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CPE NETWORK TAX REPORT

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Topics for future editions may include:

- Cryptocurrency
- Trust Fund Issues and Possible Criminal Exposure

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EXECUTIVE SUMMARY

PART 1. CURRENT DEVELOPMENTS

The field of taxation is dynamic, and practitioners are constantly being confronted by changes through the Courts, the IRS, and Congress. This segment covers some of those recent changes.

Learning Objective: Upon completion of this segment, the user should be able to analyze current issues in taxation, including analyzing the basic exclusion for current gifts for persons dying in 2026 and after, assessing the availability of damages for wrongful IRS disclosure, and determining the applicability of equitable tolling for Tax Court review of a CDP determination. [*Running time 41:16*]

PART 2. INDIVIDUAL TAXATION

Many clients have experienced financial issues and find that additional money is needed. One source can be certain retirement accounts such as an IRA or 401(k) plan. IRC §72(t) provides exceptions to the early withdrawal penalties that may apply to distributions prior to age 59½. Notice 2022-6 has revised and clarified some of the applicable rules.

Learning Objective: Upon completion of this segment, the user should be able to analyze issues related to Notice 2022-6 and Section 72(t), including determining the different types of calculations of a Series of Substantially Equal Periodic Payments (SEPPs), applying the appropriate interest rate, and analyzing the 10% early withdrawal penalty. [*Running time 31:15*]

PART 3. BUSINESS TAXATION

One tool available in tax collections is bankruptcy. It is highly complex, and practitioners should be very familiar with the rules before entertaining it as a collection alternative for a client.

Learning Objective: Upon completion of this segment, the user should be able to analyze issues related to the tax aspects of bankruptcy, including determining the different types of tax claims; applying the three-year rule, the 240-day rule, and other legally assessable rules to tax claims; and evaluating dischargeability of tax claims. [*Running time 42:38*]

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.

Lawrence Pon is a Certified Public Accountant, Personal Financial Specialist, Certified Financial Planner, Enrolled Agent, United States Tax Court Practitioner, and Accredited Estate Planner in Redwood Shores, California. Mr. Pon has been in practice since 1986 and enjoys helping his clients reach their financial goals. He frequently speaks nationally on tax and financial planning topics to tax professionals, financial advisors, and the general public. Mr. Pon received his BS in Business Administration with emphasis in Accounting and Finance from the University of California, Berkeley and an MS in Taxation from Golden Gate University in San Francisco.

Gary Bluestein, JD a partner in the law firm of Andreozzi Bluestein LLP, focuses his practice exclusively on tax representation. He previously served as a Senior Attorney for the IRS and a Special Assistant United States' Attorney, represented the IRS in the U.S. Tax and Bankruptcy Courts, served on several National Task Forces addressing IRS enforcement issues, and received numerous Special Act Merit Awards. Gary has taught Tax Practice & Procedure at the University at Buffalo School of Law and in the Canisius College's Master in Tax Program. He is a member of the Erie County Bar Association, the Tax Committee, and the Bankruptcy Committee. He also serves on the Planning Committee for the University at Buffalo School of Management Tax Institute. Gary frequently lectures and writes on a variety of topics relating to tax representation for numerous local and national professional groups and has published articles in the Thompson Reuters Tax Practice Series and the Erie County Bar Bulletin.

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Program Level	Update
Prerequisites (Circle One)	Basic Accounting and Auditing professional experience
	Basic Tax professional experience
	Basic Governmental professional experience
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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 segment includes discussion of a tax court case involving whether the IRS Chief Counsel has final authority to concede or settle an innocent spouse defense in a deficiency proceeding.

Let's join Ian.

A. Intuit Settles State False-Advertising Claims; FTC Case Continues

Mr. Redpath

Hi, everybody. Welcome to the program. I'm Ian Redpath with Network Tax. And I want to thank you for joining me. This is the segment where we go over a number of changes that have happened, some interesting cases, things from the IRS and Congress. And so, let's jump right in and see what's happened.

On a previous program, we spoke about the fact that the FTC was going after Intuit and their claims about free filing of tax returns. In addition to that, there were a number of states. In fact, almost every state and the District of Columbia also went after them for their claiming that the tax filing software, they could e-file for free. And, of course, the claim was that this was just basically false advertising, because the simple return that it applied to, which was a federal return, was basically only if you had a W-2. What happened is Intuit agreed to pay $141 million to settle their false advertising claims that were brought by the states and the District of Columbia.

Okay. They agreed that there was false advertising and they decided to settle. Well, not so fast. The FTC said, "Well, they didn't settle with us." And the FTC said they are going to continue their administrative case against Intuit. So, yes, they settled it with the states but not with the FTC. So, there may be more to come beyond the $141 million that they're to pay the false advertising claims to the states and to Washington, D.C.

B. Proposed Donor-Advised Fund Fix

Well, we have a real interesting notice that came out. In the fiscal-year budget for 2023, Biden has proposed what's really considered a needed change to the donor-advised funds. And one of the reasons and one of the problems here goes back to a Notice 2017-73 wherein the question that arose was the use of donor-advised funds in order for private foundations to meet their distribution requirements.

Now, Section 4942 of the Code requires private foundations to annually distribute at least 5% of the total fair market value of the noncharitable assets from the preceding year or there's a 30% penalty. And of course, if this continues not to be, that penalty gets even higher up to 100%. Now, donor-advised funds, if you're not familiar with them, they've been highly controversial. But they are charitable funds that are maintained by a sponsoring organization; and private foundations are allowed to donate to them.

And the IRS has said these might be questionable donations and allowing for questionable deductions because they might provide impermissible economic benefits to donors and their families through the use of the donor-advised funds. And many sponsoring organizations have donor-advised funds where someone will donate to the fund and then the fund makes various donations. Now, many organizations set that up` assuming that the donations will end up coming to them.

And that's the case. And many people have said, we're not going to set up a private foundation. We're not going to go through all of this, and the reporting requirements, and the scrutiny. We'll just donate to a donor-advised fund for an organization. Now, remember, donor-advised, not donor-directed. And that's kind of the key there.

But, the IRS has said this is just being used improperly. And so the proposal is to, in essence, provide that a distribution from a private foundation into a donor-advised fund will not meet the definition of a tax-qualified distribution in order to satisfy the distribution requirements on the penalty tax, the 5%.

They did provide that or are providing for an exception to this—the donor-advised funds must be expended as qualifying distributions by the end of the following year. And the private foundation has to maintain adequate records or evidence showing that the donor-advised fund has made qualifying distributions within the timeframe. In other words, what they're really trying to do is put onto the donor-advised funds a kind of a flow-through.

So, the contribution that the donor-advised fund makes has to be one that would qualify for the distribution from the private foundation. And so again, the same basic timeframe; you make it, you have to distribute it within the year, by the end of the following year. So, Treasury has wanted to scale this back for quite some time. And now, they really are going after it.

Now, again, this was in the Biden proposal. However, the IRS is going to take action. Now, whether this action is statutory, as is being suggested in the Biden administration, or whether the IRS takes this and tries to do this regulatory. Either way, you can expect something is going to happen here.

So, we also know that there's a Senate bill aimed to revise—significantly reform—donor-advised funds. If you have clients that are engaged and involved with donor-advised funds—which is getting quite common now—or private foundations, this is something you should monitor closely because the IRS is certainly monitoring this closely. So, watch out for this. It is an issue.

C. *Aspro, Inc. v. Commissioner*

CA 8

Now, we have a case that comes out of the Eighth Circuit Court of Appeals, *Aspro, Inc. v. Commissioner*. The tax court—and this is something that happens often—people try to say, well, we're a small, closely held business. In this case, what they tried to do was they had purported management fees that they paid to organizations who were, in fact, the owners. [The court] said, "No, this is a disguised distribution of profit; they are dividends." The taxpayer argued that they had experts.

Well, the court said you had experts, but the experts never put a value on the services. They never applied any scientific approach to… what they were saying. And also, your CPA just summarized the facts and argued that these should be considered to be payments for services, so deductible by the corporation. But they never did an analysis. They never provided anything other than summarize the facts. So what they said was, under circumstances like this, what would other organizations pay for management services? They didn't quantify the value of the services or show that similar corporations would pay the same amount. And then, here's a big one. They had no dividend history. They hadn't paid dividends to these shareholders at all. And perhaps even more damning for the shareholders is that the payments were in proportionate share to their ownership. So, all of those taken as a whole, they said, you know what? These are clearly a distribution of profit. And again, what also didn't help was these distributions tended to be at the end of the year.

D. Notice 2022-23

IRS Proposes Changes to 2017 Qualified Intermediary Agreement

Now, we have Notice 2022-23. The IRS has proposed significant changes to portions of the 2017 qualified intermediary withholding agreement that applies to qualified intermediaries with the transfer of an interest in a publicly traded partnership or receiving a distribution from a publicly traded partnership on behalf of a foreign account holder of the QI, the qualified intermediary.

So what is a qualified intermediary for this case? It's a foreign financial institution or a foreign branch of a U.S. financial institution that enters into an agreement, the QI agreement, the qualified intermediary agreement with the IRS to report and withhold taxes from payments made to their account holders. Under that agreement, a QI is entitled to follow a simplified withholding and reporting requirement.

So, the current agreement expires at the end of this year, at the end of 2022. And so, the IRS is looking at how are they going to address this when it expires. Essentially, what the IRS is proposing is that a QI is not permitted to act as a QI with respect to an amount subject to withholding under Section 1446(a) on a publicly traded partnership distribution received on behalf of the account holder.

It would extend the scope of the QI agreement to include any withholding required under 1446(a) or (f). So, the IRS anticipates that the proposed changes, based on this, the IRS would include a revenue procedure with that and would take into effect on January 1, 2023. This would affect, for example, a partner who receives an interest in a PTP has to withhold 10% of the amount on the disposition of that interest, if any portion of the gain is treated as effectively connected with a U.S. trade or business.

