the matter is, I believe the number's what? 700 billionaires in the country.

Mr. Lickwar

I believe that's the number, Ian. And if you do the math, that'll be roughly 124 new IRS agents for each audit of a billionaire. That's a pretty good team, Ian. And I've got to be telling you, if I'm a billionaire, I thought that my world was trouble free. But now, when I have 125 people scurrying around the house, and it's not grandkids and great grandkids, it's IRS agents, I'll be a little bit frightened. Of course, we're being a little facetious and joking a little bit. We all know, Ian, that there's a tax gap. Okay. There's an underground economy. That economy is pretty strong. There's a lot of lost revenue there. It's politically unpalatable to talk about auditing lower income individuals, whatever that terminology means in Washington, DC these days, but the reality is, Ian, that they have to do something to try to close the tax gap. And what I really think is, however long it's going to take to hire and train these individuals, remember that the IRS has said, we really don't understand partnerships, you guys and gals who are CPAs, we need to assemble a team. And I just have to think, Ian, that that's part of the overall game plan as well.

Mr. Redpath

Yes. I totally agree with you. You know, we've heard for years, now we're coming after partnerships, now, we're really going to come after them now, and the audits still tended to be basically basis related. You didn't have enough basis to take the losses, these types of audits, not the substantial audits. And then, we got the centralized partnership audit rules, which make it easier now to audit the partnership. And I agree with you. I think we're going to see significant enforcement in the partnership area. I'm not sure that the assurance that there's going to be people, that nobody will be audited who has less than $400,000 a year. That strikes in the face of… what the CBO has said, the numbers that the projections of revenue that we're making are based on auditing everybody. And I believe it's something like 75% of all of the current audits are of people below that. So, are we suddenly going to have no more enforcement than that? I don't know. I just know that the CBO has said, if you don't, you're not meeting your projections of revenue, if all you're going to do is go after those with $400,000 or more. So, we'll see what happens.

Mr. Lickwar

One of the problems Ian, that we've had in the profession as CPAs is finding people. I don't think it's going to be that easy for the IRS to find people either. You're going to have to train those people, Ian; and it takes time to train them. I'm working on an audit right now. It's the first one I've seen in years. Seems like a nice young guy. But I know I'm going to end up doing some training here, Ian. I would rather be spending the training time with my staff. So, I think if the audit rates increase, that's what we as CPAs and as tax practitioners are going to be doing. We're going to be doing a lot of training for the IRS when we could be dedicating that to our staff. It's problematic. I'm just wondering what their timeline is for hiring everyone. I don't know that they're knocking down the doors to go work for the IRS.

Mr. Redpath

No, and we know that, for example, accounting enrollments in colleges and universities are dropping nationwide. So, right now, there's fewer, even though the market is great. I mean, if you have a child that was thinking about college and wants a pretty assured job, have them go into accounting because there's plenty of jobs out there. Everybody from the nationals down to the small locals are looking to hire right now. So, there's that marketplace. The CBO has made interesting comments. In the past, remember that there was a proposal to provide for additional funding for the IRS. And the CBO said that the projections of revenue are only going to work if—and the big if—if they hire qualified individuals. In other words, individuals that are already well versed in the tax law, which looks at them bringing in experienced people. I'm not sure that's what's going to happen.

Mr. Lickwar

Yes. And I'm going to say unequivocally that that's not going to happen, Ian. And the reason is because right now, if you're trying to find an experienced person in public accounting, for example, they're getting a pretty good price. Even though they may not have the experience that they claim to have, because the firms are really so desperate. And as you said, the college enrollments are extremely low. It's not like you're going to take someone who's in one area of Civil Service and move them over to the IRS, Ian. As you said, I mean, the code is this big. I mean, this doesn't include the regulations, the Rev. Procs., the bulletins, the Internal Revenue bulletins. It's amorphous, to say the least, if I can use that word; and it's going to take a long time to train people. And I just don't see how they're going to find experienced people. I could be wrong. Maybe everybody just wants out; they want to work for the government and that's all. But I don't know. We'll say the jury's still out on that.

Mr. Redpath

Obviously. Bob, just to drive that point home, I had an audit recently of a real estate professional and nice, nice young agent. But I kept trying to explain that, "No, no, no. You're looking at the wrong things. Here, look at this, look at this." And so, right in her report, she said, "I have reviewed the taxpayer's expense reports, and they don't justify being a real estate professional." That's what that was. I kept trying to show her the time records, and it's right in her report. Of course, when we went to appeals, it was okay, guess that's not the issue.

Mr. Lickwar

So you're in one of those circumstances, Ian, where your client actually had the documentation, but they looked at the incorrect documentation. And that's to my point and your point, and that is, there's going to be a lot of training time. You just did training there. She'll know what to ask for, or he'll know what to ask for the next time they're out on an audit of a real estate professional. And reading the case law, they know that the big issue is documentation, and they just didn't see what you had. So, that's going to be the problem we're going to have. I guess, from my perspective, Ian, I'll be 61 in December, and I'm counting my time. At 65, by the time they unleash all of these individuals I'll probably be retired. I'll probably be audited; and so, I'll have to represent myself at that point. Or hopefully, you're still working and you can help me out, but it's a little scary.

Mr. Redpath

Only if they review our programs, Bob. So, is it a fair statement to say that one of the things that's going to create problems with this Act for staff is the needing that additional documentation, knowing that they need additional documentation? For example, okay, the client comes in, "Here's my bill of sale. I just bought a new electric vehicle." "Well, those Teslas, they don't qualify. Oh, that GM car, that Ford car, they don't qualify. Well, that particular battery doesn't qualify that's in that vehicle because the parts assembled… or part of our free trade agreement." It's going to be a nightmare. And of course, we're going to always, I think, [need] these certifications that we're going to have to get from all of the companies to say, okay, does this qualify or not? It's not going to be something that we can just say, "Oh great. You bought a new vehicle." And if that client calls and says, "I'm thinking about buying a new vehicle," you might have to say, "Okay, you're going to get an electric car or truck or SUV?" The new Rivian, the upstart California company—none of their vehicles qualify.

Mr. Lickwar

Right, because too much of the production is occurring offshore, and it's not part of any free trade agreement, Ian. Exactly right. So, the thing you're going to have to inform your clients is number one, they're going to need certification from the actual dealer. They have to buy the car from a dealer. In certain cases, Ian, adjusted gross income has to meet thresholds to be able to claim credits; so that, in certain cases, married filing joint over $300,000 won't be eligible. They've also added in a credit for used EVs, electric vehicles. But there, the AGI threshold, I believe is $150,000. So, it's a really low number, Ian. I don't know that a $7,500 or $3,750 credit makes it affordable; but the cost of the car also can't be more than $25,000. So, there's a lot going on here, Ian, and a lot that people are going to have to be familiar with.

Mr. Redpath

Yes. And I think this is one of those ones where you need to tell your clients in advance, whether you have a newsletter that goes out. Because I can see a lot of people right now out there, just a casual conversation with people. They go, "Oh well, maybe I'll get an electric car this time. I'm going to look at that." "Okay, well, hold off because you probably make too much money. No, your Tesla's not going to qualify." Which cars? I guess the manufacturers, as I look at it, this is just to try to incentivize them to come out with lower cost vehicles. And the other side of it, I think, that's missing in this discussion is if we all got electric vehicles and plugged in today, I think our grid's going to have a problem; because the grid is not capable of handling that many electrical vehicles being plugged in. So, we'll have rolling brownouts.

Mr. Lickwar

We've had a hot streak, Ian; and I've got to tell you, it was nice to have the air conditioning on. So, when we bust out the air conditioner and the electric vehicles, yes, that could be a little bit problematic. I'm in a pretty good place, Ian, to put on solar panels, but I've never pulled the trigger on it. I just looked at the cost and said, "Yes, there's a credit and a little bit of a subsidy, but does it make sense? And will I be at the house long enough?" And my point there is, is not that I'm a hero for putting on a solar panel if I decided to do so, it's that that's the type of conversation you're going to want to have with your clients. Does it make sense economically by selling back to the grid, and you reduced energy cost? Does it really make sense for you? How long will you be in the house? What is your investment? Will it increase the value of your residence? All of those things need to be considered and discussed with your clients when they're thinking of making these decisions. So, yes, I agree. I've had plenty of clients, Ian, who have purchased electric vehicles well after the expiration of the number of vehicles sold and then come in and say, "Yeah, I bought this car. Do I get my credit?" And the answer is, "No, they've already sold too many vehicles," like Tesla. The client is shocked to hear that, and tells me they're not getting that news from the dealer. Maybe they didn't ask the question; but certainly the answer is not given to them. It's not solicited; therefore, it's not given. So, you have that issue as well, although this bill removes some of the production caps related to electric vehicles.

Mr. Redpath

Right. And I think that's a good point. The production caps are eliminated pretty much in the bill. And I think what you're going to see, and you said, there's a very expansive list now of things that qualify for the—what used to be the home energy credit—but the energy efficiency credit. But you know, what we're going to see is we're going to see advertisements all the time, you know, get your tax credit, solar panels today, get this, get that. But these aren't unlimited credits. And sometimes, they sound really good until you look and say, well, but there is a cap on how much you can take.

Mr. Lickwar

Yes. There is a cap on what you can take. It's generally a 30% credit. Solar panels, by the way, Ian, retroactive to 2022. So, you got lucky. Instead of a 26% credit, they're going to put this back retroactive to 30% and bring it all the way out to 2032. There are some carryover provisions here with respect to those types of items. So yes, there are limitations. We did expand some of the home improvement credits like windows. We made the credit a $1,200 credit. I guess the question is, if you've already used $500, are you down to $700? The answer should be no. It's like restarting a $1,200 credit, but there's a $600 a year cap on windows, for example. So, what do you do? Do you do half the house in one year and half the house the next; or do you do the skylight this year and then the windows next year? It doesn't seem to make a lot of sense to me. But that's the way the bill is certainly drafted. It seems, Ian, if you're changing to energy-efficient, double-hung windows—which by the way, are very convenient to clean—that your credit's probably going to be limited to $600 unless you can spread it. It's kind of nonsensical. And here's my point. I think over the next six to eight months, you're going to get a lot of guidance from the IRS because there's lots of provisions in this bill that say "pursuant to subsequent guidance issued by the IRS." Section 179D of the code was extended here, Ian. And I bring that one up because that's a provision that allows a deduction similar to a 179 deduction for making commercial buildings, energy-efficient. And the other reason I bring it up is because, if you have people designing systems working on government buildings, guess what? The government can decide who gets the deductions. Now, the IRS was told 16 years ago to come up with regulations. Well, they never came up with regulations. They came up with three pieces of guidance in 2008, 2011, and 2012. And basically, what they said is if there are multiple designers—we're not talking about the installers, they don't qualify—you, owner of the building, government, state, federal, whatever, can allocate the deduction to the various designers of the project. Now, Ian, upon audit—and I have this actually going on—they're saying, "Oh no, we didn't really mean that. You only get… one person gets the deduction. You don't get to spread it around. But that's clearly not what the guidance says. So, here's my concern. We're in a similar situation when we get all of the guidance related to the IRA of 2022 provisions.

Mr. Redpath

Yes. Well, I mean, hold on, right? So, one thing we've heard a lot about Medicare, and it's not a tax provision per se, but these prescription drugs; but it's 10 drugs beginning 2026. So, we're not talking about lowering drug costs now. And then, these are negotiated prices; so, we don't know what those are going to be. And then 10 more for 2029. So, when you hear this big thing is well, it's reducing drug costs, we don't know what that means. And it's because it's sometime in the future… The drug companies are saying this is going to stifle innovation; it's going to stifle our research. I'm not saying that's true, but who knows? I mean, that's a question. I do know that the U.S. subsidizes other countries, countries like Canada that put a limit on drug pricing. Somebody's paying for that to the drug companies. So, we are doing some subsidy there. But it's really not starting. There's a huge—I mean, there's up to a 1,900% excise tax on companies that don't—I'll repeat that— 1,900% excise tax, up to that if they don't comply with negotiating drug prices. So, when you hear that, it's not necessarily what it sounds like. And, the Medicare prescription premium [is limited], increases for Medicare can't be more than 6% up through 2029, so, there is a limitation.

Bob, let's just take kind of a quick run through on some of the provisions. We've talked about a lot about some of the highlights of the bill. You mentioned the corporate alternative minimum tax. And I guess other than my clients, it's not affecting a whole lot of people out there. But as you said, very few people, very few of our viewers, are ever going to be affected by this. But there is a minimum tax. Essentially it's a book tax, right? It's 15% on the difference between your book, your adjusted book, because you can use tax depreciation, so, you go back and adjust it and use tax depreciation. And so, 15%, a billion or more for three years. So, I'm assuming it's going to be like the tests we use—average annual gross receipts—but it's a book basis, right?

Mr. Lickwar

It is, Ian. And it's actually three years including the year in question, which makes it really interesting. I guess you're going to have an idea as you go along that you're going to be subject to the tax, and you'll make estimated payments accordingly. You can use credits, 75% roughly of credits. You can use NOLs, book NOLs to the extent of about 80%. If you fall out of the billion-dollar range, at the IRS's discretion, they can let you out of the tax; that's to be issued guidance. It seems kind of strange to me, Ian, that there's no black and white test that says for three years, you haven't had a billion, so now you're out. It's kind like you petition the IRS to say, "Hey, I haven't had a billion in three years. Can I get out of this tax?" It's very, very bizarre. I don't think I've ever seen a tax provision written like that.

So you can use some credits, Ian. And then also, if you pay this alternative minimum tax at 15%, guess what? It becomes creditable against your normal corporate income tax of 21%. So, really, the TCJA, Ian, a few years ago eliminated the corporate alternative minimum tax. This kind of brings it back, just with a different measure and some adjustments, including NOLs, credits. And as you stated, Ian, tax depreciation—that was actually a last minute change to the corporate AMT. We'll call it the CAMT is what everybody's calling it right now. (Or the camp—I put a P in there, but there's no P in there. I just can't pronounce it.) So, it's an interesting provision. It's going to affect, I think, as I mentioned, the 150 companies. Though, I would be very careful in certain cases because you do have related-party provisions; foreign corporations can be subject to this tax based on their U.S. operations. There's a lot of things going on. Of course, S corporations are not subject to this tax. And at the last minute, we took out portfolio companies, Ian, you know, the companies that go in, the venture capitalists, they own a number of companies. Unless they are otherwise required to aggregate, in my opinion, there's no requirement that those companies' incomes be grouped together and be subjected to this tax.

Mr. Redpath

Now, there's also an excise tax of 1% on stock buybacks. I see Elon Musk thinks this is great. You know, he's always been an opponent of stock buybacks. He thinks it… doesn't help the workers, it basically helps management and upper investors. Just kind of a run through of this—it's a 1%, it starts next year, and it's on the fair market value of the shares that are repurchased. But you've got to have a million, right? I mean, it has to be a million or more.

Mr. Lickwar

And we are talking about publicly traded companies here. So, if you were concerned maybe that your closely held business would face this tax in an ESOP transaction, the answer is no. And in addition, of course, larger companies can have ESOPs as well. And there's a specific exclusion there if the shares are purchased by a plan. Some people are questioning, Ian, why. Why are we doing this at this point in time? Is it because companies are doing inversions whereby they're changing their status and they're moving to foreign jurisdictions or whatever. I think what really happened here, Ian, is that companies did pretty well. Some of them did during the pandemic. They used some of their excess cash to buy back shares. This is no more than a revenue raiser, in my opinion. I don't think you need to read any further into it. But there are certainly exceptions here, including reorganization. So, if there's a stock buyback in accordance with a 368(a) reorganization, there's exceptions there. It will affect our clients, Ian. It'll be one of those things where potentially their stock is repurchased and there's a 1% withhold on it. So, it will affect people. Should that discourage them from investing in their plans and otherwise? Absolutely not. It's just an additional cost of investing; but there's no way that people should decline from investing for this reason alone.

Mr. Redpath

And it doesn't apply if they take the stock, if the repurchased stock is put into, for example, an ESOP?

Mr. Lickwar

That's correct.

Mr. Redpath

So, now we're going to have a reporting mechanism, right? What's the company doing with the stock that they've repurchased? The research credit—you know, we had that temporary that you could apply up to $250,000 against your payroll tax. And that's been increased and extended, correct?

Mr. Lickwar

It has. It's going to apply to Medicare taxes as well, Ian, which it only applied to payroll taxes before. So Medicare taxes, there is a catch here, Ian. It has to be a small business that's less than $5 million in receipts, but I think it's a good mechanism, Ian, for a startup that's doing innovative research that may not have that tax liability to use the credit. It will get them some cash that they need to continue the research that they've started.

Mr. Redpath

I thought it was interesting because there was, I recall that a group of senators—senators from states like New York, Connecticut, Illinois, California—all said no starter if we don't repeal the SALT limitation. Yet, this bill actually acknowledges the SALT limitation and says it's going to be continue in place through 2025. So, just the opposite. They, basically, didn't extend it, they didn't change it; but they certainly didn't get rid of it. And they acknowledged it; they didn't have to acknowledge it. I thought it was interesting that they just threw that in the bill, kind of okay, we're going to keep it.

Mr. Lickwar

Yes. The revenue loss, Ian, was too big. So, the question for our listeners today is business form. Many states have enacted pass-through entity taxes [PTET]. And we know that many listening in today, their client's own interests in partnerships and S corporations. About 25 states now have passed SALT limitation workarounds. Be familiar with the various jurisdictions in which your clients are doing business. And see if you can elect into a PTET tax regime, if it makes sense; or alternatively, maybe it's mandatory. As far as I know, Ian, the only state that's mandatory at this point is my state of Connecticut. And I could be wrong on that. But many of them, you actually have to elect in like Massachusetts and New York. So that's going to be the workaround. Do you do it for a two-year period? When SALT comes back, does the AMT come flying back? There's a lot of questions that we'll see get answered in the next three years or so.

Mr. Redpath

Excess business losses, where do we stand on that one?

Mr. Lickwar

The gift that keeps on giving, Ian, 461(l) of the Code. Tax Cuts and Jobs Act brings it in; says you file a joint return. You have business losses that could be losses from partnership, S corps, pass-throughs, farms, etc., Schedule F activities, $500,000 a year joint, $250,000 if you're filing in any other format, and we'll increase it for inflation, I think we're up to about $540,000. Provision gets repealed for a two-year period of time during the pandemic, comes back for 2021. That expires in 2025. ARPA brings it out another year. The IRA brings it out to 2028. This will be the perpetual gift that keeps on giving. What do you need to know about 461(l)? What you need to know is, if your client, for example, sells an interest in a business and triggers losses like passive activity losses, those losses are going to be limited to a half a million as indexed for inflation or less if they file other than married joint. Also, be very careful with bonus depreciation. Bonus depreciation percentages can start to head down in 2023, and you may want to load up on bonus. That could create an excess business loss as well. Remember with S corporations, Ian, you've got to keep paying reasonable compensation even in a loss year. Maybe if you can't pay it in a loss year, nobody works for free and the IRS knows that. It's kind of insulting that paying reasonable comp generates an excess business loss. Well, how could that be, Bob, because the wages are business income? Unfortunately, folks, that is not the case. Wages are not business income for purposes of this limitation. What is a trade or business? Well, it's one of the 15 definitions that are floating around the Code. Anything you do regularly and continuously to make a profit? Well, I guess if I place a $10 bet on FanDuel and am I in the business and betting $10 a day… I'm being a little bit facetious, but 461(l) is back around. I think what's most amazing about this bill is what's missing. Carried interest…

Mr. Redpath

Bob, one thing about that reasonable comp, because you and I actually did a program on reasonable comp in an S Corp. We know that the Treasury Inspector General says S corps aren't giving any compensation, let alone reasonable. They're not giving any. But you and I did a program not too long ago exactly on that issue, because it is such a hot topic right now. And I expect more enforcement coming in that area.

