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CPE NETWORK TAX REPORT

OCTOBER 2021 VOLUME 34, ISSUE 9

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- Offers in Compromise
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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

Tax is a dynamic field with constant changes and updates from the IRS, the courts, and Congress. This material highlights some of those that have occurred in recent weeks.

Learning Objectives: Upon completion of this segment, the user should be able to analyze current issues in taxation, including assessing the existence of excess benefits transactions, evaluating the benefit of filing amended returns for taxpayers who received unemployment benefits, and assessing the use of a safe harbor for employers claiming the Employee Retention Credit. [*Running time 28:47*]

PART 2. INDIVIDUAL TAXATION

There are multiple benefits available to taxpayers related to child and dependent care expenses. Practitioners should understand the various benefits and qualifications and the interplay of rules to optimize the tax benefits to the client.

Learning Objectives: Upon completion of this segment, the user should be able to analyze the treatment of child and dependent care expenses, including utilizing the child and dependent care credit, assessing whether an individual is a qualifying individual, and assessing related benefits. *[Running time 34:56*]

PART 3. BUSINESS TAXATION

When a building is constructed, purchased, or renovated, the ability to characterize expenditures as for tangible personalty rather than realty can result in great tax savings to a taxpayer and have a major impact on the financial aspects of the deal. Cost segregation has been a matter of controversy with the IRS and will generally require a cost segregation study by experts in the field. Practitioners should be aware of the advantages of cost segregation and what is generally required in order to properly advise clients.

Learning Objectives: Upon completion of this segment, the user should be able to analyze current issues in taxation, including assessing the need for a cost segregation study, evaluating the use of cost segregation in like-kind exchanges, and assessing the steps in a cost segregation analysis.
[*Running time 30:23*]

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.

Julie A. Welch, CPA, PFS, CFP is a partner/shareholder and Director of the Tax Department at Meara Brown Welch, P.C. in Leawood, Kansas. She has written numerous articles, is a co-columnist for the Journal of Financial Planning, and has co-authored a book entitled *101 Tax Saving Ideas*. She speaks nationally on tax-planning topics, has appeared on radio and television, and has been quoted in numerous publications. Julie is a member of several professional organizations including the AICPA, MSCPA, and FPA. She has over 30 years' experience advising individuals, business professionals, and their companies.

Bruce Johnson, MBA is a founding partner of Capstan Tax Strategies and works closely with commercial real estate owners, investors, and accounting firms to provide practical, creative, and client-specific solutions. As an engineer and consultant with significant experience in cost segregation, energy consulting, and capital improvement projects, Bruce understands the importance of leveraging fixed assets to enhance cash flow and meet business needs. Bruce has served as a guest lecturer, is a frequent speaker for professional organizations including the AICPA and CCIM, and conducts popular webinars that can be found on respected industry platforms. Bruce is a senior member of the American Society of Cost Segregation Professionals and an active member of the Counselors of Real Estate and the NAIOP. He holds an MBA from the University of New Haven and a BS from the Massachusetts Maritime Academy.

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PART 1. CURRENT DEVELOPMENTS

Experts' Forum

This month we join Ian Redpath for Experts' Forum, a popular feature in which we review recent developments in taxation. This month we join Ian Redpath for Experts' Forum, a popular feature in which we review recent developments in taxation. We begin with a discussion about a Tax Court Memo case involving excess benefits transactions.

Let's join Ian.

A. *Gloria Ononuju v. Commissioner,* TC Memo 2021-94

Health Insurance Payment Not Subject to Excess Benefits Transaction Tax

Mr. Redpath

Hi, I'm Ian Redpath with Network Tax. This is the segment that we go over changes since the last time we spoke, changes from the IRS, the courts. As we know, the law is constantly changing. Let's just jump right in and look at some of the changes that maybe we should look at if they relate to any particular type of client that we have.

Let's start right in with a Tax Court memo case, Ononuju, O-N-O-N-U-J-U. What happened here, and this is something to be aware of, is that the IRS is looking significantly at what they call excess benefit transactions. In this particular case, the doctor set up a not-for-profit to provide medical services to lower income people. He was an employee; his wife was the secretary-treasurer. The IRS actually attacked this because he was receiving health benefits. They also went after some checks, upwards of $15,000, that the wife had cashed, or I'm sorry, $15,000 in one year, it was 130,000 for the two years in two different checks.

The IRS said, "Those are both excess benefits." This is an area that they're going after. I've had a couple of cases in this area where the IRS has gone after this excess benefit. So it's something to really watch out for if you have not-for-profit organizations that may have a situation where someone can take a benefit that's in excess of what they receive. And so in this particular case, the IRS said, "Well, as an employee, he's receiving health care, he's providing services. That would be a normal payment." The excess benefit to the spouse, they said, "You can't show what happened with those checks. And so therefore the benefit, the money, is far in excess of the value you gave to the organization." And this is really what it is. So they said, "Absent you being able to show where these funds went to on behalf of the organization, we're going to say that they came to you. And, by the way, that's an excess benefit." Well, there's huge excise taxes on excess benefit transactions.

A couple of areas where you have to watch out for. Things like booster clubs. I've had a couple of cases where the IRS has gone after booster clubs. Here's a typical type of thing. They sell candy, and then let's say that the cost of going to whatever events they're going to, or the cost of participating, it's, let's say, $5,000 a year. I'm just picking a number. They're going to do a lot of traveling. And so the $5,000 they hold, let's say, candy sales or different types of sales for fundraising. And here's what a lot of organizations do is they'll say, "Okay, here's the cost per person, and whatever you sell gets applied against your cost. You only have to pay the difference." Of course, if you raised everything, then you would go for free, and that excess then would be used into the general fund.

That's an excess benefit transaction. The IRS has been clear about that in going after booster clubs. Most national organizations or those types do tell you. The band boosters, the cheerleaders, these types of things, they say, "Don't get engaged in those because that's an excess benefit." What should happen is everything goes into the pot and you thank the people who worked hard, but everything goes in and it is then shared by everyone else. The other problem you have with most small organizations is often, it is one of the people who is on the board that can be participating in excess benefits. So you've got to watch out for those things. So watch out for excess benefit transactions.

The case I had was a museum; and they gave the guy a gift of a trip for him and his wife. The IRS said it was taxable. We settled that by just picking it up into his income. So, that's how we settled. We just said, "He'll pick it up into income. They'll take a deduction, but it's not an excess benefit." And the IRS even agreed that it would still constitute a reasonable compensation. Even adding that in would be still considered reasonable. We argued that it was still reasonable comp, and so therefore it can't be an excess benefit. But anytime you have unreasonable comp, you're opening yourself up to an excess benefit claim.

Of course, with the wife, she couldn't provide that she provided anything. And so therefore, if she can't show she provided anything, where those payments went, they said, "That's income to you."

B. Chief Counsel Advice 202130014

Charitable Contribution Deductions/Easements

Another tax exempt, and this is a problem, watch out, but we have Chief Counsel Advice 202130014. Now, conservation easements, you can donate a facade, you can donate open space. You can donate that, "We're not going to build higher. This is a historic structure." There's all sorts of things that qualify other than just the environment, conservation for the environment purposes. There's a lot of litigation, and the IRS, it's a strict compliance. You better dot your Is, cross your Ts. By the way, the courts have pretty much applied the same thing and said, "You know what? We're going to look very strictly at the statutory language here, and you better have everything covered exactly."

One of the areas is the idea of in perpetuity and then the extinguishment. What happens at the end if the purpose is no longer valid and there's no reason to pursue that purpose anymore? What happens here is this conservation easement, the IRS said, "Well, you can have an extinguishment." Generally, the rights say it has to be by court action. It can't just be by the terms, because if it's by the terms, it's not in perpetuity to the conservation. Basically, in this case, they said on extinguishment then, they would get significantly less. The IRS said, "Whoa. Can't do that." Because if it ever does get extinguished, and generally that's only by a court, they're supposed to get, the charity, the same value of the proceeds, the net proceeds, as the value was to the value of the whole when it was contributed. So, that percentage has to be kept track of, and it stays going straight through.

Watch out for these. The IRS has put them on listed transactions for reporting purposes. So if you have a client that comes in, the IRS has said, if it provides tax benefits that in essence the return is greater than 2.5% or 250%, I'm sorry, if it's triple, if you're getting 300%, so anything more than 250% is suspect, and the IRS is going to be looking at those. The IRS is going after syndicated. In 2019 and in 2020 in their Dirty Dozen of tax schemes, they put in syndicated conservation easements. The IRS came out not too long ago and said, "Any cases that are currently pending in Tax Court, here's how we'll settle them," and they set out their settlement information. And so we have a guide that we can look to. But again, watch out for conservation easements there. The documentation to even qualify to get one, tremendous benefits, you get a 15-year carryover, 50% rather than 30% of AGI, 100% if you're a farmer or rancher. So there's some great benefits. But again, when a client comes in, make sure that you remember that.

C. *New World Infrastructure Organization v. Commissioner,* TC Memo 2021-91

Exempt Organizations—Solely Owned Organizations—Private Inurement

New World Infrastructure organization is another warning in the not-for-profit area. And so what happened here is New World Infrastructure, this was a couple, they tried to set up a 501(c)(3) that essentially was doing the same thing they were doing, some engineering design. And they said, "It doesn't matter. You don't qualify for 501(c)(3) simply because the government might benefit." And they said, "Well, the government might benefit due to reduced costs." And they said, "That's not what a 501(c)(3) for scientific purposes... It doesn't qualify. And, oh, by the way, this is the exact same business, and the same couple involved in doing the same business that you were doing as a for-profit. Now you want to do it for as a not-for-profit. And one of the reasons is to get additional funding that you didn't qualify for. It kind of looks like it's not a 501(c)(3). It was just your trade or business that you're trying to claim that it's a charity. Well, it's not," and it didn't qualify. Just basically they said, "This is essentially the same entity. And so therefore it is a for-profit. It's not a not-for-profit."

D. IR-2021-159

Unemployment Benefits—Special Rule for 2020

IR-2021-159, the unemployment benefits. You might want to look at this because the IRS… said, "We're going to return. You don't have to file anything because we'll go back and we'll exclude the unemployment benefits for 2020. And so we'll just take it off and recalculate the tax." They didn't want amended returns. But you ought to look at amended returns because by taking it out, it reduces AGI. Now, does that affect various thresholds? How does that impact the return? It could impact the return in a lot of different ways. And so I've always recommended, look at an amended return first and file the amended return regardless of what the IRS says. The IRS has now come out in this notice and they've essentially listed a number of transactions that they say, "If you've got these, you should file an amended return." So you might want to look at that to make sure you check on it.

E. IR-2021-170

Security Summit Alerts Tax Professionals Regarding Identity Theft

The next one is really interesting, IR-2021-170, but certainly I think it's something you might want to look at. It's really a plea from the Security Summit to tax professionals saying, "Hey, look, you're targets. And also, you need to work with your clients about possible targeting." They came out with five critical signs of a possible security breach. The client e-filed returns are rejected because the social security number has already been used on another return. More e-file acknowledgements are received than returns. You should check and make sure that the number of returns that are filed on your e-filing, check on your taxpayer ID, your PTIN number, and find out, make sure that there aren't a lot more returns being filed than you believe you filed. Clients responded to emails from tax professionals, but they weren't sent by you. Slower, unexpected computer or network responsiveness, or being unexpectedly locked out of your computer. Those are what they say the five signs that you've had a security breach. Again, you might want to read this just to keep yourself up on it. They also believe possible security breaches can come from clients when they receive, for example, authentication letters like the 5071C or 4883C even though they have not filed a return. They haven't filed for a refund even though they didn't file a return. They get a transcript that they didn't expect. They get emails or calls from the tax professional that they didn't initiate. Notices that someone created that look like the IRS account and asking for consents. These are all signs that we should be careful of. You may want to look. They also talk about what you should do; and it does tell you that if you believe that you've been a victim of identity theft, you should contact the IRS Stakeholder Liaison and then report it to the Federation of Tax Administrators, which is at statealert@taxadmin.org.

F. wi-21-0821-1042, Advance Child Tax Credit (CTC)

Internal IRS Memo—Additional Child Tax Credit Issues

We have an internal memo from the Internal Revenue Service. This internal memo is WI-21-0821-1042. This gives us just some additional information and clarifies a lot of issues with the child tax credit and clarifies who actually qualifies. But it really goes into a clarification of what to do and how to report if you're going to be using the prior year. Remember that if you're using the prior year, that can also be used for the earned income tax credit. What this does is it basically says that you should enter the term PYEI, previous years earned income, and you should write that in the line next to where you're claiming it. So we're using previous years taxed income.

G. IR-2021-167, Rev. Proc. 2021-33, 2021-34 IRB

Safe Harbor for Employers Claiming Employee Retention Credit

We have a safe harbor then, and the safe harbor essentially provides items, and this is IR-2021-167 and Rev. Proc. 2021-33. Basically, it provides a safe harbor for employers that are claiming the Employee Retention Credit. It also says you can exclude certain items such as the forgiveness on a PPP loan, Shuttered Venue Grant, the Restaurant Revitalization Grants. They can be excluded. Then, it provides a number of other issues related to the Employee Retention Credit. For example, an employer that elects the safe harbor can exclude those amounts from gross receipts; but it says, "Hey, only for this purpose." And the amounts are by quarter. So, the amounts that you exclude above the amounts per quarter are relevant then in determining the eligibility for the Employee Retention Credit. Then again, and here's the one, if you're considered under the aggregation rules a single employer, then everyone has to elect the safe harbor.

H. IR-2021-172

2022 Compliance Assurance Program

For large corporations, if you do any public work, if it has $10 million in assets, it has to file the 10K, the 8K, the 10Q, and they're not under investigation, the IRS has now opened up under IR-2021-172. They have opened up participation; and the application is only until November 1, 2021, to enter into the CAP program, which is essentially the Compliance Assurance Program. Essentially, you work with the IRS to settle matters to resolve the issues before a tax return is filed. So again, if you have any corporations that fit that, then you should check into it.

I. *Deborah C. Wood v. Commissioner,* TC Memo 2021-103

Foreign Earned Income Exclusion—Physical Presence, Tax Home

The next one's a really interesting case. This is an individual who is a defense contractor, *Deborah Wood versus the Commissioner*. It's a Tax Court memo case. What happened here is that Deborah is a defense contractor. She was working at an unnamed air base in Afghanistan. She was not allowed off base. She was not allowed, essentially. She couldn't go and set up a bank account. She couldn't go and worship. She couldn't belong to any local clubs. Essentially, she couldn't do anything. She wasn't allowed off the base. She did meet the requirements in order to take the foreign earned income exclusion. Except the question was really, what was she doing there? And did she establish that as her home?

Essentially, the Tax Court looked at it and said, "Hey, look, that base essentially is her home, and we can't, because she's restricted, we can't limit the idea of the intent." And the intent, she had a place which was basically empty here in the States. She had bank accounts in the States, but those were because she couldn't do the banking there. And this was to facilitate the payment because she was being paid by a U.S. company, and it was just to facilitate the payment itself. She counted the Afghan colleagues as some of her closest friends. She didn't have a lot of connection back to the U.S. And the court said, "Hey, look, this qualifies. Essentially, this is her tax home; and she does qualify, then, for the earned income exclusion. She is a bona fide resident."

J. *Jessica Lynn Grady a.k.a. Jessica Lynn Gans v. Commissioner,* TC Summary Opinion 2021-29

Equitable Innocent Spouse Relief

This Grady case… Grady is a Tax Court summary opinion 2021-29. But it's interesting because, essentially, they set forth a number of factors to be looked at. They said, "Number one, she qualifies under the 'inequitable to hold her liable,' even though her husband filed a return and… 30 days later,… he asked for an installment agreement, which he then didn't pay." And she filed for innocent spouse. They said, "Well, it's not just limited, but the factors that marital status, economic hardship, knowledge or reason to know," notice that's only one, "significant benefits received, subsequent compliance with the tax laws, and mental or physical health." And again, Rev. Proc. 2013-34 says that not one factor is overriding. And so essentially, what happened here is even though, again, as I said, within 30 days he had filed, they said she had no reason to believe they wouldn't be paid, and even though she knew they weren't paid, but that he was going to do an installment agreement.

K. Form 8992 (rev. December 2020)

IRS Clarifies Instructions for GILTI Calculation Form

If you do any international work, the Global Intangible Low-Taxed Income or GILTI, the Form 8992 has been revised and we have clarified instructions. This is the main thing is that the instructions have been clarified. And so, if you have a situation where you have an 8992, then you may want to look at the revised instructions, the changes for any tax year beginning in 2020. So, they're retroactive. Again, you may want to look at those.

L. IR-2021-171

IRS Updates, Improves Child Tax Credit Update Portal

So IR-2021-171, the IRS has said they've updated the portal. So there's more information, more things we can do, like have our clients switch from paper to direct deposit, change the account for direct deposit, verify their eligibility for the additional child tax credit, change their address, or opt out of receiving payments for the rest. So again, the portal has been updated.

M. Notice 2021-51, 2021-36 IRB

IRS to Defer Applicability Date of Foreign Partnership Withholding Regs

If you have any foreign partnership withholding issues, the regs were supposed to come into effect and to be effective as of January 1. The IRS has pushed this off and issued Notice 2021-51 that says they intend to amend the regs and to defer the application to January 1 of 2023.

N. Clarification Concerning Completion of Tax Year 2020 Form 1118, Schedule D Clarification for S Corp Shareholders

The IRS website has been updated for clarification concerning completion of a 2020 Form 1118, Schedule D; and this would be foreign income taxes, essentially, or foreign deemed income taxes paid. This is providing clarification if you're an S corporation filing a 2020 return.

O. *Alexander B. Wathen v. Commissioner*, TC Memo 2021-100

Unreported Income—Reconstruction of Income

An interesting case, *Wathen versus Commissioner*. Wathen is a taxpayer but also a bankruptcy attorney, and this is a Tax Court memo case. What happened here is that the IRS came in and reconstructed his income and used the bank deposits method, which if you've gone through audits, you know that's very common. And the court agreed that was an acceptable method. He obviously challenged it. He also challenged the disallowance of deductions on his office and also travel expenses. The court just simply agreed with the IRS. He didn't provide any substantiation, again just saying, "Here's a receipt, but it doesn't relate to anything." He would file court notices, for example, as if somehow that justified any expenses he might have. So, again, the court denied that.

P. *Today's Health Care II LLC v. Commissioner*, TC Memo 2021-96

Business Deductions—Illegal Drug Sales—Medical Marijuana

If you have any cases involving drugs, people selling marijuana, remember that the federal government still says that it's a controlled substance. And so in *Today's Healthcare LLC versus the Commissioner*, a Tax Court memo case, the court, again, upheld that drug trafficking, trafficking in a controlled substance, that even though it's legal under state law, it's still illegal, and that provision did not violate the Constitution. It was not unconstitutional under the 8th or 16th Amendments. And so, therefore, they said, "The limitation on deductions, essentially cost of goods sold, at the federal level, that is still going to apply."

Q. Declaring Bankruptcy—Individual Taxpayers

Now, on the IRS website, we have a provision declaring bankruptcy, again, kind of an FAQ on things you should know, because it is really important that you understand the role of taxes and what taxes can be discharged. One of the things, this happened where we had a client come in and they had gone through bankruptcy, and the IRS was trying to collect. And literally, the bankruptcy attorney had filed two days too early, and so therefore those taxes were non-dischargeable. So, really something to be very, very careful on. But that's really a very good case for you to look at. Again, the IRS updated its website as it relates to that. So it's IRS on their webpage, declaring bankruptcy.