So, if the partner transferee fails to withhold the amount required to be withheld, the partnership then has to deduct it and withhold it from the distributions of the transferee for the amount that they failed to withhold, plus interest. So, watch out for this if you have this situation. They are looking to make changes effective at the beginning of 2023.

E. Legal Advice Issued by Field Attorneys 20221101F

We now have a legal advice issued by field attorneys 20221101F. And in this, the question—and this is a very interesting one if you have tax-exempt entities, especially smaller tax-exempt entities. The issue's been going around quite a bit and what exactly is required for that, having your status automatically revoked for failing to file.

I had a situation where an organization came to me, and they asked me to look at their status; and one of the problems was that they had never filed for tax-exempt status. Now, they didn't have to. They were operating appropriately under the code section. So, they didn't have a determination letter. But the problem was that they hadn't been filing anything. They just never filed. They never filed a 990, a 990-EZ, a 990-N. Well, the attorney representing them took the position that they didn't lose their status because the IRS had never notified them that they had lost their status. Well, the IRS isn't going to notify you that you lost your status if the IRS has no idea that you're a tax-exempt entity. So there's kind of the failure in that logic. He was convinced. And to my knowledge, I don't know if the IRS has come after them yet. I do know that they're still not filing.

So, this is a similar type of situation. And the question here that the IRS has to look at—and it's a little broader than the direct question. But the direct question was, "What if you've been improperly filing a 990-N and you weren't entitled to file the 990-N? And if you're not familiar, the 990 is the full form. And then there's an EZ. You can think of that as a 1040 and a 1040-EZ. But there's also—and this is for organizations that normally have less than $50,000 in gross receipts—they can file what's called a 990-N or the postcard. And really, all it is, is a sort of basic certification that your gross receipts are less than $50,000, and you give some basic information about the organization. It's filed electronically. There's no amendment to it. You can't amend that. Also, there's no late filing; so it's not like you can file that late. What the IRS said essentially is, you know what, if you're not entitled to file a 990-N but you've been filing it, is that a filing? Have you complied? And the IRS uses a lot of outside sources if they want to come in and check your gross receipts. For example, they use financial information from other federal forms like W-2s, 1099-MISCs, 1099-Ks. And they use that to attempt to identify organizations that are improperly filing the 990-N. Now, we know that the general rule is that if you fail to file for three consecutive years, your status is automatically terminated.

And that's the key point. It's automatically terminated. Now, Regulation 1.6033-6B1—there's a mouthful—that says that if you improperly file a 990-N, you have not filed a "required return." Well, if you haven't filed a required return for three years, your status would be terminated automatically. Now, there is no appeal to loss of your exempt status. There's no appeal process there. There's a process to get reinstated, but there's no appeals. You can't, for example, go to tax court. You can't go to district court. There is no appeal. You can't appeal to the appeals court.

Now, there's a notice requirement. Under Section 6033, the IRS is required to notify an organization when it has no record of the organization having filed a required return for two consecutive years. That's called a non-filer notice. So, the notice has to warn the organization that it's going to lose its exempt status if it fails to file for the third year. What the IRS counsel has said here, because taxpayers have raised and said, "I didn't get that notice," similar to the one I mentioned to you. Although in their case they would never get a notice because they had never filed for tax-exempt status. There was a corporation established and nothing after that.

But according to the IRS, they've been getting plenty of cases in which what's happened is people have said, well, you can't revoke my status because you didn't send me the non-filer notice. Well, there's two different statutes here. According to the chief counsel, the statute on revocation doesn't condition it on the notice. In other words, they're two separate things. There are two conditions. If an organization fails to file the required return for two years, the IRS has to provide them with the non-filer notice. If the organization fails to file the required return for the third consecutive year, the organization's tax-exempt status is automatically revoked. So, the failure to file the required return in the third consecutive year is the only requirement for revocation. In other words, they don't have to send you that notice. So, the notice doesn't excuse the organization from its compliance with the reporting. Therefore, there is no requirement then that the IRS send you the notice, according to the chief counsel.

The next issue to come up is appeals rights. The chief counsel has said that there is no right to appeal the revocation because that's not an adverse determination which gives you a right to appeal administratively. In other words, you could go to the Independent Office of Appeals. This is not an adverse determination. So therefore, since it's not an adverse determination, there is no appeal right. They do have, the IRS has the discretion to afford appeal rights on the issue of gross receipts. So, if you're going to come in and argue, no, we normally had less than $50,000 in gross receipts, therefore the 990-N was appropriate, they may allow you to appeal. They don't have to; but they may allow you to appeal based upon determination of the gross receipts. So, no right to appeal the termination of status because that is not an adverse determination. You do not have the right to appeal. They may grant you an appeal based upon the gross receipts. So if you're coming in and saying, "No, you're wrong, IRS. I do not normally have more than $50,000, so we were entitled to the 990-N. Therefore, we did file a required return; and therefore, your status revocation was invalid." They may allow you that appeal. They're not required to, however; but they may.

Interesting approach here. Something to look at, especially small tax exempts. There's all sorts of issues going on with them. And so, I would say you definitely need to look at that if you have any small tax exempts that you're working with, especially those that do not keep really good records on gross receipts or any that may talk with you, but they kind of prepare everything themselves. Those are the ones that have all sorts of issues.

F. J5 Media Release

Global Tax Chiefs Warn of Dangers of Nonfungible Tokens

We have a J5 media release. This is interesting. What's the J5? The Joint Chiefs of Global Tax Enforcement, the J5 is the grouping of tax agencies from the U.S., Canada, the U.K., the Netherlands, and Australia. But this is something that's huge. You know, we've been talking on a number of programs about cryptocurrency, and virtual assets, and digital assets, and the changes—not only the changes that have happened, but changes in the 1040, right, where they moved it, changing in the wording. Now, we have even more because there's a new thing out there; and this is these so-called nonfungible tokens. What exactly is that? The J5 sees this as a huge area of potential tax avoidance. So, discussion with our clients in this area is important.

It's really a new thing where essentially you're buying an interest in anything digital; it could be drawings, music, other items that can be considered art. It's kind of a new way of collecting. So NFT, nonfungible tokens, it's built around the same programing as cryptocurrency, like Bitcoin or Ethereum. But that's kind of where the similarity ends here. Physical money and cryptocurrencies are fungible. They can be traded or exchanged for one another. The NFTs are individual tokens with a value stored on them because they hold value set by the market and demand. They can be bought and sold like physical art, music. And unique data makes it easy to verify and validate the ownership. Helps with fraud issues. So, it's unique. Cryptographic tokens—they exist on a blockchain. They can't be replicated. They represent real world items. So, what types of items could this be? Again, it's blockchain technology. NFTs can be graphic art, GIFS, videos and sports highlights, collectibles, designer sneakers, music; even a tweet counts. Twitter co-founder Jack Dorsey sold his first ever tweet as an NFT for more than $2.9 million. Collectors—instead of getting an oil painting to hang on the wall, you get a digital file, and it gets you exclusive ownership rights. Some of the things—brands like Charmin and Taco Bell have auctioned off themed NFTs to raise money for charity. Charmin dubbed it's offering nonfungible toilet paper. Taco Bell sold art out in minutes with the highest bid coming at the equivalent of $3,723 at the time. Nyan Cat, a 2011-era GIF of a cat with a pop-tart body, sold for $600,000. An NBA Top Shot generated more than $500 million in sales. A single LeBron James highlight NFT fetched more than $200,000. Celebrities like Snoop Dogg, Lindsay Lohan, they're all jumping on the NFT bandwagon releasing unique memories, artwork, moments as NFTs. The IRS is going to highly scrutinize these as they believe there will be a lot of fraud.

G. Wyden Eyes Possible Cryptocurrency Industry Links to Opportunity Zones

Now, Senator Wyden and the Senate Finance Committee recently wrote to two cryptocurrency companies and a certified public accountant involved in crypto transactions about reporting efforts to use—and this is the problem—Opportunity Zone programs to avoid taxes without significantly benefiting any low-income communities. They wrote a letter to the CEO of Redivider Blockchain Opportunity Zone Fund LLC and a similar one to UK-based Argo Blockchain. And then, a third was sent to HCVT LLP in Park City, Utah. And these are all based upon an interview in the Huffington Post where these individuals basically described as saying 100% would have founded a data center based with or without Opportunity Zones. And so, if you would have done it anyway, what's the use of this? A similar one to Argo requesting documents about the organization and operation of Argo's blockchain investment in an Opportunity Zone in Texas and any other investments the company has made. And then again, in this Huffington Post article with the HCVT LLP, they attributed a statement to you in which you assert that some cryptocurrency mining investors just had this big windfall. And invariably, they're looking for a way to save money because they're about to get drilled on short-term capital gains. They want to keep the dice rolling, and so, using Opportunity Zones. Something to be looking at. And if you have a client who gets into something like that, you may want to make sure that they have seen this.