So what's not in the bill?

Mr. Lickwar

Carried interests aren't there, Ian. The hedge funds managers have gotten another reprieve. I think there's two reasons for that. Number one, obviously the politicians are a bit concerned. It's an election year. I think secondarily though, Ian, they have to be really careful; because I believe if you're exchanging a management fee for an interest in profits, the IRS can make an argument that that's disguised compensation. All you need to do is look at the regulations, okay. So, I think they have enough weaponry there when they get their staff going.

The increase in the net investment income tax on certain taxpayers—that didn't survive. The 1202 phaseout for people over $400,000 didn't make it. My question for you would be—and I don't have a crystal ball—do these provisions come back, particularly if we have a Senate and House takeover by Republicans in November? Does a lame duck session bring these tax provisions back into play? I don't know the answer to that question. I'm kind of tired of speculating, Ian, because everything I do is always wrong. And I'm always losing bets to you and others that I know about what's going to happen. So, I don't speculate anymore.

Mr. Redpath

Yes. And I agree with you. I think a lot is going to be determined by the midterms as to what happens. Do we get some of these provisions that get put in, in a lame duck? I think that's very possible. I think we're going to end up, we're going to have to decide what can or cannot be done. Let's say the Republicans do take the House and the Senate. What we used to have and discuss was this idea that people negotiate, bipartisanship; because is the President going to sign some bill that would repeal all of this? Probably not. Would it be veto proof? Well, they're not going to be able to override the President's veto. So, you know there may not be as many changes as people think, simply because if the Republicans do take over the House and the Senate, because you still have the President. And there's not enough; if they do happen to take it over, it's not going to be enough to override any veto. So it's going to be an interesting dynamic starting in the midterms in November to see what happens; but I don't envision significant changes coming about, unless there's an attempt to ram through some of these additional things. But remember, the things that were taken out were taken out by the Democrats that were not in the bill. So some of these things, you know, Kyrsten Sinema said, "If you don't take out the carried interest, you're not getting a bill." So, it was the Democrats that took some of these things that you discussed out. So, we talked about a lot of the credits, not every one; but there's a lot of different credits now for energy efficient buildings, etc. The clean vehicle, we've talked about those credits. One thing that I've heard a lot about, Bob, is that you can transfer credits, that there's this idea of transferring credits. What does that mean?

Mr. Lickwar

You can actually, basically, sell credits, Ian, if you can't use the credit, but you can use the cash. For example, you can sell credits. You've seen this at the state level a lot where certain entities have earned credits and transferred them for cash. The question from the IRS's perspective is, "Will that be a gain recognition event?" So, we'll have to hear from them on those types of items. Also, Ian with respect to certain of the electric vehicles, you can transfer; or you can transfer the credit to the dealer, which means that the dealer can apply the credit to reduce the price of your vehicle today. And you're making them wait to receive the credit, but there will be a mechanism to advance credits to the dealer, rather than you waiting until you file your tax return. The sale of credits is pretty interesting to me. I'm thinking some people are going to use credits and they will pay for them. There's anti-abuse provision powers given to the IRS in there. So we'll have to see what those are. It's going to be interesting to see what they say there. I'm thinking that there's potential for income recognition; but then I say, well, would I have gotten the credit anyway? It's kind of a dollar-for-dollar exchange. Is there really a quid pro quo that results in gain recognition? So, we'll see what happens.

Mr. Redpath

Could a manufacturer transfer, for example, a production tax credit to the buyer to reduce the cost of the vehicle?

Mr. Lickwar

Yes, absolutely. It appears that that's going to be possible, Ian. Again, there has to be some type of symmetry there where there's not an abusive situation; for example, I'm buying credits for 50 cents on the dollar from a related party. So, I think that's an issue that Treasury's going to have to come up with regulations to tell us what to do here.

Mr. Redpath

Yes. And they also have this direct pay option on some credits. There's going to have to be regulations on this, because it sounds simple enough until you try to figure out how is it going to be implemented.

Mr. Lickwar

Yes, exactly. And I think the direct pay provision is interesting, Ian, because that's going to help get you cash when you purchase an item. Theoretically, speeding it up from an already understaffed and overwhelmed IRS. But you know, I bet that they'll put some teams on there, that'll be finance department, and they'll get those things going. That's an important thing to know for your clients who want to buy a vehicle that they have that option. Can they take the credit now, let the dealer apply for it? And now they can get the cash right off of the purchase price of the vehicle.

Mr. Redpath

Well, and of course, you're reducing the purchase price of the vehicle. You're reducing, if it is a business vehicle, you're reducing your depreciation. So, a lot of things to consider there, right? It's not as easy as it sounds. This sounds good, we'll reduce the cost of the vehicle; but you're giving up a tax credit for that.

Mr. Lickwar

Right. And there are credits for business vehicles as well in there, Ian, electric vehicles. And I think we know what we see. It's the big box trucks is what I'm thinking that are used, for example, by Amazon that are zooming through my neighborhood every day, and like-type vehicles. So, there are additional credits for those types of vehicles as well.

Mr. Redpath

Bob, thanks for being here today. It's always great to go over these things. As you said, I think we're going to have to wait in a lot of areas for guidance. My concern is that the clients are going to hear some of these things and jump before they talk. We have to make sure we can educate them before they take action; because I don't know about your clients, Bob, but I often get the, what did you do? Well, why didn't you call me before? And I think we're going to see a lot of that. What did you do? Why didn't you call me? So, maybe this is a good opportunity. And I know firms like yourself, Bob, your firm puts out newsletters, so the clients are kind of kept up to date. And the newsletter doesn't tell them the law, other than this is out there. Come talk to us. Make sure you talk to us if you're thinking about it. I think a really good idea for any firm out there is to try to educate your client on these before they come in and you have to tell them, I'm sorry. Because right now, I'm not relying on the dealer to say yes, buy, buy the cheap car, but don't buy the more expensive one. Oh, that doesn't qualify right now. Again, I think we're going to have to see what happens. But Bob, thanks for your insight on the new bill. Really appreciate you being here, and we'll have you on the program again real soon.

Mr. Lickwar

Thanks, Ian. Great to be here.

SUPPLEMENTAL MATERIALS

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. Introduction

On August 16, the President signed into law the Inflation Reduction Act of 2022 (IRA/Act). This $430 billion over 10 years bill has a stated goal of taming inflation and addressing the climate, tax, and health care issues. According to many economists, however, it will boost the level of GDP by about 0.2%-0.3% by the end of 2031 and will have no measurable impact on inflation. It is a slimmed down version of the $4.3 trillion Build Back Better plan. Many of its provisions are not applicable until future years.

B. Health Care Provisions

Drug Negotiation

The IRA enables Medicare to negotiate pricing for a maximum of 10 designated negotiation-eligible drugs, with those new prices taking effect in 2026. For 2029, another 10 drugs will be added. The IRS will administer the program. At this point, the criteria for which drugs are chosen has not been established. Many commentators have noted that drug companies may increase the costs of drugs to account for this program.

ARPA Premium Tax Credit – ACA

The Act extends the ARPA rules for three additional years. It suspends indexing of the applicable percentage table for tax years beginning in 2023 through 2025. The Act supersedes the inflation-adjusted table for 2023 that IRS computed in Rev Proc 2022-34. Instead, the following applicable percentages apply for those years [§36B(b)(3)(A)(iii)]:

Household Income Relative to FPL:	Initial Percentage	Final Percentage
Up to 150%	0%	0%
150% to 200%	0%	2.0%
200% to 250%	2.0%	4.0%
250% to 300%	4.0%	6.0%
300% to 400%	6.0%	8.5%
400% and higher	8.5%	8.5%

For tax years beginning in 2023 through 2025, the PTC is available to taxpayers with household incomes that exceed 400% of the FPL, as it was in 2021 and 2022.

The changes allow more people to claim the PTC for 2023 through 2025 than would have otherwise qualified. These apply to tax years beginning after December 31, 2022.

C. Revenue Raising Provisions

Corporate Alternative Minimum Tax

For tax years beginning after 2022, there will be a 15% corporate alternative minimum tax on the adjusted financial statement income of applicable corporations [§ 55(b)(2)]. This will apply if the tentative minimum tax exceeds the taxpayer's regular tax including its base erosion and antiabuse tax (BEAT) for the tax year. [§§ 55(a)(2) & (3)].

An applicable corporation is any corporation, not including an S corporation, regulated investment company (RIC), or a real estate investment trust (REIT), which meets the average annual adjusted financial statement income test ("Income Test") for **one or more earlier tax years that ends after December 31, 2021.** [§59(k)(1)(A)]. A corporation meets the Income Test if its average annual adjusted financial statement income, not considering any loss carryovers, for the three-tax-year period exceeds $1 billion [§59(k)(1)(B)(i)]. Note that special rules apply to short years and those in existence for less than three years [§59(k)(1)(E)(i)].

This is a **Book Minimum Tax** with a starting point of a corporation's average annual adjusted financial statement income which includes financial statements prepared in accordance with generally accepted accounting principles (GAAP) rather than the old AMT that started with taxable income. Note that financial statements may be adjusted to reflect MACRS.

A domestic corporation can take a corporate AMT foreign tax credit for the relevant foreign or U.S. possessions taxes that are taken into account on the corporation's applicable financial statement and paid or accrued for tax purposes by the applicable corporation. [§ 59(l)(1)(B)].

If regular tax is higher than the minimum tax, a corporation may carry forward a credit for the net minimum tax for all prior tax years beginning after 2022 to reduce the taxpayer's regular tax. This also applies to any BEAT [§§ 59A & 53(e)].

1% Excise Tax on Repurchase of Corporate Stock

Beginning in 2023, "covered corporations" will be assessed a tax equal to 1% of the fair market value of any stock of the corporation which is repurchased (as defined in Code Sec. 4501(c)) by the corporation during the tax year [§ 4501(a)]. A "covered corporation" is any domestic corporation whose stock is traded on an established securities market within the meaning of §7704(b)(1) [§4501(b)]. The tax does not apply:

(1) to the extent that the repurchase is part of a reorganization (within the meaning of Code Sec. 368(a)) and no gain or loss is recognized on such repurchase by the shareholder by reason of such reorganization,

(2) in any case in which the stock repurchased is, or an amount of stock equal to the value of the stock repurchased is, contributed to an employer sponsored retirement plan, employee stock ownership plan, or similar plan,

(3) **in any case in which the total value of the stock repurchased during the tax year does not exceed $1 million,**

(4) under regulations prescribed by the IRS, in cases in which the repurchase is by a dealer in securities in the ordinary course of business,

(5) to repurchases by a regulated investment company or a real estate investment trust, or

(6) to the extent that the repurchase is treated as a dividend.

Extension of the Excess Business Loss Rules

The Code provides that if a taxpayer other than a C corporation receives any applicable subsidy for any tax year, any excess farm loss of the taxpayer for the tax year shall not be allowed. [§461(j)(1)]. The Code also provides that, in the case of a taxpayer other than a corporation, excess business loss (as defined under Code Sec. 461(j)(3)(A)) of the taxpayer for the tax year is not allowed. The Act extends the limitation for any tax year beginning before December 31, 2029.

Increased IRS funding

The IRS funding has been increased by $80 billion with an increase of agents by approximately 87,000 over 5 years. The Congressional Budget Office has estimated this increase in funding would raise $206 billion in revenue for a net increase of $126 billion. The CBO says if enforcement is only on those making over $400,000 then there will be a $20 billion shortfall as the projections are based on enforcement at all income levels.

D. Climate Related Provisions

Residential Clean Energy Credit

The ACT extends the credit through December 31, 2034, restores the 30% credit rate through 2032 and then it will reduce to 26% in 2033 and 22% in 2034. Qualified battery storage technology was added was added to the list of eligible property.

Energy Efficient Home Improvement Credit

The credit for qualified energy-efficiency improvements and expenditures for residential energy property on a taxpayer's primary residence is reinstated, increased and extended through 2032. It expired at the end of 2021. For property placed in service after December 31, 2022, the ACT increases the credit for a tax year to an amount equal to 30% of the sum of (a) the amount paid or incurred by the taxpayer for qualified energy efficiency improvements installed during that year, and (b) the amount of the residential energy property expenditures paid or incurred by the taxpayer during that year. [§25C(a)]. The allowable credit is $1,200 per taxpayer per year with an annual limit of $600 with respect to residential energy property expenditures, windows, and skylights, and $250 for any exterior door ($500 total for all exterior doors. The $500 lifetime credit limitation has been repealed. In addition the credit applies to any dwelling unit used by a taxpayer not just a primary residence.

The Act revises the energy efficiency certification requirements for building envelope components, eliminates treatment of roofs as building envelope components, and adds air sealing insulation to the definition of a building envelope component. It also substantially revises the definition of residential energy property expenditures, including repeal of the requirement that residential energy property expenditures must be made with respect to the taxpayer's principal residence.

The credit for geothermal and air source heat pumps and biomass stoves, is an annual limit of $2,000. Some of the required energy-efficiency standards will automatically update over time without requiring additional legislative action.

Starting in 2025, taxpayers will have to submit a product identification number to claim the credit. Not putting the correct product identification will be treated as a math or clerical error.

Energy Efficient Commercial Buildings Deduction

The ACT updates §179D's energy efficiency commercial building requirements by providing that a qualifying building must increase its efficiency relative to a reference building by 25% rather than 50%. The maximum deduction amount would be the total deduction a building can claim less deductions claimed with respect to the building in the preceding three years (prior law was all years).

New Energy Efficient Home Credit

The reinstates the credit under §45L available for eligible contractors for building and selling qualifying energy-efficient new homes through December 31, 2032. The Act extends the $1,000 or $2,000 credit through December 31, 2022. Beginning January 1, 2023, qualified new energy efficient homes are eligible for credits of $500, $1,000, $2,500, or $5,000, depending on which energy efficiency requirements the home satisfies and whether the construction of the home meets the prevailing wage requirements. A dwelling unit qualifies for the credit if it's certified as a zero-energy ready home under the zero-energy ready home program of the Department of Energy as in effect on January 1, 2023, or any successor program, and it satisfies a set of requirements based up the type of home. Taxpayers claiming the low-income housing tax credit do not have to reduce their basis for credits claimed under this section.

E. Vehicles

Clean Vehicle Credit

Clean vehicles are a class or category of vehicles certified to meet the clean-fuel vehicle standards for a particular tax-year. The new qualified plug-in electric drive motor vehicle credit is retitled the clean vehicle credit. For vehicles placed in service after the Act, taxpayers get a $3,750 credit for meeting the critical minerals requirement and a $3,750 credit for meeting the battery component requirement [§30D(b)]. Therefore, the change in the calculation rules apply to vehicles placed in service after August 16, 2022. The IRS is required to issue regulations and guidance no later than December 31, 2022.

The Act eliminates the 200,000 per model manufacturer limitation for vehicles sold after December 31, 2022.

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

Clean vehicle credits are only allowed for vehicles that have a manufacturer’s suggested retail price of no more than $80,000 for vans, SUVs, or pickup trucks, and $55,000 for other vehicles. Taxpayers are allowed only one credit per vehicle and no clean vehicle credit is allowed with respect to any vehicle unless the taxpayer includes the VIN on the taxpayer's return.

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

Credit for Previously-Owned Clean Vehicle

A credit is available for the purchase of a used clean vehicle for taxpayers with modified AGI not exceeding $150,000 for Married filing jointly ($112,500 in the case of head of household filers; $75,000 in the case of other filers) for **either** the current or prior taxable year. The sale price of the vehicle must be $25,000 or less and it must be a model year least two years earlier than the calendar year in which the vehicle is sold. It can only be claimed for vehicles sold by a dealer and on the first transfer. Taxpayers can only claim it once every three years and must include the VIN the tax return. The credit applies after December 31, 2022 through 2032.

Qualified Commercial Clean Vehicles

The Act provides a credit per vehicle equal to the lesser of: (1) 15% of the vehicle's basis (30% for vehicles not powered by a gasoline or diesel engine) or (2) the "incremental cost" of the vehicle over the cost of a comparable vehicle powered solely by a gasoline or diesel engine. The maximum credit per vehicle is $7,500 for vehicles with gross vehicle weight ratings of less than 14,000 pounds, or $40,000 for heavier vehicles. The vehicle must be acquired for use or lease by the taxpayer, and not for resale. The credit applies to vehicles acquired after December 31, 2022 through December 31, 2032.

Additional Credits

There are a number of other credits and deductions related to climate.

✓ **Increase in Qualified Small Business Payroll Tax Credit for Increasing Research Activities**

Beginning after 2022, a qualified small business, a corporation or partnership, with respect to any tax year, has gross receipts of less than $5 million, and did not have gross receipts for any tax year preceding the five-tax-year period ending with the tax year. [§ 41(h)(3)(A)(i)] will be allowed an additional $250,000 in qualified research credits against the Medicare portion of payroll taxes. Currently it applies only to the social security portion. The credit cannot exceed the tax imposed for any calendar quarter, with unused amounts of the credit carried forward.

Other included provisions:

- ✓ **Extension and Modification of Credit for Electricity Produced from Certain Renewable Sources**
- ✓ **Extension and modification of the energy credit**
- ✓ **Extension, Increase, and Modifications of Nonbusiness Energy Property Credit**
- ✓ **Extension and Modification of Residential Clean Energy Credit**
- ✓ **Hazardous Substance Superfund Tax on Crude Oil and Petroleum Products Reinstated, Increased**
- ✓ **Certain Green Energy Property Classified as MACRS 5-Year Property**

F. Transferable Credits and Direct Pay Options

The ACT also provides that eligible taxpayers can transfer certain eligible credits are to other taxpayers [§6418(a)]. The provision provides the credits that are eligible. To transfer credits, the transferee must pay for the credit in cash and the buyer is not allowed to deduct the amount paid for such credit or subsequently transfer the credit. The payment will not be included in the gross income of the original recipient. A penalty for excessive transfers is imposed which are the transfer of credit in excess of what the transferee could properly claim.