R. IR-2021-166

Security Summit Warning—Pandemic-Related Email Schemes

The Security Summit is warning again [about] email scams going after tax professionals. Usually, the scam is the email that says, "Information on a new client." There's a bunch of attachments, "Here's my prior returns." You open them up, and now you've got a Trojan inside your computer. So, be very careful.

S. Employee Plans News: Plans Retroactively Adopted After End of Plan Year Have No 2020 Form 5500 Filing Requirement

One interesting thing, the Employee Plan News. The IRS, in an email newsletter, the IRS reminded employers that they do not have to file the 2020 Form 5500 series if they retroactively applied for their plan, so the retroactively adopted plans that were allowed.

T. IRS Practice Unit: Penalty for Failure to Include Reportable Transaction Information with Return

Then the IRS Practice Unit, and again, this is on the IRS website, this is something you might want to look at if you're not that familiar with reportable transactions. And one of those we've already mentioned, listed transactions, syndicated conservation easements, and then there's a whole series of others, loss transactions, that require reporting. And so again, I would refer you to the IRS Practice Unit.

Well, thanks for joining me today. A lot of interesting changes going on, a lot of things with the courts. The IRS, they always keep us going. Please be safe, and we'll see you next month.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. *Gloria Ononuju v. Commissioner,* TC Memo 2021-94

The Tax Court held that a health insurance payment for insurance on a tax-exempt organization's employee and family (family coverage that included the wife who was the organization's treasurer) was not an excess benefit transaction and thus not subject to the §4958 excess benefit transactions tax. However, bank withdrawals that the treasurer took, and which the organization did not contemporaneously substantiate, were excess benefits.

IRC §4958 imposes an excise tax on excess benefits received by a "disqualified person" as a result of an excess benefit transaction. An "excess benefit transaction" is "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration, including the performance of services, received for providing such benefit." A disqualified person includes treasurers of a tax-exempt organization. An economic benefit is not treated as consideration for the performance of services unless the organization clearly indicated its intent to so treat such benefit with written substantiation that is "contemporaneous with the transfer of the economic benefit at issue." [Reg. §53.4958-4(c)(1)] This is sometimes referred to as the contemporaneous substantiation requirement. This is not required if it is an excludable benefit.

Dr. Ononuju created a tax-exempt organization to provide medical services to needy people in Saginaw, MI. His wife, Ms. Ononuju, was on the board of directors and was secretary and treasurer of the organization. Dr. Ononuju was an employee of the organization and provided medical services. The organization provided health insurance for the doctor and his family. In addition, Ms. Ononuju received checks totaling $27,000 from one of the organization's accounts and $88,000 from another of its accounts. She claimed she distributed the $88,000 to needy people in Saginaw, but provided no documentary evidence of how the money was spent. The organization did not provide written substantiation of the health insurance payment or the bank withdrawals.

The Tax Court found that the organization was an "applicable tax-exempt organization" and that Ms. Ononuju was a disqualified person. Then the Court found that the checks were an excess benefit to Ms. Ononuju since she provided no evidence of how she actually used the money.

But the Court found that the health benefits were not excess benefits and that the benefits were properly "excluded from the disqualified person's gross income for income tax purposes." Thus, the organization was "not required to indicate its intent to provide an economic benefit as compensation for services."

B. Chief Counsel Advice 202130014

A conservation easement deed that decreased the portion of proceeds required to be allocated to donee upon extinguishment under Reg. §1.170A-14(g)(6)(ii) would cause easement to fail §170(h) requirements unless state law provided that donor was entitled to full proceeds from above. This is under the so-called extinguishment regulations. Additionally, the CCA provides model language to be used related to the "in perpetuity" requirement.

C. *New World Infrastructure Organization v. Commissioner*

TC Memo 2021-91

A charitable infrastructure organization founded by a married couple as successor to a for-profit business—with intent of researching, building, and placing in service prototype pipe production machinery that would ultimately benefit the government through cost savings and economic development—did not qualify as exempt under §501(c)(3). The organization was not a scientific organization since design and construction of prototype machinery are activities excluded from the scientific research definition under Reg. §1.501(c)(3)-1(d)(5). It appeared that the organization was merely a front for the predecessor corporation whose benefits would inure to individual founders in violation of Reg.§1.501(c)(3)-1(d)(1), since it appears the founders filed for exemption to assist in soliciting tax deductible donations and secure funding which predecessor was unable to obtain. It was essentially the same business.

D. IR-2021-159

IRS announced that it will be issuing the fourth round of automatic refunds this month to people who filed their 2020 returns reporting unemployment compensation as income before recent changes made by the American Rescue Plan Act of 2021, which allows taxpayers who earned less than $150,000 in modified adjusted gross income to exclude unemployment compensation up to $20,400 if married filing jointly and $10,200 for all other eligible taxpayers. While this refund is automatic, the IRS listed several scenarios where taxpayers might need or want to file an amended return because they would now be eligible for deductions or credits not claimed on their original return.

Taxpayers **should** file an amended return if they:

- did not submit a Schedule 8812 with the original return to claim the Additional Child Tax Credit and are not eligible for the credit after the unemployment compensation exclusion;
- did not submit a Schedule EIC with the original return to claim the Earned Income Tax Credit (with qualifying dependents) and are now eligible after the unemployment compensation exclusion;
- are now eligible for any other credits and/or deductions not mentioned below. Make sure to include any required forms or schedules.

Taxpayers **do not need to** file an amended return if they:

- already filed a tax return and did not claim the unemployment exclusion; the IRS will determine the correct taxable amount of unemployment compensation and tax;
- have an adjustment, because of the exclusion, that will result in an increase in any non-refundable or refundable credits reported on the original return;
- did not claim the following credits on their tax return but are now eligible when the unemployment exclusion is applied: Recovery Rebate Credit, Earned Income Credit with no qualifying dependents or the Advance Premium Tax Credit. The IRS will calculate the credit and include it in any overpayment;
- filed a married filing joint return, live in a community property state, and entered a smaller exclusion amount than entitled on Schedule 1, line 8.

E. IR-2021-170

The Security Summit—a partnership between the IRS, state tax agencies, and the tax industry—has concluded its five-week campaign dubbed "Boost Security Immunity: Fight Against Identity Theft" with a plea to tax professionals to watch for telltale signs of identity theft. One common refrain the IRS hears from tax professionals reporting data theft is that they did not immediately recognize its signs, the agency said. It stressed that a heightened awareness of clues suggesting possible identity theft allows tax professionals to react quickly to protect clients.

Tax professionals are urged to watch out for the following five critical signs of possible security breaches: client e-filed returns are rejected because the client's Social Security number was already used on another return; more e-file acknowledgements are received than returns filed by the tax professional filed; clients responded to emails the tax professional did not send; slow or unexpected computer or network responsiveness; or being unexpectedly locked out of a network or computer.

The IRS stressed that if a tax professional or his/her firm becomes a victim of identity theft, they should immediately report it to their local IRS Stakeholder Liaison. In addition, a report should be sent by email to the Federation of Tax Administrators at statealert@taxadmin.org.

F. wi-21-0821-1042, Advance Child Tax Credit (CTC)

In an internal memo, the IRS has clarified some issues regarding the Additional Child Tax Credit (ACTC). The issues include:

1. Certain individuals are entitled to the additional CTC if they get less than the full amount of the CTC. The additional CTC may result in a refund even if no tax is owed.
2. To be a qualifying child for the CTC, the taxpayer must claim the child as a dependent and the child's Taxpayer Identification Number (TIN) must be reported on the taxpayer's tax return.
3. There are special rules for taxpayers claiming a religious (e.g., Amish/Mennonite) or conscience-based objection to obtaining a TIN for themselves and their children. [See Internal Revenue Manual (IRM) 21.6.1.6.1.]
4. For tax years after 2015, taxpayers who file Form 2555, *Foreign Earned Income*, cannot claim the additional CTC.
5. If a bona fide resident of Puerto Rico has U.S. government wages, they cannot exclude those wages under Code Sec. 933, which applies to income derived from sources within Puerto Rico. Such taxpayers must file Form 1040 or Form 1040-SR and use Schedule 8812, *Additional Child Tax Credit*, to claim the additional CTC.
6. For 2018 and 2019, taxpayers affected by a disaster may elect to use their prior-year earned income when calculating the additional CTC. Generally, to use prior-year earned income (PYEI), the taxpayer's main home must have been in a Presidentially declared disaster that occurred in 2018 or 2019.
7. For 2020, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (PL 116-260) allows taxpayers to figure their additional CTC using their 2019 earned income if it is more than their 2020 earned income.

Taxpayers should enter "PYEI" and the dollar amount of their 2019 earned income on the dotted line for additional CTC. Taxpayers electing to use PYEI when figuring their 2020 ACTC and who also claim the EITC may also elect to use PYEI when figuring their 2020 EITC, but they are not required to do so.

G. IR-2021-167, Rev. Proc. 2021-33, 2021-34 IRB

The IRS has provided a safe harbor for employers claiming the Employee Retention Credit (ERC). This safe harbor allows employers to exclude certain amounts from their gross receipts when determining their eligibility for the ERC.

Rev. Proc. 2021-33, allows employers to exclude the following amounts from gross receipts:

- The amount of the forgiveness of a Paycheck Protection Program (PPP) Loan;
- Shuttered Venue Operators Grants under the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act; and
- Restaurant Revitalization Grants under the American Rescue Plan Act of 2021.

The revenue procedure points out that, absent the safe harbor, these amounts would be included in gross revenue. An employer electing this safe harbor:

- may exclude the above amounts from gross receipts *only* to determine whether it is an eligible employer for a calendar quarter for purposes of claiming the ERC on its employment tax return.
- must exclude the above amounts from their gross receipts for each calendar quarter in which gross receipts are relevant to determining their eligibility to claim the ERC.
- must also apply the safe harbor to all employers treated as a single employer under the aggregation rules.

This safe harbor does not permit the employer to exclude the above items from gross receipts for any other federal tax purpose.

H. IR-2021-172

The IRS will open the application period for the 2022 Compliance Assurance Process (CAP) program on September 1, 2021. The application period will run through November 1, 2021. CAP is a voluntary real-time issue resolution program for large corporate taxpayers. The goal of CAP is to resolve tax issues before the taxpayer files a return. To *apply* for CAP, new applicants must:

- Have assets of $10 million or more;
- Be a U.S. publicly traded corporation with a legal requirement to prepare and submit SEC Forms 10-K, 10-Q, and 8-K; and
- Not be under investigation by, or in litigation with, any government agency that would limit the IRS's access to current tax records.

For the 2021 and 2022 CAP Years, the IRS modified the requirement of "one filed" to allow "two filed" open returns.

General program information and the 2022 application details are available on the CAP webpage.

The IRS will inform applicants in February 2022 if they are accepted into the program.

I. *Deborah C. Wood v. Commissioner,* TC Memo 2021-103

Taxpayer was largely entitled to IRC §911 foreign earned income exclusion for wages she earned while employed as a defense contractor on a U.S. military base in Afghanistan for a number of years. Taxpayer met bona fide resident test as to all but one year at issue with proof that, among other things, she intended to work in Afghanistan as long as options to do so existed, repeatedly turned down job offers in U.S., worked a demanding schedule in Afghanistan that demanded her presence on base, and fully assimilated into her community on base, although she was not allowed to leave base to be part of the local community. Also, while she was not a bona fide resident for the last year, she met the physical presence test for that year, but adjustment was required to account for discrepancy with her calendar taxable year. Finally, she met tax home test as to all years when considering that, although she had a U.S. driver's license, such was condition of her employment; that although she had U.S. bank account, such was necessary to enable her employer to make direct deposit of her paychecks; that opening local bank account or buying property in Afghanistan would have been impracticable if not impossible given requirements of her security clearance and ban on leaving base; that she worked 12 hours per day with half-day off only every 14 days; that she had limited family and personal ties to the U.S.; that her house in the U.S. was unoccupied and did not require her to manage any tenants; and that she counted her Afghanistan colleagues as her close friends.

J. *Jessica Lynn Grady a.k.a. Jessica Lynn Gans v. Commissioner,* TC Summary Opinion 2021-29

The Tax Court held that, both for a tax year with respect to which a wife *didn't* know her joint return taxes weren't being paid by her husband, and for several years with respect to which she *did* know her joint return taxes weren't being paid, the wife was entitled to equitable innocent spouse relief.

The IRS's guidelines for determining whether to grant §6015(f) relief are found in Rev. Proc. 2013-34, 2013-43 IRB 397. If certain threshold conditions are met, then the IRS will relieve the requesting spouse of liability if either (1) three additional conditions for so-called "streamlined" relief are met, or (2) relief is justified upon consideration of multiple equitable factors. The Court concluded that Ms. Gans qualified for streamlined relief in 2006, noting that Ms. Gans was no longer married to Mr. Dickey when the IRS issued its final determination and Ms. Gans would suffer economic hardship if relief was not granted. A requesting spouse will suffer economic hardship if payment of part or all of the tax liability "will cause the requesting spouse to be unable to pay reasonable basic living expenses."

Ms. Gans did not have reason to know that Mr. Dickey would not pay the 2006 joint federal income tax liability. When the couple filed their 2006 joint federal tax return, Mr. Dickey requested an installment agreement within 30 days after the return was filed that would apply to the 2006 tax liability. Therefore, when Ms. Gans signed the 2006 joint federal income tax return, she did not know or have reason to know that the underpayment would not be paid.

As to the other tax years in question, the Court held that each of the factors weighed in favor of relief other than the knew-or-had-reason-to-know factor. The Court looked to the same factors as in determining that she met the economic hardship test. And the Court noted that the "significant benefits" test weighed in her favor—she did not receive a significant benefit from the failure to pay the outstanding tax liabilities.

K. Form 8992 (rev. December 2020)

The IRS has clarified the instructions for Form 8992, *U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI)*, effective for tax years beginning in 2020. The IRS has clarified that a domestic partnership is not required to attach a Form 8992 with a completed Schedule A to its Form 1065, *U.S. Return of Partnership Income*, if the partnership is a U.S. shareholder of a CFC only by reason of applying the downward attribution rules in Code Sec. 318(a)(3). In addition, the IRS has clarified that a domestic partnership that is a U.S. shareholder of one or more CFCs is not required to attach a Form 8992 with a completed Schedule A to its Form 1065 if the partnership knows that no direct or indirect owner of the partnership (other than another domestic partnership) is a U.S. shareholder.

L. IR-2021-171

The IRS has updated its Child Tax Credit (CTC) Update Portal. Families receiving monthly CTC payments can now update their mailing address using the Portal. Address updates made through the portal by midnight Eastern Time on August 30 were to apply to the September 15 advance CTC payment.

In addition to changing their address, advance CTC recipients can use the CTC Update Portal to:

- Verify their eligibility for the advance CTC;
- Switch from receiving a paper check to having the payment direct deposited;

- Change the account where their payment is direct deposited; or
- Opt out of receiving monthly payments for the rest of 2021.

Qualified taxpayers receiving their advance CTC payment via paper check should use the CTC Update Portal to change their address if they move. Qualified taxpayers receiving their advance CTC payment by direct deposit may also use the CTC Update Portal to change their address.

M. Notice 2021-51, 2021-36 IRB

The IRS has issued a notice announcing that it intends to amend regulations under §1446(a) and §1446(f) to defer the applicability date to January 1, 2023 (from January 1, 2022) for certain provisions relating to: (i) withholding on transfers of interests in publicly traded partnerships; (ii) withholding on distributions made with respect to PTP interests; and (iii) withholding by partnerships on distributions to transferees. Before the issuance of these amendments, taxpayers may rely on the provisions of the notice regarding the modified applicability dates. The notice says that before the issuance of these amendments, taxpayers may rely on the provisions of the notice regarding the modified applicability dates.

N. Clarification Concerning Completion of Tax Year 2020 Form 1118, Schedule D

On its webpage, the IRS has clarified how certain individuals, estates, and trusts might need to fill out Part II (Foreign Income Tax Deemed Paid) of Schedule D [Tax Deemed Paid With Respect to Section 951A Income by Domestic Corporation Filing the Return (Section 960(d))] of Form 1118 (Foreign Tax Credit—Corporations) for tax year 2020.

O. *Alexander B. Wathen v. Commissioner*, TC Memo 2021-100

IRS's bank deposits reconstruction of taxpayer/bankruptcy attorney's underreported gross receipts was upheld. The IRS provided necessary predicate evidence of the underreported income with bank statements, stipulated exhibits, and supporting testimony; and taxpayer did not show any error in, and in fact appeared to concede, same. Taxpayer was not allowed deductions for the majority of his office expenses as he failed to property substantiate them. This also applied to unsubstantiated travel expenses.

P. *Today's Health Care II LLC v. Commissioner*, TC Memo 2021-96

In deficiency case involving medical marijuana dispensary that was run in accord with state law but denied deduction for expenses relating to its business, the Tax Court determined that the §280F drug trafficking provision did not violate the 8th Amendment's Excessive Fines Clause and 16th Amendment based on reasoning in a substantially similar case. Taxpayer's contrary arguments were rejected accordingly.

Q. Declaring Bankruptcy—Individual Taxpayers

On its website, the IRS has updated what an individual taxpayer needs to know about taxes and bankruptcy. Any practitioner with a client in bankruptcy or contemplating bankruptcy should review this webpage. Also, reference can be made to Publication 908.

R. IR-2021-166

The Security Summit—a partnership between IRS, state tax agencies, and the tax industry— has warned tax professionals to be wary of COVID-19 pandemic-related email schemes. It describes phishing emails or SMS/texts attempting to trick the recipient of the message into disclosing personal information such as passwords, bank account numbers, credit card numbers, or Social Security numbers. Such schemes generally have two traits. First, they appear to come from a known or trusted source. Second, "they tell a story, often with an urgent tone, to trick the receiver into opening a link or attachment," the IRS said.

The latest twist on the danger of such schemes is an offshoot of the ransomware attacks that have shut down large companies. Criminals are now resorting to smaller scale tactics against tax professionals which attack their computer systems to encrypt files and hold the data for ransom.

S. Employee Plans News: Plans Retroactively Adopted After End of Plan Year Have No 2020 Form 5500 Filing Requirement

In an email newsletter, the IRS has reminded employers that they are not required to file a 2020 Form 5500 series return for retirement plans retroactively adopted in 2021.

Under §201 of the SECURE Act, an employer may adopt a retirement plan after the close of its tax year and elect to treat that plan as having been adopted as of the last day of the prior tax year (retroactively adopt a plan). An employer must retroactively adopt a plan by the due date, including extensions, for filing its prior-year tax return. According to the IRS, an employer is not required to file a 2020 Form 5500 series return for a retroactively adopted plan, if the employer:

- adopts a plan during its 2021 tax year (before the due date, including extensions, for filing the employer's 2020 tax return), *and*
- elects to treat the plan as being adopted as of the last day of the employer's 2020 tax year.

Instead, the plan's first return will be a 2021 Form 5500 series return.