H. Proposed Reg. REG-118913-21 [§20.2010-1(c)(3)]

IRS Proposes Exception to Special Rule Regarding Basic Exclusion Amount

This is something that we've been wondering exactly what's going to happen. There's a proposed regulation now, Proposed Reg. §20.2010-1. If you recall, the IRS proposed an exception to the rule that they made before 2026 that basically said that when the exemption goes down related to estate taxes, the estate and gift tax, that if you made a gift and it's brought back, in other words, you'd be able to rely on that higher exemption amount. So, the final regs under 2010 protected gifts before 2026. The rule didn't distinguish between the types of transactions, whether it was a completed gift or whether it was a gift that would be brought back into the estate as a testamentary gift. And so, the proposed regs here simply say if it's going to be brought back into the estate, then it's not going to be subject to the rule allowing you to rely on the former exemption amount. Remember, it's going down to $5 million. And they use an example here. Assume that the [basic exclusion amount] BEA was $11.4 million ($10 million adjusted). A donor gifted an enforceable $9 million promissory note to the child; it constituted a completed gift of $9 million. On their death, that note is brought back in. Nonetheless, if the donor dies after 2026, the credit to be applied is the current based BEA allowable as of the donor's date of death, which would be $6.8 [million] as we now look at it. In other words, they weren't allowed to use the higher one, which would be over $11 million at the time of the gift. They were forced to use that because it's brought back into the estate. This is meant, at least right now, they're talking about that the applicable rate would be deaths on or after April 27th of 2022. So, something to keep in mind.

I. *Christian Sezonov, et ux. v. Commissioner*

TC Memo 2022-40

We have an interesting case here. The tax court memo, *Christian Sezonov, et ux. v. the Commissioner*. The issue here, the real estate professional, and this is just another warning—they did not provide adequate records. The records weren't contemporaneous; and they didn't differentiate whether the husband or the wife were performing the duties. For the 750-hour test, it doesn't include both spouses. For the material participation, you can combine them, but not for the $750 test. Therefore, they said even though your records clearly weren't contemporaneous, you don't even say who performed the services. So, keep that in mind with the real estate professional.

J. *Treece Investment Advisory Corp. v. Commissioner*

TC Memo 2022-38

Treece Investment Advisory Corp. is another tax court memo case. The tax court upheld its jurisdiction to review the IRS's determination that the voluntary program on employment tax, which provided partial relief from federal employment tax, was eligible to be reviewed by the tax court. The IRS claimed that they did not have jurisdiction. But the court said, yes, we do have jurisdiction because you need to know whether or not the agreement was valid to determine the actual amount of employment taxes due, thereby giving jurisdiction to the tax court. Interesting case, changes the rule relative to what previously the IRS has always said, that the tax court has no jurisdiction on that. Apparently, they do.

K. *Josepha Castillo v. U.S.*

DC NY

Castillo was an interesting case because the individual has a situation with the IRS. The taxpayer fired their original representative and hired another firm to represent them in a collection due process hearing. After the hearing is over, the IRS happens to send a notice of the termination to their former or fired CPAs. The person sues and says, "Wait a second! You disclosed that to someone that you shouldn't." Well, the IRS said, "You didn't prove any damages, so you can't get punitive damages."

And the court came in, and they said the statute reads that, Section 7431 reads that unauthorized disclosure of protected information, the taxpayer may recover the greater of $1,000 statutory, $1,000 minimum, or the sum of actual damages plus where unauthorized [disclosure] was made willfully or by gross negligence, punitive damages. The court noted that there's a split in the circuits. The Fourth Circuit allowed punitive damages without actual. The Ninth Circuit said no. This case is in the Second Circuit. They agreed with malice with the Fourth Circuit. They said the statute doesn't require that you show actual damage. It just says the greater of $1,000 or actual—okay, zero, couldn't prove anything—plus punitive. So, they can get punitive without having actual damage."

L. *Boechler, PC v. Commissioner*

SCt Docket No. 20-1472

Now, we have an interesting case out of the Supreme Court, one that we have talked about in previous programs, *Boechler, PC*. In this particular case, the issue is the 30-day time limit to petition for a review, in this case, of a CDP determination. There was a CDP hearing. The IRS appeals office sustained a levy against Boechler. Boechler had 30 days to petition the tax court. They were a day late; the petition was on the 31st day. Normally, this has been considered a jurisdictional issue. They argued it's not jurisdictional; therefore, it's subject to equitable tolling. Equitable tolling means that the court can consider accepting it. If it's equitable to do so in the best interest of justice, they can consider an extended period of time, more than 30 days. Well, the Supreme Court has stepped in. And first, the tax court said it was jurisdictional; they couldn't hear it. The Eighth Circuit affirmed them, jurisdictional, they can't hear it. But the Supreme Court held that the 30-day time limit on the petition is not jurisdictional or rather is a nonjurisdictional deadline. Therefore, it's subject to equitable tolling. They rejected the IRS's argument that it's a jurisdictional question. They said it's not a jurisdictional issue. And so, therefore, the Supreme Court said that the tax court has the right to decide if, in fact, equitable tolling should apply and they should accept over the 30-day limit. They didn't decide whether they should. The Supreme Court sent it back for the lower courts to decide if, in fact, equitable tolling should apply. So they didn't say equitable tolling applied, but they did say it should be sent back.

M. *Douglas Mihalik, et ux. v. Commissioner*

TC Memo 2022-36

We have an interesting one, Douglas Mihalik, retired airline pilot. He was given the right on retirement that family, adult relatives, were able to fly under the retirement benefit program at favorable charges. He claimed that these were no additional cost benefits and/or *de minimis* fringes. And the IRS said no. And the court agreed that your adult relatives weren't dependent children. They don't qualify as an employee for purposes of the no additional cost. They don't qualify as *de minimis* fringe. It's income to you. So, the actual cost less what they had to pay is includable income for that benefit.

N. *New York v. Yellen*

CA 2

And lastly, the Supreme Court has refused to hear *New York v. Yellen*. So what does that mean? That was a Second Circuit Court of Appeals case which held that the SALT cap of $10,000 in the Tax Cuts and Jobs Act, that SALT cap is constitutional. The suit was filed by New York, New Jersey, Connecticut, and Maryland. And the Supreme Court has refused to review the case. And so, at least as of right now, it is constitutional. And we know that there's been a lot of talk in Congress about changing it. Not a lot of talk of eliminating it. Talks of changing it. Wait and see if anything ever does happen. But the Supreme Court has refused to review the *Yellen* case.

Well, I want to thank you for joining me this month, and I hope to see you next month. Please be safe.

Current Material: Experts' Forum

By Ian J. Redpath, JD, LLM

A. Intuit Settles State False-Advertising Claims; FTC Case Continues

Intuit has agreed to pay $141 million to settle state false-advertising claims brought by all 50 states and the District of Columbia, claiming the maker of tax filing software tricked millions of customers into paying for TurboTax products that had been advertised as "free." However, Reuters reported that the FTC indicated it would continue pursuing a false-advertising case against the company before an administrative judge.

B. Proposed Donor-Advised Fund Fix

A proposal in this year's Green Book would provide that a distribution into a donor-advised fund (DAF) no longer meets the definition of a tax-free qualified distribution under §4966(c), except for limited situations. The Treasury argues that the use of DAFs "subverts the goal behind requiring minimum distributions." Pending legislation in both the Senate and House would make sweeping changes to DAFs.

C. *Aspro, Inc. v. Commissioner*

CA 8, 129 AFTR 2d ¶2022-604

The Court of Appeals upheld a Tax Court decision that the taxpayer, an asphalt paving company, was not entitled to deduct purported management fee payments to its shareholders, who were one individual and two corporations. The court found that the fees were actually disguised distributions of corporate earnings, not compensation. The taxpayer's experts/contractor's and CPA's testimonies did not offer opinions as to the value of the services or apply scientific principles and methods. Further, there was no evidence of what "like enterprises under like circumstances" would ordinarily pay for these services, the value of management services provided, or what similar companies would pay for similar services. Additionally, there was no record of taxpayer making dividend distributions for decades; however, taxpayer paid management fees to shareholders in amounts roughly proportional to their interests. The payments were made in a lump sum at the end of year, which reduced the taxable income.

D. Notice 2022-23, 2022-20 IRB

IRS Proposed Changes to 2017 Qualified Intermediary Agreement

The IRS has proposed changes to portions of the 2017 qualified intermediary (QI) withholding agreement (QI agreement) that apply to a QI effecting the transfer of an interest in a publicly traded partnership (PTP) or receiving a distribution from a PTP on behalf of a foreign account holder of the QI. Currently, a QI is not permitted to act with respect to an amount subject to withholding under §1446(a) on a PTP distribution received on behalf of an account holder. The proposed modifications extend the scope of the QI agreement to include withholding required under §1446(f). The modifications would be included in a revenue procedure containing a new QI agreement to apply on or after January 1, 2023.

E. Legal Advice Issued by Field Attorneys 20221101F

Generally, exempt organizations must annually file a "required return" on one of the forms in the 990 series. Which form in the 990 series an exempt organization must use depends on the type of organization and the amount of the organization's assets and gross receipts. Under the regulations, organizations that improperly file Form 990-N have not filed a "required return." [Reg. §1.6033-6(b)(1)] An organization will automatically lose its exempt status when, for three consecutive years, the organization does not submit a required return. [§6330(j)(1)(B)] Organizations that automatically lose their exempt status do not have an opportunity to appeal that revocation to the IRS's Independent Office of Appeals because it is automatic and not an "adverse determination."

Under §6033(j)(1)(A), the IRS is required to notify organizations when it has no record of the organization having filed a required return for two consecutive years (nonfiler notice). The notice must warn the organization that it will lose its exempt status if it fails to file a third consecutive required return. According to the Chief Counsel, automatic revocation is not contingent on the issuance of the notice. In addition, the lack of notice does not excuse an organization from its obligation to file the "required return."

F. J5 Media Release

Global Tax Chiefs Warn of Dangers of Nonfungible Tokens

On April 28, the Joint Chiefs of Global Tax Enforcement (J5) issued an intelligence bulletin containing best practices for taxpayers who have, or are planning to buy, nonfungible tokens (NFTs). The J5 is the tax agencies of the U.S., Canada, the United Kingdom, the Netherlands, and Australia. NFTs can be anything digital, including drawings, music, or other items that can be considered art. They have been described as an evolution of fine-art collecting, only digital. As with all new technology, criminals are looking for ways to exploit cryptocurrencies and NFTs and exist on a blockchain. "Tokenizing" real-world tangible assets makes buying, selling, and trading them more efficient while reducing the probability of fraud.