Certain entities, including tax-exempt entities, states and political subdivisions, the Tennessee Valley Authority, Alaska Native Corporations, and Indian tribal governments, will be able to elect to be treated as making a payment against their income tax equal to the amount of certain specified credits. The election is available for the Production Tax Credit (§45) if the applicable facility is placed in service after December 31, 2022. The election must be made no later than the due date for the tax return of the year in which the election is made (or a date determined by IRS if the eligible entity is not required to file a return), but in no event earlier than 180 days after the enactment of the Act.

G. Conclusion

While most of these provisions take place in the future, it is still important that practitioners are aware of the provisions to provide appropriate advice to clients. In addition there may be changes that need to be made to client organizers etc.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, John, has household income that exceeds 400% of the poverty line. He wonders if he will be able to have any government subsidy of this health insurance premiums.

Another client, Julia, is considering making improvements to her home. She wonders if there are any tax benefits available.

Alex is considering purchasing an electric vehicle. She wonders if there are any tax considerations.

Required:

Address the issues raised by the above clients in the Inflation Reduction Act of 2022.

B. Suggested Answers to Discussion Problems

1. The Act continues the availability of a Premium Tax Credit for those whose household income exceeds 400% of the poverty line. The maximum amount the taxpayer must pay is limited to 8.5% of household income. The Act supersedes the inflation-adjusted table for 2023 that IRS computed in Rev Proc 2022-34. The changes allow more people to claim the PTC for 2023 through 2025.

2. The Energy Efficient Home Improvement Credit has been reinstated for 2022. It also expands eligible improvements and increases the credit. The lifetime limit has been eliminated and it now applies to residences beyond the primary residence of a taxpayer.

3. The current credit applies until the end of 2022 with the added requirement that the vehicle's final assembly occurred in North America. Thereafter, the Credit for Clean Vehicles, which has been substantially revised. There are separate critical mineral and battery component requirements. The IRS is to issue regulations no later than the end of 2022. The 200,000-vehicle limit per model will be removed for vehicles sold after December 31, 2022.

PART 2. INDIVIDUAL TAXATION

Stock Basis in an S Corporation

It is important that an S corporation shareholder know their stock basis when the S corporation allocates a loss and/or deduction item to the shareholder, when the S corporation makes a non-dividend distribution to the shareholder, or when the shareholder disposes of stock in the S corporation. A shareholder's stock basis changes each year and, therefore, must be recomputed each year. Starting with the shareholder's initial capital contribution to the S corporation, the shareholder's stock basis is increased and/or decreased by pass-through amounts from the S corporation and other factors. In addition, the order in which stock basis is increased or decreased is important. Ian Redpath and Jonathan Tretter discuss issues related to calculation of stock basis in an S corporation.

Let's join Ian Redpath and Jonathan Tretter as they discuss the importance of properly computing a shareholder's stock basis.

Mr. Redpath

Jonathan, welcome to the program.

Mr. Tretter

Hi, Ian. Thanks for having me; looking forward to it.

Mr. Redpath

Yes. It's great to have you here. I'm really looking forward to getting your insight on this because we've been finding that… Well, when I say we, I haven't personally, but the IRS has been saying, which is more important, that there's been a lot of noncompliance with [Form] 7203. And we have the new filing requirements for S corps. But also, I think the problem just is basis in an S corp, basis in a partnership, they sound like they should be the same because they're flow-through entities. But wow—tremendous differences, right?

Mr. Tretter

Oh, yes! There's a lot of differences. There's some similarities but also a lot of differences. I think the thing with this new Form 7203 is, although it is a new form, tracking basis isn't really a new concept. I think starting in 2018, the IRS has required that a basis schedule was attached to personal returns for S corporations. The 7203 formalizes the format that the IRS likes to see. But again, it's nothing new. It just formalizes the process and the reporting requirements.

Mr. Redpath

Yes, I agree with you. And unfortunately, as the IRS has said, people weren't tracking basis properly. And, I think part of that was a misunderstanding as to who tracks the basis. Is it the shareholder? Is it the S corp? And I think one of the things, and we were talking before we went on camera that, some software at the S level is doing 7203, some is still doing basis worksheets for you. So. . . it's all over the place. Now, you were telling me your software does do a 7203 for each shareholder. Is that right?

Mr. Tretter

That is correct. Yes, it's an option to generate it; but yes, our software does calculate and generate a 7203 at the S corporation level for the shareholders, as well as at the individual level.

Mr. Redpath

Well I think that's been a lot of confusion because people are still saying the 7203… Is that with the 1120-S filing? Or is that a 1040 filing? So, what do we do with that one? Because people are confused about that out there.

Mr. Tretter

Right. Yes, actually, we've received calls from practitioners or from clients that say, my tax preparer is looking for my 7203 with my K-1. And, we have to push back and say, that's really not an S corporation requirement. Sometimes there's basis, there's things that impact basis that, at the S corp level, you may not know about if stock was purchased outside of the corporation or what not. So, really it's a shareholder responsibility, not necessarily the S corporation responsibility.

Mr. Redpath

Yes. And I think that what you just said goes to the other side of it, which is that I know some practitioners when they do the 1120-S, if they're not doing the shareholders' returns also, but they're sending out the 7203 with the K-1, as just kind of information. You can't always rely on that. If you're doing the 1040, you can't just rely on the fact you got a 7203 and say, oh, they did my work for me.

Mr. Tretter

Right. Yes, really the 7203 is only as good as the beginning basis number that you start with. And with suspended loss rules and the other rules, there's things that the S corporation quite frankly doesn't always know that will impact the form. So, yes, you do have to tread cautiously if you see a 7203 attached to a K-1 and know that it's not necessarily exactly correct.

Mr. Redpath

Yes. And the 7203, just so people are aware, when do you file it? Well, if you're claiming a deduction for your share of the aggregate loss from an S corp, including any aggregate loss that wasn't allowed in a prior year because of a basis limitation. So, you had a suspended loss that you're now going to take this year. You received a non-dividend distribution from an S corp. You disposed of stock in an S corp, whether or not you recognize gain. Or you received a loan repayment. So, that's almost saying you always have to file a 7203 with a 1040.

Mr. Tretter

Generally, it's best practice to just generate it, at least for your file, because you never know when you may be required to. But I'd say 95, 99% of the time, one of those four criteria is going to happen in a tax year that would require it to be attached.

Mr. Redpath

I'm going to go back to what you just said because I think that's really important. I think it is best practice, even if you don't have to file the 7203, to generate it and have it in your client's file. It's allowing you now to track basis and not have to go back for, oh, now we've got to go back three years ago, we've got to figure it out because we haven't been tracking it. So, best practices. That's an excellent point. Some practitioners will say well, what do you mean, a dividend? A non-dividend? Well, what's a dividend distribution? Actually, an S corporation can issue dividends; and they have to issue a 1099-DIV if they issue a dividend. How? Well, if they have E&P. How can an S corp have E&P? Well, it previously was a C, and whenever you do a conversion, I think you need to do due diligence on this. Was there any E&P at the time of the conversion? You acquired the assets, a reorganization, C and an S. The S survives. Tax attributes carry over, part of due diligence. And then, the other one which is missed sometimes is if you had an existing C that had E&P and you elect QSub. Suddenly, that E&P now becomes E&P of the parent. So it's possible to have E&P in an S Corp. And it's possible to do a distribution that is actually a dividend distribution. Now, that's another course. So, we won't get into all the distribution rules. But just so people are aware when that requirement for a 7203. So, I know that the basis establishes your ability to take losses. What does that mean? Because we also have at risk rules, we got a lot of hoops—at risk, passive activity loss, excess business loss. A lot of hoops to go through before we can take the loss. What does that mean—these hoops to go through? And basis is the first.

Mr. Tretter

Yes. Basis is essentially the first test or the first hurdle to go through. That basically tells you that, in the S corporation stock, that you have sufficient basis to deduct the loss. And then once that determination is made, then at the individual level, it can flow through to the at risk Form 6198. The determination is made that you have at risk basis. Then, if it's a passive activity, then it goes to the 8582. And then, if you can determine that you have passive losses that can be deducted, then it goes to the excess business loss. So, S corporation basis is kind of the first step to kind of trickle down to the remaining loss limitations that are present on a personal return.

Mr. Redpath

And these are the things being generated on the K-1, right? So, if the practitioner doing the 1040, they're going to be looking at the K-1 to determine what are these items flowing through, correct?

Mr. Tretter

Correct. Yes. Basically, the items on the K-1 impact shareholder basis. And then, once that's determined, then the 6198, the 8582, and the 461; all those forms are tied to the personal return that are all impacted by the K-1 that is received.

Mr. Redpath

Now, on the K-1, just so practitioners are aware if they aren't already, there's also other things other than just the normal, the separately stated and non-separately stated. There's other items on there that, if we're doing the shareholder's return, is important. And you have to report other items that go to basis, correct?

Mr. Tretter

Correct, yes. I think it's either this past year or the year before, there's been robust, more reporting requirements on a K-1. Number of shares owned—I think that's good information for practitioners to determine if there was a sale or a purchase of additional stock units; that would impact basis. A new requirement is also reporting, on the face of the K-1, any outstanding shareholder loans. That information obviously impacts basis as well that the practitioner may not always know about; and it's a good way for them to ask the question.

Mr. Redpath

And I think we've seen the same thing with partnerships. And it's part of the idea that the IRS is using more computer-generated AI to audit, to pull out returns for audit. And the information, like you mentioned, that's information that they never had before. And now, it can generate things to say okay well, what are they writing off? And what are we showing on the K-1? On the K-1's, what are we showing as, for example, their loan basis? Yes, I agree with you. This has been something that the IRS is kind of going after. So, let's look at basis. Basis is basis. Well, you had a good statement earlier on, Jonathan. You said it depends on your initial basis. So, we don't always have that. Can you give us some ideas what that means? Because you have maybe a gift, or inheritance, or purchase, or a contribution to capital? There are different rules, aren't there?

Mr. Tretter

Yes, there are different rules. Generally, if stock was received by a gift, it is carryover basis from the person that gifted the stock. If you inherit stock, generally the basis is stepped up to fair market value at the date of death. If you purchase the stock, your initial basis is the purchase price that you paid for the stock. If it's a reorganization, generally it carries over from stock given up plus gain minus boot. And then, in corporations, generally you apply rule 351, carryover basis plus gain minus boot. So, you can see there's a multitude of different ways that you can calculate your initial basis. And that's just the starting point on current-year basis.

Mr. Redpath

One thing that is often misunderstood, is that the IRS says per share per day; that's how you calculate basis, essentially. And that's okay. It's easy if you bought all the shares at one time or if you got all the shares in one contribution to capital. Or you got them all from a gift; but maybe you initially contributed to capital, later you inherited some, later you got a gift. Well, you can't treat it as one pool of basis. And one of the things the IRS has said is that practitioners are often treating stock bases as just a pool of money. It's just a bunch of dollars. And we adjust the dollars. That isn't true, right? It's per share per day.

Mr. Tretter

Yes, that is correct. It's per share per day. I mean really with the 7203, I believe the requirements are you're supposed to file the 7203 for each, I think they call it, block of basis that you have. And each block is determined based on how it's acquired; and then, how the income and distributions get allocated is per share per day. So, it's not here's your pool of shares and all bets are off, everything applied equally. I mean, it is pretty granular.

Mr. Redpath

And I think you're right. That's something that you need to watch out for because the IRS has said that it's a separate 7203 for each block of basis, which should trigger the thought that, whoa, do I have different blocks of basis in here because I haven't been tracking it that way? But the IRS says hey, two different 7203s. They've also said, by the way, that people aren't necessarily doing that right now and reminding us that yes, that's how you have to do it. You also have an issue of holding period, right? I mean, holding periods could be different. It doesn't really matter after the first year. But first year, it could.

Mr. Tretter

Right. Yes I mean holding periods for stock that's acquired through gift, that usually tacks on from the donor. Inheritance, stock from inheritance, is always pretty much going to be long-term holding period. For purchase price, your holding period starts the day that you purchase it. Reorganization, generally carry over from previous assets. And then, with incorporations, kind of the same, carry over from capital, and it starts after the day of the incorporation. So, how you calculate basis in the holding period, as you can see, it's different for each block quite honestly that you're calculating.

Mr. Redpath

And I think what this is doing is telling people that, for a lot of people, I was doing it wrong before because I was treating everything as just a pool. Like it was one thing. And that's not how the IRS looks at it.

Mr. Tretter

Yes. So, in a shareholder's initial basis example in a Section 351 transaction, the detail is Pete transfers property with an adjusted basis of $100,000 to SmithCo, an S corporation, in exchange for all of its stock plus an assumption of a $35,000 mortgage on the property. While the assumption of liabilities is not stock, Pete will not recognize any gain because under 357(a), the mortgage will not be treated as boot. It is boot for basis purposes under 358. Accordingly, Pete's basis in the stock will be as follows. So, as we discussed, it has a carryover basis of $100,000 in the reorganization. There's no gain recognized, but there was boot received of $35,000, which is assumption of liability, which would give the initial basis starting point of $65,000 in this example.

Mr. Redpath

I think that what's important here in looking at this is people often confuse 357(a), which says liabilities assumed are not boot for purposes of gain or loss as a general rule with the fact that they're always boot for basis.

Mr. Tretter

Right, yes, I mean one number away is a world of difference when it comes to gain or loss in basis.

Mr. Redpath

Yes. And one other thing I think that is important is that when you're going back and tracking distributions and basis, if you're going way back, remember our practitioners if you may see an old K-1, which would be 1982 and before, it might have some concept called PTI. And PTI is the old version of AAA. So, if any of our viewers see that on an old K-1, if they're trying to go back and track basis, that's what that one means. Now, very much like a partnership, you have an annual adjustment to the basis. And our annual adjustment—and we're going to look at a slide here as to what the annual adjustments are on the last day of the year, because there's a specific ordering, right? So, what is the ordering here?

Mr. Tretter

Yes. And the 7203 kind of follows the ordering; but the ordering of basis is critically important. It's adjusted in the following order. So, first and foremost, basis is increased for income items and excess depletion. Next, it's decreased for distributions. Distributions do come and reduce your basis before losses do. Three is basis is decreased for nondeductibles, non-capital expenses, and depletion with a little caveat—there is an ability to make an election to not treat nondeductibles third in the ordering. But if that election is not made, nondeductibles do come third for a decrease. And then fourth, stock basis is decreased for items of loss and deductions that flow through from the K-1. Where I find this most important is trying to figure out when do distributions trigger excess basis? Make sure that you know when your basis gets down to zero, with the ability to deduct the loss or distributions that may be taxable to the recipient.

Mr. Redpath

Yes. And you mentioned that there is an election to make; but that election is binding on all future years. So, has an election been made? Because the difference is that if an election is made, as you said, number four, deductible items gets taken before nondeductible. Now, I'm going to put you on the spot here because I always do when I talk about basis; and I've put you on the spot before, so I'll put you on there again. Do you normally just elect it as a matter of course? Because it would seem if I'm going to—and to put this in perspective, it means we are suspending with the normal ruling if we have suspended losses—we're suspending deductible losses. And we're reducing our basis by nondeductible items that we're not going to get any value out of. We're not going to get any deduction. Is there a hidden thing that we should be looking for here to say maybe we shouldn't with a new S corp, we should wait? Or if you have an existing S corp and it hasn't been elected—you get a new client, for example. What's the thought in your firm on making that election?

Mr. Tretter

It's kind of facts and circumstances. I don't know if we necessarily have a common decision. I think in a lot of times, it seems that client that are inherited in most cases, the election was made to treat losses first. And I don't know if that's just because it creates kind of a better current answer for clients that allow them to deduct the losses. If you deduct a nondeductible loss, there's no immediate benefit. But I don't necessarily think we have a general standard. It's kind of facts and circumstances.

Mr. Redpath

Yes. And I've heard people say I don't elect it because of how uncertain tax rates are, or uncertain a particular shareholder will be in their particular tax bracket at any time. So therefore, we may be suspending deductible losses against a low tax bracket years. And so, therefore, why not save them for a future? But that's real speculative too. So, you're right. It's facts and circumstances. But once you do elect it, it's elected. I mean, it's there. And if you get a new client, you should make sure, has this been elected or not? That you know. But it's an election that becomes an irrevocable election going forward. So, I think it's important. The regulation is 1.1367-1(g), which is just an attachment for the shareholder. And keep in mind that the shareholder—one shareholder can elect it, another shareholder not; because it's a shareholder election, not an S corporation election. So, Jonathan let's kind of take a 35,000 foot view of the 7203. And really, what we're dealing with is Part I, which is stockholder basis. And you and I are going to do a program for those because people are on their seat about loan basis in an S corp. And this is the stock basis. But remember, you can deduct losses to the extent of both the stock basis and the loan basis. But they're calculated. The whole thing is very different than a partnership. So Part I. And then Part III, which says basically what you can deduct. So, can you give us kind of an overview of Part I, which is the basis? Stock basis, I should say.

Mr. Tretter

Yes. So Part I, it more or less follows the lines on the K-1, I would say. And it follows the ordering rules, where Part I starts with your initial stock basis at the beginning of the year. It allows you to add any additional contributions that might have been made that increase your basis. And then, lines 3, A through M, more or less follow the increases, the items on your K-1 that would be an addition to your basis. So, that kind of gives you a subset. Then, if you look, once you kind of have your increases in play added to your original basis at the beginning of the year, then you subtract out distributions, because that's number two in the ordering rules.

And then, from there, it goes down to the deductions. The nondeductibles are line A. And then, you have your other losses below that. And I think that's just another point that drives home that this is really, although the S corporation could provide the 7203, the S corporation may not know what election was made and if nondeductibles were elected to be treated after losses. So, I think just more of the onus that it's really on the shareholder's personal return to make sure that the 7203 is correct.

Mr. Redpath

Yes. And it does follow basically what we were saying. But one thing that's on there, and we said income. But income from a basis standpoint includes tax-exempt income, correct?

Mr. Tretter

Yes, that is correct. And I mean, that was kind of a big point over the last year or two with PPP and all those regulations that came out is, PPP is treated as tax-exempt income. So, it was S corp basis, which benefited the shareholders, for sure.

Mr. Redpath

As soon as you mentioned PPP, half of our audience dove under their desks.

Mr. Tretter

Three letters people thought they would never have to say again, right?

Mr. Redpath

Were hoping they would never have to say again. But you're right. I mean, the whole issue with tax exempt and how to treat tax exempt because it affected basis was really a big issue with the PPP. And then, when we talk about Part III. Part III, really, that is saying essentially what it is that you can take, right?

Mr. Tretter

Yes. So Part I and Part III kind of work together. Part III more or less determines, if there are losses, what losses can be deducted on the current year of return. And I think in the eyes of the IRS, carryover losses and current-year losses more or less get combined to determine what can get deducted in the current year. But Part III does kind of dictate what losses actually flow through and get captured on the personal return. And it's really the character of the losses too that are important.

Mr. Redpath

That's a good point. So if you have suspended losses, do you just get to pick and choose? "Hey, I'm going to take the losses that are ordinary. I'm not going to take capital losses." Do you get to pick and choose here when you have suspended losses?