T. IRS Practice Unit: Penalty for Failure to Include Reportable Transaction Information with Return

The IRS has issued a Practice Unit that discusses the §6707A penalty for failure to include reportable transaction information with a return. The Practice Unit provides a step-by-step process for an examiner to follow to impose this failure to report penalty.

A. Discussion Problems

Discuss the issues presented by the following three independent factual situations:

1) Homeless, Inc. is a §501(c)(3) tax-exempt charity. The Director has done such a great job that the Board of Directors wants to reward her with an all-expenses paid vacation.

2) Your client wants to make a donation of a conservation easement. If for any reason the conservation easement is extinguished, then the client wants the property to revert to him or 100% of the proceeds to go to him should the property be sold.

3) Your client comes to you seeking innocent spouse relief on joint return liabilities. His former spouse "took care of all their financial affairs," including their taxes. You have ascertained that he knew or should have known that the taxes would not be paid. He did not receive any significant benefit from the failure to pay the taxes.

B. Suggested Answers to Discussion Problems

1) IRC §4958 imposes an excise tax on excess benefits received by a "disqualified person" as a result of an excess benefit transaction. An "excess benefit transaction" is "any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration, including the performance of services, received for providing such benefit." A disqualified person would include the director. An economic benefit is not treated as consideration for the performance of services unless the organization clearly indicated its intent to so treat such benefit with written substantiation that is "contemporaneous with the transfer of the economic benefit at issue." [Reg. §53.4958-4(c)(1)] This is sometimes referred to as the contemporaneous substantiation requirement. This is not required if it is an excludable benefit. Since this would not be excluded then to avoid the excise tax, it will be income and meet the contemporaneous substantiation requirement.

2) The terms of the conservation easement would fail the "in perpetuity" requirement. Reference should be made to the extinguishment regulations which will require that the charity receive some of the proceeds from any sale or termination unless state law overrides the easement grant by requiring it. The Chief Counsel has provided model language for the "in perpetuity" requirement for a conservation easement to be respected.

3) "Knew or reason to know" is just one factor to be considered in innocent spouse relief. The courts have looked to the same factors as in determining if the economic hardship test is met. If your client received no "significant benefits" from failure to pay the taxes, that will weigh heavily in his favor.

PART 2. INDIVIDUAL TAXATION

Child and Dependent Care Expenses

Tax benefits are often available to taxpayers with child and dependent care expenses. Such benefits include the child and dependent care credit, the employer-provided child care exclusion, and the advantages of flexible spending arrangements. Ian Redpath and Julie Welch discuss these potential benefits and cover topics such as the credit in general, the specific changes for 2021, who is a qualified individual, and what expenses qualify.

Let's join Ian Redpath and Julie Welch as they discuss options that should be considered by taxpayers with child and dependent care expenses.

Mr. Redpath

Julie, welcome to the program.

Ms. Welch

Thanks Ian, glad to be here.

Mr. Redpath

Always great to have you, always great to get your insight in this. I know a lot of our viewers love having you on the program. We have an interesting one. We did a program on the child tax credit, so this is kind of a corollary to that. They often fit together, because you have a child or a dependent, and you have a credit that can be available for dependent care. Exactly what is it and what's the purpose of it?

Ms. Welch

Well, the purpose of it, that's probably the most important thing, is it helps those working families offset the cost of care for children under the age of 13. I say children, but like you said, other dependents can qualify. But typically, it's for kids under 13. And there's a credit out there that the IRS provides, it ranges from... Well, the rules are changing. The old rules, 20% to 35% was the credit amount. A lot of people with higher income ended up with the 20% credit. Those who had really low income had the 35% credit. Again, it's changing for 2021 and for the future, but this was... It's a great credit, and it does help offset, because it's not a huge amount of a credit. And we all know that the cost of daycare is a very, very, very large number for those working families who have to get daycare for their children while they're working.

Mr. Redpath

Yes, I can see that. I have two daughters that have daycare, and those expenses—it runs up! It can be a large percentage of their paychecks. You mentioned that there's been a change, in fact, an increase. The rate was a sliding scale starting at 35%. I think people should remember that even if you have a higher level of income, you can still get the credit, because it bottomed out at 20%. But that high end now, the 35% credit, that's been increased for 2021, hasn't it?

Ms. Welch

It has. You're right, the old credit was as you mentioned 35%. And that was for people with income, what we call income being adjusted gross income, of $15,000 or less. But by the time that your income was $43,000, you were at the 20% limit, under the old rules. For 2021, we get some really beneficial new rules because now the credit's going to go up to 50%, is the maximum. But on the downside, it goes all the way down to zero, rather than stopping at 20%.

Mr. Redpath

Well, that is a big difference, from 20% to zero. No question about that. The credit for 2021 is going to be refundable too, isn't it?

Ms. Welch

Yes, it is going to be refundable. And refundable means that you get it back. So, the old rule was that the credit wasn't refundable. That meant you had to have tax liability in order to get the credit. And you had to do certain things in order to get the credit, like provide ID numbers of both your dependents and the care providers. And that rule really started... I think that rule started in 2018, it might have been before that. But you have to provide that information, so you no longer can just say, "Well, I paid the babysitter X number of dollars." If you paid the babysitter, you better have a social security number or the taxpayer identification number in order to claim that credit.

But the American Rescue Plan, which was one of the most recent tax bills that we had, did change the income level when that credit begins to be reduced. We were talking earlier about the reduction amount. And the credit percentage, it phases down gradually. It used to be to 20% for individuals with incomes between $125,000 and $400,000 of income. It would phase down by one percentage point more to $2,000. So, for 2021, it's going to be completely phased out, because now they're going to phase out that extra 20%. It'll become completely phased out when adjusted gross income reaches $438,000.

So, before 2021, the credit was not reduced below 20%. Anybody could get it; very, very, very high-income taxpayers could get it. And now, what they call... They call, I guess, the $400,000 is where the definition now is of a high-income taxpayer. So, somebody with [over] $438,000 would not be able to get any of the credit anymore.

Mr. Redpath

Now, there is, for some people, their employers provide them with a benefit for childcare. And we'll talk about that a little bit, but the Dependent Care Assistance Program, how does that relate to this? And we can talk about the specifics later on that, but how does it relate to the credit?

Ms. Welch

Because of these changes, some employees who previously might have been better off from a tax perspective using their employer's Dependent Care Assistance Plan, they may find it more favorable to claim the full credit in 2021. Or vice versa. So, you really have to run the numbers to see which works out better. And with that Dependent Care Assistance Plan, typically you have to run the numbers before the year begins, because you have to know whether to make that election to be considered in the plan.

And also for 2021, as we mentioned, the credit is refundable. So, it helps lower-income taxpayers; since they'll be able to get the credit amount that's in excess of their tax liability. They're going to get it refunded even if they have zero tax liability for the year.

Mr. Redpath

Yes, this is going to be, again, a different tax year for 2021. We have amounts that are set. That doesn't necessarily relate to your expenses. So, the credit, when we say it's a percentage, we talked about it, 50% going down to zero. But that sliding scale, it's a percentage of what? You look at that percentage as based upon your income, and the percentage goes down, but what's the percentage of? It's a percentage of what? We take the percentage and multiply it by what?

Ms. Welch

Well, the maximum credit. So, the maximum credit for 2021, and again, 2021's a special year. We've got extra amounts here. We get to count the first $8,000 of expenses that a person incurs for employment-related—I guess you would call it employment-related expenses. So, you can count the first $8,000 if you have one child, or one qualifying individual; and if you have two or more qualifying individuals, you get to count up to $16,000 of those expenses. With the credit being a 50% credit, that makes the maximum credit either be $4,000, which is $8,000 times 50% if you just have one child. And if you have two or more, the maximum amount is going to be $16,000 times 50%, or $8,000. Those are going to be the maximum credit, so that's then where you start to phase it down after that.

Mr. Redpath

You made a good point there that I don't want to overlook because sometimes that's misunderstood, is it's $8,000 for one, but it's $16,000 for two or more. You don't get $8,000 per child. If you have three children, it's still $16,000; four children, it's $16,000. So, two and above, it's based on $16,000. So, it would be the lesser of $8,000 or $16,000, or your actual expenses. You can't take a credit on more than what your actual expenses are.

So, the credit... Can you take both? So, you decide to take the credit on some of the expenses. Could you still take the employer Dependent Care Assistance on other expenses?

Ms. Welch

Yes, you can. And we'll talk later, I think, what those limitations are on the Dependent Care Assistance Plans. But it usually has a set dollar amount, whether you have one child or many children, whereas this credit is different if you have one child or more than one child, that you're getting the credit for. But yes, you can take it. So, to the extent you don't take it in the employer plan, so let's say that you take... Well, this year we get to use a higher number, but I'm just going to throw out a number, $6,000 in the employer plan, even if I just have one child, I can go up to $8,000 of expenses, for one child.

And if I have two children, I can go up to $16,000 of expenses for this credit. So, I would have to take whatever my maximum was, either the $16,000 for two or more, or $8,000. And subtract off what I used in that Dependent Care Assistance program, the employer plan. So, track that, and that difference is what I can use in the calculation—assuming my expenses are at least, you know, that maximum number we're talking about.

Mr. Redpath

You're really going to have to do an optimization for a client that does have the dependent care option with their employer. Now, I think we'd be remiss if we didn't say in 2021, we talked about those numbers. But everything kind of goes back, absent any legislation, to 35%. And then the expenses are $3,000 and $6,000. So, for 2022, it's going to go back down. So, $3,000 and $6,000 are the maximum expenses, and then the credit goes back to the old sliding scale starting at 35%.

So, let's say that you have a spouse who is either disabled or a spouse who is a full-time student. What do you do in that instance? Because general rule is when we're talking about these numbers, since the concept is to allow a person to work, then you use the lower AGI. So, if you have married filing jointly, you're going to use the lower AGI. What if your spouse is disabled and has no AGI, contribution to AGI, or is a full-time student? What do we do in that case?

Ms. Welch

Then, they're actually going to treat it as if that spouse had incurred expenses equal to that maximum amount, depending on the number of qualifying children. So, they're not going to penalize you because your spouse is unable to work because they're disabled or because they're a full-time student. They're going to give you the benefit, and allow you to claim this credit, because the credit is out there to allow people to work. So, it's kind of an encouragement for people to work, and they need to then spend money to have their children cared for while they're working. And if one spouse is a full-time student, and the other spouse is working full-time, you need to have somebody to care for the children. So, they're going to allow the credit in those situations.

Mr. Redpath

And that's a great benefit. So, we mentioned that the credit is refundable for 2021. But not refundable for 2022. We go back to the old rule. Where is this credit taken? I mean, where do we see it? When we're looking at the return, where are we going to see the credit?

Ms. Welch

There's actually a tax form that you attach, it's the Form 2441. And on that form, it asks for all of the information. Obviously, it's going to ask your dependents' names, even though they're usually listed on the front of your tax return. But it asks which dependents were covered for this care, and how much dollar amount. And then it also asks for the care providers. I believe it asks name, address, but it definitely asks for the taxpayer identification number. And now, you must, as I mentioned before, you must provide that taxpayer identification number in order to get the credit.

Mr. Redpath

And generally, you are going to need to have information to document from the care provider. Not just the client saying, "Well, this is what I spent." The care providers do provide you with what the amount of qualifying expenses are.

Ms. Welch

Yes. And my experience has been at the end of the year, they know everybody needs it, so they give you a receipt or a printout for the whole year that'll show everything listed, along with their taxpayer identification number, because they get asked these questions by every client if they don't do it. So, they put it right on there, and they usually will give you the full printout. Otherwise, you have to go back to them and ask for the detail. And it's going to be based on when you paid; generally, you're going to be looking at when you paid the money. Most people exceed that amount, when we had the lower limits, when the expenses were only up to $3,000. I mean, most people were exceeding that. So, did it matter what year you paid it because you paid at least 3,000 in a year? In 2021, it may matter, because the $8,000 and the $16,000 is related to 2021 only.

Mr. Redpath

Well, not to get into the weeds of what is a qualifying child or a dependent, but there are some general requirements for a qualifying individual. What are those general requirements that our viewers should be looking at?

Ms. Welch

Well, one of the main ones is that the person hasn't attainted age 13 when the care is provided. So, that's important, because it's not turned 13 during the year, it's turned 13 when the care is provided. So, I look at my children and say, "Okay, well this was great for my one..." Because my boy, when he turned 13, it was late in the year, November. So I'd incurred all the expenses before that. My daughter, on the other hand, has a birthday on January the 2nd. It's really hard to incur many expenses before she turned 13, because January 1st is a holiday. And technically, other than being an accountant, you don't work on a holiday. So, it would have to be employment-related expenses.

But again, with the qualifying individual, it can also be a dependent who is physically or mentally incapable of caring for themself. And they have the same place, they live with the taxpayer. So, generally it's going to be a child who is incapable of caring for themself, or it's going to be the taxpayer's spouse—if the spouse is physically or mentally incapable of caring for themself, and they live with the taxpayer for more than half of the year. So, it's not, "My spouse is in a home somewhere." That doesn't count. It has to be in my home.

Mr. Redpath

Right. That age limit, that 13, doesn't apply if they're physically or mentally incapable of self-care.

Ms. Welch

Correct, correct. The under 13 relates only to children. It doesn't matter if they have any issues or not. But if they do have issues for self-care, then you look at any age.

Mr. Redpath

So, one of the things that comes up when I look at childcare, and I get a statement from the daycare facility, and as you said, it gives the ID number, details what was paid. But there are expenses because not everybody does it. Some people have someone that comes in the home and takes care of the child. They may have a nanny. Of course, my wife says I need a nanny.

So, these expenses. What types of expenses, then, can we be looking at? Because clients are going to say, "Well, I've got everything I've got to cover. Now, I have to build on my house, and I have to put on an addition for the childcare provider." You can get all sorts of things like this where people will come in with these questions. So, what types of expenses would qualify here?

Ms. Welch

You're typically looking for something that is for the care of a qualifying individual or a qualifying child. So, we're going to be looking at that related to care. So, you had mentioned, "I have to build onto my house." That is not really for the care of the child. But some of the other things that might be household services might qualify. So, basic household services. It could be, if you employ a maid, a cook, or other domestic help in the home, as long as that includes care for the child. But typically, it's not going to cover like a chauffeur—although I think we need a lot of chauffeurs to get the children back and forth to all their activities these days—bartenders, gardeners, those type of thing. Gardeners, that's not really—that is a household service, but it's not caring for the child. So, you're really looking at something that's caring for the child.

And, if you have, like you mentioned, a nanny or an au pair, or something like that, somebody coming into the home and living with you, room and board for the care giver can usually count as expenses for this credit. Although, when it used to be the $3,000 amount, you were probably capped out already anyway, because you still had to pay the person. But the $8,000 amount for 2021, we may see more of that. But again, the primary function has to be the wellbeing of that child, so it's really the motive that the taxpayer has when they're hiring this help, or getting this help lined up, with whether they're going to be covered or not.

Mr. Redpath

Yes, and we do have to look at things like okay, what if the daycare facility provides a lunch? Is that part of care? So, there is kind of a gray area of what expenses might get included here. Although, you mentioned chauffeurs—for common folk, we would just call that a driver, somebody to drive our kids around. But some people might contend, with their children, that a bartender is an essential service! Not for the children. But those types of things are not included.

So, I think it is a wide range. But again, they have to be essentially for the care and related, somehow, to employment, right? Some employment that's being provided.

Ms. Welch

Yes. And again, you mentioned where you have the daycare, and they provide the lunch. Typically, that's going to be incidental, and it's something that you don't normally separate out from the care. We're not going to count how many Goldfish the child ate today and try to say that wasn't for care. So, that's all going to be included. But like, an overnight camp. They don't count those. That's not really for employment related, just to sleep, and that type of thing. But again, the normal daycare things.

There are some funny, interesting cases where the things that people try to get through as an expense. And some of these might be interesting to look at. So, the cost of driving alone to work instead of carpooling, so the parent could stay with the parent's children until school started. That doesn't qualify, because that really wasn't for the care of the children. Home security system—while it's for the benefit of the child, it doesn't qualify as employment related and for the care of the child. So, that doesn't qualify. It's where the employment-related expense is. If the taxpayer is reimbursed—I mean, we were talking earlier about the Dependent Care Assistance programs—but somebody can also be reimbursed by a social services agency for things. And those expenses cannot be taken into account for purposes of the credit if you're reimbursed for it already. So, those type of things won't qualify.

Mr. Redpath

Another thing that, like for some of my clients, they use care, but they use care so that they can be engaged in, essentially, volunteer work. "Well, I do a lot of work at the church. I do a lot of work at the school. I'm volunteering my time." But that's not so you can be gainfully employed. It doesn't qualify.

Ms. Welch

Right. It has to be gainfully employed. It does include self-employment income, not self-employment loss. It does include self-employment income. But like you mentioned, work as a volunteer or for just a little bit of consideration, we're going to buy your lunch or something, that's really not gainful employment. So, really they're going to be looking at the dollar amount that you have of earned income and when the expenses were incurred. So, was the purpose of the expense to enable you, the taxpayer, to be gainfully employed?

Mr. Redpath

So Julie, job searching would qualify? I'm out looking for a job, so I brought in somebody to watch the children and paid them, so I could go out and try to find a job.

Ms. Welch

Assuming that actually turns into a job, and you have earned income for the year, and you are gainfully employed, that would count. But if it doesn't turn around and you don't have of the earned income for the year, and you don't meet those other qualifications being a full-time student spouse, or a disabled spouse, then no. You won't get it. Because I looked at that one too and I thought, "Oh, that would be great! Just go out and pretend you're trying to get a job, and have somebody else watch the kids and pay for it, and take a credit." But that doesn't work that way. But you can, if you're looking for a job and document your expenses, and you actually get a job and go forward.

On the other hand, a hobby doesn't count as gainfully employed. So, if you hire somebody to watch your kids or you enroll them in a daycare service, just to do your hobby, then that's not going to count as gainfully employed, technically even if you have other employment at other times, it's for that period of time. In this case, it would really take somebody looking at the receipts, and the dates of the receipts, and the dates you were actually working to figure out if they qualified.

Mr. Redpath

So, what about who can provide the service? Is there any limitation on who provides the service? Can I just hire my 15-year-old kid and pay them to watch the younger children?

Ms. Welch

Generally, there is a limitation. Just think about it; if it's your own kid, the answer is probably no. But the specific rules are if you can claim this other person as a dependent for the tax year, then you cannot hire your dependent, and pay your dependent, and take the childcare credit. And if the taxpayer, if you have another child that's under the age of 19, even if the person isn't your dependent, you can't use them and pay them, and take the childcare credit on it. You can't do it for your spouse, if it was your spouse at any point during the year. So, if you marry the nanny—you know the cases we hear about—you marry the nanny before the end of the year, then none of those expenses will qualify, because it'd be the taxpayer's spouse at any time during the year.

Mr. Redpath

So, what records do you have to keep? Our viewers should be aware of what records they need to tell the clients to keep, and what records that they need to look at.

Ms. Welch

Okay, well really, a couple of sets of records. You have the records to show how much you actually paid for the care. So, you've got the evidence to substantiate the expenses that you paid. But if you have somebody with a disability, your spouse, you have a dependent that's incapable of providing self-care, you better get good records there. A doctor letter talking about the nature and length of the disability would be very helpful in that case. And any other records that you have about doctor visits, or anything like that. All the work-related expenses that you are going to try to use for the credit. Those need to be documented. Most of the time, you have to have documentation. And now, you have to provide the taxpayer identification number in order to put anything down and get the credit. So, you can't just take the occasional babysitter that you pay $30 or $40 for in cash. If you don't get their identification number; you won't be able to take the credit based on that.