G. Wyden Eyes Possible Cryptocurrency Industry Links to Opportunity Zones

Senate Finance Committee Chairman Ron Wyden (D-OR) recently wrote to two cryptocurrency companies and a certified public accountant involved in cryptocurrency transactions about their reported efforts to use the Opportunity Zone program to avoid taxes without significantly benefiting low-income communities. Wyden said he was "concerned by recent reports that companies involved in cryptocurrency mining may be seeking to avoid taxes without meaningfully benefiting distressed communities" using the program. Letters were sent to the CEOs of Redivider Blockchain Opportunity Zone Fund LLC, U.K.-based Argo Blockchain, and the head of HCVT LLP. The letters asked for information to better inform Congress on the use of these funds and benefits to low-income communities.

H. Proposed Reg. REG-118913-21 [§20.2010-1(c)(3)]

IRS Proposes Exception to Special Rule Regarding Basic Exclusion Amount

The IRS has proposed an exception to the special rule protecting gifts made before 2026 from the declining basic exclusion amount. Prop. Reg. REG-118913-21 would add a provision at §20.2010-1(c)(3) for an exception to the special rule for transfers that are includible, or are treated as includible, in a grantor's gross estate. These proposed rules would apply, after being published as final, to the estates of decedents dying on or after April 27, 2022.

I. *Christian Sezonov, et ux. v. Commissioner*

TC Memo 2022-40

Married taxpayers' claims that either or both of them qualified as real estate professionals under §469(c)(f) failed for lack of documentation. Taxpayers provided time logs of hours they spent on real estate activities; however, what was provided was not contemporaneous and did not identify which spouse performed the services for the hours claimed. Additionally, the hours estimated were well short of the 750-hour test for a real estate professional.

J. *Treece Investment Advisory Corp. v. Commissioner*

TC Memo 2022-38

The court held that under §7436(a), it had jurisdiction to determine proper amounts of employment taxes that related to an IRS's worker classification determination; so, denial of taxpayer's eligibility for the Voluntary Classification Settlement Program (VCSP) was subject to review as it directly affected amounts of tax involved. Also, there was a genuine fact dispute as to whether there was an employment tax audit and thus whether VCSP even applied.

K. *Josepha Castillo v U.S.*

DC NY, 129 AFTR 2d 2022-1254

The court held that a taxpayer does not need to prove actual damages to get punitive damages for the IRS's unauthorized disclosure of their return information, a federal district court held. The IRS sent a collection due process (CDP) determination to a former representative of the taxpayer. The IRS claimed that the taxpayer was not entitled to punitive damages under §6103 because they did not show actual damage. The court held that §7431(c)(1) provides for recovery of the greater of:

(A) $1,000 in statutory damages, or

(B) the sum of (i) actual damages "plus" (ii) where the unauthorized disclosure was made willfully or by gross negligence, punitive damages.

The court noted that there is a judicial split on this issue. The Fourth Circuit in *Mallas* (CA4 1993), 71 AFTR 2d 93-2036, allowed punitive damages absent actual damages, while the Ninth Circuit, in *Siddiqui,* (CA9 2004) 93 AFTR 2d 2004-1305, did not. The court agreed with *Mallas*.

L. *Boechler, PC v. Commissioner*

(S Ct 4/21/2022) 129 AFTR 2d ¶2022-584

The Supreme Court has held that the 30-day time limit to file a petition for review of a CDP determination is a nonjurisdictional deadline subject to equitable tolling. In this case the petition was filed one day late. The court found that many procedural requirements are not jurisdictional but simply instruct parties to take certain procedural steps at certain times without conditioning a court's authority to hear the case on compliance with those steps. The statute does not clearly mandate a jurisdictional deadline because there are multiple, plausible nonjurisdictional interpretations of the text. The IRS will still try to get late-filed petitions dismissed for lack of jurisdiction; but now, late-filing taxpayers can argue that they are entitled to equitable tolling of the filing deadline.

M. *Douglas Mihalik, et ux. v. Commissioner*

TC Memo 2022-36

Taxpayers were required to include in gross income the value of standby airline tickets that were provided to their adult relatives under the airline's retiree benefits program. Taxpayers argued for exclusion under §132; but the court ruled that the adult relatives were not taxpayers' dependent children and, thus, did not qualify as "employee" for purposes of the no-additional-cost service benefit. Likewise, the tickets did not qualify as *de minimis* fringe benefits.

N. *New York v. Yellen*

(CA 2 2021) 128 AFTR 2d 2021-6202

The Supreme Court declined to review the Second Circuit's decision upholding the $10,000 cap on state and local tax (SALT) deductions as constitutional. The suit was filed by New York, New Jersey, Connecticut, and Maryland.

GROUP STUDY MATERIALS

A. Discussion Problems

- Jade has come to you for some estate planning. She is a high net worth individual and wants to have overall planning, including current gifting.

- Your office represented Emory in appeal of an audit determination that was handled by another CPA firm. The auditor appeals determination was inadvertently sent to the former CPA. While your client is angry, they do not show any actual damages as a result of the error.

- A new client, Kaylee, comes to you with a CDP determination. You discover that her former representative failed to provide her the determination on a timely basis and her 30-day period to petition the Tax Court for a review is past by three (3) days.

Required:

1. What considerations need to be made for Jade regarding the available basic exclusion and the change after 2026?

2. Can Emory receive any compensation for the wrongful disclosure with actual damages?

3. Can Kaylee still petition the tax court?

B. Suggested Answers to Discussion Problems

1. Consideration must be given to the types of assets that should be retained and how to effectuate the transfer to take full advantage of the increased basic exclusion that is scheduled to be significantly decreased in 2026 and after. The IRS has proposed an exception to the special rule protecting gifts made before 2026 from the declining basic exclusion amount. Prop. Reg. REG-118913-21 would add a provision at §20.2010-1(c)(3) for an exception to the special rule for transfers that are includible, or are treated as includible, in a grantor's gross estate. These proposed rules would apply, after being published as final, to the estates of decedents dying on or after April 27, 2022.

2. There is a split in the circuit courts on this issue. The Fourth Circuit in *Mallas* (CA4 1993), 71 AFTR 2d 93-2036, allowed punitive damages absent actual damages, while the Ninth Circuit in *Siddiqui* (CA9 2004), 93 AFTR 2d 2004-1305, did not. The District Court in *Castillo* sided with the Fourth Circuit. Section 7431(c)(1) provides for recovery of the greater of:

   (A) $1,000 in statutory damages, or

   (B) the sum of (i) actual damages "plus" (ii) where the unauthorized disclosure was made willfully or by gross negligence, punitive damages.

3. The Supreme Court has held that the 30-day time limit for a petition to review a CDP determination is not jurisdictional. The court may apply equitable tolling. An argument will have to be made to the court to have it allow the late petition for equitable reasons.

PART 2. INDIVIDUAL TAXATION

IRS Notice 2022-6 and IRC Section 72(t)

Internal Revenue Code Section 72(t) allows penalty-free withdrawals from IRA accounts and other tax-advantaged retirement accounts like 401(k) and 403(b) plans. IRS Notice 2022-6 relates to Section 72(t) and has some wide-ranging implications for taxpayers that need early access to their retirement accounts.

Let's join Ian Redpath and Larry Pon as they discuss Notice 2022-6 and Section 72(t).

Mr. Redpath

Larry, welcome to the program.

Mr. Pon

Hi, Ian.

Mr. Redpath

Always great to have you here and get your insight. I think this is a really interesting topic, and I think it's one that kind of slid by people. Everybody is so busy right now in tax season, and now we're just coming out of tax season and taking a short breath. But this IRS Notice 2022-6, which relates to the Code Section 72(t), really has some dramatic impact for a lot of our clients. Let me just start from the beginning, Larry, and just ask you what is 72(t)? And then we can get to this notice and its impact.

Mr. Pon

Right. There's at least a dozen exceptions to the early distribution penalty. When you take money out of a retirement account before age 59½, the substantial equal periodic payments, also known as 72, is number two on that list. And that's one of the exceptions where if you follow these rules, you could take money out of a retirement account before age 59½ without a penalty.

Mr. Redpath

And I think, Larry, that's something that if you generally talk to people—and when I say people, I mean accountants—you usually don't think of that. You think of the hardship and these other ones, medical. You really don't think about the 72(t); but yet it is something that we have, for want of a better term, in the arsenal to avoid having to pay those taxes. But let me ask you a question. You avoid paying the early withdrawal penalty tax, but you don't avoid the taxes, do you?

Mr. Pon

No, the tax is still due. You still need to do the same calculation as you would do as you take a distribution from any retirement account. Now, if you take a distribution from an IRA, what's important is to track the basis in your IRA. So, that's on Form 8606. You still need to do the calculation. You might not pay tax on the entire distribution, because you have basis in the IRA. So, that's an important calculation to make.

Mr. Redpath

Yes, and sometimes I think that's missed a lot too, is keeping in mind that there can be a basis. There may have been contributions that were previously taxed, and so that does make a difference. Now, what about a Roth IRA? How would this fit with a Roth since we're not paying tax? Are we still going to have that penalty?

Mr. Pon

Well, that's something you've got to watch out for because with a Roth IRA, when you take a distribution, you have two kinds of distributions, a qualified distribution and an unqualified distribution. To have a qualified distribution from a Roth IRA, you've got to have the Roth for at least five years. You make a contribution. It's got to be seasoned for five years. If you do a Roth conversion, each one of those Roth conversions are another five-year rule there. So, if you take it before the five years, that's an unqualified distribution. If you take it before age 59½, that'll be an unqualified distribution. Then, there are exceptions, such as $10,000 for a first-time home buyer. That's an exception for the Roth. So yes, the Roth distribution can be subject to tax and penalty if it's unqualified.