Mr. Tretter

It is my understanding that the losses get deducted based on a pro rata of the nature of the losses.

Mr. Redpath

Yes. Unfortunately, you can't pick and choose the good ones. You get a pro rata share. Would be nice if you could pick and choose, although I'm sure there's some returns out there that have followed the pick and choose the best ones this year. But that's obviously not the correct way to do it. Again, basis is just so important. And just to emphasize that, you get to take your losses against your stock and loan basis. Partnership, it's one basis. Your loans are included in your equity interest. So, it's one interest. Includes equity and—or it's called capital in the partnership—capital and your loan. But this is very different. You have two different bases here that you deal with. When you reduce basis—and we've talked about reducing basis—you know you get to take losses against loan basis and stock basis. The 7203 kind of tracks it, right? Because it's stock first, loan second.

Mr. Tretter

That is correct, yes. And then, I mean really in your loan basis, you have to look at each loan separately. But yes, essentially, stock first, loan second. And then, as loans are repaid—which we'll go over in our next program—there are considerations on loan repayments if those loans generated deductible losses in prior periods.

Mr. Redpath

But they are separate bases. I mean, you reduce your stock basis to zero.

Mr. Tretter

Correct.

Mr. Redpath

Then you go to your loan basis. And like a partnership, where it's one basis that you have. And just as teaser about the loan basis program, as a teaser, it's easier to create basis in a partnership, right? I mean, just go borrow some money.

Mr. Tretter

Yes. I mean, that basis in an S Corp is a lot different than basis in a partnership. In an S corporation, it really has to be shareholder debt and an agreement between the shareholder and the corporation. With a partnership, if the partnership enters into a debt agreement, essentially the partner gets his pro rata share of that basis in the loans. But in an S corporation, if an S corporation goes out and borrows a million dollars from a bank, that creates no debt basis for the shareholder. If the shareholder loans a million dollars to the S corporation personally, that would create that basis for the shareholder.

Mr. Redpath

Yes. And you know that's always a misunderstanding with clients. It's just like the cash basis when you tell them they can't write off their bad receivables. What do you mean, I can't write it off? Well, this is kind of the same type of thing, right? Well, what do you mean, I can't take those losses? So, they are different; they're so similar in concept and so different in rules. And these are some of the major differences is, when you take something, when you flow something through, what you can take—well, basis. Basis is so different. But yet, often we just think of it as they're the same; partnership, S corp debt—[we often think] they're the same.

So Jonathan, we covered a lot of things today. Any closing thoughts for our viewers on the stock basis in an S Corp?

Mr. Tretter

Yes, just a couple closing thoughts. As we discussed, I think it's best practice to create and prepare the 7203 every year, even if it's not required. And I think just another key takeaway is, it's really on the shareholder and the personal return to make sure that the 7203 is correct. Just because it's attached to a K-1 that you receive does not mean that it's accurate, because there's things that are decided at the shareholder level that the corporation may not know about. So, just a couple closing thoughts that I have on best practices and the importance of the form.

Mr. Redpath

Jonathan, thank you very much for being here today and giving us your insight. It's been really great. You've provided a lot of direction for our viewers. So Jonathan, thank you very much for being here. Really appreciate it.

Stock Basis in S Corporations

By Ian J. Redpath, JD, LLM

A. Introduction

In all pass-thru entities, one of the most often encountered problem areas is that of basis. This is true whether it is operating as a partnership or an S corporation. It is the key to proper determination of the taxability of distributions, limitations on the owners' ability to take losses, as well as gain or loss from the sale of an owner's interest in the entity. While partnerships, LLCs taxed as partnerships, and S corporations are similar in concept as conduit entities, there are significant differences in the calculation of the owner's basis in the entity. While it is technically the owner's responsibility to determine and maintain records of their basis in the entity, in practice that burden falls on the practitioners. It is important to understand the basics of that determination.

Partners have one basis in the partnership. That basis includes both debt and equity. Debt is allocated by a complex set of rules related to recourse and nonrecourse loans. [Reg. §1.752-2 and 1.752-3]. The shareholders in an S corporation have two separate bases – stock and loan. The loan basis is very limited and there must be a bona-fide debt obligation. Essentially the shareholder has a basis in loans it makes to the corporation. Debt basis for a shareholder was covered in another program. Another significant difference in the entities is a partner's ability to make basis adjustments to the inside basis of assets with an IRC §754 election.

Stock may be acquired at different times for different amounts and/or in differing ways. Basis is not always one aggregate of basis but should be maintained on a per share per day basis.

B. Initial Basis

The original (initial) beginning shareholder basis depends on how it was acquired. This is often the most difficult determination in recreating a shareholder's basis. Most of the information may be obtained by a review of the past Form 1120S, Schedule K-1s. However, that will not account for contributions to capital or initial basis.

If purchased, the basis is the cost paid for the shares. Assuming the stockholder is not a dealer or day-trader, the stock will be a capital asset. [§1221] The shareholder's holding period for the stock will begin the day after acquisition and includes the day of any disposition. [Rev. Proc. 66-7, Rev Proc 66-97 and Rev Proc.93-84]. Once the stock is held for a year and a day, it will generate long-term capital gain or loss upon sale.

Stock that is received as a gift generally takes a carryover basis from the donor. It is adjusted upwards to the extent of any gift tax paid solely related to any appreciation (gifts prior to 1977 were adjusted for all of gift taxes paid). [§1015(a) and §1015(d)(6)]. This is often called the gain basis. If the fair market value of the stock is less than the gain basis on the date of the gift, then the basis will not be determined until the stock is disposed of. If it is disposed of at a gain, then the gain basis will be used. If it is sold at a loss then the basis for loss is the lesser of the fair market value or gain basis on the date of the gift. [§1015(a)]. If the stock is sold at a price in between the two bases, then no gain or loss is recognized. The loss basis is used to determine limitations on the flow-thru of losses and deductions. It is the obligation of the shareholder to establish the appropriate basis.

The holding period for stock acquired by gift generally "tacks" on the ownership of the donor. However, if the loss basis is used, then the holding period will begin the day after acquisition. [§1223(2) and Rev. Proc. 59-86, 1959-1 C.B. 209].

Example: George gives his daughter, Pat, 100 shares of his S corporation stock. The gift is made on December 31, 2020. George acquired the stock in 2010. His basis on the date of the gift was $2,000 and the fair market value was $1,000. George paid no gift tax on this transfer. Pat sells the stock on May 1, 2021. The amount of gain or loss and basis to use will depend on the sales price as shown below:

Sales price	Basis	Gain (loss)	Holding period
$3,200	$2,000	$1,200	Long term
$2,100	$2,000	$ 100	Long-term
$1,500	$1,500	$ 0	
$ 500	$1,000	($500)	Short-term

The basis of property inherited from a decedent is generally the fair market value (FMV) of the property on the date of the decedent's death or six months later if the executor elects to use the alternate valuation date. [§§§1014(a); 1022 and 2032]. If the stock was held jointly with a spouse, there is an adjustment for half of the basis attributable to the spouse. Special rules apply to jointly held stock in both common and community property states. Inherited property is considered long-term regardless of the decedent's holding period.

Absent the non-recognition provisions of §351, a contribution of property to a corporation would be a taxable event. [§1001]. §351(a) provides that:

> "No gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control of the corporation."

Property in this context includes realty and personalty, both tangible and intangible. However, it does not include services. [§§61 and 83]. The value of the stock received will be compensation income if services are contributed for stock. The basis and holding period will be determine as if it was a purchase.

§351 requires those contributing property be in control of the corporation immediately after the exchange. Control is stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock of the corporation. [IRC§368(c)]. It should be noted that voting is combined regardless of class but non-voting is on a class-by-class basis. This is an often-overlooked distinction.

Anything received by the shareholder that is not "solely" stock is consider "boot" and will cause the gain to be recognized to the lesser of the boot or the gain. Boot is often cash or a note (debt of the corporation) but can also be the assumption of liabilities. §357(a) provides that liabilities assumed are not boot for gain or loss, however, they are boot for basis and reduce the basis in the stock received. [§358(d)(1)]. There is an exception for certain liabilities that give rise to a deduction such as general trade payables. [IRC§358(d)(2)]. The shareholder's basis in the stock received for property is:

- Carryover basis from the assets
- Plus gain recognized
- Minus boot received. [§358].

The basis is allocated to the different classes based on relative fair market value. Remember that S corporations cannot have a second class of stock but can have voting differences. Reg. §§ 1.358-1 and 1.358-2 sanction the "specific identification" method for determining the bases when multiple assets are transferred to the corporation. Under this approach, the shareholder matches specific items of property with specific shares of stock in the transferee corporation.

IRC §351 treatment is mandatory. If there is a loss, consideration should be given to structuring the transaction to fail the §351 test.

The holding period of stock received in a §351 transaction depends on the type of asset contributed. The holding period for Capital or §1231 assets tacks on to the stock, for other property such as inventory, the holding period begins the day after the transfer. [§§1223(1) and (2)]

C. Annual Adjustments to Basis

Each year the basis of an S corporation shareholder's stock is adjusted to reflect additional contributions as well as the results of operations. Since the shareholder will be taxed on the income of the corporation, they are able to adjust their stock basis so when distributed it is not double taxed. The basis adjustments from operations will be reflected on the Schedule K-1 issued to the shareholder.

If a shareholder is allocated a loss or deduction on Schedule K-1, the shareholder must have adequate stock and/or debt basis to claim that deduction/loss. The basis in stock cannot be less than zero. If the shareholder has insufficient stock basis, they will then reduce any debt basis until that is zero. Thereafter, deductions/losses will be suspended until basis is restored. In restoring basis, the debt basis is restored before stock basis. [§1367(b)(2)]. The character of the suspended deductions/losses are allocated on a pro-rata basis.

The shareholder's basis is adjusted for positive adjustments before considering negative adjustments for the year. This occurs on the last day of the year regardless of the actual chronology of events. There are two possible methods of accounting for items adjusting a shareholder's basis, the general rule and the alternative elective method. Unless the shareholder elects the alternative method, the adjustments are to be made to the basis of stock in the following order:

Beginning Year-Basis

Plus:

Allocable share of taxable and non-taxable income on a per-share, per-day basis, (whether or not distributed) and includes both separately (Schedule K) and nonseparately (page 1 of the 1120S) stated income and The excess of the deductions for depletion in excess of the cost basis of the property subject to depletion, then;

Minus:

Distributions treated as return of capital;

Allocable shares of nondeductible expenses, including those related to the production of tax-exempt income, noncapital expenses, and deductions for oil and gas depletion up to cost basis, and finally and

Allocable share of deductible items of loss and expenses.

The alternative treatment under Reg. §1.1367-1(g) provides an election to change the ordering rule for negative basis adjustments. It is binding on all future years unless revoked with IRS consent. Alternate treatment order for negative adjustments is:

- Decrease for distributions;
- Decrease for separately and nonseparately computed items of deduction/loss; then
- Decreases for nondeductible expenses, noncapital expenses, and deductions for oil and gas depletion up to cost basis.

The regulations says that any amount of the nondeductible, noncapital expenses will carry forward until used to reduce stock or loan basis in a future year. This is a shareholder not a corporate election. If the shareholder does not make this election, then S corporation nondeductible, noncapital expenses allocated to a shareholder that exceed the shareholder's basis in the S corporation's stock and loans do not carry over to a succeeding shareholder tax year and do not reduce basis in any succeeding year.

D. Distributions

As noted above, basis is first increased for positive adjustments and then reduced first by any distribution that is treated as a return of capital. Distributions in excess of basis will generally be capital gain, short-term or long-term. If an S corporation has earnings and profits (E&P) then a distribution may result in dividend income to the shareholder. This requires the issuance of a 1099-DIV rather than being reported on the shareholder's K-1. Deductions/losses in excess of basis are suspended due to the basis limitation and retain their character and are carried forward indefinitely until the basis is restored or the shareholder disposes of the stock.

The amount of a distribution is equal to the sum of any cash distributed plus the fair market value of other property distributed less any debt to which the distributed property is subject to. It should be noted that if appreciated property is distributed, the corporation will recognize gain as if it had been sold to the shareholder at FMV. [§ 311(b)]. The gain will flow thru and increase the shareholder's basis before the reduction for the distribution.

If a corporation has no E&P, then all distributions will be return of capital/capital gain. As a general rule, S corporations will not have E&P. However, if the S corporation was a former C corporation that had E&P on the date of conversion; an S corporation elected Qualified Subchapter S Subsidiary treatment for an existing C corporation subsidiary that had E&P at the time of the election; or a C corporation with E&P and an S corporation reorganize and the S corporation survives then the S will have E&P carried over under §481. Once the S corporation has E&P, it must maintain an Accumulated Adjustments Account (AAA) in order to determine the character of any distribution. Distributions will be treated as coming from AAA before E&P; thus, distributions will be treated as return of capital/capital gain before a dividend. [§1368(c)]. If the corporation was an S corporation prior to 1982 it may have the predecessor of AAA called Previously Taxed Income (PTI). To have any PTI there would have to be undistributed pre-1982 income. PTI is a shareholder account verses AAA, which is a corporate level account. Only cash distributions can reduce PTI. If there is PTI, any distribution is return of capital/capital gain to the extent of AAA and then PTI. Thereafter, it is a dividend to the extent of E&P. Anything remaining is a return of capital/capital gain.

§1368(C)(3) allows a shareholder to make an election to by-pass both the AAA and PTI and distribute E&P first. Once elected, all distributions are treated dividends coming from E&P until that account is exhausted.

The AAA is the cumulative total of the S corporation's post-1982 income and gains, other than tax-exempt income, reduced by all expenses and losses, both deductible and nondeductible other than those related to tax-exempt income, and any distributions deemed to be made from the account. There are several distinct differences from basis calculations. First, contributions to capital are not considered for AAA. Secondly, items of tax-exempt income and related expense are not adjustments to AAA. These are accounted for as Other Adjustments after the E&P account. Lastly, distributions come out of AAA last. Essentially, AAA reflects the operations of the corporation and as such may be negative. A distribution may not create a negative AAA, only operations. The AAA account is determined on Schedule M-2.

E. Post Termination Period

If an S corporation election is terminated or revoked, there are potential benefits during the post-termination period. The post-termination period is:

- the period beginning the day after the last day of the corporation's S tax-year and ending on the later of: the day which one year after such day or the due date for filing the return for the last tax year as an S corporation including extensions;
- the 120-day period beginning on the date of any determination pursuant to an audit which follows the termination and which adjusts an S corporation tax item arising during the S period, or
- the 120-day period beginning on the date of determination that the S election was terminated for a previous year.

During this period, any distribution in cash may be treated as coming out of the S corporation's ending AAA, if any. The result is the C corporation is distributing a return of capital regardless of the existence of E&P. Additionally, a shareholder with suspended losses may increase their stock basis to free-up suspended losses for deduction. [§§1368; 1371(e) and 1377(b)]

F. Reporting

Form 1040, Schedule E, Part II, line 28, column (e) provides a box to be checked if basis reporting is required. New for 2021, Form 7203 and its instructions were developed to replace the 3-part Worksheet for Figuring a Shareholder's Stock and Debt Basis and its related instructions formerly found in the Shareholder's Instructions for Schedule K-1, Form 1120-S. The purpose of Form 7203 is to figure potential limitations of a shareholder's share of the S corporation's deductions, credits, and other items that can be deducted. It is broken down into three Parts:

- Part I Shareholder Stock Basis;
- Part II Shareholder Debt Basis; and
- Part III Shareholder Allowable Loss and Deduction Items.

IRS requires shareholders of an S corporation to disclose a stock and debt basis computation with their tax return if an S corporation shareholder does any of the following:

- Claims a deduction for their share of an aggregate loss
- Receives a distribution
- Disposes of stock
- Receives a loan repayment from an S corporation

Because the requirement to maintain tax basis and to disclose tax basis on Form 1040 is the responsibility of the S corporation shareholder, there is no requirement for the S corporation itself to maintain tax basis schedules for its shareholders or to include basis information with the Schedule K-1s. However, even though it is part of the Form 1040, most software will prepare them with the 1120S. If you are not preparing the corporate return, you should make a separate analysis and not just rely on that Form from the corporate return preparer. It is a “best practice” to prepare the Form 7203 each year, even if not required to file it. If not required, do not file it, rather keep it in your permanent client file.

G. Other Issues

While not directly affecting basis, shareholder’s that have losses may also have to deal with additional limits before taking deductions/losses on their return. Basis is the first hoop. The next hoop is At-Risk and then Passive Activity Losses. Under §465, deductions and losses will be limited to the amount the shareholder is at-risk in the activity. If the shareholder is not at-risk, then any deductions/losses will be suspended under those rules until the shareholder increases the amount at-risk. If at-risk, then the deductions/losses will be subject to the passive activity loss rules of §469. S corporations are not subject to §469 but individual shareholders are. Essentially, deductions/losses are limited to income in that activity and then net income from other passive activities. If income is insufficient, they will be suspended under those rules. Questions 18 and 19 on the shareholder’s Form K-1 ask about aggregating for At-Risk and Passive Activity Losses.

Additionally, the shareholder may be limited by the Excess Business Loss Limitation Rules of §461(l). This rule has been extended through 2028 with the Inflation Reduction Act of 2022 signed into law in August of 2022.

H. Conclusion

The determination of a shareholder’s basis in an S corporation is an important concept. Differing rules can apply to the determination of basis as well as holding period. Care must also be taken on the annual adjustments. Basis will determine the ability to take deductions/losses as well as the tax treatment of most distributions.

A. Discussion Problems

Jane, Homer, and Heather form a new S corporation, SmithCo. Jane transfers inventory from her existing business (FMV: $50,000 and basis: $10,000) in exchange for 50 shares of common stock. Homer transfers a capital asset he has owned for 3 years (FMV: $60,000 and basis: $30,000) in exchange for 40 shares of common stock and the assumption of the mortgage on the property he contributed of $20,000. Heather provided services worth $10,000 for 10 shares of common stock.

For the first year, the corporation reported $100,000 of non-separately and separately stated income and $50,000 of deductions. Jane received a cash distribution of $20,000.

Required:

1. What is the appropriate basis on contribution for each of the parties?

2. What is Jane's basis at the end of the first year?

3. Is there any reporting requirement for Jane?

B. Suggested Answers to Discussion Problems

1. The initial inquiry is whether the contribution meets the requirements of §351 in order for the property givers to get tax-free treatment. The property givers are Jane and Homer. Each gives property in return for stock and as a group are in control immediately after the exchange (90% = 90/100). Heather won't qualify since she did not contribute property.

   Jane has no gain or loss recognized under §351. Her realized gain is $40,000 ($50,000 FMV – $10,000 basis) and her recognized gain is $0. Her basis in the stock is a carryover basis of $10,000.