Mr. Redpath

We mentioned earlier that some employers provide a benefit under Section 129; they have a dependent care program. There's an exclusion. It's great. There's an exclusion, box 10 of the Form W-2. And then, it's going to show up on box 13 of a K-1, with code 'O' for a partner. But, there's a change also for 2021. So, if you have this program in place, you have the ability to provide for dependent care. What is the exclusion amount for 2021?

Ms. Welch

For 2021, it's increased to $10,500. That's if you're married, filing jointly. If it's others, then it's only half of that, $5,250. But the $10,500 is more than the $8,000. So, that's why we talked earlier. Which one is better? Do I take the deduction, or do I take the exclusion, or do I mix them up a little bit and take a little bit of both? Or do I max out the exclusion and take the credit for the difference? But again, with one… The old rule was, I've got one child, well if I can get more with my employer plan, more expenses covered than I can getting the credit, and my rate—you've got to look again at the rate on the credit. If my rate works out, then I usually would want to… use the employer plan, and use the credit for the difference. Now, you kind of have to look at the whole situation for the taxpayer. But you can use both. But $10,500 just for 2021. That's the change there.

Mr. Redpath

Right. And then, we have another option that we have to talk with our clients, is if the employer has an FSA, flexible spending arrangement. There's two parts to flexible spending arrangements; there's the medical, but there's also the dependent care portion of that. So, how would that work?

Ms. Welch

Again, the dependent care portion of that, assuming the employer amends the plan. We mentioned this increased limit, but the employer has to amend the plan to allow for that. And if the employer amends the plan and says, "Yes, for 2021, we're going to allow $10,500." Then you can use that in the plan. It is the old "use it or lose it" rule. So, use the expenses, or lose it. Then, normally you have to identify before the beginning of the year. Well, guess what happened in 2020? People identified before the start of 2020. So, in 2019, they scrabbled around, filled out their election, and all of a sudden, March hit. And everything was off the table.

And so, then there are some things that came out that said, "Okay, well we're going to be—I'm going to say—just more lenient in 2020, and allow some of that to carry over to 2021." If the plan still allows, we'll allow it to carry over to 2021, because it was something totally unforeseen by everybody. It's not just one limited situation. I mean, normally people can lose out on that amount, because they've said, "Take this out of my paycheck," and it's going to come out every single paycheck, no matter what, even if you don't spend it. But for 2020, because of the pandemic, there were some changes there.

Mr. Redpath

And also, you get to carry over for 2021, age 14. So, it adds an extra year there. And also, you can carry over from 2021 to 2022. So, we're going to have some additional carryover. And this is Notice 2021-15 on the FSAs. I guess, in general, it sounds like we really do need to sit down in 2021 and do a lot of optimization analysis for our clients who may have dependent care through their employer, or they have an FSA. Or, they have all three. You have to do really an analysis here, as to the benefit.

So, what can you leave our viewers with, just the things they should be looking at for the dependent care for 2021?

Ms. Welch

Well again, I would look at that rate. So, for example, in 2021, if a married couple has $120,000 of adjusted gross income, they'd be eligible for the 50% credit rate whereas their income tax rate isn't going to be 50%. So, if they pay $20,000 for two children in daycare, they'd receive more benefit by using the dependent care credit. So, take the $8,000; they'd get an $8,000 credit, $16,000 times 50%. As opposed to having a reduced income, because their tax rate's not going to be 50%. If their income, if their AGI had been $200,000, they likely would claim the maximum exclusion through the dependent care plan, if they had one available. So, the $10,500. And then, the remaining amount that they had, we can use up to $18,000 of expenses for the credit. So, $18,000 of expenses, minus 10,500 that we used in the dependent care plan leaves us with whatever the difference is, $7,500, times 20% would be $1,500 of an additional credit.

So, you just have to look at the situation and weigh, where does that 50% credit rate apply? And right now, we know the income tax rates aren't 50% at the high level. So, where does it apply? And where do the phaseouts all kick in? Just see which works out better. And again, you're usually doing this before the beginning of the year, before the money's earned, or if a new employee starts, before they begin employment, in order to do that.

Mr. Redpath

But we've had an unusual year, and we get a lot of these changes now that actually came in during the year, during 2021. So, the analysis that we had already done may not still hold. So, I think we need to go back with our clients and review this situation to see where we are. And if there's a possibility of making some changes.

Ms. Welch

Exactly. And because of that, that's what I think the notice that you mentioned does allow some changes to be made.… Normally, we mentioned use it or lose it, make the election early. Well, they came out with some of these rules after, very late, after people had already made their elections and everything. So, they did allow changes. Again, assuming the employer amends their plan and allows the $10,500, many people may want to switch to that and use more of it along those lines.

Mr. Redpath

Great. Julie, I want to thank you for your insight. Something for our viewers to talk to their clients about, and make sure that they're maximizing all these potential plans. Again, thanks for your insight, always enjoy having you on the program, and we'll have you on again soon. Thank you very much for being here.

Ms. Welch

Thank you.

Child and Dependent Care Expenses

By Ian J. Redpath, JD, LLM

A. Introduction

Child and dependent care expenses can be a major problem for working parents. The Code provides a number of tax provisions that can be utilized to reduce this financial burden. Practitioners should be cognizant of these rules as they impact a growing number of taxpayers.

B. Tax Credit

Under §21, an individual taxpayer who has one or more qualifying individuals gets a credit of 20% to 35% (0% to 50% in 2021) of the expenses the taxpayer paid for the care of the qualifying individual(s) so that the taxpayer can be gainfully employed. These are referred to as "employment-related expenses." Married couples must file a joint return to claim the credit. It is available if the qualifying individual(s) live with the taxpayer for more than half the year, regardless of whether the taxpayer provides over half of the cost of maintaining the household.

The increase to 50% is for taxpayers whose adjusted gross income for the 2021 tax year is $125,000 or less. The American Rescue Plan Act (ARPA) also increased the maximum amount of those expenses that may be taken into account in computing the credit. The percentage is reduced one percent for each $2,000 (or fraction thereof) that AGI exceeds $125,000 until it reaches 20% when AGI exceeds $183,000. The 20% credit applies to taxpayers with AGI greater than $183,000 and less than or equal to $400,000. For those with AGI in excess of $400,000, the $20% credit is reduced by one percentage point (1%) for each $2,000 (or fraction thereof) that AGI exceeds $400,000. It is completely phased out when AGI exceeds $438,000. Remember that prior to 2021, the credit rate was not reduced below 20%.

		Maximum Eligible Expenses	Maximum Applicable Percentage	Maximum Credit
Pre-ARPA	1 Qualifying Child / Dependent	$3,000	35%	$1,050
	2 or more Qualifying Children / Dependents	$6,000	35%	$2,100
ARPA	1 Qualifying Child / Dependent	$8,000	50%	$4,000
	2 or more Qualifying Children / Dependents	$16,000	50%	$8,000

Because of these changes, some employees who previously would have been better off from a tax perspective contributing to a Dependent Care Assistance Plan may find themselves in a more favorable tax position by claiming the full child and dependent care tax credit in 2021 or vice versa.

For 2021, the first $8,000 if the taxpayer has one qualifying individual, or $16,000 if the taxpayer has two or more qualifying individuals, of care expenses qualify for the credit. As a result the maximum credit is $4,000 if there is one qualifying individual or $8,000 for two or more. After 2021, the maximum expenses will be reduced to $3,000 and $6,000 respectively resulting in a maximum credit of $1,050 or $2,100. There is an earned income limitation on the qualifying expenses, which makes sense considering the purpose of the credit. Also, expenses must be reduced by amounts excluded from gross income under a dependent care assistance program. If one spouse is disabled or a full-time student, they will be considered to have incurred expenses equal to the maximum amount allowed depending on the number of qualifying children, thus allowing the maximum credit available.

The credit is generally nonrefundable—meaning a taxpayer cannot get a refund for any part of the credit that's more than the taxpayer's tax—and is subject to an annual limitation on certain total nonrefundable personal credits. For 2021, the ARPA made the credit refundable for taxpayers who have a principal place of abode in the U.S. for more than one-half of the tax year.

Taxpayers claiming the credit will attach Form 2441 to Form 1040, Form 1040-SR, or Form 1040NR. The taxpayer identification numbers (TINs) of all qualifying individuals must be provided on the return claiming the credit. Additionally, identifying information about the care providers is also required. The credit is lost if proper identification information is not provided.

For purposes of the credit, a "qualifying individual" is:

1) a dependent of the taxpayer, as defined by §152(a)(1) (i.e., a qualifying child, who has not attained age 13 when the care is provided);

2) a dependent of the taxpayer who is physically or mentally incapable of self-care and who has the same principal place of abode as the taxpayer for more than half of the tax year;

3) the taxpayer's spouse, if the spouse is physically or mentally incapable of self-care and has the same principal place of abode as the taxpayer for more than half of the tax year.

A qualifying individual must have the same principal place of abode as the taxpayer for more than one-half of the tax year. An individual is not treated as having the same principal place of abode as the taxpayer if, at any time during the tax year of the taxpayer, the relationship between the individual and the taxpayer violates local law. [§21(e)(1)]

The individual's qualifying status is determined on a daily basis. The day the person no longer qualifies will be the termination day of their status. [Reg. §1.21-1(b)(3)]

Example: Megan's daughter, Jade, is a qualifying individual as a qualifying child. Jade turned 13 on May 2, 2021. Jade is considered a qualifying individual from January 1, 2021 to May 2, 2021.

A "dependent" means either a:

- qualifying child [§152(a)(1); Prop. Reg. § 1.152-1(a)(1)] or

- qualifying relative [§152(a)(2); Prop. Reg. § 1.152-1(a)(1)].

To be a dependent:

- the return on which a dependency deduction is claimed must include the dependent's taxpayer identification number (TIN),

- the dependent must satisfy the joint return test,

- the dependent must satisfy the citizenship/ residency test, and

- an individual who could be claimed as a dependent by another person cannot claim anyone else as a dependent.

A "qualifying child" is an individual who:

1) bears a relationship to the taxpayer;

2) has the same principal place of abode as the taxpayer for more than one-half of that tax year, except that a child of divorced or separated parents will be treated as the noncustodial parent's qualifying child if the custodial parent has released the claim to the child's dependency exemption to the noncustodial parent under §152(a);

3) meets the age requirement (under age 19 or a full-time student under 24);

4) has not provided over one-half of the individual's own support for the calendar year in which the taxpayer's tax year begins; and

5) has not filed a joint return (other than for a refund claim) with the individual's spouse for the tax year beginning in the calendar year in which the taxpayer's tax year begins.

To be a qualifying child, the child will have to be the taxpayer's son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any these individuals. An eligible foster child will be treated as a child. Note that if a child does not meet the above definition, the child might still be able to qualify as a dependent under the "qualifying relative" test.

The term "qualifying relative" means a person:

1) who bears a relationship to the taxpayer,

2) whose gross income for the calendar year in which that tax year begins is less than the exemption amount,

3) for whom the taxpayer provides over one-half of the individual's support for the calendar year in which that tax year begins, and

4) who isn't a qualifying child of that taxpayer or of any other taxpayer for any tax year that begins in the calendar year in which that tax year begins.

The following relationships will meet the relationship test [§152(d)(1)(C); Prop. Reg. § 1.152-3]:

- a child, i.e., a son, daughter, stepson, stepdaughter, or eligible foster child;
- a descendant of a child;
- a brother, sister, stepbrother, or stepsister (the terms "brother" and "sister" will include a brother or sister by the half-blood);
- the father or mother, or an ancestor of either;
- a stepfather or stepmother;
- a son or daughter of a brother or sister of the taxpayer (i.e., a nephew or niece);
- a brother or sister of the father or mother of the taxpayer, i.e., an uncle or aunt (the terms "brother" and "sister" include a brother or sister by the half-blood);
- a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law; or
- a member of taxpayer's household.

Example: Jane has a 22-year-old son, Jason, who is disabled. He is not a full-time student. Jason's gross income is less than the exemption amount, and he receives more than half of his support from Jane. Jason does not qualify as a child because he fails the age test. But Jason will be taxpayer's dependent because he meets the definition of a "qualifying relative."

If more than one eligible parent claims the individual as a qualifying child, and those eligible parents do not file a joint return together, then the child would be treated as the qualifying child of:

- the parent with whom the child resided for the longer period of time during the tax year, as determined under Prop. Reg. §1.152-4(c)(3) et seq; or
- if the child resided with both parents for the same amount of time during the tax year, then the parent with the higher AGI.

If a parent can claim a particular qualifying child, then no other individual will be able to claim that child unless:

- no parent claims the qualifying child;
- another individual is otherwise eligible to claim the child; and
- that individual has a higher AGI for the tax year than any parent eligible to claim the child.

The credit is for employment-related expenses. These are expenses for household services and/or care of a qualifying individual if incurred to enable the taxpayer to be gainfully employed or search for such employment [Reg. §1.21-1(c)(2)(i)]. The employment may occur in the home and includes self-employment. The taxpayer's motive determines whether an expense is for "care" [*Zoltan, Edith W*., (1982) 79 TC 490].

Example: Taxpayer has a qualifying child who is incapable of caring for herself. In order to be gainfully employed, the taxpayer hires a practical nurse whose sole duty consists of providing for the care of the child in the home while the taxpayer is at work. The payments to the nurse would be qualifying expenses.

Expenses for household services may be employment-related expenses if the services are performed in connection with the care of a qualifying individual. Household services consist of the performance of ordinary and usual services necessary to the maintenance of the household and be attributable to the care of the qualifying individual. The basic kind of expenditure intended by the term "household services" is the cost of employing a maid, cook, or other domestic in the home; however, chauffeurs, bartenders, or gardeners are not household services. The additional cost of providing room and board for a caregiver over usual household expenditures may be an employment-related expense. Amounts paid to provide food, lodging, or clothing are not expenses paid for the care of a qualifying individual. If care is provided in such a manner that the expenses of the care cover other goods or services that are incidental to and inseparably a part of the care, the full amount is for care and no allocation is needed.

The child or dependent care credit is not allowed for amounts paid by the taxpayer to any of the following persons [§21(e)(6); Reg. §1.21-4(a)]:

(1) a person who can be claimed as a dependent for the tax year by the taxpayer or the taxpayer's spouse (if filing jointly);

(2) a child of the taxpayer who is under age 19 at the close of the tax year, even if the child is not the taxpayer's dependent;

(3) an individual who is the taxpayer's spouse at any time during the tax year; or

(4) a parent of the taxpayer's child (under age 13) who is a qualifying individual.

Work-related payments that a taxpayer makes to relatives who do not fall in the above categories can count towards the credit, even if the relative lives in taxpayer's home.

A taxpayer who works part-time but is required to pay for dependent care expenses on a weekly or longer basis does not have to make an allocation. For purposes of this rule, a day on which the taxpayer works at least one hour is a day of work. Nor is allocation required if expenses are incurred during a short, temporary absence from work, such as for vacation or minor illness, provided that the care-giving arrangement requires the taxpayer to pay for care during the absence. An absence of two consecutive calendar weeks is a short, temporary absence. For longer periods, it is a facts-and-circumstances test. [Reg. § 1.21-1(c)(2)(iii)]

C. Employer Dependent Care Benefits

Under §129, qualified payments made by an employer on behalf of an employee for dependent care assistance are excluded from the employee's gross income. Generally, the exclusion is limited to the lesser of $5,000 ($2,500 for married individuals filing separately), the employee's earned income, or the income of the employee's spouse. However, for 2021, the dollar amount is increased to $10,500 ($5,250 married filing separately). Any additional cost would be included in the employee's income. This includes amounts paid or reimbursed by the employer, as well as dependent care provided in kind. A plan must meet a number of requirements to qualify including several nondiscrimination rules. Note that in applying the maximum to a taxable year, the dollar limitation applies to the amount of dependent care assistance that is covered by a program and received during the taxable year, even if the employee does not receive payment until a later taxable year.

Where the cost of the dependent care assistance is not equal to its value, such as in-kind assistance, the amount includible is not the cost in excess of the limit, but the value attributable to this excess cost.

Example: An employer provides an employee qualifying dependent care assistance that costs $11,500, but which is worth $14,500. The employee and his spouse, who file a joint return, must include in income the market value of the dependent care assistance attributable to the cost, figured as follows:

a.	$11,500 (employer's cost)	– $10,500 (limit of cost exclusion)	= $1,000 (excess cost)
b.	$1,000 excess cost $11,500 total cost	X $14,500 (total value of benefit)	= $1,261

The amount of expenses qualifying for the credit must be reduced by any excluded benefits from an employer plan. The amount excluded from gross income should be shown in box 10 (Dependent care benefits) of the taxpayer's Form W-2; if the taxpayer received these benefits as a partner, the amount excluded from gross income should be shown in box 13 of Schedule K-1 (Form 1065) with code O.

Example: Taxpayer has two children, both of whom are qualifying individuals for the child and dependent care credit. As a result of care provided to one of the children by a dependent care assistance program established by taxpayer's employer, taxpayer has a benefit of $10,500 that is excluded from gross income under §129. So, the otherwise applicable $16,000 dollar limit on the amount of employment-related expenses that taxpayer may take into account in computing the child and dependent care credit must be reduced to $5,500 ($16,000 − $10,500).

D. Flexible Spending Arrangements

If a taxpayer's employer has a dependent care flexible spending account (FSA) under which money is withheld from the taxpayer's pay and used to pay child care costs, the employee may have to choose whether to make contributions to the FSA, which are excludable under §129 up to $5,000, or pay the child care costs directly and claim the credit. If the taxpayer has more than one qualifying individual, so that the limit on expenses qualifying for the credit is $6,000, the taxpayer can claim the full $5,000 exclusion and also claim the credit for $1,000 ($6,000 − $5,000) of expenses. These amounts withheld are not subject to FICA.

Like the amounts received under an employee child and dependent care plan, the amounts under a child and dependent care FSA will reduce the amount of expenses available for the child and dependent care credit. There is no double or triple dipping.

E. Conclusion

There are enhanced benefits for child and dependent care expenses related to work. Practitioners should work with each individual client to determine what is available and the optimization of the tax benefits when more than one benefit is available.

A. Discussion Problems

Your clients, Josh and Carlie, have two children that they fully support. Jose is currently a full-time student, and Carlie is employed as a customer service manager. While Josh currently has no income, their joint return AGI is $300,000 that is all earned income. One child, Paulo, is 10 years old, while Marguerite is 16. Carlie's employer offers child and dependent care assistance as a fringe benefit. They also have an FSA which has a child and dependent care option. Their child care expenses are $20,000, divided equally for each child.

Required:

1) What would you advise Josh and Carlie about the available amount of child and dependent care credit?

2) Are the children "qualifying individuals?" Why or why not?

3) Discuss the options with the fringe benefit and FSA.

B. Suggested Answers to Discussion Problems

1) The child and dependent care credit has been expanded for 2021 to be 50% of $8,000 in expenses for one qualifying individual or $16,000 for two or more. They do not have to worry about the income limitation because Josh is a full-time student and is deemed to make at least the amount of eligible expenses. Since their AGI is $300,000, the percentage is reduced from 50% to 20%.