Mr. Redpath

So, you could still then use 72(t) to avoid the early withdrawal penalties on a Roth?

Mr. Pon

You can, but I think that's a bit complicated, a bit rare. So, most of the time we take the SEPP on traditional IRAs; that's usually when we do it. And let me go over the... Yes, go ahead.

Mr. Redpath

No, I think I was going to just ask you the exact question you're going to, so go ahead.

Mr. Pon

All right. There are three methods on how to compute the SEPP, three methods that the IRS allows to avoid the penalty. The first method is called the required minimum distribution method, which means you'll look at the tables to see what is your life expectancy and figure out what that amount's going to be. And that amount gets recalculated every year. It's based on the December 31 balance of that IRA divided by your life expectancy. So, the number could change year by year. This calculation uses the lowest payout because it's your life expectancy.

The second method is known as the amortization method; and the third method is known as the annuitization method. And those methods use an interest rate. Prior to Notice 2022-6, you had to use 120% of the mid-term AFR; and that's been pretty low, and we'll go over that in a second here. But what's the consequence of not following these rules is that you've got to take the distribution for at least five years or up to age 59½.

So for example, you start this at age 40, that means you've got to take your 72(t) distribution for 20 years, if you're starting at age 40. Or age 50, that's 10 years. So, there's some counseling we need to do with our clients. If they're age 58, we tell them, can you wait? If they're age 58 or 57, whatever, right? What's the consequence of blowing it? And sadly, too many people do blow it because they don't meet the five years or take the distribution before they're 59½, or they change the number. The word is substantially equal periodic payments. So, if you change the number, that can cause the penalty to kick in for all your previous distributions. It's called recapture. Yes, it's pretty expensive.

Mr. Redpath

So, retroactive. Retroactive, you can get hit with everything going back?

Mr. Pon

So if you started at age 40, you were great for the first 10 years, then you blew it in year 12. Well, you've got to pay the penalty on all those previous years you took plus interest, late payment interest. So, it's a pretty expensive thing if you blow this. We have to walk with them very carefully on that.

Mr. Redpath

Yes. That's a huge issue that could come up. The other thing, and I don't want to slide by this is, when we're talking to our clients about it, it's the longer of five years or 59½. And you used a great example. If you're 58, well, can you wait? Because otherwise, you're stuck into five years, right? It doesn't matter that you're 59½ in two years. It's wait a second, you're stuck for five years. And the other side of it is, you mentioned 40. If you're 40, it's not till 45; you've got to wait till you're 59½ and keep taking it. So, there's really a lot of considerations to go into this. It's not something you jump into lightly. And as you said, if we got to go retro, we blow it for a year and all of a sudden retroactively we have to go back and pay the penalties and interest on this. Boy, it could be a disaster, right?

Mr. Pon

The rule 72(t) allows you to make one change. So, if you're using the amortization method or the annuitization method, you can switch down to the RMD method. Let's say we started using the amortization method. It gives us a big amount, $20,000, let's say. And you find out you are a few years down the road and you don't need it anymore, but you can't stop it because it'll cause a recapture; but you can switch to the RMD method, which would dial it down.

Mr. Redpath

You've used the term RMD. And most of our viewers are familiar with that terminology, RMD, in the sense of, okay, we know we've had changes in what are RMDs, required minimum distributions. And we think of it in the context of, okay, you've now turned 72 and you have to start taking distributions after your required beginning date. Is that the same thing we're talking about here? Is it the same type of thing, same calculation for RMD as the normal rules?

Mr. Pon

Yes. It's the same calculation. You use the December 31 value of that specific IRA account divided by the life expectancy. And you have a choice of tables too, of which table you want to use. You can use the Uniform Lifetime Table, the Joint and Last Survivor [Expectancy] Table, and the Single Life Expectancy Table. But once you pick a table, you're stuck with that table. For example, you might decide to use the Joint and Last Survivor Table, but then you change the beneficiary. Well, you're still stuck with that table, even though you changed the beneficiary.

Mr. Redpath

But it's based upon the December 31 value each year?

Mr. Pon

Exactly. So, here's what could happen. Let's say your investments are very poorly invested, and you're stuck on this requirement to take a distribution every year. But what if my account goes to zero? And that happens. Well, if your account goes to zero, you're not going to violate the rule of not meeting the 72(t) requirements. Some people invest not so well, right?

Mr. Redpath

Right. I mean, you could end up, depending on the table you use, I guess in theory, you could end up zeroing it out as the market changes. You could definitely end up zeroing out your account. Not something you want to do, but could happen. So what is the fixed amortization method?

Mr. Pon

Right. Well, before we go there, let me just finish our talk about the tables. There's been some change in the life expectancy tables. Before the pandemic, the IRS updated the life expectancy tables, and they kick in for required minimum distributions in 2022. However, Notice 2022-6 gives us an option here. So for 2022, you can either use the old life expectancy tables or the new life expectancy tables. In 2023, you have to use the new life expectancy tables. So you have a choice. You have a choice and see which way you want the numbers to go, if you want to go higher or go lower. So in 2022, you have a choice.

Mr. Redpath

In 2023, you have to go to the new table?

Mr. Pon

You have to go to the new tables, right. So, the three methods of calculating 72(t), so the RMD method is basically the value divided by the life expectancy. That number can change from year to year because the life expectancy changes every year, and the value of the IRA changes every year. So that's a calculation. You're not going to violate any rules because one year it might be $20,000, the next year it could be $18,000, and it could be $22,000, but it's just a math calculation there.

The next method is the fixed amortization method. So that's the annual payment that's based on amortizing the account balance over the specified number of years, your life expectancy, using the tables and the chosen interest rate. Prior to Notice 2022-6, it's 120% of the mid-term AFR. Notice 2022-6 adds the higher of the table amount, the AFR amount, or 5%. And that's a real big deal. 5% is a real big deal because the rates are, and I looked this up, for January 2022, the AFR, 120% mid-term AFR is 1.57%. In February, it's 1.69%. In March, it's 2.09%. And these are issued by the IRS every month. So you go to the IRS website, type in AFR in the search box, and it'll take you to the revenue ruling that announces these rates. So with the 5% rate, it gives you substantially more; and we will go over an example in a minute here.

The third method is the fixed annuitization rate. It's a little different calculation, but it's the same thing. It's based on the balance divided by the annuity factor, which you calculate based on the person's life expectancy and the interest rate. Same thing here, the notice makes the interest rate the higher of 5% or 120% of the mid-term AFR. Now these last two methods, once you calculate—it's a one-time calculation—once you make that calculation, you're stuck with that number. Whatever that number is, you're stuck with that during the term of the 72(t) requirement; you can't change. But with these two methods, you can switch back to the RMD method, because the annuitization and the amortization method will yield a higher payout. The RMD method yields a lower payout.

Mr. Redpath

And you mentioned that the RMD method is one that does change. I mean, the amount you get each year generally will change; whereas with the other methods, you can't change. The amount you establish in the beginning is what you have. Is that correct?

Mr. Pon

Right. Exactly. So it doesn't change. It's a fixed number.

Mr. Redpath

Okay. And you mentioned tables, and I know there're different types of tables. We talked about the fact they changed them, but what are really the different types of tables? I know there's a Uniform Life and Joint and Last Survivor. What are the tables that you're referring to? You said the IRS changed them, but I know there's different tables. So what should people be looking at when they're looking at the table?

Mr. Pon

Right. So the IRS publication that publishes these tables is IRS Publication 590-B. So it's in the back, the tables. And also the tables are also at the back of this notice too. So you can go look up the notice, flip to the back of it, and it's got the actual tables right there. It's got the numbers right there you can use for these calculations. So you can choose whichever table you want; but once you pick it, that's the calculation you're going to use.

Mr. Redpath

So you have Uniform Life, Joint and Last Survivor Table, Single Life. And you mentioned, for 2022, you can use either the old or the new tables, but for 2023, you have to go with the new table. So this Joint and Last Survivor, to use that table, does one of my beneficiaries have to be my spouse?

Mr. Pon

No, not necessarily. It could be anybody. It could be anybody else.

Mr. Redpath

Oh, okay.

Mr. Pon

On the physical tables, you see on the X axis, age for one person, and then the Y axis, the benefit for the other. But we use software, so you don't have to look at the tables. And we'll talk about software when we go over our example here.

Mr. Redpath

That was a great lead in, Larry. Let's go over a couple of examples here. We have an example of a pre-Notice 2022-6 example using Sally. So could you go over this example and then we'll do one using the notice.

Mr. Pon

Exactly. So let's go over our friend Sally here. She's 50 years old, she's got $1,000,000 in her IRA, and this pandemic is too much for her. She goes, "I'm going to quit. I'm not going to work anymore." But I told her, "You're 50 years old. So if you take money out of your IRA account, it's going to be subject to penalty; but there's this thing called 72(t) we could take advantage of." So let's run the example of before this notice was issued. So we look at the 120% of the mid-term AFR, and let's say it was 1.69% at the time. So 1.69%. So we look at the three methods.

The first method is the RMD method. With the RMD method, under the Single Life [Expectancy] Table, that comes up to be $27,624. If we use the Uniform Life Table, that's $20,619. Then let's take a look at the amortization method if we plug in 1.69%. Under the Single Life Table, that gives us $37,156. That's going to give us the highest payout using the Single Life Table, fixed amortization method. Using the Uniform Life Table, it drops to $30,375. Under the fixed annuitization method, we get an annuitization factor. So it's really close to the fixed amortization method. So generally, when we work with clients on this, we look at the highest calculation and the lowest calculation; and preferably, you do want to use the highest.