   Homer has a realized gain of $30,000 ($60,000 FMV – $30,000 basis). The assumption of liabilities is not considered boot under §357(a); however, the liability is boot for basis under §358. His recognized gain for the transfer is $0. His basis in the stock is: $10,000 ($30,000 carryover basis + 0 gain recognized – $20,000 mortgage assumed).

   Heather is taxed on the stock received for services. Her basis is the value of the stock is $10,000.

2. Jane's share of the income is $50,000 which increases her $10,000 basis to $60,000. Then, her $20,000 distribution reduces her basis to $40,000. Finally, her $25,000 share of deductions reduces her basis resulting in a final year-end basis of $15,000.

3. Because of the distribution, Jane will have to report her basis and check the box on Schedule E. She will also be required to report her basis on Form 7203 attached to her Form 1040 for that year.

PART 3. BUSINESS TAXATION

Rehabilitation Credit

The TCJA affects the Rehabilitation Tax Credit for amounts paid or incurred for qualified expenditures after December 31, 2017. The credit is a percentage of expenditures for the rehabilitation of qualifying buildings in the year the property is placed in service. The legislation requires that taxpayers take the 20 percent credit ratably over five years instead of in the year they placed the building into service; and it eliminates the 10 percent rehabilitation credit for the pre-1936 buildings. A transition rule provides relief to owners of either a certified historic structure or a pre-1936 building by allowing owners to use the prior law if the project meets certain conditions. Ian Redpath and Greg Urban discuss key rules regarding eligibility for and calculation of the Rehabilitation Credit.

Let's join Ian Redpath and Greg Urban as they discuss the rules and guidance related to the Rehabilitation Tax Credit.

Mr. Redpath

Greg, welcome to the program.

Mr. Urban

Hey, Ian. Good to see you again.

Mr. Redpath

It's always great to have you here. I always love your insight, as our viewers do; and we have an interesting topic today, the Rehabilitation Credit. And it's something that, if you're not actively doing it, I think it kind of slips by and you don't think about it. But you have to be cognizant of it. I can remember looking at a project that they said qualified for the Rehabilitation Credit because it was in a historic district. Unfortunately, it was a historic district determined by that city, not a historic district. But they actually advertised that it qualified for the credit. The numbers looked a little different when we took that credit out of there, the numbers on rehabilitating this old mansion. This particular city has what they call mansion row, a lot of old mansions that are being rehabilitated into either condos or office buildings. And the dynamics of it changed dramatically. So where are you seeing this now in practice, Greg?

Mr. Urban

We see a lot of our clients who are interested in diversifying their portfolios, maybe investing in private real estate transactions. So, we're seeing it in that context. A lot of times, I'm in New York state, New York state has a credit that can even exceed the federal Rehabilitation Credit. That credit can be refundable in a lot of cases, particularly on the state side, that is. What you're seeing is a lot of investors that are looking to get into real estate, the Rehabilitation Credit makes it much easier for them to do that and oftentimes provides an incentive and maybe a perceived safety net for them when they make the investment.

Mr. Redpath

So, a lot of investment vehicles using partnerships are being set up; and the idea is we're going to find some buildings to rehabilitate. And one of the great advantages is we're going to be able to flow through these credits to you on a state or federal level. I think that's kind of my point.

Mr. Urban

And I think it's important to just point out, like in our market, we see a couple different structures. For instance, we're working on a transaction right now, we see a direct investment into a partnership. Maybe an investor will come in, make a capital contribution, and those credits will be specifically allocated to that particular credit investor for a period of time, maybe approximately something like five years. Or we'll see other structures that will involve maybe a multi-tiered entity where there's holding companies. So, I think it's important to just understand that the form of these transactions can vary from transaction to transaction.

Mr. Redpath

And I think we've got a case out there that really is a hallmark case that came out of the third circus. Circus I said, I think I meant circuit, but some people might say the circus. The Third Circuit, the historic boardwalk. And following that up, we have Revenue Procedure 2014-12. Because one of the things the IRS has attacked in some of these different types of structures is what are you? What really are you? Are you a real partner or are you not? And they will challenge the allocations that come out of these partnerships. And that's kind of the hallmark is that case and Revenue Procedure 2014-12, setting forth, "This is what we're going to look at to see are we going to respect those allocations?" Because you can make all the allocations you want, but just like any other special allocations, they've got to be respected, right?

Mr. Urban

Yes. I think that's a really good point. As a matter of fact, the single-tier structure that we were just looking at recently brought up all those issues. And a lot of them are rooted in partnership tax, things like substantial economic effect. You also see things like deficit restoration obligations and qualified income offset. So, one of the things I think I would point out is in this area, particularly in the partnership area, you see many partnership concepts that become very relevant in terms of the allocation of income and the credits to these credit investors.

Mr. Redpath

So, we've really got two things. We've got a focus of the IRS on these particular types of credits with rehabilitation, and that's the case we mentioned and the revenue procedure. But then we also just have general concepts, 704(b), special allocations, substantial economic effect, and all of those general rules. So, that's a really good point. You've got two sides that the IRS can come after you for.

Mr. Urban

Yes. And if you think about it, I think from a book capital perspective, a lot of times the allocation of these credits can create deficit capital accounts. So, the question I think that comes up is can the credit be allocated when there is a deficit capital account? What needs to be in the partnership agreement in order for that to occur? And I just think that's just another layer of consideration that the people watching today really should be cognizant of.

Mr. Redpath

Are you seeing these set up as LLCs taxed as partnerships, or just general partnerships, or limited partnerships? What structure are you seeing?

Mr. Urban

What I've seen is mostly the use of LLCs. I can't think of a general partnership or a limited partnership structure that I've seen recently. Usually, what happens is there's an initial allocation period where a lot of times a client will come in and they're going to say, "We're going to sell the credit." So, the credit will become available; oftentimes, it approximates 70 cents on the dollar, at least that's been my experience. But you're really not maybe selling the credit. What's happening is somebody's coming in, making a capital contribution into the partnership, and they're getting a preferential allocation of the credit. And then, usually what happens is that partnership agreement will have an allocation for maybe a period of four or five years, and then that allocation will change. But it's typically after the credits have already been allocated to the party that came in that really wanted to use them.

Mr. Redpath

But you used a good term because the IRS has been saying that there are in fact investment vehicles where all they are doing is selling the credits. And they've been saying, "We're going to challenge those. We're going to look at those very closely." And one thing that you mentioned that we really do have to look out for, and this is a general comment, is anytime you have an LLC, make sure if you're going to make those special allocations, that you don't have an unlimited deficit makeup. Because if you did, you just backdoored the potential open liability to make up those deficits, have that qualified income offset. Now, that's a whole different program. Greg, we'll have to do that program someday; but it's an important consideration.

So, you've got the client that came in and said, "Look, I've got this great opportunity; and my investment person told me I'm just going to make a ton of money off of this." So, what are these rehabilitation credits? Because over the years, they have changed, and they changed dramatically with the Tax Cuts and Jobs Act in 2018. So what exactly is the Rehabilitation Credit, and where are we now?

Mr. Urban

Yes. Typically, what you would have, we would have a structure that would be certified basically through the Department of Interior. And it would be certified as a structure that would be qualified for rehabilitation, and then you've got a period of time where certain expenditures go by the name QREs, or qualified rehabilitation expenditures, are made to rehabilitate the project. And those aren't really costs of acquisition necessarily; they're really costs that would exceed your basis in the property. And typically, they're made within a period of 24 months. And to the extent that those expenditures are incurred, a credit equal to 20% of the expenditures would become available.

Some of the states that I'm aware of have some differing rules. Sometimes, as I mentioned at the outset, the percentage of the qualified Rehabilitation Credit is even greater on the state side. But that would be the typical fact pattern is you would identify a piece of real property. It can be residential or nonresidential; and that would become certified through the Department of Interior, and then, you would begin to incur expenditures to rehabilitate the project. Once those are done and the building is placed in service, generally that's the point in time where the credit is freed up.

Mr. Redpath

But a lessee can take this also, right, on expenditures?

Mr. Urban

The owner can make an election to pass the credit through to a lessee. And the lessee then is basically provided all the information relative to the expenditures, and they can claim the credit themselves.

Mr. Redpath

So you mentioned a 24 month, and I know there's also a 60-month period. So what is this 24- and 60-month period? Because our viewers are going to see that. They're going to say, "Oh, the 24 month, 60 month." But what do those mean?

Mr. Urban

Yes, the 24 month I would say would really be the default. I think that's the thing that we see most frequently. So, you would basically identify a 24-month period to incur qualified rehabilitation expenditures. And those are generally expenditures to rehabilitate the building, generally are greater than your basis that you would put that you had to acquire the property; and that would become your base upon which you would compute the qualified rehabilitation expenditures. The 60-month timeframe is similar; but it's usually used when you have phased rehabilitation, so rehabilitation that would happen maybe in steps or distinct phases. Honestly, we probably don't see that as frequently. Typically, we see the expenditures made within the two-year period. But that 60-month period would be available in the case where you've got phased rehabilitations; and that's usually supported by some type of engineering or architectural work.

Mr. Redpath

So, you mentioned that you're rehabilitating and the credit, I think you said, is taken in the year that it's placed in service again? But it has to be substantially rehabilitated. To qualify, you've got two things too. You've got to substantially rehabilitate it. And I believe you mentioned in the 24-month period, the qualified expenditures would be the greater of the adjusted basis—so what you paid for it isn't included—or $5,000, whichever is greater. And I say that because, for example, I'm familiar with one project where they bought the building for a dollar. So, their adjusted basis is a dollar. The rehabilitation costs are significant, so it would be the greater of the adjusted basis or $5,000 that you use for that rehabilitation of the building. And you mentioned, I think, nonresidential, residential. Any real property, I think the class life is 12-1/2 years or greater will qualify. Does it qualify for improvements if you're just improving it?

Mr. Urban

No, it has to be a rehabilitation of the building. So, even some enlargements won't qualify for the Rehabilitation Credit. Typically, what you would see would be a plan of rehabilitation determined with maybe the National Parks Association or the Department of the Interior. Oftentimes, it's tied into a state historic preservation organization set of standards; and it would be those types of rehabilitation costs that we would be talking about. But not typically enlargement or the acquisition of a building.

Mr. Redpath

So, in the old days, a lot of this wasn't really relevant, and that's why I think it slipped by; because we got the Tax Cuts and Jobs Act that came in, and then we got hit with COVID. And so we had people not really getting involved with these rehabilitation projects, and so now it's coming back. And so pre-COVID, you had this, you could get a 10% credit if the building was originally, before 1936, placed in service. So, you had really a broader number of projects that you could use. Those were eliminated, right?

Mr. Urban

Yes, those were eliminated. So now post-COVID in my mind, the biggest change that TCJA made was the timing at which the credit can be claimed. So, it's determined typically at the end of the 24-month period; and then that credit, for federal purposes, is claimed ratably over a period of five years. So that's, I think, the biggest thing that we're dealing with now and the thing that's different. And not to maybe jump ahead, but typically what you would see then is, "Okay, when can that credit be claimed? How is it treated?" So it's, I think, important for the viewers to note that credit is subject to all of your typical general business credit limitations, so passive activity rules, at-risk rules, things like that. That's oftentimes part of the modeling when we talk with our clients about this.

Mr. Redpath

And that's a good point because you're still subject to at risk under 465. You're still subject to the passive activity loss rules as an investor. You're going to be subject to the passive activity loss rule. Now, for some, depending on your income, there's that $25,000 exception that you can write off, which is deductions or deduction equivalents; and deduction equivalents are credits, credits equal to that deduction. So, that does qualify, but it actually raises the AGI limit for this credit to $200,000, whereas normally it's over $100,000. Here, it raises it to over $200,000. So, it's phased out when you get to $250,000; then you can't take the $25,000 because it's 50 cents phased out on the dollar. Now Greg, I remember going back and having to have architects come in and the engineers, and you had to leave 75% of the structural integrity on the outside of the building, but you could have the inside be the outside. I remember we did an atrium in one building, so the outside of the building was actually now in the inside, but it was still considered to be there. And we used to go through all of these types of things to say, "Okay, do we meet the rule to keep the building integrity?" Do we still have to look at all those things?

Mr. Urban

Still generally, we look at a lot of those. The reality is, I think what you would advise most people listening to the program today is there are consultants available. Really, I would recommend using them because they're familiar with state historic preservation organization standards, some of the standards that are available through the National Parks Department. And what you really want to do is I think get buyoff. And typically, there's an engineering element to it of what your qualified rehabilitation expenditures are going to be; and make sure that everybody agrees that these are going to be part of an overall rehabilitation program.

Mr. Redpath

And there's a lot of things that aren't. As you mentioned, enlargement, increasing floor space from the interior remodeling would not be considered. So, what's an enlargement versus what is just enlarging the interior space?

Mr. Urban

And like I said before, the acquisition cost. A lot of people think just the acquisition cost is a qualifying expenditure; and it's important to point out it's not.

Mr. Redpath

And that could include the interest on a construction loan; that's not being considered a QRE. Also other things—sidewalks, parking lots, landscaping, things of that nature—are not included in that QRE, the qualified rehabilitation expenditures. And so yes, it's something that you really have to pay attention to.

And I don't want to go too far, you mentioned about the certification. There's actually a process it has to have gone through. So, if you are doing it, and I mentioned the example of the project that they brought to me, but that was them. They wanted to buy this mansion and make it their headquarters. That's looking at it a little differently. But when people come to you and say, "Hey, I've got this investment," some of the things that you want to know is was it certified? There's a process that has to go through. There's forms that are filed, that you're going to want to see. Have these been done?

Mr. Urban

Yes, absolutely. You're going to want to see has an application been made of the Department of the Interior, has documentation been in place? Our plan for rehabilitating the project, has that been agreed upon? It's a really good point. This isn't the type of thing where you want a taxpayer to go out, incur a bunch of costs, and maybe incur them over an undefined timeframe. That 24-month timeframe is an important thing to stick to. So, defining what the costs are going to be, having the application and the paperwork lined up is an absolute must. And adhering to that plan, an engineering and architectural plan, at least from my experience, has been really important. Like I said, in the typical circumstance, I think it is probably a best practice to engage a consultant in the area. But if you were to go at it alone, understanding what those requirements are and sticking within the parameters of the initial application are important.

Mr. Redpath

And there also has to be, and the National Park Service has Form 10-168. Part three… That form is a request of the completed work. In other words, we've completed the work. They have to certify that it satisfies the requirements to be a rehabilitation according to the Secretary of the Interior's standards and consistent with the historic property.

Mr. Urban

Yes. And in fact, I'm aware of some firms that have a practice area that will look at the costs that were incurred and make sure that they're consistent with that overall application. So, documenting and being organized relative to the expenditures is really important.

Mr. Redpath

So once that's done, right, the taxpayer has to attach a copy of that to their return that this has been approved?

Mr. Urban

Yes. Usually, in the year that you place the building in service, which typically coincides with the year that you would claim the credit, you would attach all of that paperwork to the return. And the credits would, like I say, get claimed; and they get claimed, in typical fashion, over a five-year period. It's important to note that a pass-through entity itself doesn't claim the credits, as we were alluding to before. They get passed through to your individual partners or to S corporation shareholders. So, that would be the mechanics, and the credits would be allocated based upon a partnership agreement; and usually that's something that's negotiated really before the building is even acquired.

Mr. Redpath

Yes, this isn't something you just say to the client, "Oh yeah, that's a great deal. Go put your money in with whoever your investment advisor is. Oh yeah, just give them the money and have them invest it for you." You've got to do a lot of work here. And also, you file the credit on Form 3468. You can file the credit, but essentially you've got 30 months that you better file the certificate saying, "We've completed it." And if you don't, the IRS is going to ask you for a reason; and they will almost always ask you to extend the statute of limitations on that credit if you haven't received that certificate.…

Mr. Urban

I was just going to say the other thing you commonly see in here—just talking about the expenditures and the timeframe—a lot of times you'll see an investor come in and will invest just for the purposes of achieving the credit. Oftentimes, it's not only important to have a reasonable expectation what those expenses will be at the outset, because that can drive the capital contribution or the investment that individual will make. But those agreements almost always have provisions that would say, "Look, if these expenditures differ.…" Maybe the amount of the capital contribution that was made would be different, or there's some other type of mechanism to make that investor whole. So, understanding where we want to go and monitoring those expenditures over the life of the project, at least from my experience, has been a best practice.

Mr. Redpath

And it also includes the building and the term "structural components" of a building. So it's not just the building itself. However, this is where you get into, "Well, this building was built especially for this one huge piece of machinery." So essentially, the IRS will come in and say, "Well, the building is machinery, so that wouldn't qualify." So; you could have that type of thing; but it does qualify if it's the structural components. What about condos? What if it's going to be condo units?

Mr. Urban

So the condo units—to be honest, I don't have a ton of experience in the condo unit area. What we see is more residential houses that we see done. What's important to note, I think, when you're dealing with residential houses is oftentimes, you would be talking about a block of houses. So, the question becomes is this one project, or is it multiple projects? And are these one set of certifications or multiple sets of certifications? Here anyways, you typically see them as multiple projects. So, each house being acquired is a separate project that's gone through the Department of the Interior and the state historic preservation organization; and you see that very commonly with real estate investments buying multiple houses and having them separately certified.

Mr. Redpath

Yes, especially in the inner cities of some areas where there may be some historic significance to certain types of buildings; and you might have, as you said, a whole block of those buildings and you come in and you're going to want to rehabilitate that whole block. Well, as you said, is it one project, three projects, five projects? What exactly is it? The other thing is it could be someone who is going to turn this into Airbnb, for example. Well, to the extent of your personal use, you don't get the credit. And the same thing with a condo; to the extent of your personal use, you don't get a credit. So, you could have a situation where you're using it, I'm going to say, like a vacation home, and you're going to have similar limitations. You can't take the credit on your personal use, and I think that that's important to remember that you have that. When you're looking at the credit; and the IRS does have FAQs, which are really good on the credit. But remember, for our viewers, the FAQs are not legal authority for these. So, when you take the credit, you file the 3468, you've got all your certificates attached. Now, you just don't worry about it, right? It's done. It's gone. You're fine. "Okay, we took the credit, we're going to take it over the next five years. We've got it built into our system. We're done, we don't have to worry about it." Is that right?

Mr. Urban

Yes. One of the bigger things that we see… Well, a couple of things. One, you ask yourself about the basis of the property and the depreciation. Once the project is in place, you can have differences in the depreciable basis of the property, depending upon whether or not you've got what's called a single-tier structure, which is basically just an investment into a partnership or you've got a multi-tiered structure, which is maybe an entity that owns the building and you've got different entities that own that entity that owns the building, if you follow me. So, the important thing with the single-tier structure is the credit reduces the depreciable basis of the building. Oftentimes, in a multiple tier structure, you still see the full cost of the building being depreciated. But in exchange for that, the recipient of the credit typically has to pick up income. [Section] 50(d) income is what it's called, which is essentially the amount of the credit. Now, the good news is you don't usually pick that up in one year. Most of the time, that's spread out over the depreciable life of the building; and it's matched with oftentimes a special allocation of depreciation. But for purposes of this session, I would say the important thing is, in a direct investment, to now look at we've got a reduction in basis in a multi-tier structure. You don't necessarily always have that in exchange. You've got this 50(d) income. So, that's important. The other thing that I think you got to watch out for is any type of a recapture event. So, a situation where maybe the building's been disposed of, things like that, where you would have to recapture the amount of the credit that's been taken.