2) They are both dependent children; but a qualifying individual must be a dependent child under age 13. Thus, only Paulo qualifies. The maximum credit would be $1,600 (20% of $8,000).

3) This will require a maximization of which benefits to use. They cannot take more than one benefit on the same expenses. The employer-provided plan will allow for the exclusion from income of up to $10,500 of expenses. The FSA uses pre-tax dollars to reimburse the taxpayers. They can combine different benefits but not on the same expenses.

PART 3. BUSINESS TAXATION

Cost Segregation

Commercial property is usually depreciated over 27-1/2 or 39 years. Certain assets can be depreciated using shorter lives such as five, seven, or fifteen years. By carving out—or segregating—the assets with shorter lives, depreciation of those assets may be accelerated. The benefits of accelerated depreciation can include tax deferral and increased cash flow. In cost segregation, depreciation is not increased. It is accelerated. Cost segregation provides the data required to support a variety of tax strategies. Ian Redpath and Bruce Johnson discuss cost segregation and its main objective which is to accelerate depreciation deductions and maximize the benefits provided by recent legislation.

Let's join Ian Redpath and Bruce Johnson as they discuss cost segregation and its by-product, accelerated depreciation.

Mr. Redpath

Bruce, welcome to the program.

Mr. Johnson

Hello, Ian. Thanks for having me.

Mr. Redpath

Oh, it's great to have you here. A lot of our practitioners out there have heard of cost segregation studies or at least have heard of the concept of cost segregation. Some people may have actually gotten involved in it to some degree, but boy, this is an area and I've been involved in cases in audit level and you bring in the experts. You bring in the big guns, because the IRS, they know that this is an area that they actually can challenge with their experts.

And so, it becomes the battle of the experts often when you get to court, so I think this is a really timely topic that people should be aware of. And, can you kind of give us a little history right now, because I think 1031 or like-kind exchanges, there was a big change which made this even more important. And, we have a change that looks like it's probably going to go through with the Biden proposals. So, where does this cost segregation fit just overall? And, then could you tell us how it fits in 1031?

Mr. Johnson

Sure, so Ian, as we all know, accelerated depreciation has been around for a long time. Prior to the term cost segregation, it was known as competent appreciation, which interestingly enough, that was done away with the second-to last time we had tax reform which was TRA of 1986. But when we look at it from a historical perspective, cost segregation between 1986 and 1997, 1998, I like to call the dark ages for accelerated depreciation because TRA 1986, again, did away with the tool.

We had a court case, a seminal court case that [Hospital] Corporation of America came in where a large-pocket taxpayer challenged the IRS to say, "Look, we have all of these pieces of case law on the books. You're allowing us in this particular instance to depreciate over five years, this MRI machine. But, we just don't push it into a room and plug it into an outlet and away we go. We have all of this infrastructure." That, basically, was the premise of their case. The IRS acquiesced, and thus we have accelerated depreciation again known as cost segregation.

Mr. Redpath

Yes and again, that was Hospital Corporation of America; and as you said, that kind of changed the landscape. So if any of our viewers are interested, you may want to read that case. The other thing I would like to point out to our viewers is there's actually an Audit Technique Guide, an ATG, that the IRS has issued. And I think if you read that ATG—again, you can find that on the IRS website—I think if you look at that Audit Technique Guide, you will see that this is an area that the IRS thinks it's well worth auditing, because often the numbers are quite large.

Mr. Johnson

Yes, that is absolutely true, particularly today, Ian. And to your point, yes, the Audit Technique Guide was first issued in 2004. In 2006, it had an update; and essentially, it's kind of the playbook for the field agents should they ever have a need to execute an audit on accelerated depreciation. So, when we look at it from another historical perspective, we've got lots of different pieces of case law, particularly the annual tax extenders that would deal with bonus.

And then, I think most importantly, as we all are aware that we almost have over four years, but the Tax Cuts and Jobs Act came and really had a significant impact on commercial real estate tax strategies, particularly when it comes to accelerated depreciation. So that's hard to believe, but it's been in effect for the better part of four years. We certainly know about the QIP, and we can talk a little bit more about that later, but that was corrected with the CARES Act in 2020.

So where we sit today, Ian, even before the Tax Cuts and Jobs Act, I think most would say that for commercial real estate tax strategies, accelerated depreciation was one of the top three tools, if you would. One of the others being 1031 exchanges, as you had mentioned. And kind of weaving the story together here of the two, as you had mentioned a couple of times, really today where we sit, there's a lot of power of the two. And as we know with current discussions in Congress and in the White House of potential tax law, tax policy changes, 1031, again, as it typically is the underdog, is probably going to have to fight for its existence again. But when we look at the TCJA, prior to the TCJA was typically an either/or proposition. And now, because of particularly the impact of change in bonus depreciation, we see 1031s and cost segregation working very, very well hand in hand again, whereas before the TCJA in 2017, we really saw them as an either/or proposition.

Mr. Redpath

So, if I'm correct in my understanding of what you're saying, really what we're doing with cost segregation is we're trying to maximize our deductions. We're trying to maximize essentially our depreciation, and especially with bonus depreciation, that can be really helpful. I mean, obviously, it's a tremendous write-off of it as much as we can get over onto that. So, if we can take it away from 39 years and get it subject to bonus depreciation, that's a pretty good deal right now.

Mr. Johnson

Absolutely, I mean, everybody looks at cost segregation and think it's a technical solution. It is, but it ultimately comes down to financial. It's a financial decision and time value of money. We're basically looking at, to your point, you could write it off for 39 or 27-1/2 in the case of multifamily, or you can write off over five. And then start applying bonus depreciation which, as we know, is at 100% at least through the year 2022—very significant savings opportunities. And I like to use the term, it's almost like monopoly money, the type of deductions that can be created under the current climate that we're in right now, the rules we have.

Mr. Redpath

Well, I like to look at things. So, we've got some buckets here. So we have a slide here with some buckets. Can you explain what these are?

Mr. Johnson

Sure. Since the early '90s, we've been dealing with the depreciation methodology, modified accelerated cost recovery system. What we've got here is just basically an illustration of the traditional, the typical class lives that we deal with. So, if you look here on the left, that would be the large bucket which would be real property Section 1250 in the tax code. Those would be things like your walls, windows, doors, and things like that. Those are going to be carrying the 39 or 27-1/2 year life.

And then you move over to the personal property, Section 1245. And there, we start to see kind of the targeted environment for accelerated depreciation, the personal property, things like your window coverings, your floor coverings, specialty electric and plumbing, things like that. And, those obviously are going to be able to carry bonus depreciation eligibility because bonus depreciation essentially says, "Anything with a 20-year or less MACRS class life is bonus eligible."

So then we have the final category, well, second to final—land improvements. Land improvements are, again, Section 1250 as well, but those are things such as your parking lot, landscaping, and such. But, also things that maybe are not really self-evident, but seeing things like your sanitary, your storm and sewer connections. All of those can be considered 15-year assets. And then finally, we've got illustrated here, land, which is something that we all know we can't depreciate. But it's very important to keep that in mind, particularly with a lot of the acquisitions that have been going on over the last few years, that in most cases, we have to allocate a portion of the acquisition basis to land, which is obviously non-depreciable.

Mr. Redpath

So, I'm thinking of our viewers. and I can understand where you'd be saying, "Okay well..." We talked about cost segregation study. We've used that term a few times. What does that really mean, a cost segregation study?

Mr. Johnson

Well, let's go back as you brought up the Audit Techniques Guides. In that, essentially, it's not just the playbook for the IRS, but kind of goes over historical references for how people have come to using accelerated depreciation. But cost segregation is essentially, if you think of it, there's the three legs of a stool. You have the taxpayer, you have the tax professional, and you have a consultant. The consultant basically playing the technical aspect for cross seg. That's the role that my firm typically would play, and there's lots of quality organizations that do the same.

Essentially what we do, our role, and again, noted in the Audit Techniques Guide, is to use a methodology, preferably an engineering based methodology to forensically break down the assets of the property or the fit-out in question. Because real estate might not just be the physical building. It might be just the fit-out within a tenant space, for example. So, our role is that piece to really essentially go in, analyze the property, break it down into its class, into its costs, into its pieces and parts, and then overlay tax law on that.

And essentially, that process is going to generate some form of a report that's, by the way, outlined in the Audit Techniques Guides, things that they're looking for. And, that ultimately will be used to substantiate a tax filing. Now, whether it be the best case when you're first placing an asset into service, and you can use the study to substantiate the beginning of depreciation. Or, we can actually go back and change prior depreciation methodology, what we call lookback study. So essentially, the role that we play is to help people, again, to forensically break down those assets, pieces and parts, price, and then class life.

Mr. Redpath

And it does give the practitioner that, "I've relied on the experts on my cost seg. I just didn't come up with these numbers." I have to admit, I've seen returns that people have done where that's exactly what they did. They just kind of threw something out there and figured it out. But there's some interesting things, I think. For example, in the Audit Techniques Guide, I believe it uses something about electrical system. And they said, "Well, part of it is used for tangible personal property; so therefore, that portion of that can be considered to be tangible personal property." So I'm going, "Wow." I mean, it's complicated and it's something, as you said, you mentioned engineering. Really, a lot of that does come down to that, doesn't it?

Mr. Johnson

Absolutely, and you bring up a good example of electrical. Certainly, if we have an invoice, the most defensible way to substantiate a depreciation claim. I have one asset shown on one invoice, and I have black and white case law to prove that it should be treated this way. But when it comes to, say you built a building. You've got an AIA, typically from a general contractor, and you're going to have one line for electrical. Well, built within that electrical are all different types of devices and systems.

And ultimately, if you look at the ATG, Audit Techniques Guide, the IRS is going to want to see, to substantiate an asset identified as electrical special purpose. Typically, you're going to have to do a load calculation to prove that, all right, yes in fact, in the field, this particular outlet is being used for a copier or a piece of equipment. Well, I've got a price associated with that, but how about when it rolls because it's not just the outlet in that case. We can go all the way back to the main electrical distribution panels for the building, the main service, and potentially take a portion of that. But to prove that out, aside from seeing how it's being used, you've got to do a load calculation in many cases to be able to substantiate that.

Mr. Redpath

So, this is pretty complicated. I'm going to put it that way. It definitely requires a level of expertise if the dollars are right. And I don't know, the IRS is not really concerned about you allocating $5,000. Okay, they may argue with you, but it's not going to trigger anything big. So, what should we really be looking at here?

Mr. Johnson

It's an interesting question we get all the time, Ian. Prior to the TCJA, most people in our industry would say start at a property with a million or $2 million basis and that's where it really starts to make sense. However, because particularly TCJA, the changes to bonus. It's 100%, as we said, through 2022; and bonus is now eligible on acquired assets—first time ever. It's dramatically changed the profile of people or taxpayers that can use the tool and properties as well.

So to answer your question, it really always starts with the taxpayer in question. What's their tax liability? What's their appetite for additional deductions? And if there isn't a need for that, then we look at what type of assets are in play; and you do an analysis on each one to determine, okay, this is what this could offer. This is what that could offer. And then, you really start to match up with that liability. But, specifically, it's hard to place a dollar value on things.

So for example, prior to the TCJA, we had the unfortunate downturn in 2008 or so, and we started to see people buying blocks of single family rental homes. What they were buying, bonus was ineligible on that. We just couldn't generate the economics, expected economics. Well, now we've seen properties as low as $100,000 basis. Now, they're pooled with a couple; say you have a portfolio of them. But we can start to generate a benefit where it makes sense to use this type of approach, because of certainly the economic justification from particularly the bonus depreciation changes. But, also just being able to leverage this tool economically and efficiently over similar property types.

Mr. Redpath

And I think also, Bruce, we've kind of talked a little bit about building. But this becomes important when you walk in, you go, "Okay, I'm going to buy this building, and I'm paying $5 million for the building." I mean, you get a cost seg study as the purchaser of the building. It's not just for builders.

Mr. Johnson

Absolutely, and I think getting back to your question, another thing that we would like to highlight or understand is really what's the hold strategy for the property. Meaning that, okay, I bought this property and I intend to keep it, renovate it, and revenue it. Fantastic, that's a perfect example of the use for cost segregation or sorry, depreciation. But if somebody says, "I'm going to flip this property, say in the next 36 months." Well, I think we all would have to step back because of the potential negative impact of recapture. So again, certainly we can look at a profile of property types. By the way, just about any property can use this. It really depends on the facts and circumstances of that property. But most importantly, it's really the need for the deductions, and what's the strategy for that owner or ownership group with it. It's really to properly apply these tools.

Mr. Redpath

Well, we've got an interesting step here on a slide. Can you tell us what we're looking at here as the life cycle of real estate?

Mr. Johnson

Sure. If you think about real estate and the typical process that it goes through from an initial concept to construction to many changes, perhaps, throughout its life to ultimate disposition of the property. And you correlate that back to proper depreciation. If you think about it, every step of the way as you see here is potentially an opportunity where there's a capital event for someone to take advantage of accelerated depreciation.

So, what we're trying to illustrate here is it's certainly the best time to use accelerated depreciation. Cost segregation is when you first place an asset into service, but just don't stop there because buildings are working, breathing organisms just like a tree, so to speak. But it needs care. You might have a change in use or a tenant coming in and out. So, those typically are going to be those capital events I mentioned. And, every time that happens is an opportunity to take a look at using the tool again.

And it also correlates to other parts of the tax code, so for example, the tangible property regulations passed in permanent form in 2014. You have the ability to use an engineering-based cost segregation study for renovations to maybe take advantage of that. So, you start to see the interplays between this very key strategy to other parts of the tax code, ultimately to have a long-lasting strategic effect for a taxpayer.

Mr. Redpath

So, it can be a combination of things as I understand you. So the so-called repair regs and depreciation, so it's kind of a mixture. It's not just one fits all. It's looking to maximize depending on the situation.

Mr. Johnson

Absolutely, it's so important. Certainly, cost segregation can stand on its own. But, I truly think that because of the opportunities and complexities of the tax code. So really, if you're going to make the type of investment you are in a cost seg study, look not just to today, but look further down the road and how you could be using that for your entire term of ownership.

Mr. Redpath

You mentioned briefly about the QIP property. Can you kind of explain that and how that fits in here? Because, we did have some changes.

Mr. Johnson

Yes, so I think qualified improvement property has been around since 2016 and was part of the PATH Act. It was all new part of the tax code, and then the TCJA came in and enhanced, at least in writing, QIP, qualified improvement property. But in the same process, they enhanced QIP, but they then allowed for qualified leaseholds to expire. So as we all know, there was the technical error and how they've fashioned that, but that was corrected in the CARES Act. So where we sit today, QIP can be a very, very powerful tool, particularly in conjunction with bonus depreciation. I know I keep bringing that up, but I can't overstate the power of that tool itself.

But QIP, now when we look at the definition as it was outlined in the PATH Act is the same then as it is today, which basically says, "Any improvement to an existing building that's not an expansion or addition, and doesn't include work to elevators, escalators, or structural members of the building and its interior can be considered a qualified improvement property." And today, what that means is that we can treat that as a 15-year straight-line asset and, therefore, as bonus eligible.

And to me, a perfect illustration of this, Ian, is that a lot of properties have been going through energy retrofits for decades. Particularly, lighting retrofits. And I use an example of, say, a warehouse which could have a substantial amount of light fixtures in that property. And you go in, you do a retrofit. Say, it's $100,000. Well, now those new lighting fixtures, so long as they meet the definition, you can now be treating those as QIP, 100% bonus, you essentially are writing off that basis. And then, what we talked about before is using that analysis also to maybe substantiate writing off the old light fixtures that you replaced. Just kind of tie that altogether there.

Mr. Redpath

And, also you might qualify for some credits, right? I mean, there may be some energy credits in what you're doing with the building.

Mr. Johnson

Well, it's interesting. Certainly, there might be... If you're going to use, say, QIP and 100% bonus and you're writing off the basis, I think you might've been referring to Section 179(D). If you write off the basis through QIP, I would say that you don't have any basis for 179D. But, there may be some dollars available through, say the utility, or the municipality might have something available for you. But again, that's a great point because it brings up, again, that complexity.

The opportunities and complexities of it's not just simply depreciation, it's really looking at things. And oh, by the way, we can also just throw in there with that lighting example, Section 179 standard business deduction for that lighting example is another option that you have. So remember, Ian, when I was saying about my role in this whole process or my independent role? This is why yours is so critical is that I can be bringing all these solutions, opportunities, to the table. It's the tax professional that's going to be able to say, "All right, this is the optimal solution. How do you create a hybrid situation?"

Mr. Redpath

And, I think that's what we started with is that we're really looking at maximization and how that's done. There's a lot of different opportunities here and it's just, okay, what do we want? And, sometimes you take the position that now, I don't necessarily want to take that risk. I'll back that off. But, we've talked now where this kind of fits as I understand it, new construction, acquisitions. You mentioned energy-efficient retrofits and renovations of property, right? All of these things, you can apply a cost segregation to it.

Mr. Johnson

Absolutely. Again, it all starts with what's your need, your appetite for this type of stack strategy, and then right fitting the solution to what you need today. In a lot of cases, because we can do lookbacks, it might be a scenario where, "Hey, I've got three or four properties. Maybe I just do one or two this year, and then I reevaluate next year to see how I could fit next year's need with that property that you still have left."

Mr. Redpath

Now, I understand, Bruce, if I called you and said, "I have a client that's buying this building, or building this building, or renovating, or whatever. I need some help here, because I think we potentially could have some benefits." We have a slide here, and of course, it's an ongoing process, right? You don't take the initial information, go out and here's your study, right. It's a constant communication, but this slide is kind of some of the basic information that is required when you're looking to start a cost seg. So, could you kind of go over that with us?

Mr. Johnson

Sure, I mean, it's some of the, as you said, the basic information, address, maybe the tax entity name. If it's a new acquisition, the settlement sheet would be fantastic because it has most of what we need on there. But if something has been depreciated, the depreciation schedule is super critical, Ian, because how would we know how the prior assets, both when they came on online, what their value was, and how they were being depreciated? It's super critical, because maybe the cost seg was already done. Maybe you inherited this relationship, and the prior CPA had already done a fantastic job. So, all right, then let's identify that.

But you can also look at, it's easy when you're starting this qualifying process to ask for the moon and the stars. But the reality is, to really do that initial analysis, unless it's a very complicated project, you start with the address, the basis, the date of service. If we can get drawings and things like that, that would be fantastic. But just in today's day and age, most people are super busy just with their everyday activities to have to come up with those drawings at this stage, because we don't even know if there's a solid opportunity. That may not be warranted, but it's always great if we could get it.

Mr. Redpath

Now, when you ultimately do the study, those are the types of things that would be included in this study. In the ATG, those are some of the things they say to look for.

Mr. Johnson

If they're available, absolutely. So, we talk about acquisitions. In most cases, those drawings are not [available]. Maybe that building literally was built 50 years ago. Those drawings are long gone, although they might be stuck behind some piece of mechanical equipment in some closet somewhere. And, that's okay because the Audit Techniques Guide gives us a way to deal with that. We can reconstruct that building on paper using standard construction industry pricing and estimating tools to basically, I use the term, forensically rebuild that property on paper.

Mr. Redpath

That's a great term, Bruce. I think that really is a great term, forensically rebuild because that is so important.