Let me point out that when you're doing these calculations, this is different than when you're over 72 years old. When you're over 72 years old, you have to calculate the RMD based upon all your IRA accounts, all your retirement accounts. So then you come up with a number and that's the amount you have to take out every year. Not necessarily from every IRA account, but it could be from one or multiple. With the 72(t) calculation, you can leave your other IRA accounts alone. Let's say Sally's got $5 million of IRAs, but we're just going to take the 72(t) from this $1 million IRA because she says, "Fine, $37,000 is going to cover most of my bills, and that's going to work." So you can do some planning by cutting down the size of the IRAs. It doesn't have to be everything. Because if you do it on everything, you're stuck. That IRA's frozen. You can't roll it over. You can't do anything to it. You can't add to it. It's a frozen account if you're doing a 72(t).

Mr. Redpath

Larry, you just said something, and I don't want to go past that. You said you can't make any other contributions or distributions. So, if you elect 72(t), if you're going to go with that, that's it. It's frozen. Whatever amount was in there, is in there.

Mr. Pon

Right. It's frozen. I mean, you are allowed to make changes to the investments. You can move things around, sell, buy, or whatever, but the account itself is frozen. You can't add to it. You can't subtract it. The only subtractions are going to be these 72(t) distributions. This takes some very, very careful planning. So, the reason I like to go with the fixed amortization method that gives us the highest amount is in case Sally changes her mind later, she gets a job again or whatever, we can dial back to the RMD method, we will use the one that gives the lowest payout, which is the Uniform Life Table, that's $20,000. So that can save her some taxes, because why have her pay taxes on money she doesn't need?

Mr. Redpath

In this case, Sally is only 50. So, Sally is going to end up having to wait until she's 59½. It's not the five years. The five years, she'd be 55, but she's got to wait till 59½ if she wants to do this. And as you said, things could change. She could get another job. A lot of different things.

Mr. Pon

Exactly. And the worksheet we use to calculate this—of course, I don't do this by hand. I use software.

Mr. Redpath

So, let's look at the example with Sally now, same basic fact, except we're going to use Notice 2022-6. Could you go over that for us?

Mr. Pon

Exactly. Now that we have this notice here, our calculations change a bit here. Under the RMD method, no change; those numbers stay the same because there's no change to that. However, the big change is in the fixed amortization and the fixed annuitization method because the interest rate is the higher of 5% or the 120% of mid-term AFR. Well, we plug in 5% in the calculation, and what that means is for the fixed amortization method, it's $60,312. That's substantially more than the $37,156. That's a big deal there. So, this could be very meaningful. It could give people an incentive to take their early retirement because $60,000 is a whole lot better than $37,000. That's the biggest change there. Under the annuitization method, it's $59,308. By changing this interest factor, it really increases the amount of the 72(t) distribution.

Mr. Redpath

And again, she can always drop back to the RMD method if something changed and she wants to take less during that period. So yes, great examples. You mentioned the life expectancy tables. When did it happen and when are they kicking in?

Mr. Pon

Well, you remember we got the proposed regulations back in 2019. This is before the pandemic and all that, and then the pandemic happened. It was supposed to go into effect for 2021, but the regulations were proposed. It didn't go final until in 2021, it went final, which is effective for 2022. What's the difference? Well, the last time the life expectancy tables were updated was back in 2002, and the IRS is supposed to update those every 10 years. We're a little late. So they're supposed to be updated every 10 years in conjunction with the census. And based on the last census, these calculations are based upon the last census. People's life expectancy are higher. The new tables are running the life expectancy to age 115. And that's when I get a lot of chuckles from my clients. I say, "Well, the government thinks you're going to live to 115." The tables are a little different now, which means the factor is a little bit less, a little bit less than what the old tables were. So that's what the change is.

Mr. Redpath

What is the alternative table in that notice?

Mr. Pon

Well, when it comes with respect to 72(t), even though we're changing tables because of an update, the regulations and the notice says, this does not violate the modification of the 72(t). It doesn't violate it. You're using the tables. So if you want to look up these tables, it's in the regulations, 1.401a9-9. So that's where the tables are located.

Mr. Redpath

And the notice itself provides a Uniform Lifetime Table, so what is that alternative?

Mr. Pon

Right. Those tables are listed at the back of the notice. So you have a choice of using that table or the Single Life Table when you decide on these calculations. So it depends on which way you want to go, higher or lower. Generally, we want to go with higher. Generally, right? Because if you want less of a distribution, just cut the IRA account smaller. So that's usually my advice here. Why go with the smallest distribution when you can just shrink the IRA account to get to the same size? Because why lock up more money into a 72(t)? We want to give you some more flexibility with the rest of your money.

Mr. Redpath

So are there certain things that we should be advising our clients about if this is a consideration? I mean, people are still in the post-pandemic. Not everybody is back to work. They're thinking about changing works. We had the great resignation period. Are there things that we need to really discuss with our clients at this point?

Mr. Pon

Yes. I think a lot of people make these rash decisions. And for many of our clients, the retirement account is their biggest source of money, because either they have an employer that's very generous with a match or generous with profit sharing. Or when money is taken out of your paycheck, you don't see it, you don't spend it, and they don't seem to save money outside of that. This is their biggest source of money. And I think it's important to do some careful planning. What is their age? Are they 40 years old? 30 years old? 50 years old? What are the consequences of starting this?

And we need to scare them a bit too, to run the calculations. Say if you blow it, this is what you're going to have to pay back. Here's the 10% penalty. Let's say you start at age 40, and by the time you're 58, you blew it. Well, that's 18 years of distributions you got to pay penalties on. Plus the interest. Show them what the interest rates are. They used to be pretty high. I mean, they've come down recently, but in those earlier years, the rates were a lot higher. So we need to run these numbers with them, run their cashflow, take a look at it. Maybe we try to find another professional who can help us. These financial coaches or financial counselors. Like, you're spending too much, and maybe we can help them control their cashflow needs. So it's going to be a big picture of planning. Big picture of money.

Mr. Redpath

One thing that I think is interesting is that there's been a number of private letter rulings. And in these private letter rulings, the one consistent thing is the IRS seems to be very understanding of the fact that companies out there are making mistakes, that investment firms are making mistakes, and they're really allowing that penalty relief for that. I mean, is that kind of a consistent theme lately with letter rulings that, yes, we understand you didn't make the mistake. You were relying on your investment company to have done this calculation properly.

Mr. Pon

Right. There's a whole bunch of private letter rulings on mistakes that have happened and people are trying to get out of the penalties. But my advice for people is, if I get a new client who has blown it, I wasn't involved with the planning or whatever, we're going to try to do what we can before a private letter ruling, because private letter rulings are expensive. I mean, not only does it cost money to file with the IRS. Also, you have to pay for a professional who specializes in private letter rulings; that can also be expensive. And most importantly is time. It takes the IRS 18 months to at least two years to get back to you on a private letter ruling. You're not going to get a letter in a week or so; it's not going to happen. So that's a long time to wait. It can be expensive and risky.

So what we try to do with clients is beg for mercy with the IRS via Form 5329, and try to lay out a reasonable cause, excuses, like the financial institution blew it. They took it out of the wrong account, or they didn't follow my instructions and took out the wrong amount. Either the wrong amount or from the wrong account. We've seen that happen too. Instead of coming out of the IRA account, it came out of the brokerage account, and things like that happen. So the more you can blame on a third party, the better. Or you were sick. Something happened to you. You were in a hospital. Or a family member got sick, or someone died, or my house got destroyed. We had a hurricane, we had a tornado, or an earthquake, or whatever. A wildfire. All these different excuses. So the IRS has a long list of excuses. You can take a look at it and see which ones we can apply.

Mr. Redpath

Just put a number down. You don't have to worry about listing it, right? We've heard it all before, it's kind of the IRS's approach. So the notice itself, when is that effective?

Mr. Pon

The notice takes effect on January 1st, 2023; but you can use it for SEPPs starting in 2022. It goes in effect January 1st, 2023, because we just got the notice this year; but you can rely upon it this year, especially if you want to use that higher interest rate. So, I think that's a real big deal.

Mr. Redpath

And you already mentioned the Form 5329, and Code 2 exception is what's used on this.

Mr. Pon

Exactly. Make sure, if you're doing a 72(t), make sure you include 5329, because if you just put the 1099-R, put on the Line 4a and 4b in the tax return, and the IRS knows what your age is, you'll get a notice from the IRS saying, "Hey, you're under 59½," and they're going to send you a CP2000 notice adding that 10% penalty. And I'm in California; we have a 2.5% on top of that. So some states have their own early distribution penalties. The two most important forms when it comes to doing this is Form 5329 and Form 8606, if you have bases in your IRA. Those are very important forms to include in your tax return.

Mr. Redpath

Larry, I want to thank you. This is really interesting. It applies to a lot of clients, and especially as we're doing planning after tax season has ended or at least slowed down. We always have those extensions, right? But now that it's slowed down a little bit, now it's time to start doing planning and this is one of the areas to really take consideration. And as you said, the notice itself has some really wide-ranging implications on what our clients may or may not do. Larry, I want to thank you for being here. It's always great to get your insight. We'll have you on the program very soon again. Thanks again, Larry.

Mr. Pon

Thank you, Ian.

SUPPLEMENTAL MATERIALS

Notice 2022-6 and IRC §72(t)

By Ian J. Redpath, JD, LLM

A. Introduction

Congress encourages individuals to save for retirement by offering a variety of tax-favored retirement account options such as IRAs and 401(k) plans. Since the intent is to provide savings for retirement, §72(t) imposes a 10% "early withdrawal penalty" on the pre-tax portion of a distribution before the owner reaches age 59½. However, a taxpayer may have a legitimate need to access the funds prior to that age. As a result, §72(t)(2) provides a list of exceptions to the penalty that allow a taxpayer to withdraw at least a portion of their retirement savings without incurring the 10% penalty. It should be noted that the pre-tax contributions will still be subject to income tax on distribution.