Mr. Redpath

Yes, and I think you have to look at it from the standpoint too, and if you're representing, for example, the entity, you may want to look and say, "Okay, are we eligible for any bonus depreciation on something?" Because if you take bonus, you can't take the credit on those expenditures. But you may be better off taking bonus at least while we still have some level of bonus on what could maybe qualify as QUIP property. So, maybe that's a better situation to take the bonus depreciation on that.

Another thing that happens a lot is these are historic buildings, and so people will sometimes say, "Okay, we're going to rehabilitate them, and then we're going to donate, for example, the facade." That's a common. Donate the facade or a familiar one where they want to do just the general conservation easements. "Well, we're not going to build any higher. So, we're restricting the ability to build." But facade easements, these types of things are very common. What's the situation with those if it's one that you want to take the Rehabilitation Credit?

Mr. Urban

To me, with those types of transactions, I think first and foremost, having appraisals, and the documentation, and all that in place is a must. It seems like every time we open a research service, there's a line of cases that deals with the contribution of real property and facade easements. But typically, what you would see when you have a charitable contribution like that is the credit just generally doesn't apply. We, in our practice, don't see a lot of those types of transactions. My experience has been people that own these types of properties like the control, and they don't make charitable contributions. But you're right. In those situations where you've got maybe a piece of property that's got historical significance and a charitable contribution is going to be made, the ability to also double dip, if you will, and take the credit is just not there.

Mr. Redpath

They're going to stop that?

Mr. Urban

Yes.

Mr. Redpath

So, there's a possibility that, as you said, the facade easement, sometimes you look and they'll make the facade easement after the five-year credit runs out. But there's going to be some limitations on what you can deduct. So essentially, you're not going to be able to double dip. You're going to have to reduce the deduction. So, they still are going to get you on that. And if you do it up front, they're going to say, "Well, to the extent of the facade and the cost of the facade, you don't get the credit on that either. So, we've got you either way." What about tax exempts? Does this credit flow through at all?

Mr. Urban

I don't believe it flows through a tax-exempt entity at all. We don't really see that all that often in our piece of the practice. But similar to the charitable contribution of facade easements, the ability of a tax-exempt organization to make the investment, and then pass it through, if you will, to a donor or to an otherwise benefactor of the organization is limited and something that we've really got to look at that type of a transaction before you enter into the document.

Mr. Redpath

I think the only time it will be allowed is if it's subject to UBIT. If it's subject to unrelated business income, then you get the credit. You can take the credit like any other business, but you're really going to have to prove that this building relates to UBIT. This is generating unrelated business income. You said, and we kind of slipped by it, but I think it really is important, this isn't a credit on its own. And a lot of times, we talk about credits as if they stand alone; but the rehabilitation credit is a general business credit. So, it's added with all your other ones. What does that mean when it's a general business credit? It has some limitations. It also has carrybacks and carryforwards. So, what does that mean?

Mr. Urban

In our practice, what you typically would see would be an investor that is going to be oftentimes passive with regard to these types of investments. So the first question I think you've got to ask yourself is, "Do they anticipate and will they have passive activity income?" Now, you mentioned a de minimis limitation before that could apply if you've got an investor that's got maybe AGI up to $250,000. There's some more, I'll say, taxpayer-friendly ways to utilize the credit. But oftentimes, what you see is high net worth individuals making these investments; and many times, the passive activity investments that they've got don't necessarily have passive activity income. So, what we see is number one, these credits are subject to having other sources of passive activity income; they're subject to your standard at risk limitations. So, is the taxpayer at risk relative to the activity, or has it been financed by non-recourse financing? But on the state side, oftentimes, those rules can be different. A lot of states will have refundable credits that might still have passive activity and at-risk limitations, but the credit may just be refundable in some states. But typically, with our investors, what we're worried about is, do they have a level of passive activity income? Are they at risk with regard to the investment? And do they have income of the sort that would be eligible for the general business credit, and can they claim it through those provisions?

Mr. Redpath

And the general business credit just in general is limited. And you've got a one-year carryback because really when the rehabilitation goes into that credit, it's treated as a general business credit subject to those rules. And you mentioned recapture. If it ceases to be investment credit used for rehabilitation, the first year you got the credit, it goes all back. After that, it's pro rata? Right? Is it pro rata over that five-year period?

Mr. Urban

It's pro rata over the five-year period.

Mr. Redpath

So, keep it for the whole period if you can; otherwise, you've got a recapture of the credit.

Mr. Urban

And you might have picked up on at the beginning when we were talking a little bit about these structures. Usually, what you will see is a partnership agreement that's written to deal with certain allocations during a five-year period, and that's really why. You're really looking at protecting the credit investors so that there's no recapture event of the credit in any way and they can understand what their result will be over the period of five years. After the five-year period, oftentimes their ownership and interest will be substantially diminished. But that's an important thing, I think, to watch out for.

Mr. Redpath

And you mentioned something that really is important; and that's many states have separate provisions, and they may even have separate requirements, and usually do. And sometimes their rehabilitation is even greater than the federal.

Mr. Urban

Like here in New York, for smaller projects, I think off the top of my head, the number's $2.5 million; and if they were placed in service after, I think it's 2021, you are eligible for a 30% credit of the QREs. And sometimes, matter of fact, one of the individuals on our staff was looking at partnership agreements, said, "This is odd. The state credit is larger than the federal credit." And when you do the math, sure enough, the state credit was based upon 30% of qualified rehabilitation expenditures. So, I think you've just got to look at state-specific rules; those change a lot. That what I just quoted is really the New York situation; but that's a really important piece of it. And the credit on the state side is oftentimes equal to the federal credit and oftentimes refundable.

Mr. Redpath

And many times, the states also have various provisions, for example, favorable as far as employment taxes, if you hire people, and you start a business, and you rehabilitate a building in a certain area, and locate the business in there. And this is, I think, important—they don't always have that same requirement. We mentioned it, but sometimes they have their own historic districts or districts that qualify for these credits.

Mr. Urban

Yes. And Ian, in today's times, what you see sometimes is these rehabilitation credits being combined with a partnership that's designed to set up as a qualified opportunity zone fund. So we've seen some situations where a partnership will be set up, it's designed to be an opportunity zone business; so, you'll have some investors that will have rolled gain in as an opportunity zone investor, and you may have other investors that come in, and they're looking specifically for the rehabilitation credit. So, the combination of those two circumstances, you can have different investors with different goals.

Mr. Redpath

Wow. That's excellent because that's an excellent opportunity. I can see that happening a lot, combining those two.

Mr. Urban

Oftentimes, those goals don't conflict because of the holding period on the opportunity zone side. So, just something for people to watch out for.

Mr. Redpath

Yes, that's a great point. Greg, thanks for being here again. A lot of great information today, something to look at. I'm sure a lot of our viewers are going to have clients that are going to come in. They're going to have this opportunity. Or, maybe the client is looking to develop a building into an office or apartments. But this is really, really an important thing to look at, look at the state, look at the federal. Greg, thanks for your input. Really great to have you here today. And again, as always, great show. Thank you.

Mr. Urban

Great. Thank you, Ian. Nice to be with you.

Rehabilitation Credit

By Ian J. Redpath, JD, LLM

A. Introduction

The federal rehabilitation tax credit is a financial incentive to invest in historic buildings and to assist private property owners to rehabilitate historic properties for an income-producing use, such as rental housing, office, retail, manufacturing and entertainment space. It is considered important in the redevelopment of historic Main Streets, as well as for neighborhood and downtown revitalization. The rehabilitation credit is part of the General Business Credit under §38. It is specifically an investment credit in §46. The credit is equal to 20% of qualified rehabilitation expenditures. It is claimed in five equal annual installments beginning on the date on which the rehabilitated building is placed in service [§§47(a) & (b)]. There are certain requirements that if failed will require recapture of all or part of the credit.

There is no limit on the amount of credits that can be claimed in any year or with respect to any project or taxpayer. Additionally, the building to which the credit applies may be commercial or residential.

The IRS administers and enforces and credit. However, certified historic structures require approval of the National Park Service and the applicable State historic preservation office to qualify.

Many states have similar incentives. This material focuses on the federal rules only.

B. Who Qualifies for the Credit?

Taxpayers that own an interest in the building directly or through a pass-through entity, or are lessees of the building in certain cases, are eligible to claim the rehabilitation credit and generally include:

- Individuals
- Corporations
- Partners, Shareholders, and Beneficiaries of a pass-through entity
- Estates and Trusts

A pass-through entity is not eligible to claim the rehabilitation credit but can allocate the qualified rehabilitation expenditures to its partners, shareholders, or beneficiaries. A partner, shareholder, or beneficiary may then claim the appropriate rehabilitation credit

Lessees may qualify for the rehabilitation credit if the lessor that owns a building elects to treat a lessee of the building, or a portion thereof, as having purchased the building. This is just for rehabilitation credit purposes and the lessee otherwise qualifies. Reg. § 1.48-4(a)(1) provides the requirements for the time and manner for making an election to treat the lessee as having purchased the building for rehabilitation credit purposes. The lessor of the property is required to provide the lessee with all the information needed to complete Form 3468 Investment Credit.

In the case of a long-term lease, the lessee's expenditures may be qualified rehabilitation expenditures and the lessee can claim a rehabilitation credit provided certain other requirements are met. This applies even without the election by the lessor. However, if on the date the rehabilitation is completed, the remaining term of the lease is less than the recovery period determined under §168(c), then the lessee's expenditures are not included as qualified rehabilitation expenditures. This does not include any renewals provided in the lease. The applicable recovery periods are 27.5 years for residential rental property and 39 for nonresidential real property.

The credit generally is not available on property used by tax-exempt entities, governments, foreign persons, or foreign entities (a "tax-exempt entity" for this purpose). It may, however, be available in the following situations:

- The property is used predominantly in an unrelated trade or business the income of which is subject to tax under I.R.C. § 511, and

- If the property is leased to a tax-exempt entity.

Note that the property can't be classified as "tax-exempt use property" which would limit the ability to claim the rehabilitation credit.

In situations where a partnership owns or leases the property, the rules provided in I.R.C. § 168(h)(5) and (6) apply, which will generally mean that a portion of the property equal to the tax-exempt entity's proportionate share will be considered property used by a tax-exempt entity and no rehabilitation credit is determined for that portion. Often, the partnership makes "qualified allocations" that meet the requirements of I.R.C. § 168(h)(6)(B) so that a portion of the qualified rehabilitation expenditures is allocable to the taxable partners and qualified allocations of a portion of the other partnership items are allocable to the tax-exempt entity partner(s) in order to ensure that the partnership's goals are being met.

C. Qualified Rehabilitation Building

A "qualified rehabilitated building" is generally defined as any building, including structural components, for which the following are met:

- The building has been "substantially rehabilitated;"

- The building was placed in service as a "building" before the beginning of the rehabilitation period;

- The building is a certified historic structure; and

- Depreciation or amortization in lieu of depreciation) is allowable with respect to the building. [§47(c)(1)(A)].

A building is generally any structure or edifice enclosing a space within its walls: usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores." It does not include a structure which is essentially an item of machinery or equipment or where the use is solely to house an item of machinery or equipment.

The term structural components is generally defined to include such parts of a building as walls, partitions, floor and ceilings, as well as any permanent coverings, and certain components related to the operation and maintenance of a building [Reg. § 1.48-1].

Prior to changes made by the TCJA, a reduced credit was available for any building, other than a certified historic structure, that was placed in service before 1936 and in the rehabilitation process (i) 50% or more of the external walls of the building must be retained in place as external walls, (ii) 75% or more of the existing external walls of the building must have been retained in place as internal or external walls, and (iii) 75% or more of the existing internal structural frame must have been retained in place [former §§47(c)(1)(A)(iii) & 47(c)(1)(B)].

D. Qualified Rehabilitation Expenditures

In general, the term "qualified rehabilitation expenditure" means amounts incurred by a taxpayer that are:

- properly chargeable to a capital account,

- for property for which depreciation is allowable under I.R.C § 168, which is

  - ✓ nonresidential real property,
  - ✓ residential real property,
  - ✓ real property which has a class life of more than 12.5 years, or
  - ✓ an addition or improvement to the above, and
  - ✓ made in connection with the rehabilitation of a qualified rehabilitated building. [§ 47(c)(2) & Reg. § 1.48-12(b) & (c)].

The following will not qualify:

- Any expenditure with respect to which the taxpayer does not use the straight line method of depreciation over a recovery period determined under § 168(c) or (g) except to the extent the alternative depreciation system of §168(g) applies by reason of § 168(g)(1)(B) or (C),
  - The cost of acquiring any building or interest therein,
  - Any expenditure attributable to an enlargement of an existing building,
  - Any expenditure attributable a building that is not a certified rehabilitation,
- In general, any expenditure allocable to the portion of property, which is tax-exempt use property,
- Any expenditure of a lessee, if on the date the rehabilitation is completed, the remaining term of the lease is less than the recovery period determined under §168(c). [§ 47(c)(2) and Reg. § 1.48-12(c)].

A "certified rehabilitation" is any rehabilitation of a certified historic structure which the National Park Service has certified to the IRS as being consistent with the historic character of such property or the district in which such property is located [§§ 47(c)(2)(B)(iv) & 47(c)(2)(C) and Reg.§ 1.48-12(d)(3)].

E. Certified Structure/Rehabilitation

A "certified historic structure" is a building either listed in the National Register of Historic Places (National Register), or in a registered historic district that is certified by the Secretary of the Interior as being of historic significance to the district. A registered historic district includes any district listed in the National Register, and any district designated under a statute of the appropriate state/local government, if certified by the Secretary of the Interior as containing proper criteria for substantially achieving the purpose of preserving and rehabilitating buildings of historic significance, and meeting substantially all of the requirements for the listing of districts in the National Register [§§47(c)(3)(A) & (B)].
A taxpayer submits the request for final certification to the National Park Service on Form 10-168, Part 3, *Request for Certification of Completed Wor*k. The National Park Service reviews the National Park Service Form 10-168, Part 3, for the property. Final approval occurs when the National Park Services certifies, on National Park Service Form 10-168, Part 3, a determination that the completed rehabilitation meets the Secretary of the Interior's Standards for Rehabilitation and is consistent with the historic character of the property and, where applicable, the district in which it is located.

A taxpayer claiming the rehabilitation credit must enter the date that the final certification of completed work was received from the Secretary of the Interior with the tax return for the taxable year in which the credit is claimed along with evidence that the building is a certified historic structure. If the final certification of completed work has not been issued by the Secretary of the Interior at the time the tax return is filed for a year in which the credit is claimed then the taxpayer must attach a copy of NPS Form 10-168, Historic Preservation Certification Application (Part 2-*Description of Rehabilitation*), with an indication that it was received by the Department of the Interior or the State Historic Preservation Officer, together with proof that the building is a certified historic structure or that such status has been requested and after the final certification of completed work has been received, file Form 3468 with the first income tax return filed after receipt of the certification

If a taxpayer fails to receive final certification within 30 months after the date the taxpayer filed a tax return on which the credit was claimed, the taxpayer must notify the IRS and shall be requested to consent to extend the statute of limitations relating to the item for which the credit was claimed. If the final certification is denied by the Department of Interior, the credit will be disallowed for any taxable year it was claimed.

F. Substantially Rehabilitated

A qualified rehabilitated building includes any building and its structural components if the building has been "substantially rehabilitated" and the building was placed in service as a "building" before the beginning of the rehabilitation. In general, a building is considered "substantially rehabilitated" if, during the 24-month measuring period that is selected by the taxpayer and that ends within the taxable year:

- The qualified rehabilitation expenditures exceed the greater of
- The adjusted basis of the building (and its structural components), or
- $5,000. [§47(c)(1)(B)(i)].

A 60-month measuring period can be substituted for the 24-month measuring period for certain phased rehabilitations [§47(c)(1)(B)(ii)]. This completion-in-phases rule is available only if the rehabilitation may reasonably be expected to be completed in phases set forth in architectural plans and specifications that are completed before the rehabilitation begins [§47(c)(1)(B)(ii)].

In general, the rehabilitation credit can be first claimed in the taxable year in which a qualified rehabilitated building is placed in service. The credit is then taken ratably over a 5 year period. A taxpayer selects a 24-month (or 60 month) measuring period ending with or within the taxable year to determine if the there is a substantial rehabilitation. As a result of the timing for claiming the rehabilitation credit and making the determination as to whether a building has been substantially rehabilitated, a qualified rehabilitated building will generally be considered "substantially rehabilitated" and "placed in service" in the same taxable year.

Instead of claiming a rehabilitation credit when the qualified rehabilitated property is placed in service, a taxpayer may irrevocably elect with respect to a progress expenditure building to claim the credit in the year the rehabilitation costs are chargeable to capital account, or when the rehabilitation is done by a contractor in the year the costs are paid. Only qualified rehabilitations having a normal rehabilitation period of two years or more qualify for this election [§§47(d)(2)(A)(i) & (ii)]. If any building being rehabilitated by or for the taxpayer has a "normal rehabilitation period" of two years or more, and it's reasonable to expect the building to be a "qualified rehabilitated building" in the hands of the taxpayer when placed in service, the taxpayer may irrevocably elect to account for "qualified rehabilitation expenditures" made with respect to such property (sometimes called a "progress expenditure building") in the following manner:

(a) For a self-rehabilitated building a qualified rehabilitation expenditure is taken into account for the taxable year in which it is properly chargeable to capital account [§47(d)(1)(B)].

(b) For a nonself-rehabilitated building a qualified rehabilitation expenditure is taken into account in the taxable year it is paid [§47(d)(2)(A)].

G. Effect on Basis

The cost or other basis of a rehabilitated building, including a certified structure, for which the rehabilitation credit is allowed must be reduced by 100% of the allowed credit [§Sec. 50(c)(1)]. The reduction amount is added back to basis if the credit is recaptured.

If the taxpayer claims the additional first year depreciation for the qualified rehabilitation expenditures under Reg. §1.168(k)-2(g)(9)(i), the term "rehabilitation credit determined" is equal to 20% of the remaining rehabilitated basis of the qualified rehabilitation building for the tax year in which the building is placed in service. The "remaining rehabilitated basis" is equal to the "unadjusted depreciable basis" of the qualified rehabilitation expenditures after bonus depreciation. [Reg. §1.168(b)-1(a)(3)].

H. Recapture

The rehabilitation credit is recaptured if the property is disposed of or otherwise ceases to be investment credit property during the 5-year recapture period. The recapture percentage is 100 percent for property that ceases to be investment credit property within one full year after it is placed in service, reduced by 20 percentage points for each year held during the 5-year recapture period [§ 50(a) and Treasury Regulation §§ 1.47-7 and 1.50-1].