Mr. Johnson

No one wants us punching holes in their walls. Is that a wood stud or a metal stud? "Hey, let me dig a hole here to find out what kind of foundation there is." You have to use some professional judgment on some of those cases.

Mr. Redpath

Now, you mentioned something, and I wanted to make sure I asked you about this. You said something about going back to amend a return. Now, how would that work?

Mr. Johnson

So, a lookback study—very powerful. So if you think about, hey, I just started a business, I put a building up. I'm not profitable, so you don't need these deductions. That's okay, because you can keep that solution, that strategy, in your back pocket to when you need it. So, yes, you can go back. Let's say it's a five-year lookback. You certainly can amend the return, probably too painful and costly for most folks to do. But, you can do the same effect through a 3115. 3115, assumptive change in accounting method, I think. Is that the term for it?

Mr. Redpath

Yes, Form 3115 is Application for Change in Accounting Method.

Mr. Johnson

So, you can do the study to substantiate the 481a adjustments claim in a 3115. And, essentially, I think you would use a designated change number seven for most of what we do to make that change. It's much easier, simpler, and less painful than having to amend the return. Now, it's interesting in scenarios where maybe it's only a year of lookback, then it might justify doing an amended return. But most cases, Ian, in those lookback scenarios, the 3115 is the perfect vehicle for it.

Mr. Redpath

Bruce, I have to tell you that this does tell me why we need to bring someone like you, an expert, in to do a cost seg and that it's not something we want to just jump into. But boy, it's highly complicated and I love the term you used regularly, this forensic approach to it because I think that does really kind of say what you do when you're looking at these costs segs. So Bruce, I want to thank you. Great information today, and I hope I have you back on the program again.

Mr. Johnson

Same here, Ian. It was great to talk with you and always a pleasure. Thank you for the opportunity.

Mr. Redpath

Thanks.

Cost Segregation

By Ian J. Redpath, JD, LLM

A. Introduction

When a building is constructed, purchased, or renovated, the ability to characterize expenditures as for tangible personality rather than realty can result in great tax savings to the taxpayer and have a major impact on the financial aspects of the deal. This is even more impactful with bonus depreciation available on certain tangible assets. Cost segregation has been a matter of controversy with the IRS and will generally require a cost segregation study by experts in the field. This may include engineering studies in some cases. Practitioners should be aware of the advantages of cost segregation and what is generally required in order to properly advise clients.

The Tax Cuts and Jobs Act (TCJA) brought about significant changes that accentuate the use of cost segregation. Among the changes were:

- Bonus depreciation boosted;
- QIP and qualified property categories change;
- Section 179 expensing expanded; and
- Like-kind exchanges of personal property no longer permitted.

The result include:

- Ten years of predictable rates through 2026
- 100% bonus depreciation in play through 2022
- Acquired assets allowed to leverage bonus

Year	Bonus Value
9/28/2017-12/31/2017	100% (50% election)
1/1/2018 – 12/31/2022	100%
2023	80%
2024	60%
2025	40%
2026	20%

It is interesting to note that the cost segregation for like-kind exchange can be used for allocating more to real property where the gain is deferred or to tangible property where bonus depreciation may be available. The IRS issued final regulations defining real property for purposes of §1031. [See Reg. §1.1031(a)-3(a) (2) et seq.] When a property is acquired in a §1031 like-kind exchange, practitioners have several considerations before deciding how to best depreciate the carryover basis from a relinquished property. Bonus depreciation applies to property with a tax life of 20 years or less (i.e., it does not apply to real property). Only the "excess basis" of property acquired after September 27, 2017 qualifies for bonus depreciation. Therefore, a property with large excess basis benefits significantly more from cost segregation because of bonus depreciation.

Example: A property was transferred in a §1031 exchange for $1 million. There was $800,000 of depreciation left over at the time of the exchange—carryover basis. The new property that is received in the exchange has a FMV of $1,600,000. Only the excess basis of $600,000 ($1,600,000 – $1,000,000) is eligible for bonus depreciation.

Generally, the carryover basis of property acquired in a like-kind exchange during the current tax year must be depreciated over the remaining recovery period of the property exchanged using the same depreciation method as the relinquished property. Any excess basis is treated as new property. This results in depreciation being separately calculated for the excess basis and the carryover basis. The cost segregation study applies only to the excess basis, not the carryover basis. In the above example, that would be the $600,000 excess basis.

Taxpayers can elect to treat the adjusted basis of the exchanged property as if it was disposed of at the time of the exchange. Under this election, a taxpayer treats the carryover basis and excess basis of the acquired property as if placed in service on the date acquired. The depreciable basis of the new property is the adjusted basis of the exchanged property plus any additional amount paid for it; this is called "net tax basis." By making this election, the taxpayer may be able to use a more favorable method of depreciation and simplify recordkeeping. Cost segregation applies now to the combined carryover basis and excess basis. In the above example, the "net tax basis" of $1,400,000 ($800,000 carryover + $600,000 excess basis). The election is made by attaching a statement to the income tax return indicating "Election made under Regs. §1.168(i)-6(i)," and describing the property.

Qualified improvement property (QIP) is any improvement to an interior portion of a building which is nonresidential real property if the improvement is placed in service after the date the building was first placed in service by any taxpayer. This replaced the separate categories of QLI, QRI, and QRIP. QIP placed in service after December 31, 2017 was intended to have a 15-year SL recovery period and be eligible for bonus; however, there was a drafting error in the TCJA. The CARES Act of 2020 fixed the problem, retroactively making QIP 15-year and bonus-eligible. It certainly may be worth revisiting projects.

Generally, in a cost segregation study, there is an analysis of all the assets that were constructed, acquired, or renovated and allocating the costs to the assets. Obviously, the intent is to allocate as much of the cost as possible to assets that can be written off over shorter periods. Typically, commercial property uses 27.5- or 39-year lives; however, certain assets to be depreciated use shorter lives of 5, 7, or 15 years. By carving out, or segregating, the assets with shorter lives, depreciation of those assets may be accelerated. The result is accelerated depreciation, tax deferral, and increased cash flow. It should be noted that cost segregation does not increase depreciation, only accelerates it. So essentially, it is a simple time value of money issue.

Many times, the parties agree on the overall price without discussing any type of allocation. The cost segregation study is used to support the tax positions taken and is generally a forensic, engineering-based analysis with the goal to identify, quantify, and reallocate assets from long-lived MACRS classes to shorter-lived MACRS classes, as demonstrated in the following image.

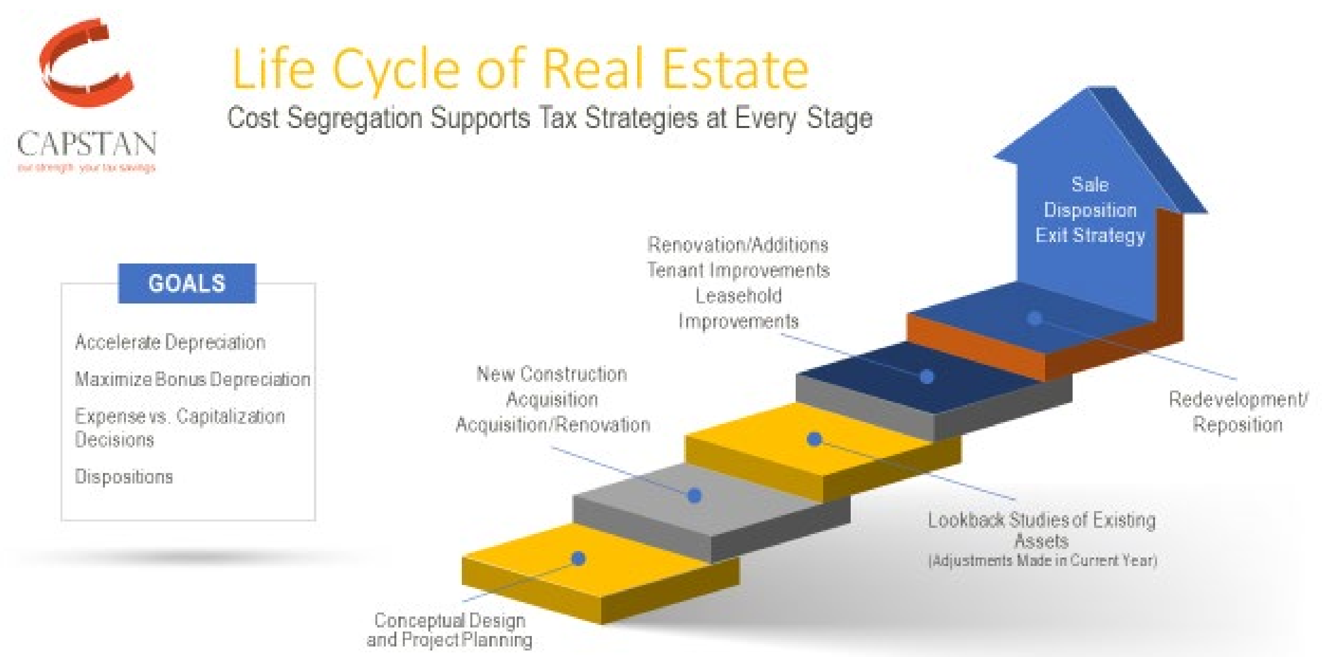
Example: Paula purchases a commercial store building on January 20 for $200,000. It has a 39-year MACRS life. The first-year depreciation using a mid-month convention is $4,914 ($200,000 ÷ 39 × 11.5/12). Assume that Paula had a cost segregation study that determines $90,000 of the cost is properly allocated to point-of-sale systems that should be depreciated over five years. Then, her depreciation deduction for the first year would be:

39-year property	$ 110,000 ÷ 39 ×11.5/12	$ 2,703
5-year property	$ 90,000 × 20%	$ 18,000
Total		$ 20,703

Properly allocating costs to the five-year property accelerates the recovery of $90,000 of the investment. This could be further accelerated if bonus depreciation or §179 expensing is used.

It should be noted that any sales price allocation agreed to in a contract between the buyer and seller could be used against the taxpayer if they later want a different allocation based on a subsequent cost segregation study. The idea of a cost segregation study should be considered up-front. Often, in the allocation of cost in a purchase, the buyer and seller have adverse interests in how the price is allocated due to depreciation and/or §1231 ordinary income recapture. This is less an issue with §1250 real estate. [*Peco Foods, Inc.*, 112 AFTR 2d 2013-5137 (11th Cir. 2013)]

Cost segregation studies are used then to maximize and support accelerated depreciation of land improvements and personal property. They are recognized by the IRS as an accepted procedure and thus may generally establish a defensible return position. They can also be used to establish a unit of property under tangible property regulations. Additionally, it provides the data required to support a myriad of other tax strategies.



Studies will have more credibility the closer they are to the event (acquisition, construction, or renovation), and thus timing is very important. In many cases, the return may be filed in advance of the completion of the study. This may require a change to the depreciation taken on the return, which may require a change in accounting method [Reg. 1.446-1(e) (2)] to reflect the changes made by the study. This type of change is one that is subject to automatic consent and is made by filing Form 3115 with the return for the year of the change and filing a copy with the IRS office shown in the address chart in the Form 3115 instructions. Of course, this does not mean that the IRS will simply accept a cost segregation study. In CCA 201805001, the Chief Counsel addressed an overly aggressive cost segregation study that significantly front-loaded depreciation to five-year assets. The depreciation needed to be adjusted, and the study's preparer penalized under §6701(a), and the return preparer penalized for five years of understated tax returns, for a total of $5,000. The § 6701 penalty is $1,000 per year for individual returns ($10,000 per year for corporate returns) for aiding and abetting understatement of tax liability.

In any project/purchase, there must be a cost/benefit analysis to whether a cost segregation specialist should be retained. Obviously, the cost of the study has a direct impact on the benefits received. On smaller dollar projects/purchases, the taxpayer may be able to provide the tax practitioner with enough reliable information to segregate out certain assets when faster MACRS classes are available. However, this may be more easily challenged by the IRS. In other situations, the taxpayer and/or the practitioner will employ a firm specializing in cost segregation to do the study. These firms usually employ engineers and other specialists to identify and classify different types of assets. Again, a cost/benefit analysis should be done taking into consideration the tax savings against the cost of the study. Many commentators put the dollar value at $200,000 or more for a study to make economic sense.

B. Structural Component vs. Personal Property

The structural components of a building are depreciated using the same life and method as the building itself. The Tax Court has ruled that property that would have qualified as tangible personal property under the old investment tax credit (ITC) rules qualifies as tangible personal property for MACRS depreciation and that cost segregation studies are an acceptable way to identify tangible personal property associated with real property [*Hospital Corp. of America & Subs.,* 109 TC 21 (1997)]. The IRS has announced that it will follow that decision (AOD 1999-008).

The regulations under former §48 contain much of the guidance on whether property is real or personal property. Tangible personal property means any tangible property except land and improvements thereto, such as buildings and their structural components [Reg. §1.48-1(c)]. Property (other than a structural component) that is contained in or attached to a building is generally treated as tangible personal property. Structural Components include walls, partitions, floors, and ceilings, as well as any permanent coverings of these, such as paneling or tile [but carpeting is not considered permanent, so it has a 7-year life (Rev. Rul. 67-3490)]; windows and doors; all components (whether in, on, or adjacent to the building) of a central heat or air conditioning system; plumbing and plumbing fixtures; electric wiring and lighting fixtures; chimneys, stairs, escalators and elevators; sprinkler systems; fire escapes; and other components related to the building's overall operation and maintenance. [Reg. §1.48-1(e)(2)]

A structural component not related to the building's overall operation or maintenance could possibly not be considered part of the building if it facilitates a particular function of the building, the use of a particular piece of equipment, or interconnections between specific pieces of equipment and are generally treated as tangible personal property [Rev. Rul. 66-299]. The more specialized the facility, the more likely components relate to specific building equipment or a particular building function instead of overall operation and maintenance. While a cost segregation study can be done for any real property, the following buildings may be especially good candidates—hospitals, restaurants, assisted living centers, and factories.

Even if an asset is not directly related to a specific building function or piece of equipment, it may not be a structural component of the building if it is not permanently attached. The following factors should be considered to determine whether property is inherently permanent (and thus not tangible personal property) [*Whiteco Industries, Inc.*, 65 TC 664 (1975)]:

- Is the property capable of being moved and has it been moved?
- Is the property designed or constructed to remain permanently in place?
- Are there circumstances showing that the property may be or must be moved?
- How substantial and time-consuming a job is its removal?
- How much damage will the property sustain if it is removed?
- How is the property affixed to the land?

C. Steps in a Cost Segregation Analysis

Differing analysts may use different approaches to a cost segregation study. Commonly, there is an initial three-step process to assign as much cost as possible to property with lower recovery periods under MACRS. The steps are:

1) Making an initial land-to-building cost allocation.

2) Identifying land improvement costs.

3) Analyzing building costs to identify assets that are not part of the building or a structural component.

The first step is to make an initial cost allocation between the land and building. The land cannot be depreciated, so this step is very important. The allocation should be based on the relative FMVs. [Reg. §1.167(a)-5] As mentioned earlier, in a purchase, the buyer and seller often agree on the price but not any form of allocation. If they do agree on an allocation, it will not be respected unless it can be shown there is a reasonable basis for the allocation and that it is a "bargained for exchange." It should be remembered that if the property acquired is part of the acquisition of a trade or business of substantial part thereof, under §1060, the parties must file Form 8954 and make the seven0step price allocation under that provision. This section is mandatory and employs a residual method whereby the price is allocated first to the classes (other than Class I, which is cash) based on the FMV of that Class of Assets. If any price remains after allocation to the first six classes, this residual is allocated to Class VII, which is goodwill and going concern value. The amount allocated to a class is then allocated on relative FMV to the assets within the class. The IRS will recognize an allocation if it is reasonable and can be supported by the taxpayer. This may be difficult without a qualified appraisal. For example, a taxpayer may not allocate cost to land and building solely based on its assessed value for property tax purposes. [PLR 9110001].

Land improvements are generally depreciated using 150% declining balance over a 15-year recovery period. This is significantly faster than real estate alone. Isolating those costs is obviously advantageous to taxpayers in most situations.

After costs have been allocated to land and land improvements, the remaining costs are analyzed to determine whether any can be assigned to assets that are not the building or its structural components (i.e. tangible property). This is generally the most detailed area of the project.

Consideration must also be given to the tangible property regulations which became effective January 1, 2014. These regulations can impact whether money spent on real estate and other tangible property is expensed or capitalized. The regulations provide guidance regarding:

- Capital expenditures in general;
- Amounts paid to acquire tangible property;
- Amounts paid to improve tangible property;
- Dispositions (*time-sensitive); and
- Expensing options.

The regulations refer to a unit of property. If a unit of property is assigned as a result of a cost segregation study to a different MACRS class than originally assigned when it was placed in service, then the part reclassified for MACRS is treated as a separate unit of property for determining when costs must be capitalized, [Reg.§1.263(a)-3(e)(5)]

Example: In 2017, Jane acquired and placed in service a building and parking lot for her business. The building and parking lot were capitalized and depreciated as nonresidential real property. In 2020, she completed a cost segregation study and determined that the parking lot qualified as 15-year property. It now becomes a unit of property separate from the building. In 2021, she incurs expenses to resurface the lot. The test, for capitalization purposes, is whether the expense results in an improvement to the separate unit of property, the parking lot. A change of accounting method is required.

The final tangible property regulations define materials and supplies. Characterizing a unit of property as a material or supply from an acquisition or production cost $200 or less.

D. IRS and Cost Segregation Studies

The IRS has issued a Cost Segregation Audit Techniques Guide (ATG) to help agents examine cost segregation studies to determine whether to accept or challenge their conclusions. An ATG, while not primary authority, is an essential tool for practitioners in crafting, analyzing and defending a cost segregation study. It can be accessed on www.irs.gov. As stated earlier, having a study does not protect the client from audit or proposed adjustments by the IRS.

The ATG gives practitioners insight into what the IRS is looking for in a cost segregation study and also the characteristics of a quality study. The IRS indicates that a quality cost segregation study has the following characteristics.

1) Prepared by an individual with expertise and experience.

2) Contains detailed description of the methodology.

3) Includes appropriate documentation, such as blueprints, contractors' requests for payments for new construction and a purchase price allocation (first allocating costs to land) for purchased properties. In both situations, documentation should include a site visit.

4) Interviews were conducted with appropriate parties (contractors, subcontractors, property managers, etc.).

5) Uses a common nomenclature (usually terminology consistent with the blueprints and other project documents).

6) Uses a standard numbering system [for example, the Construction Specification Institute's (CSI) system].

7) Explains the legal analysis for the allocations with references to the applicable case law.

8) Determines the unit cost of assets (process of allocating costs to assets).

9) Organizes assets into lists or groups (for example, land improvements, furniture and fixtures, electrical systems, etc.) that tie to the client's fixed asset ledger.

10) Reconciles total allocated costs to total actual costs.

11) Explains how indirect costs are treated.

12) Identifies and lists Section 1245 property.

13) Considers related aspects (for example, sampling techniques).

The following table from the ATG shows what the IRS is looking for in different types of studies.