Most of the exceptions generally require taxpayers to be in certain circumstances such as permanently disabled taxpayers or an employee who separates from service during or after the year they turn 55. If a taxpayer does not meet any of the exceptions, §72(t)(2)(iv) provides a more generally applicable exception to the penalty for "72(t) Payments" or "Series of Substantially Equal Periodic Payments" (SEPPs). Generally, SEPPs must be taken at least annually and are based on the life expectancy of the account owner or account owner and a beneficiary. There are three methods to determine the SEPP: 1) the required minimum distribution (RMD) method, 2) the fixed amortization method, or 3) the fixed annuitization method. To qualify for this early distribution penalty exception, a series of payments must continue unchanged until the later of five years or until the account owner reaches age 59½. Regardless of which method is used, the price for modifying or canceling a §72(t) payment is significant, usually resulting in a 10% penalty tax on all distributions previously taken – plus interest!

Final regulations updating the life expectancy tables were issued in 2020 to better reflect actual life expectancies. The IRS has issued Notice 2022-06, providing guidance on whether periodic payments from an individual account are considered SEPPs. The IRS notes that when using the RMD or fixed amortization methods, the new life expectancy tables are to be used for any series of payments commencing on or after January 1, 2023 and may be used for a series of payments commencing in 2022. Account owners that begin a series of payments before 2023 using the RMD method may switch to an updated table without being treated as having a modification of payments. These changes can impact the maximum distributions and provides an opportunity to access these funds without penalty. This notice modifies and supersedes Revenue Ruling 2002-62.

In Notice 89-25, the IRS provided three safe harbor methods for satisfying the SEPP requirement. Two of these result in a fixed amount to be distributed each year, which could result in a significant depletion of the account. In Revenue Ruling 2002-62, the IRS announced a one-time allowance to switch from either of these two fixed methods to the safe-harbor method that varies the distribution based on the annual account value, called the required minimum distribution ("RMD") method. The RMD method calculates the annual payment for each distribution year by the number of years from the chosen updated life expectancy table, now included in Notice 2022-6.

In applying the tables, there are several options available under the notice. The tables will be applied:

- for a person under 70.5/72 (as applicable) who was in pay status pre-2022, the old tables may continue to be used to calculate the RMD option;
- if payments commence in 2022, the old tables or the new tables may be used; and
- if payments commence in 2023, the new tables must be used for the relief.

For payments started under the old tables, there is a one-time change allowed to the new tables. Also, if using a method other than the RMD method, an individual may switch to the RMD method to determine the payment for the distribution year of the switch and all subsequent distribution years. This is not a modification affecting the ability to the exception. Taxpayers can use any of the life expectancy tables:

- Uniform Lifetime Table
- Joint and Last Survivor Table ("Joint Table")
- Single Life Expectancy Table

Until recently, the interest rates used to calculate the amounts of §72(t) payments have been so low that the payments may not have been sufficient to meet the needs of individuals. Notice 2022-6 modifies the interest rate to be used under the fixed amortization method or the fixed annuitization method to a rate not more than the greater of (i) 5% or (ii) 120% of the federal mid-term rate. At the time, 5% was a great potential benefit; but as interest rates rise, it may not have the intended benefit. Also, individuals may now need to consider ways to reduce their §72(t) payments if the payments are more than they need to withdraw. For example, one option is splitting a retirement account into two separate accounts and taking §72(t) payments from only one. Also, remember that if using the annuitization or amortization methods, a one-time change to the RMD method is allowable and generally results in lower maximum payments.

B. Overview of §72(t) Payments

Once an individual begins to take a distribution, they must continue doing so over the *longer* of 5 years *or* until they reach age 59½. Thus, the payment must continue even if the individual turns 59½ prior to the 5-year period expiring. However, if a taxpayer begins distributions at age 50, the payments would have to continue for 9½ years—the longer of 5 years or upon reaching age 59½. The penalties for changing are steep, and penalties and interest are retroactive.

Using the RMD method, like the regular RMD method, the taxpayer's current account balance is divided *each* year by an appropriate life expectancy factor. Notice 2002-62 provided that taxpayers could use any of the life expectancy tables and provides for a transition from the 'old' life expectancy tables to the new tables. Individuals who start with the RMD method may not switch to another method.

Distributions under either the amortization or annuitization method remain level from year to year. When calculating such distributions using the amortization method, payments are determined by amortizing the individual's account balance over a number of years determined using the life expectancy tables and the appropriate interest rate. The annuitization method is determined by "dividing the account balance by an annuity factor that is the present value of an annuity of $1 per year beginning at the employee's age and continuing for the life of the employee, or the joint lives of the employee and designated beneficiary. The annuity factors are provided by the IRS, and the present value is determined using a reasonable interest rate. Note, there is a one-time switch allowed to the RMD method.

The most significant change made by Notice 2022-6 updates the rules regarding the "reasonable" interest rate that can be used when calculating §72(t) payments. As mentioned, it provides for the *greater* of 5% *or* 120% of the applicable federal mid-term rate. The 5% rate is effective for any series of payments starting in 2022 or later. Since it increases the maximum interest rate that can be used, it increases the penalty-free distributions that can be made. Of course, the benefit of this increase will be dependent on where interest rates go in the future. The effect of the 5% amount is significant while interest rates remain low. However, interest rates have been increasing; but as of this writing, it is still a benefit to use the 5%. Note that the rate is the highest rate from the prior two months from when the payments begin.

It should be noted that any additional contributions to the account(s) or rollovers into or out of the account(s) are deemed a modification of the §72(t) payment schedule. That would trigger the retroactive penalty plus interest. Also, if no assets remain in the retirement account, then it is not subject to a penalty as a result of not receiving a SEPP, and the retroactive penalty and interest will not apply.

Example 1: Sam started taking a SEPP in 2007 at age 50. His annual payment was $65,809 per the amortization method. In 2022, he changes to the RMD method at a time that the balance of the IRA is $750,000. Using the age 54, single life expectancy of 30.5, the new distribution is $750,000/30.5 = $24,590. Sam must use the RMD method for all subsequent years.

Example 2: Pre-Notice 2022-62

Sally, age 50 has $1 million in her IRA. Assume 120% mid-term AFR = 1.69%. Under the RMD method using the Single Life Table, her RMD is $27,624. Using the Uniform Life Table, it is $20,619. With the fixed amortization method, using the Single Life Table, it is $37,156, and using the Uniform Life Table, it is $30,375. Under the fixed annuitization method annuity factor (single life), the payment is $36,978.

Example 3: Notice 2022-62

Sally, age 50, has $1 million in her IRA. She may use the 120% mid-term AFR (1.69%) or 5%. With the RMD method, using the Single Life Table, her RMD is $27,624, and using the Uniform Life Table, it is $20,619. With the fixed amortization method, using the Single Life Table, it is $60,312, and using the Uniform Life Table, it is $55,177. Under the fixed annuitization method annuity factor (single life), the payment is $59,308.

C. Conclusion

Notice 2022-6 has provided many planning opportunities for clients wanting to take early withdrawals from retirement accounts but avoid penalties. Great care must be taken to determine the best method to use to determine any §72(t) distributions.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, Carlie, has a $1 million balance in her IRA. She is currently 51 years old. Due to some financial issues, she is in need of additional cash but does not want to pay any penalties. All of her contributions were pre-tax.

Required:

1. Discuss the methods under Notice 2022-6 to avoid the 10% penalty on early withdrawal.

2. Discuss the available interest rates for Notice 2022-6.

3. Explain to Carlie what will happen if she fails to meet the rules for the SEPP exception in Notice 2022-6.

B. Suggested Answers to Discussion Problems

1. If a withdrawal is taken before age 59½ and one of the other exceptions to the penalty does not apply, then §72(t) payments or SEPPs can avoid the penalty. Taxes will have to be paid on the amount of the withdrawal. Notice 2022-6 provides for the updated life expectancy tables to be used. The three allowable methods are RMD, fixed amortization method, and fixed annuitization method. Payments must continue for the greater of five years or until she reaches age 59½ (which is longer in this case). If the RMD method is selected first, Carlie cannot change to a different method. If one of the other two methods is selected, then she can make a one-time change to the RMD.

2. Notice 2022-6 provides that the interest rate allowed for the fixed amortization method and the fixed annuitization method is the greater of 5% or 120% of the federal mid-term rate.

3. If Carlie fails to take the full SEPP payments, then she will have a retroactive penalty and interest going back to the first distribution from the account.

PART 3. BUSINESS TAXATION

Tax Issues Related to Bankruptcy

Bankruptcy can be an incredibly useful tool for taxpayers since the goal of bankruptcy is normally to give somebody a fresh start by wiping out dischargeable debt. However, mistakes in dealing with tax issues related to bankruptcy can create significant problems for taxpayers. Discharging taxes in bankruptcy is difficult but not impossible. Ian Redpath and Gary Bluestein discuss various types of bankruptcy and how to deal with issues related to taxation.

Let's join Ian Redpath and Gary Bluestein as they discuss this important topic.

Mr. Redpath

Gary, welcome to the program. Your firm is one of the best in the country when it comes to doing especially collection areas and all of these things that we're looking at; and with that, there's so much misunderstanding. When we talked about this topic, I was thinking back to the days, I remember sitting in your conference room and having this whole bankruptcy issue coming up, and the timing and I remember specifically someone that had blown [the timing]. The accountant had blown the timing on this and the attorneys. So, the attorneys and the accountants have got to really work together here on bankruptcy when it deals with tax issues; or your client can find out they still owe a lot of taxes at the end of the bankruptcy. Gary, can you kind of fill us in first? What should accountants know about bankruptcies because there are different bankruptcy provisions, and they do really have different results when it comes to taxation?