I. Conclusion

The rehabilitation credit for historic structures is a tremendous benefit for revitalizing many areas. Practitioners must take care that clients meet the rules to fully take advantage of this credit.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client is a partner in a partnership that is considering investing in a building that is registered on the Federal Historic Register. The building is currently in disrepair. They intend to use the building as office space for the partnership.

Required:

In regards to the building discuss the following:

1. Can the partnership take the rehabilitation credit?

2. What is a qualified rehabilitation is building?

3. What is substantially rehabilitated mean?

B. Suggested Answers to Discussion Problems

1. A partnership cannot take the credit but the partners may be allocated qualified rehabilitation expenses. Rev. Proc. 2014-12 establishes a safe harbor under which the IRS will not challenge partnership allocations.

2. In general, the term "qualified rehabilitation expenditure" means amounts incurred by a taxpayer that are:

   - properly chargeable to a capital account,

   - for property for which depreciation is allowable under I.R.C § 168, which is

     - ✓ nonresidential real property,
     - ✓ residential real property,
     - ✓ real property which has a class life of more than 12.5 years, or
     - ✓ an addition or improvement to the above, and
     - ✓ made in connection with the rehabilitation of a qualified rehabilitated building. [§ 47(c)(2) & Reg. § 1.48-12(b) & (c)].

   Care should be taken to assure that all expenditures qualify.

3. A building must be substantially rehabilitated. That means during the 24-month (or 60 is applicable) measuring period that is selected by the taxpayer and that ends within the taxable year:

   - The qualified rehabilitation expenditures exceed the greater of
   - The adjusted basis of the building (and its structural components), or
   - $5,000. [§47(c)(1)(B)(i)].

GLOSSARY OF KEY TERMS

American Rescue Plan Act of 2021 (ARPA)—The American Rescue Plan Act (ARPA) of 2021 (H.R. 1319, P.L. 117-2) was signed into law on March 11, 2021, and contains numerous individual, business, payroll, and pension provisions. The provisions, including $1,400 stimulus payments and an extension of payroll credits, relate to the COVID-19 pandemic. Additionally, the Act makes certain 2020 unemployment benefits tax-free, provides premium assistance for COBRA continuation coverage, expands the 2021 child tax credit, provides additional support for small businesses, and other relief.

CBO—Congressional Budget Office

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

Debt Basis—For loss and deduction items, which exceed a shareholder's stock basis, the shareholder is allowed to deduct the excess up to the shareholder's basis in loans personally made to the S corporation. Debt basis is computed similarly to stock basis but there are some differences. If a shareholder has S corporation loss and deduction items in excess of stock basis and those losses and deductions are claimed based on debt basis, the debt basis of the shareholder will be reduced by the claimed losses and deductions. If an S corporation repays reduced basis debt to the shareholder, part or all of the repayment is taxable to the shareholder.

ESOP—Employee Stock Option Plan

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

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

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

PTET—pass-through entity taxes

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.

Residential Energy Efficient Property (REEP) Credit—A personal tax credit for solar electric, solar hot water, fuel cell, small wind energy, geothermal heat pump, and biomass fuel property installed in homes in years before 2024. For property placed in service after December 31, 2019, and before January 1, 2023, the REEP credit rate (applicable percentage) was 26%. For property placed in service after December 31, 2022, and before January 1, 2024, the applicable percentage was scheduled to be 22%. The Inflation Reduction Act of 2022 extends and modifies this credit.

Stock Basis—It is important that a shareholder know his/her stock basis when: (1) The S corporation allocates a loss and/or deduction item to the shareholder. (2) The S corporation makes a non-dividend distribution to the shareholder. (3) The shareholder disposes of their stock. Since shareholder stock basis in an S corporation changes every year, it must be computed every year. In computing stock basis, the shareholder starts with their initial capital contribution to the S corporation or the initial cost of the stock they purchased (the same as a C corporation). That amount is then increased and/or decreased based on the pass-through amounts from the S corporation. An income item will increase stock basis while a loss, deduction, or distribution will decrease stock basis.

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

CUMULATIVE INDEX 2022

BY TOPIC

BY CITATION

BY SPEAKER

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

1. According to Ian Redpath and Bob Lickwar, what is generally predicted to be the impact of the Inflation Reduction Act (IRA) on inflation?

   A. Minimal or no impact
   B. Moderate increase
   C. Significant increase
   D. Significant reduction

2. According to Ian Redpath and Bob Lickwar, what is the tax rate of the corporate alternative minimum tax enacted by the Inflation Reduction Act of 2022?

   A. 1%
   B. 10%
   C. 15%
   D. 25%

3. According to Ian Redpath and Bob Lickwar, which of the following may be subject to a 1% excise tax imposed by the Inflation Reduction Act of 2022?

   A. Coal mining activities
   B. Corporate stock buybacks
   C. Production of aviation fuel
   D. Noncompliant drug manufacturers

4. According to Ian Redpath and Bob Lickwar, the Inflation Reduction Act of 2022 does which of the following?

   A. It adds one category of green energy property to the MACRS 5-year property classification.
   B. It eliminates the limitation on excess business losses of noncorporate taxpayers.
   C. It allows for a credit for qualifying research expenses against the employer share of Medicare.
   D. It reinstates the hazardous substance superfund tax effective August 16, 2022.

5. According to Ian Redpath and Bob Lickwar, which of the following is ***not*** extended or increased by the Inflation Reduction Act of 2022?

   A. Credits for purchase of electric vehicle
   B. Energy efficiency credits
   C. Net investment income tax
   D. Research credit

Continued on next page

6. According to Ian Redpath and Jonathan Tretter, which of the following forms should a shareholder use to track stock basis in an S corporation?

   A. Form 1040
   B. Form 1120-S
   C. Form 7203
   D. Schedule K-1

7. According to Ian Redpath and Jonathan Tretter, which of the following forms is filed by an S corporation shareholder to calculate at-risk limitations?

   A. Form 1120-S
   B. Form 6198
   C. Form 7203
   D. Schedule K-1

8. According to Ian Redpath and Jonathan Tretter, which of the following is used to report passive activity loss limitations?

   A. Schedule K-1
   B. Form 8582
   C. Form 7203
   D. Form 1120-S

9. According to Ian Redpath and Jonathan Tretter, stock basis in an S corporation is increased for which of the following?

   A. Depletion
   B. Distributions
   C. Income items
   D. Nondeductibles

10. According to Ian Redpath and Jonathan Tretter, which of the following is correct regarding bases in an S corporation?

    A. Debt basis may be higher or lower than stock basis.
    B. Debt basis must be higher than stock basis.
    C. Debt basis must be lower than stock basis.
    D. Debt basis must equal stock basis.

Continued on next page

11. According to Ian Redpath and Greg Urban, when is the qualified rehabilitation credit claimed?

    A. In the taxable year the structure is placed in service
    B. Ratably over a 2-year period
    C. Ratably over a 5-year period
    D. Ratably over a 6-year period

12. According to Ian Redpath and Greg Urban, which of the following activities is required to take the rehabilitation credit?

    A. The enlargement of a structure.
    B. The substantial rehabilitation of a structure.
    C. The acquisition of a rehabilitated structure.
    D. The remodeling of a structure.

13. According to Ian Redpath and Greg Urban, which of the following is a qualified rehabilitation expenditure (QRE)?

    A. Parking lot repairs
    B. Landscaping installation
    C. Construction loan interest
    D. Engineering costs

14. According to Ian Redpath and Greg Urban, who is ***not*** eligible to claim the rehabilitation credit?

    A. Individuals
    B. Corporations
    C. Pass-through entities
    D. Estates and trusts

15. According to Ian Redpath and Greg Urban, which of the following forms is filed to claim the Rehabilitation Credit?

    A. Form 3468.
    B. Form 6198.
    C. Form 7203.
    D. Form 8982.

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 September 2022 **CPE Network® Tax Report?** Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	**Topic Content/ Coverage**	**Topic Timeliness**	**Video Quality**	**Audio Quality**	**Written Material**
Experts' Forum	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Stock Basis in an S Corporation	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Rehabilitation Credit	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|

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

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

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

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

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

	Overall	Knowledge of Topic	Presentation Skills
Ian Redpath	|______|	|______|	|______|
Robert Lickwar	|______|	|______|	|______|
Jonathan Tretter	|______|	|______|	|______|
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, September 2022 Date: __________

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

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

Instructor Name: ____________________ Date: __________

E-mail address: ____________________

License State and Number: ____________________

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

CPE Network/Webinar Delivery Tracking Report

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

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

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED March 11, 2022

Welcome to CPE Network!

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

This User Guide has the following sections:

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

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

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

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

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

Copyrighted Materials

“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:

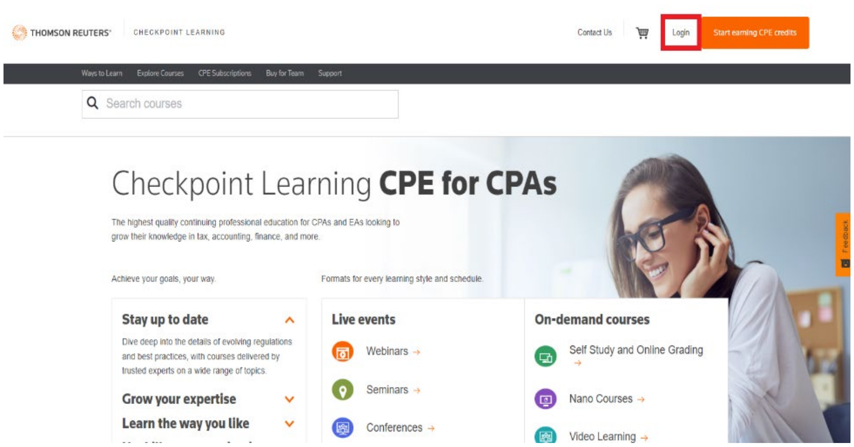
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

  Thomson Reuters
  PO Box 115008
  Carrollton, TX 75011-5008

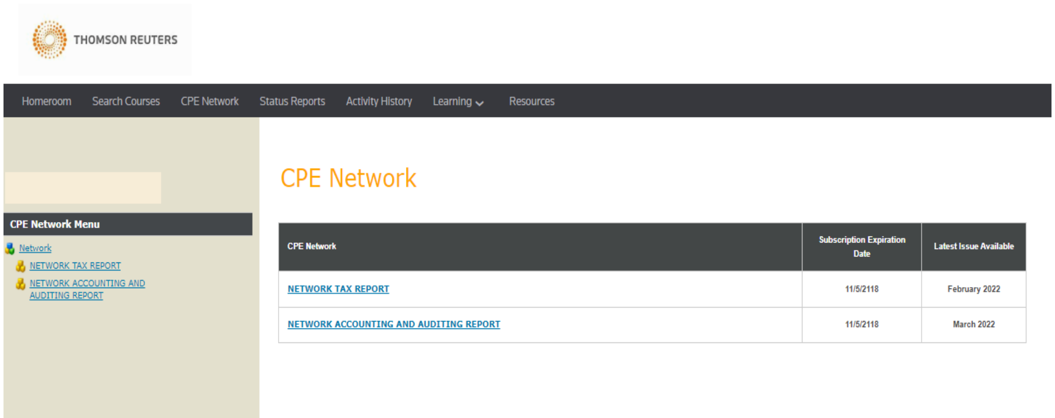
Self-Study—Online

Follow these simple steps to use the online program:

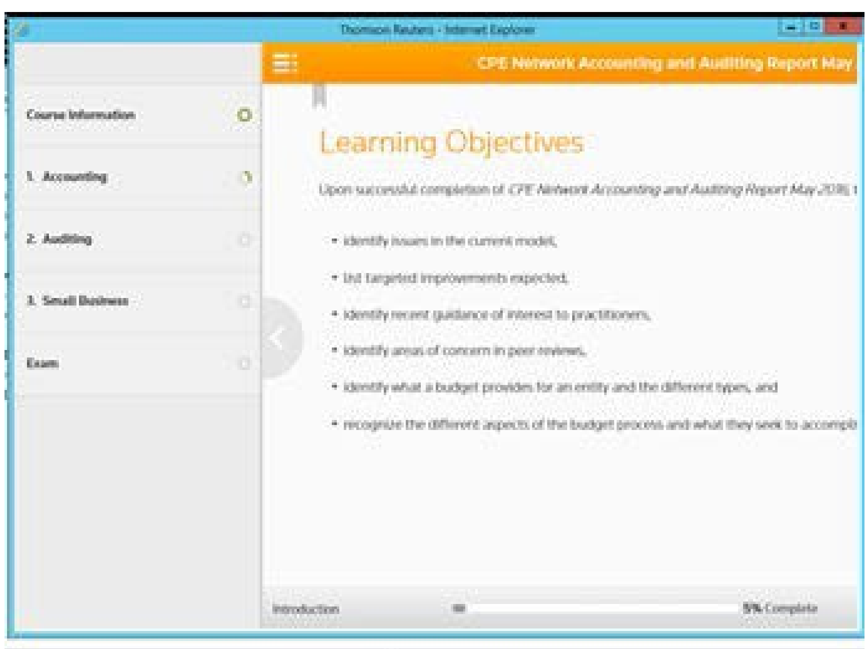
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



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

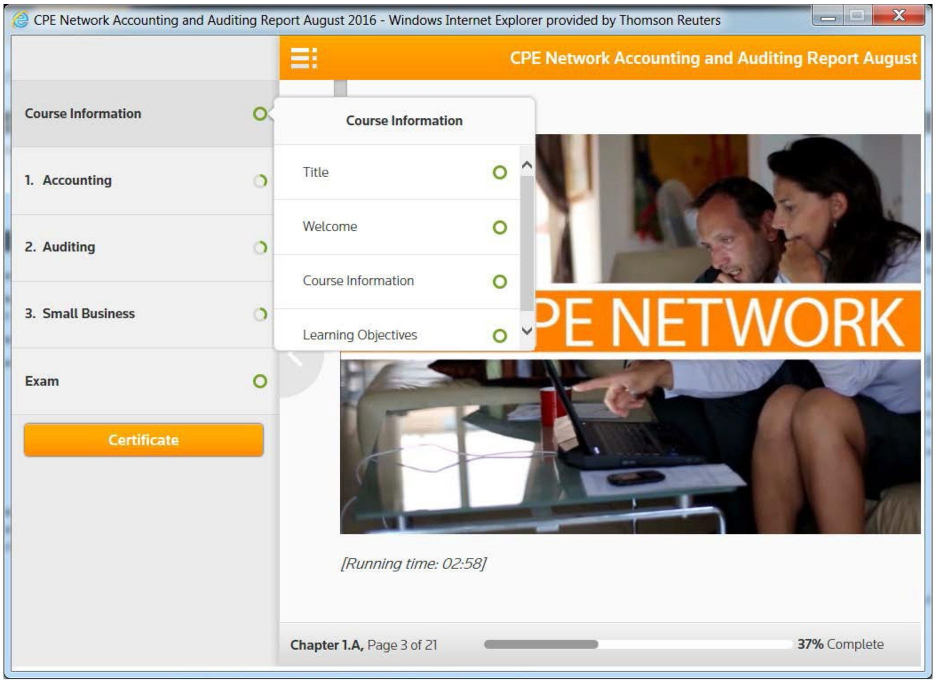


The Chapter Menu is in the gray bar at the left of your screen:

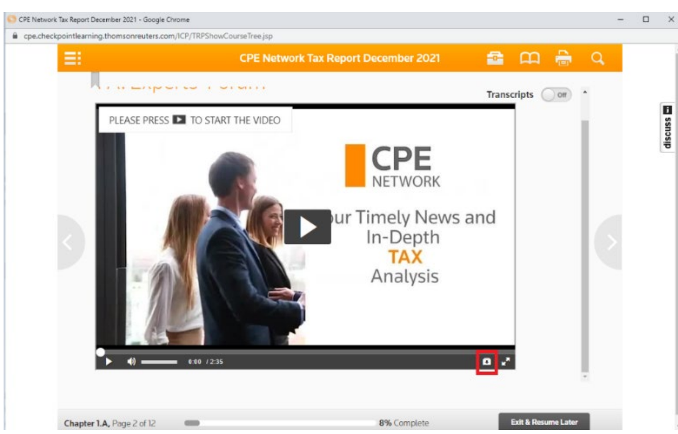


Click down to access the dropdown menu and move between the program Chapters.