Table: IRS Evaluation of Cost Segregation Studies

Type of Study	**Description**	**IRS's Evaluation**
Detailed Engineering Approach from Actual Cost Records	This approach uses actual costs from recently prepared construction and accounting records. It relies on solid documentation and minimal estimation. However, it is also the most expensive type of study and can only be applied to new construction where detailed cost records are available.	This type of study produces the most accurate cost allocations.
Detailed Engineering Cost Estimate Approach	This is similar to the detailed engineering approach, except that costs are estimated rather than using actual costs. It is used when cost records are not available or for an acquisition when the purchase price must be allocated.	If detailed cost estimates are prepared by qualified individuals, and the estimates are reconciled to actual costs, reasonably accurate cost allocations are possible.
Survey or Letter Approach	This approach is an alternative method for estimating costs. Contractors and subcontractors are contacted via a survey or letter to provide information on the cost of specific assets that they installed on a particular project. These costs are then used in one of the engineering approaches or in the residual estimation approach (discussed below).	If the contractor provides actual cost data, the allocations may be reasonably reliable. However, when contractor data is obtained from other sites or projects, the data may not be comparable or reliable.
Residual Estimation Approach	This is an abbreviated method where only short-lived (five to seven years) asset costs are determined. Short-lived asset costs are added together and then subtracted from the total project cost. The residual cost is then simply assigned to the building.	This method is less accurate than the previously discussed methods and does not reconcile total project costs. Generally, residual costs are not estimated or checked for reasonableness. The IRS would like to see a reasonable estimate of the residual (building) cost, and then the residual cost can be added to the cost of short-lived assets to determine if total project cost is reasonable.
Sampling or Modeling Approach	The sampling or modeling approach uses a created model (or template) to analyze multiple facilities that are nearly identical in construction, appearance and use (traditionally, fast food chains and retail outlets).	The sampling method used may not be statistically valid, and a population of less than 50 could limit the accuracy of a sampling technique unless an appropriate sampling error is considered. Additionally, differences in building codes, geographic location and material and labor costs may make it difficult to determine an appropriate model.

Type of Study	Description	IRS's Evaluation
Rule of Thumb Approach	This approach uses little or no documentation and is based on a preparer's experience in a particular industry. For example, a preparer may estimate Section 1245 property as a fixed percentage of project cost by relying on industry averages.	The IRS warns its examiners to view this type of approach with caution since it usually lacks sufficient documentation to support its allocation of project costs.

E. Conclusion

Cost segregation can result in tremendous benefits for taxpayers. It is important to be able to defend a cost segregation, and this is generally through a cost segregation study. In any purchase, construction, or remodeling, practitioners should evaluate whether a study should be done and the possible savings to the client.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, Yolanda, LLC, has contracted to construct a new factory for its manufacturing business. Construction will begin in late 2021.

Another client, Grant, has approached you about doing a §1031 like-kind exchange of one of his apartment buildings for another apartment building.

A third client, Peter, has obtained a building and will be renovating it this year.

Required:

1) Would you recommend a cost segregation study to Yolanda, LLC? Why or why not?

2) Is a cost segregation study relevant to a §1031 transaction?

3) What steps need to be done for a cost segregation study?

B. Suggested Answers to Discussion Problems

1) Cost segregation studies are used to maximize and support accelerated depreciation of land improvements and personal property. They are recognized by the IRS as an accepted procedure and thus may generally establish a defensible return position. They can also be used to establish a Unit of Property under Tangible Property Regulations. Additionally, they can provide the data required to support a myriad of other tax strategies. A cost/benefit analysis should be done to determine if a cost segregation study would be cost effective. The practitioner should determine if he/she has enough information from the client to do a defensible cost segregation or if a cost segregation specialist should be brought in.

2) Cost segregation is still relevant to like-kind exchanges under §1031. It could be used to put more into deferrable gain, but more likely would be used in a similar manner to any other purchase, accelerating a depreciation of the assets and where bonus depreciation will apply only to the "excess basis."

3) Generally, there is an initial three-step process to assign as much cost as possible to property with lower recovery periods under MACRS. The steps are:

    a. Making an initial land-to-building cost allocation.

    b. Identifying land improvement costs.

    c. Analyzing building costs to identify assets that are not part of the building or a structural component.

GLOSSARY OF KEY TERMS

Conservation Easement—Conservation easement is the generic term for easements granted for preservation of land areas for outdoor recreation, protection of a relatively natural habitat for fish, wildlife, or plants, or a similar ecosystem, preservation of open space for the scenic enjoyment of the public or pursuant to a federal, state, or local governmental conservation policy, and preservation of a historically important land area or historic building. Conservation easements permanently restrict how land or buildings are used. The donor gives up certain rights specified in the deed of conservation easement, but retains ownership of the underlying property.

Coronavirus Aid, Relief, and Economic Security Act (CARES Act)—H.R. 748, also known as the CARES Act, is the third coronavirus relief package and was signed into law on March 27, 2020. This bill had bipartisan support in both the Senate and House and contains both tax and non-tax provisions applicable to individuals and businesses.

Excess Benefit Transaction—An excess benefit transaction is any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration, including the performance of services, received for providing such benefit.

Qualified Conservation Contribution—A qualified conservation contribution is a contribution of a "qualified real property interest," to a "qualified organization," exclusively for "conservation purposes," and prohibits the donee from making certain transfers.

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.

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 2021

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, in which of the following cases were checks written by the organization's treasurer deemed to be excess benefits transactions?

   A. *Alexander B. Wathen v. Commissioner*
   B. *Deborah C. Wood v. Commissioner*
   C. *Gloria Ononuju v. Commissioner*
   D. *New World Infrastructure Organization v. Commissioner*

2. According to Ian Redpath, which of the following does the IRS recommend taxpayers consider filing an amended return if they reported 2020 unemployment benefits?

   A. IR-2021-159
   B. IR-2021-167
   C. IR-2021-170
   D. IR-2021-172

3. According to Ian Redpath, which of the following discusses the safe harbor for employers claiming the employee retention credit?

   A. IR-2021-159
   B. IR-2021-170
   C. IR-2021-172
   D. Rev. Proc. 2021-33

4. According to Ian Redpath, which of the following addresses the foreign earned income exclusion?

   A. *Alexander B. Wathen v. Commissioner*
   B. *Deborah C. Wood v. Commissioner*
   C. *New World Infrastructure Organization v. Commissioner*
   D. *Today's Health Care II LLC v. Commissioner*

5. According to Ian Redpath, in which of the following did the IRS reconstruct income based on the bank deposits method?

   A. *Alexander B. Wathen v. Commissioner*
   B. *Deborah C. Wood v. Commissioner*
   C. *New World Infrastructure Organization v. Commissioner*
   D. *Today's Health Care II LLC v. Commissioner*

Continued on next page

6. According to Ian Redpath and Julie Welch, which of the following is correct regarding the child and dependent care credit for ***2020***?

   A. The *maximum* percentage of work-related expenses eligible for the credit in 2020 is 50%.
   B. The *maximum* percentage of work-related expenses eligible for the credit in 2020 is 35%.
   C. The *minimum* percentage of work-related expenses eligible for the credit in 2020 is 35%.
   D. The *minimum* percentage of work-related expenses eligible for the credit in 2020 is 10%.

7. According to Ian Redpath and Julie Welch, which of the following is correct regarding the child and dependent care credit for ***2021***?

   A. The *maximum* percentage of work-related expenses eligible for the credit in 2021 is 35%.
   B. The *maximum* percentage of work-related expenses eligible for the credit in 2021 is 20%.
   C. The *minimum* percentage of work-related expenses eligible for the credit in 2021 is 35%.
   D. The *minimum* percentage of work-related expenses eligible for the credit in 2021 is 0%.

8. According to Ian Redpath and Julie Welch, which of the following is correct regarding the child and dependent care credit?

   A. It is refundable for 2020 and 2021.
   B. It is refundable for 2019 and 2020 but nonrefundable for 2021.
   C. It is nonrefundable for 2020 but refundable for 2021.
   D. It is nonrefundable for 2020 through 2022.

9. According to Ian Redpath and Julie Welch, what is the AGI threshold at which the child and dependent care credit is completely phased out for a married couple filing jointly in 2021?

   A. Over $43,000
   B. Over $125,000
   C. Over $438,000
   D. Over $450,000

10. According to Ian Redpath and Julie Welch, what is the maximum amount of 2021 work-related expenses eligible for the child and dependent care credit for a married couple filing jointly with four (4) qualifying dependents?

    A. $8,000
    B. $16,000
    C. $24,000
    D. $32,000

Continued on next page

11. According to Ian Redpath and Bruce Johnson, what is the first-year bonus depreciation rate through 2022?

    A. 0%
    B. 25%
    C. 50%
    D. 100%

12. According to Ian Redpath and Bruce Johnson, which of the following qualifies as Section 1250 real property?

    A. Floor coverings
    B. Specialty electric and plumbing
    C. Walls
    D. Window coverings

13. According to Ian Redpath and Bruce Johnson, which of the following ***cannot*** be classified as 15-year assets?

    A. Land
    B. Landscaping
    C. Parking lot
    D. Sewer connections

14. According to Ian Redpath and Bruce Johnson, the technical error regarding qualified improvement property was corrected by which of the following?

    A. ARPA
    B. CARES Act
    C. SECURE Act
    D. TCJA

15. Which of the following do Ian Redpath and Bruce Johnson recommend using to report a change in accounting method for a taxpayer based on a five-year lookback study?

    A. Form 3115
    B. Form 1040
    C. Form 1065
    D. Form 1120

CPE Network®
Tax Report
Volume 34, Issue 9 **October 2021**

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 October 2021 **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	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Child and Dependent Care Expenses	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Cost Segregation	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|

Which segments of the October 2021 issue of **CPE Network® Tax Report** did you like the most, and why?

____

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Which segments of the October 2021 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 October 2021 **CPE Network® Tax Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Ian Redpath	|______|	|______|	|______|
Julie Welch	|______|	|______|	|______|
Bruce Johnson	|______|	|______|	|______|

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 ☐ ____________________

Specific Comments: ____

____

Name/Company ____

Address ____

City/State/Zip ____

Email ____

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

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: ____________________

Account #: ____________________

Location: ____________________

Program Title: CPE Network Tax Report, October 2021 Date: __________

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

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

Instructor Name: ____________________ Date: __________

E-mail address: ____________________

License State and Number: ____________________

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

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

Group Live CPE Credit (Sponsored by "Checkpoint Learning Network")

Promotional Information:
CPE Program Sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. If you are delivering this course within your firm, you should complete the following table and circulate it to attendees prior to the classroom course delivery. Refer to the executive summary for certain information noted below. Be sure to include the completed sheet when you request certificates for this event.

Title of Course (Enter full title)	
Date of Class (MM/DD/YYYY)	
Time (Enter time of class)	
Location (Enter location of class)	
Learning Objectives (Refer to executive summary)	
Program Description (Refer to executive summary)	
Instructional delivery method	Group Live
Recommended CPE credit	3.0 Credits
Recommended field of study(ies) (Refer to executive summary)	
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)	

(1) Insert instructions for your students to register for the class and any other attendance requirements (e.g., bring your laptop, be prepared to work in groups, you will be required to sign in and sign out of the session, etc.

Determining CPE Credit Increments

Group study sessions 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. Discussion leaders must monitor the program length and the participants' attendance in order to request the appropriate numberof CPE credits.

Note: All Network CPE products are developed and intended to be delivered as 3 CPE credits.*

Monitoring 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 CPE group attendance 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 sign the CPE group attendance sheet at the beginning and sign out at the end of the session. If a participant arrives late and/or leaves early, the hours actual hours they attended should be documented on the sign-in sheet and should be reflected on the participant's CPE certificate.

***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 designed by Checkpoint Learning Network. After November 1, 2018, Checkpoint Learning Network will no longer 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).

Note that Checkpoint Learning CPE Network can still be tailored by firms to smaller courses (e.g., 1 credit or 2 credit deliveries); however, when this is done, "Checkpoint Learning Network" cannot act as the sponsor and will not issue certificates of completions to participants. If a firm wishes to tailor (i.e., shorten. lengthen, and/or adjust field(s) of study), the firm delivering the tailored content must become the sponsor and that firm's name and sponsor identification number must appear on the certificates of completion. In these cases, there is no need to send attendance sheets back to Checkpoint Learning Network. If attendance sheets are submitted to Checkpoint Learning Network for modified deliveries as noted above (not withstanding late arrivals and early departures), the attendance sheets will be returned to you.

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 print materials are used, the user should read the materials, watch the DVD, 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 study documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completions should 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

NASBA requires the group study session to include a means for evaluating quality. At the conclusion of the group live session, evaluations should be distributed and collected from participants and sent to Checkpoint Learning Network along with the other course materials. 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

Copyrighted Materials

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

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/

Request Participant CPE Certificates

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

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

Email: CPLgrading@thomsonreuters.com

Fax: 888.286.9070

Before sending your package to Thomson Reuters, please be sure to include the following:

___ Promotional Sheet (completed)

___ Group Attendance Sheets (indicating any late arrivals and/or early departures)

___ Subscriber Survey Evaluation Forms

___ Name, title, and credentials of discussion leader(s) entered at the bottom of Group Attendance Sheet

CPE Network Self-Study Options

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

Best Practices Via Teams/Zoom
With the events surrounding the coronavirus many groups are unable to meet in person. Playing the video via Teams/Zoom or other conferencing software is one means of viewing the video. While the video from the Checkpoint Learning online accounts can be played through Teams/Zoom, the user experience will be better if the video files are shared via the desktop, which can be accomplished by copying the files from the DVD to the desktop and then sharing. Please note to enable viewers to hear the video being played follow the below instructions.

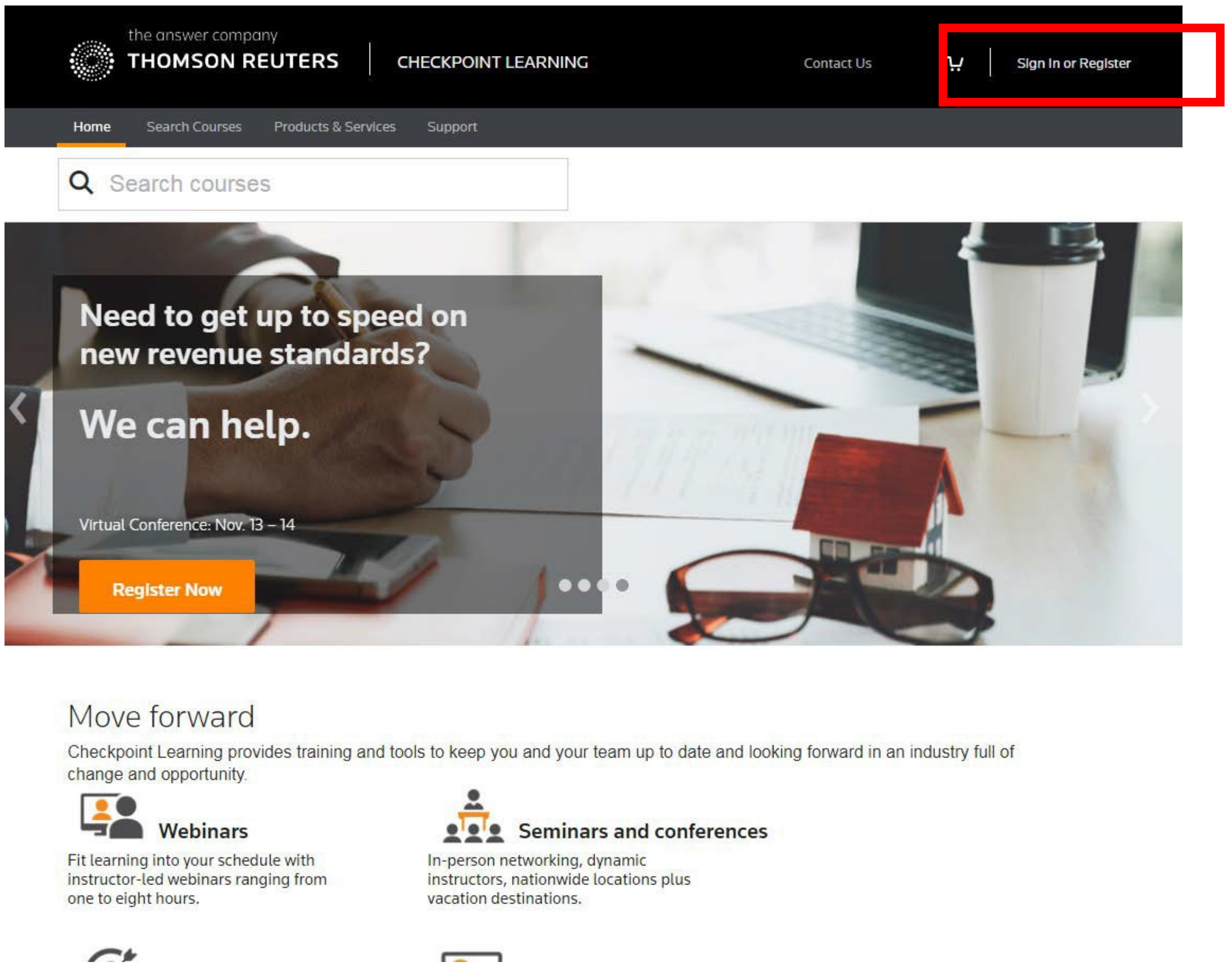
In Teams, when sharing the desktop with others, be sure to check the Share system audio box directly above the desktop to be shared, for the video's audio to be heard by others.

In Zoom, click the Share Screen button in the toolbar. Check the box to Share computer sound at the bottom of the Share Screen popup. Adjust the volume to an appropriate level. Do make sure the video is visible to participants.