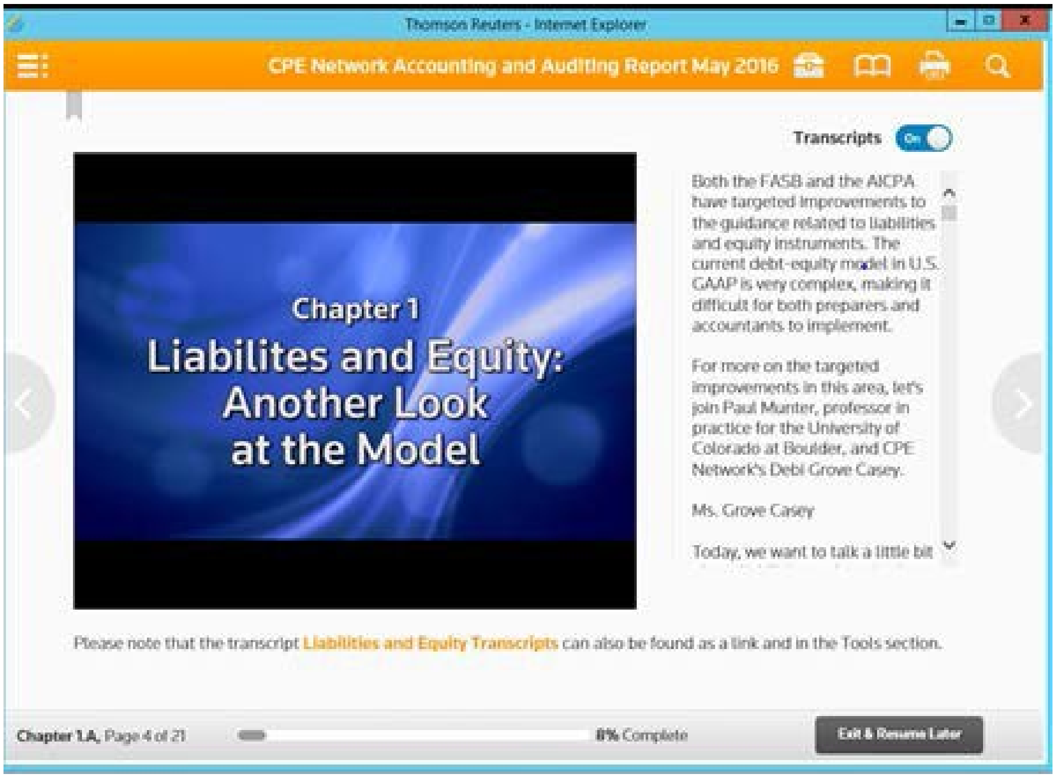
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



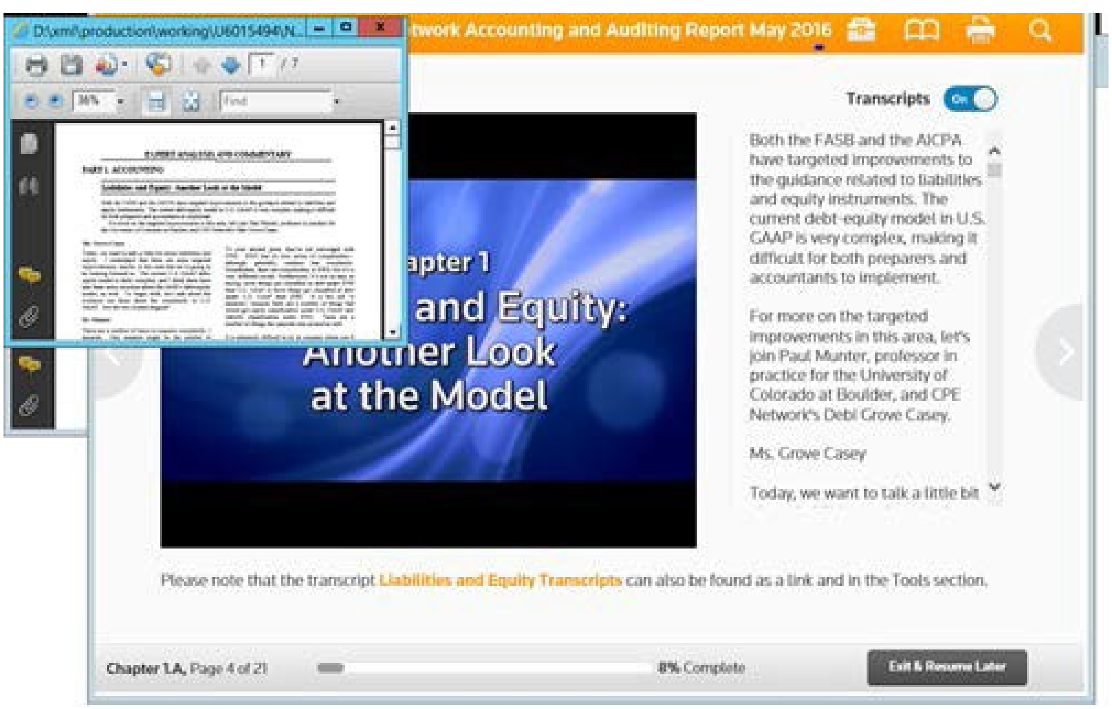
- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental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



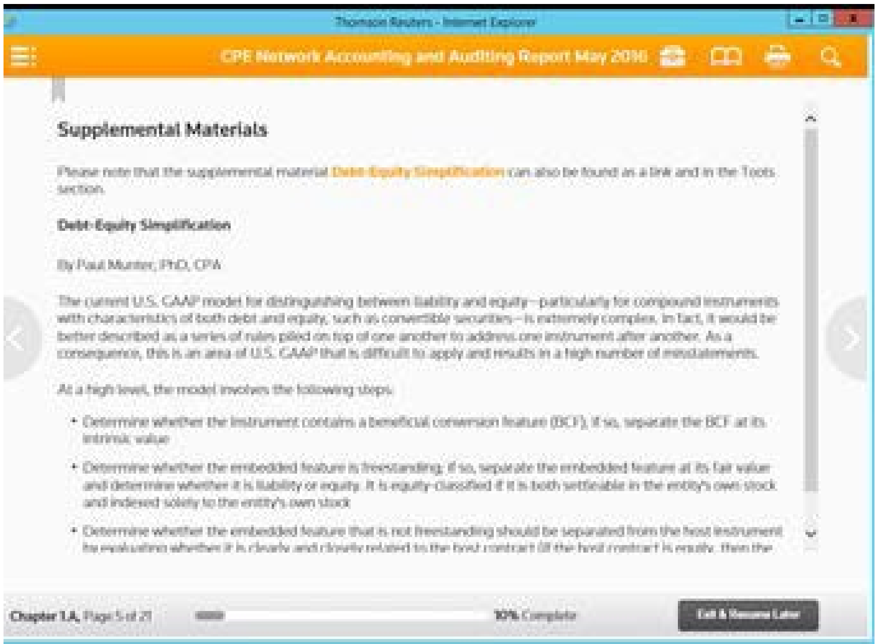
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

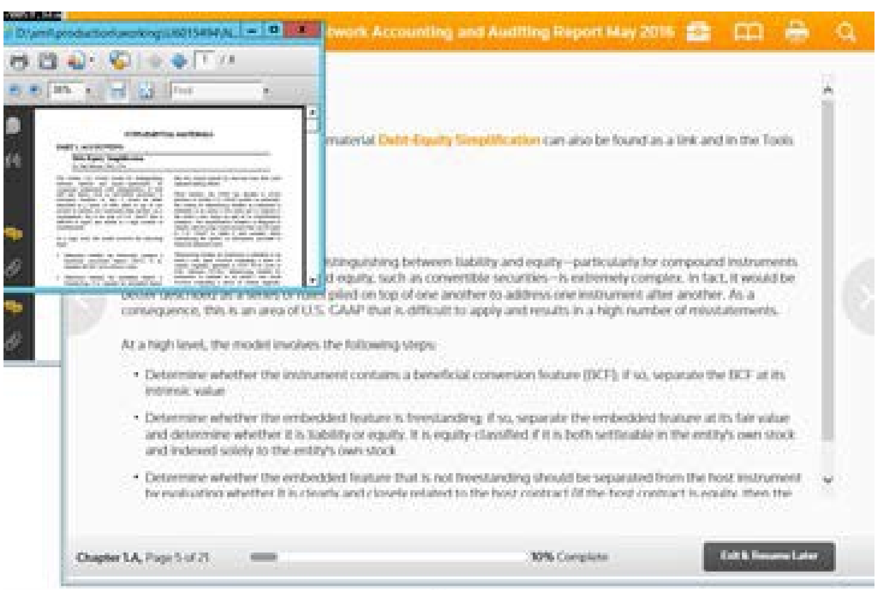


Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.



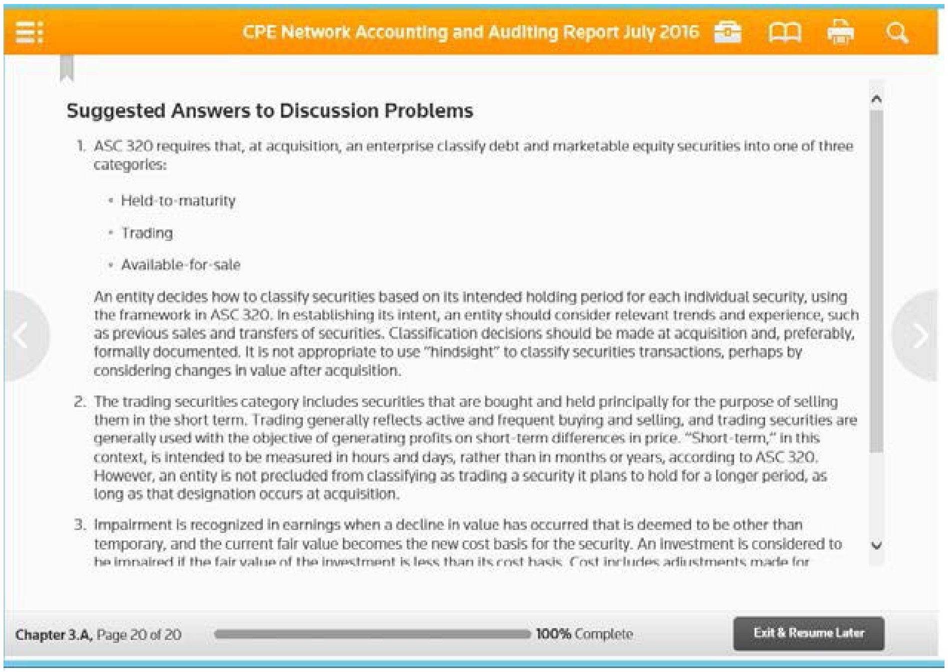
Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.





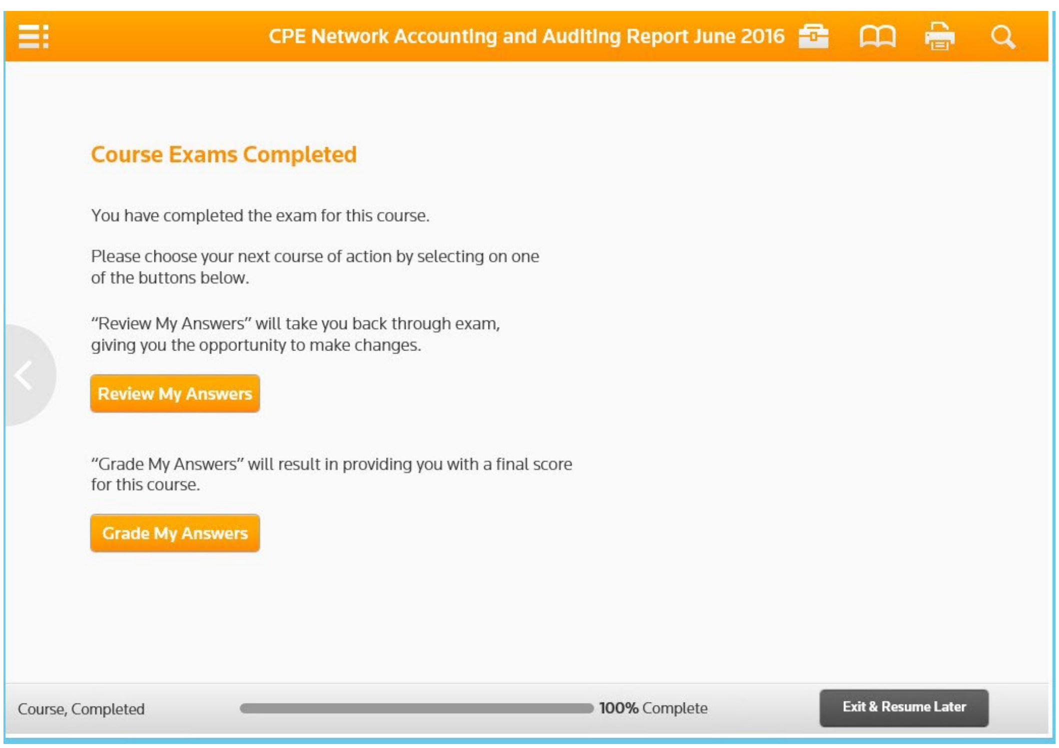
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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



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

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



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

Additional Features Search

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

Search Results are displayed with the number of hits.

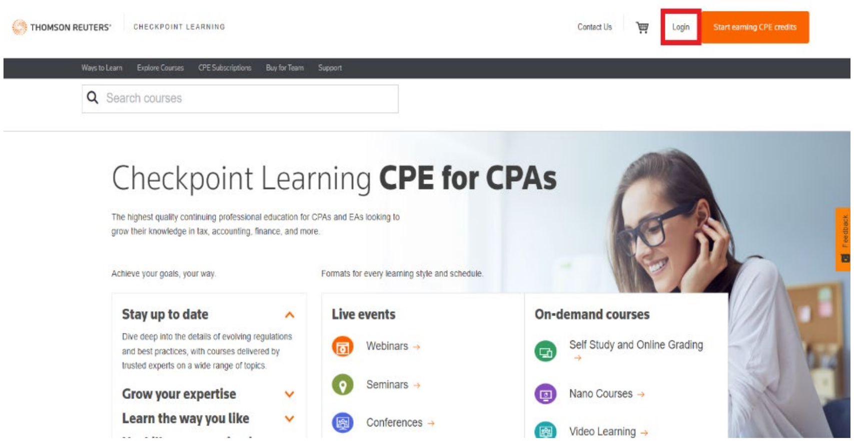
Print

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

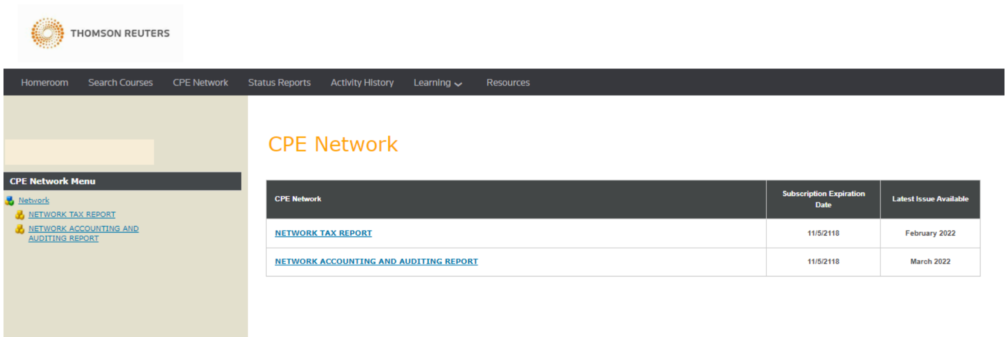
Transitioning From DVDs

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

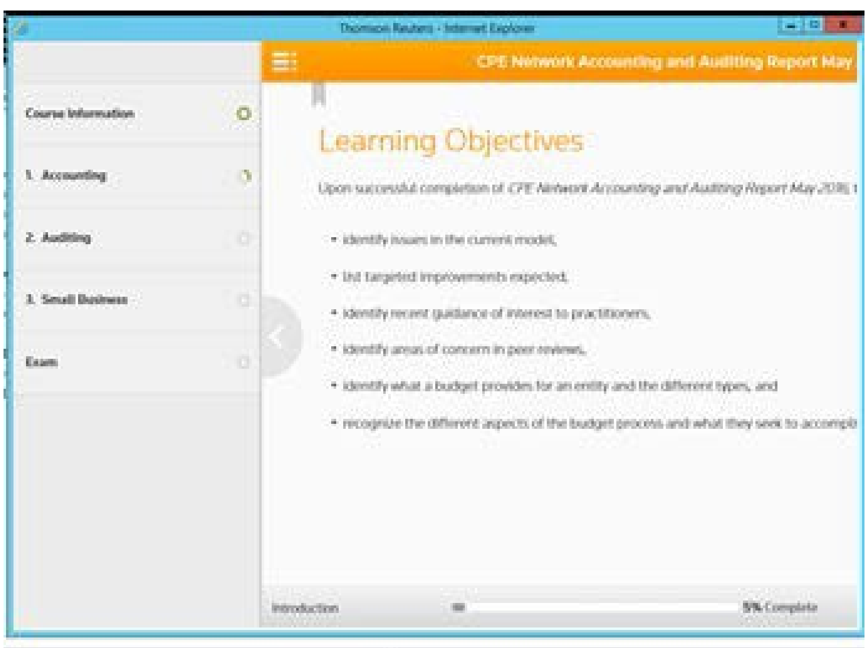
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



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

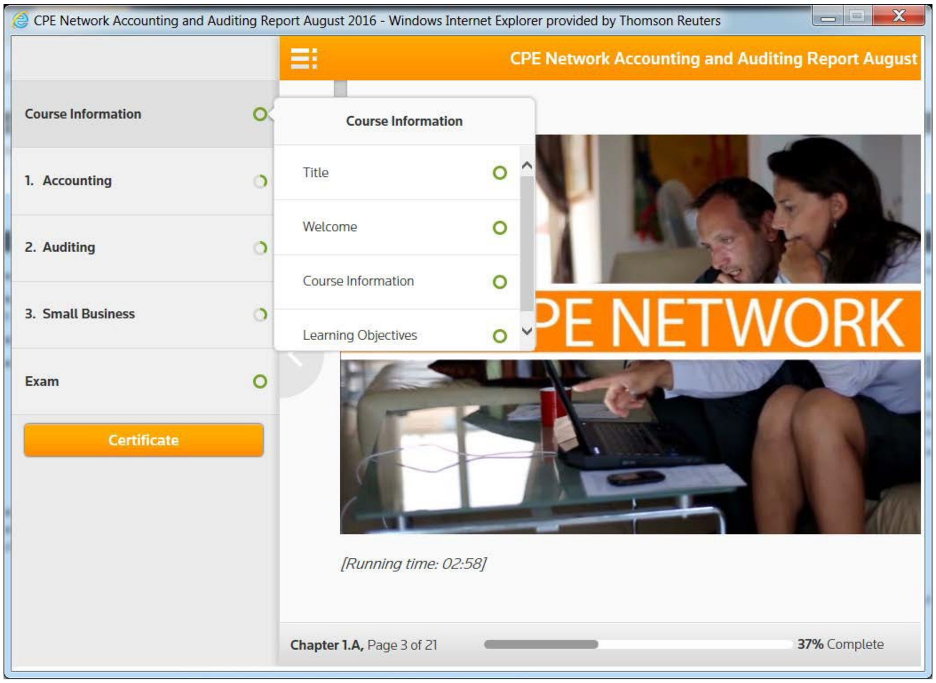


The Chapter Menu is in the gray bar at the left of your screen:

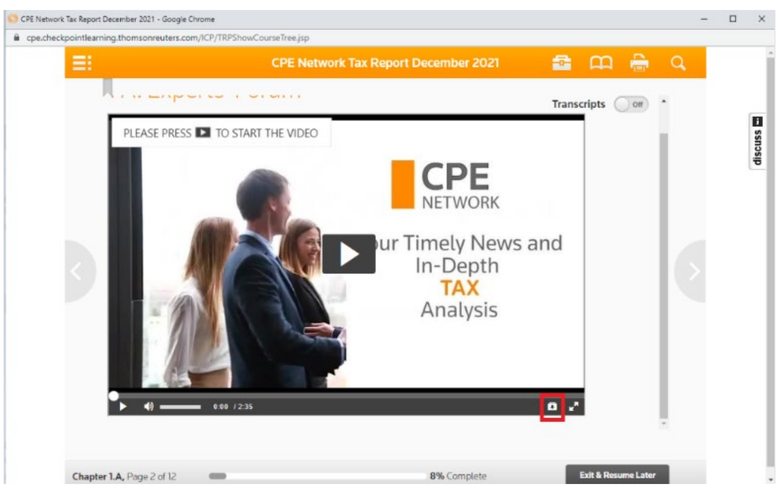


Click down to access the dropdown menu and move between the program Chapters.

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



- Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



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

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent by Checkpoint Learning CPE Customer Service.

What Does It Mean to Be a CPE Sponsor?

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

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

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

CPE Sponsor Requirements

<u>Determining CPE Credit Increments</u>

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

Program Presentation

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

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

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

Appendix: Forms

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

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

Getting Help

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

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	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.cpecustomerservice@ thomsonreuters.com	• Billing • Existing orders • Cancellations • Webinars • Certificates