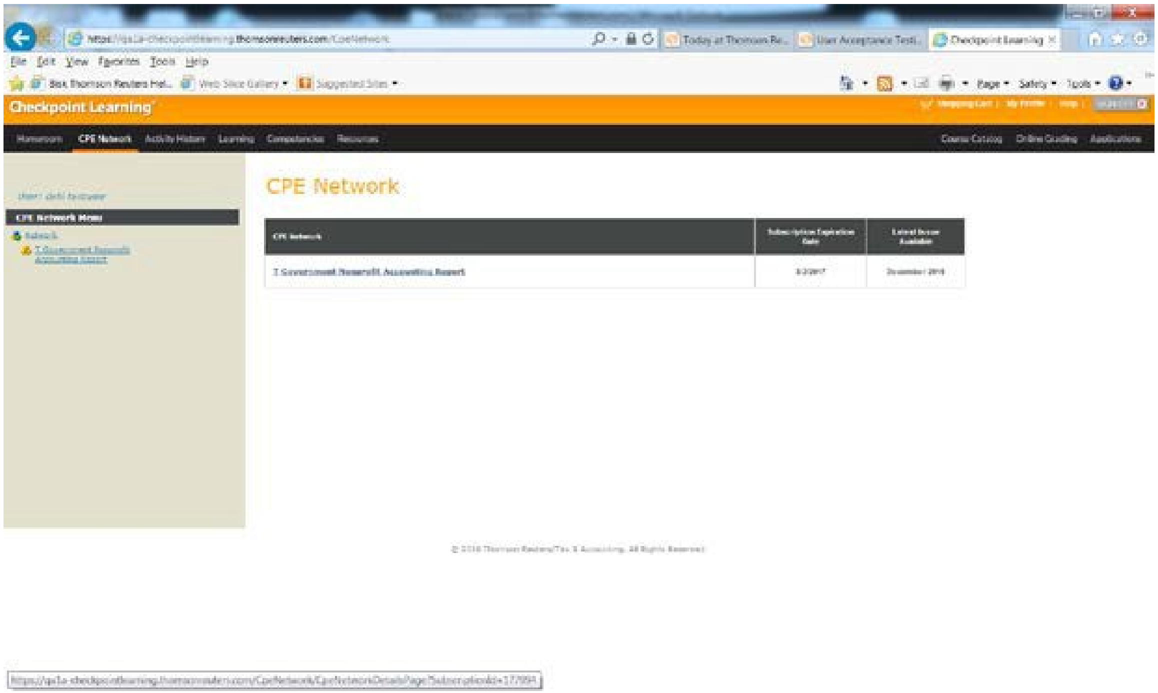
Self-Study—Online

Follow these simple steps to use the online program:

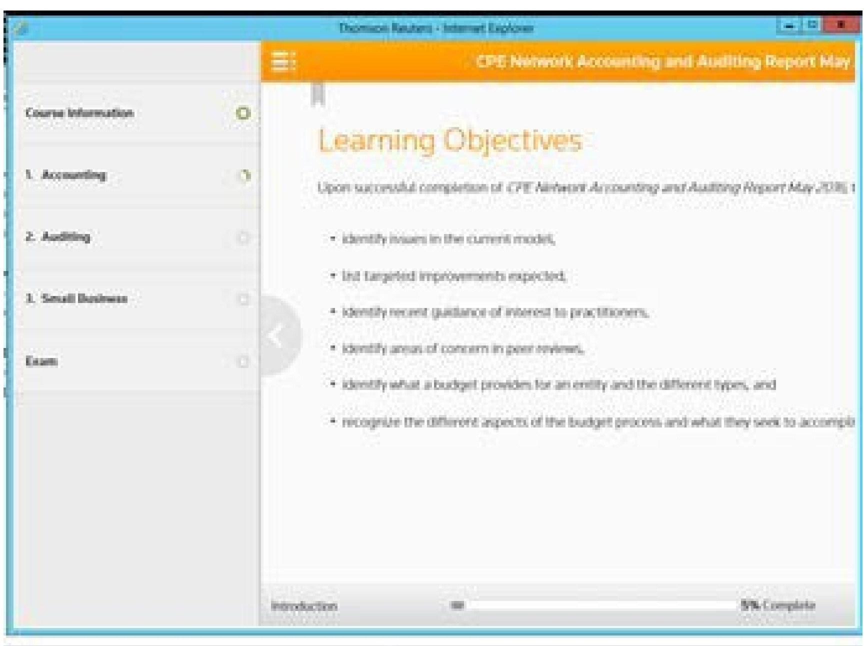
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Sign In or Register").



- In the **Network** tab, select the Network Report for the monthdesired.

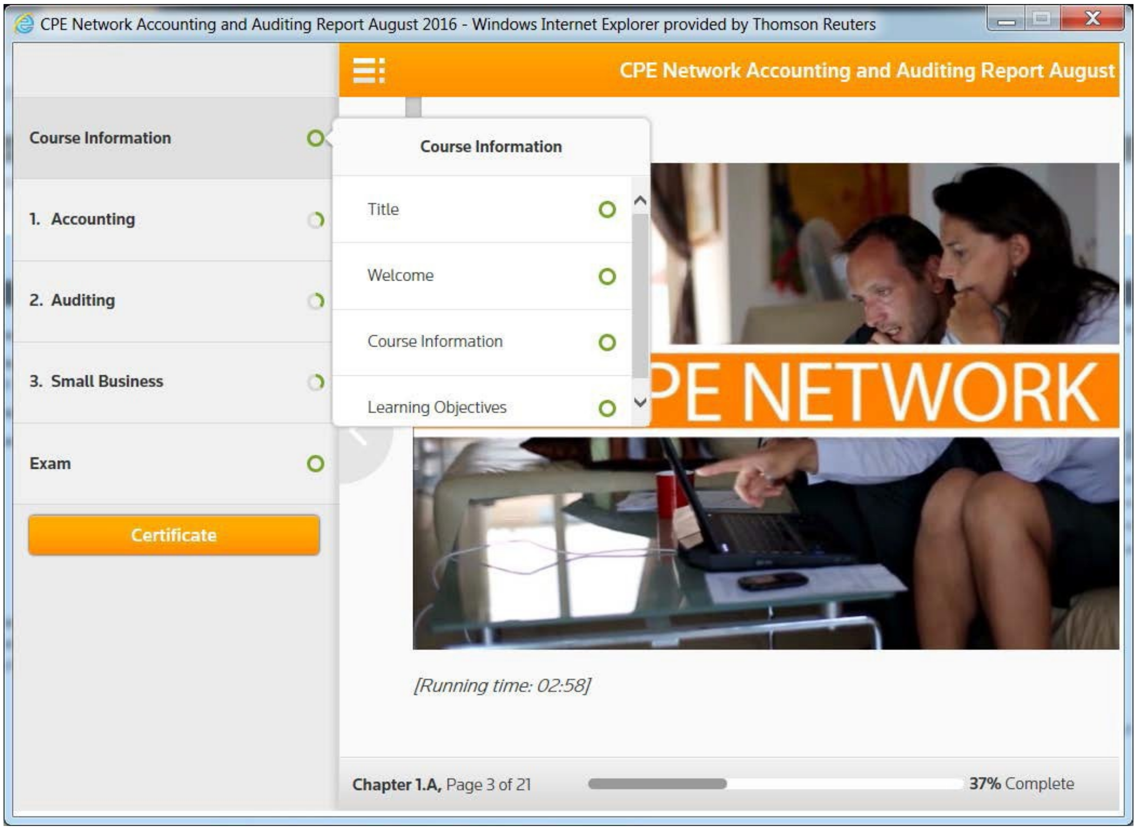


The Chapter Menu is in the gray bar at the left of your screen:

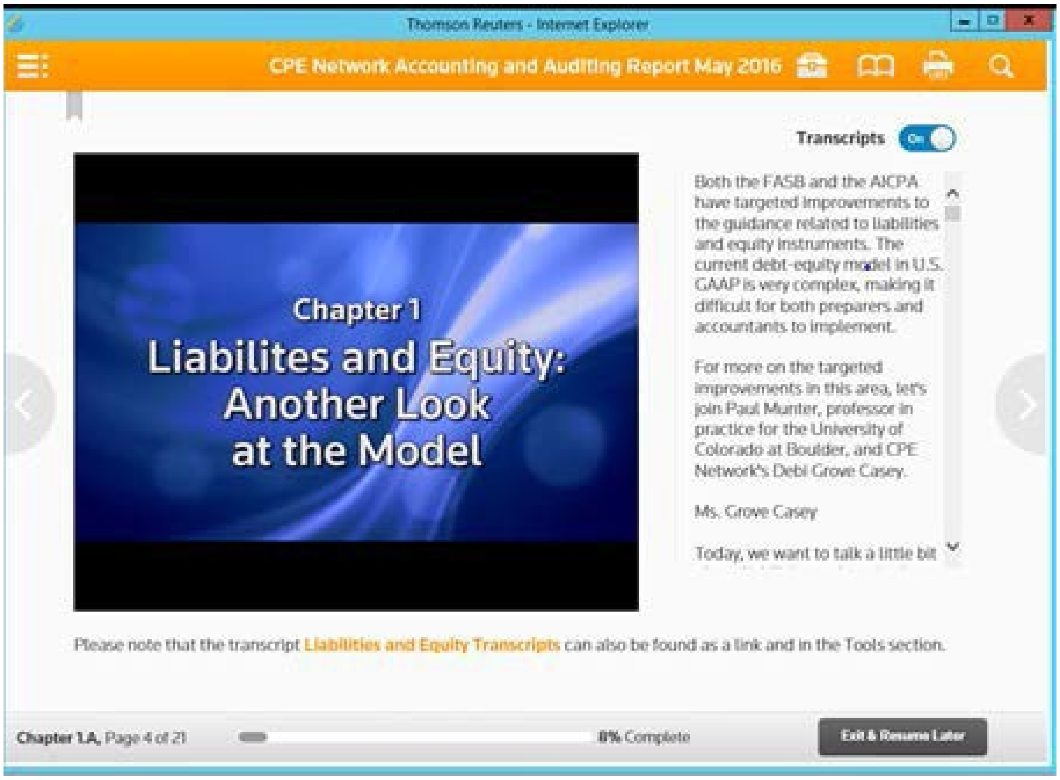


Click down to access the dropdown menu and move between the program Chapters.

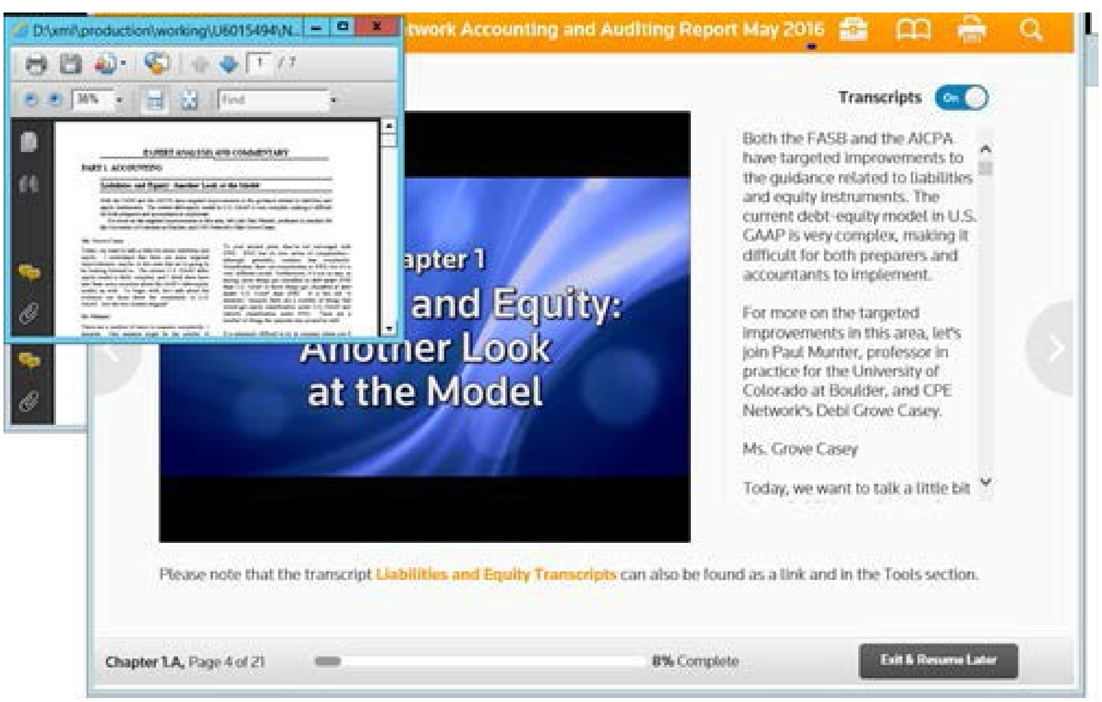
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



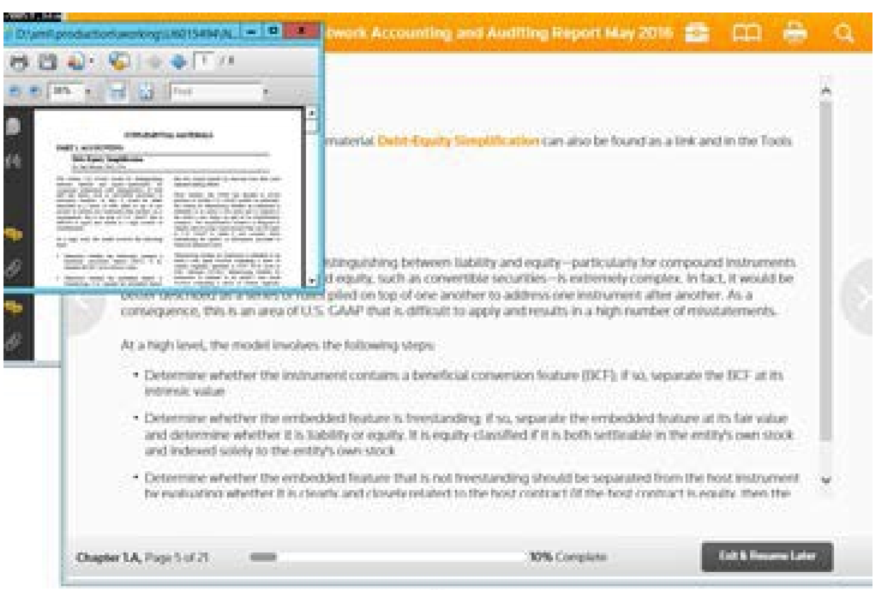
- **Each Chapter is now self-contained.** While on the CPEasy site the interview segments were all together, then all of the supplemental materials, etc., each chapter now contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials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



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.

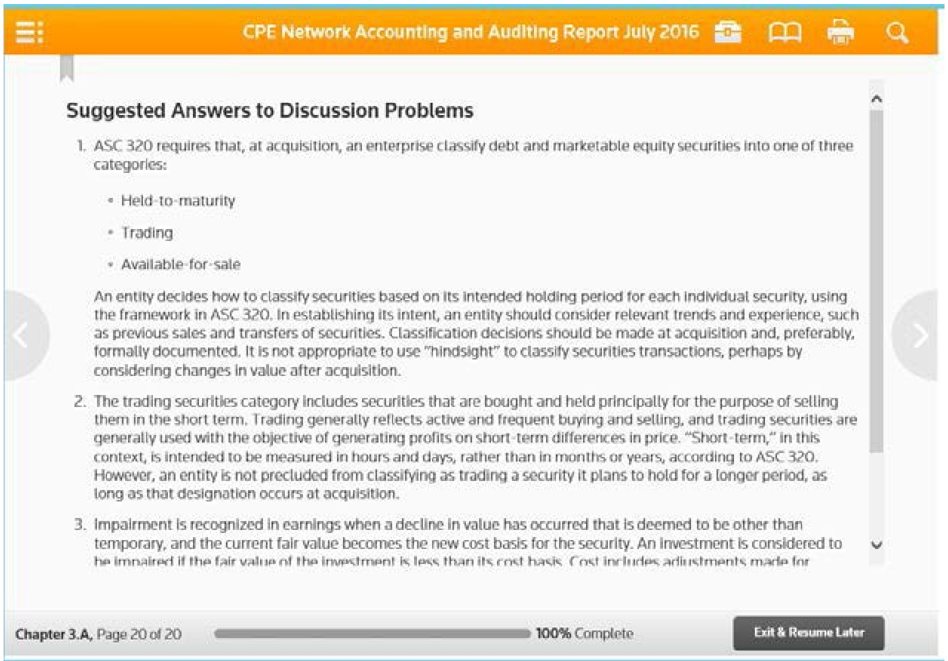


Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



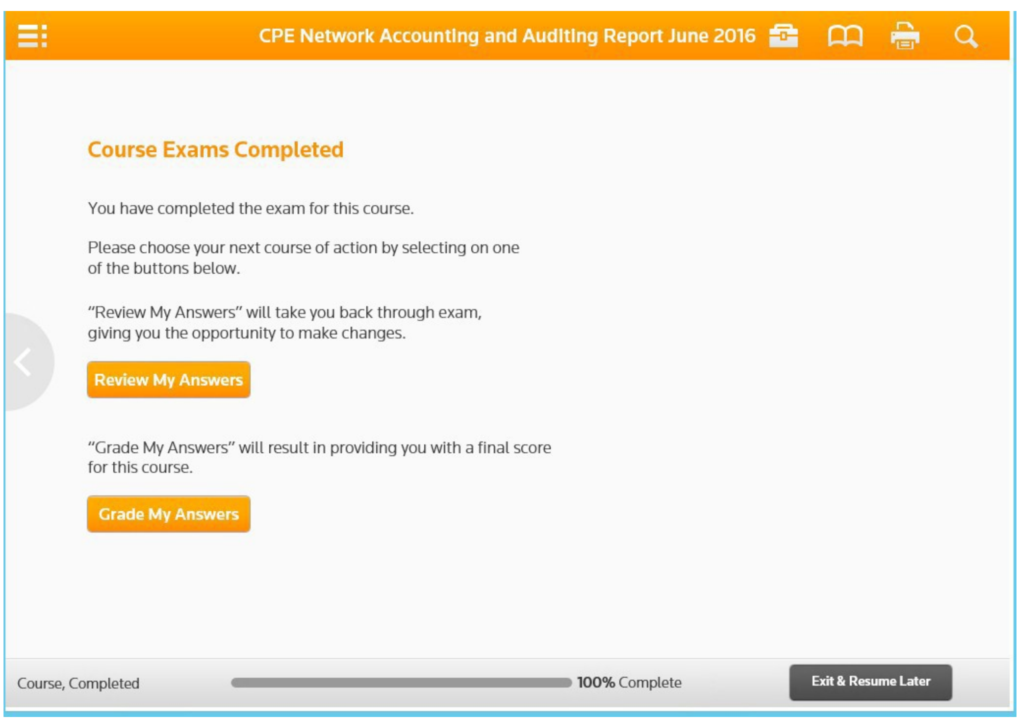
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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 CPEcertificate.
- 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**.

GETTING HELP

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

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

Checkpoint Learning Network: CPE Compliance

Checkpoint Learning Network courses can be group live, group internet based, or self-study. Unless otherwise stated in each course's descriptive information, no other prerequisites or advanced preparation are required.

Checkpoint Learning Network is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit. Complaints regarding registered sponsors may be submitted to the National Registry of CPE Sponsors through its website: www.nasbaregistry.org.

Checkpoint Learning Network is approved for Group Live, Group Internet Based, and QAS Self Study delivery methods.

Checkpoint Learning Network is an approved IRS Continuing Education Provider to deliver CPE to Enrolled Agents and IRS tax preparers. The IRS Tax Preparer Office requires that any course to be used for IRS PTIN holders must be pre-registered with the IRS. If you are a PTIN holder and are interested in obtaining IRS CE credit, be sure to review the course details in Checkpoint Learning to determine if the course you are considering is accredited to IRS.

What Does It Mean To Be a CPE Sponsor?

Your organization is the CPE Sponsor for this monthly series. The sponsor highlights below 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 attendance of the participants (make notations of late arrivals, early departures, and "no shows")
- Solicit course evaluations from participants
- Award CPE credit
- Retain records for five years

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

CPE Sponsor Requirements

Determining CPE Credit Increments

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

Program Presentation

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

- Learning objectives.
- Instructional deliverymethods.
- 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 resolutionpolicy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPEcredits**).**

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 weremet.
2. Prerequisite requirements were appropriate.
3. Program materials wereaccurate.
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 wereeffective.
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

(SAMPLE) Certificate of Attendance (SAMPLE)

This Certifies That:

Participant's Name

Attended:

Course Title

Field(s) of Study and Breakdown

Total CPE Credits

Completion Date

Location (City, State)

Instructor Name(s)

Sponsored By:

Sponsor's Name

Sponsor's Mailing Address

Sponsor's Identification Number

Sponsor's Signature

Sponsor's Signature

In accordance with the standards of the National Registry of CPE Sponsors, CPE credits have been granted based on a 50-minute hour. (Use this Statement if the Sponsor is Registered with NASBA.)