Mr. Bluestein

Absolutely, Ian, and you're right when you highlighted that a bankruptcy lawyer who doesn't know how to deal with taxes can make colossal mistakes that create a problem for years for a taxpayer that should never happen. In a nutshell, bankruptcy is an incredibly useful tool for any debt. Most people realize that. And the goal of bankruptcy normally is to give somebody a fresh start, to wipe out dischargeable debt. What most people think though, however, including lawyers and even including bankruptcy lawyers, is that taxes, unlike other debt, can never be discharged in bankruptcy. And I've been dealing with this since I left the IRS where I was an attorney who represented the IRS in bankruptcy. I've been hearing that statement for 20 plus years, and it's just simply not true. It is more difficult to discharge taxes in bankruptcy. They have a certain status; and if you don't know what you're doing, yes, you can make a mistake and not discharge them. But many types of taxes are completely dischargeable in bankruptcy if they're timed right. And timing is everything. So, first let me go over the type of taxes that we see all the time. We're dealing with, normally, either income taxes, or trust fund payroll type taxes, or sales type taxes. Now, if you're dealing with let's say a trust fund tax—two types we deal with—it's New York state sales tax, for example, or other states that have sales tax. Since it's a collected tax for the benefit of the taxing authority, it's held in trust. Those are never dischargeable in bankruptcy, and they're always paid as a priority creditor. Unfortunately, those are easy.

Mr. Redpath

Well, they're easy, Gary, but they're really important because I think that's one of the things that people don't understand, and especially accountants, is there—you mentioned it—there is this assumption that everything is dischargeable, we can just go into bankruptcy and discharge the debts, everything.

Mr. Bluestein

Usually, actually, it's that no tax is dischargeable. So, what I'm saying is they're right about trust fund taxes. When I say, unfortunately, it's simple; what I mean is it's not a complicated situation. They're not dischargeable, all debt. So if you owe sales tax or you owe withholding tax—and I'll talk about that briefly for a second. That's where you have payroll tax where federal payroll tax is broken down into three parts. You have withholding from the employee for their taxes, for their social security, and then the third part of payroll tax is the employer's contribution. The first two parts are held in trust for the government. That's a trust fund tax just like the sales tax. Those type of taxes are always what's called priority taxes in bankruptcy and never dischargeable. So unfortunately, that is very simple, never dischargeable. Where the attorneys make mistakes and commit malpractice in the bankruptcy area is with income tax; because income taxes can be discharged if you time it right and you know what you're doing. And so many times over the years, unfortunately, I've had situations where clients have come to me, and they went to a bankruptcy lawyer who was not familiar with the tax provisions.

Well, the attorneys often will tell people no tax is dischargeable, so they don't pay attention to it. And that's just simply incorrect. So I've had people come to me with a significant tax problem. I'll analyze it. And I'll say your best solution here is a bankruptcy. And they'll say, well, I already filed a bankruptcy. And I say, "You did? When did you do that?" And they'll tell me, and I'll say, "Oh, you timed it wrong." Well, they'll respond, "My bankruptcy lawyer told me it didn't matter. I got rid of other debt, but taxes are never dischargeable." And just like you said, Ian, I've had situations where if they would've waited a week, two weeks, they would've wiped out hundreds of thousands of dollars. Now, here's the problem. If you file what's called a Chapter 7—I'll briefly go over the types of bankruptcies—you can only do it once every eight years. So if you played that card and you filed a week early, you've destroyed your client's fresh start. It's disaster.

So, let me go over first the type of bankruptcies. Then, I'm going to get specific about the timing periods to discharge income tax. There's basically three general types of bankruptcies we deal with all the time. There's some more obscure ones I'm not going to touch on; but normally it's a Chapter 7, Chapter 13, or Chapter 11. Chapter 7 is a liquidation. It can be used by individuals. And the goal is you get a fresh start. You're in and out very quickly. It's not very expensive. And if your debt is dischargeable—there are certain types of debts, including some taxes that I've already alluded to, that cannot be discharged. But if your debt is all dischargeable, Chapter 7 is a really good tool, assuming you don't have assets that you want to keep. Now, even if you do have assets, some assets are exempt because Congress realized that to give somebody a fresh start, you can't take away everything they own. So, there are certain exemptions; there's federal exemptions, and there's state exemptions. And the states can opt out of the federal exemptions and use the state ones, and so it varies across the country. Now, in New York, for example, there's a homestead exemption of 80 something thousand dollars per person. And it's higher in New York City where there's an adjustment for cost of living. So you could have a husband and wife—that's double. In addition, IRAs—this is huge—IRAs and 401(k)s are fully exempt. So these are all benefits of a bankruptcy. You get to keep those kind of assets.

There's some other smaller type of exemptions also. So, if you're a person who doesn't have non-exempt assets that you're worried about losing, and the debt you have is dischargeable, [Chapter] 7 is a great tool. If your situation is where some of your assets are not exempt and you want to keep them and/or some of your debt isn't dischargeable and you want time to pay it, then a Chapter 13 is a great solution. In a Chapter 13, you get to keep all your assets. You pay your creditors over time through a five-year plan. The nice thing about it is you don't often have to pay all the creditors in full. The top-level creditor, whether it's Chapter 7 or Chapter 13, is a secured creditor. That means they have a lien on assets. So a mortgage on your house. Now the IRS or New York State can be secured creditors also if they file liens. In any event, secured creditors have to be paid in full in a 7 and a 13 to the extent they're fully secured. The next level of creditor involved is called a priority creditor. Those are certain types of things that are not dischargeable, certain types of taxes, like the trust fund taxes I just said. They'll survive a Chapter 7 if they're not paid out of the assets. And in a Chapter 13, they have to be paid in full. But then there's bottom-level creditors, certain income taxes that are old enough, penalties and other non-tax debt like credit cards. Those get paid nothing usually in a Chapter 7; other than what assets that are liquidated, they get wiped out. In a Chapter 13, they often get paid a very small percentage on the dollar, which is based on the person's excess income and excess equity and assets—most [Chapter] 13s again, very small percentage. So, it's a very useful tool.

The next type of bankruptcy is a Chapter 11. Chapter 11s are usually used for corporations or LLCs because they can't use a 13. A 13 is limited to individuals, and a 13 has a secured and unsecured debt limit that's adjusted for COLA periodically. Chapter 11s have no debt limit. They can be used by individuals or by entities like corporations or LLCs. However, a Chapter 11 is very expensive, very complicated. So, if you're an individual, you're normally going to want to use a 13 if you can fit into the debt limit. We've had some situations where we have used an 11 for an individual.

Mr. Redpath

Now, Gary, there's a Subchapter V that came in February of 2020. How does that impact Chapter 11?

Mr. Bluestein

You're ahead of me. That was my next statement exactly. What I had a big problem with over the many years I've been doing this is when somebody would come to me with a troubled business. Let's take New York State. They're very unreasonable when you owe them sales tax, very unreasonable. And often, they were going to just seize and shut down a business. And I would explain to them, please don't do this. If you do this, the client can't pay you back. And they're going to go after the individual trust fund taxes, both federal and state. Not only do they go against the entity, they go against an individual for the trust fund portion. So I'm saying, you're going to close this guy's business. You're going to ruin his livelihood, ruin his ability to pay you. And then you're going to come after him personally. And they would say, we don't care. We're shutting them down.

So when they were a DBA, I could do a Chapter 13, which was inexpensive. And the great thing about bankruptcy, which I should have emphasized, is something called the automatic stay goes into effect immediately. All creditors, including the IRS and New York State or any state, they're all frozen. They've got to stop all collection; very, very powerful tool. So I would want to do that to save a business, and then we can pay them over time through a plan. The problem was Chapter 11s were too expensive, and they couldn't do a [Chapter] 13 if they were a corporation or an LLC. Those people were really stuck. And it was really frustrating. However, what you've just pointed out, Ian, Subchapter V was enacted in 2020; and its purpose was to allow these small businesses to have the benefits, these entities to have this benefit of a Chapter 11, but much simpler and much less costly.

So, we're using that a lot more. Now, it had a debt limit that wasn't very high; but because of COVID, they increased it to $7,500,000, which for most of the small business clients I have, that's fine. And this is going to be such a useful tool post-COVID because so many people are trying to survive. Now that debt limit, unfortunately, sunset in March of 2022, actually; but there's a bill pending in Congress to make it permanent at $7,500,000. So, it was a perfect question. For those people who have clients who have a troubled business, that they're being pursued by creditors, and they're small enough, this is an excellent tool. And it allows you to pay your debt over time through a five-year plan. And you, again, often don't have to pay all the debt in full. So, that's the general overview of the types of bankruptcies. And Subchapter V falls under Chapter 11; but it is unique and it's going to be very useful.

Mr. Redpath

Now, Gary, you talked about dischargeable debts, nondischargeable debts, the status as a secured claim. So, let's focus in on the IRS right now. How does the IRS get a secured claim? And how does that affect you? Somebody comes to you and you think bankruptcy; and I know your firm actually has bankruptcy people in the firm. What's the first thing you want to look at and determine if it's secured or not?

Mr. Bluestein

Okay, to address that, it's important to know that there's three types of claims the IRS can file. Most creditors have two types of claims, either a secured or unsecured. The IRS has three types; there's a secured, a priority, and then a general unsecured. We, if we can make it happen, want the IRS and New York State—same rule applies—to fall into the general unsecured category. Because as I said, in a Chapter 7, they just get wiped out. In a Chapter 13 or 11, they're often paid a small percentage on the dollar, unlike the secured and priority that survive discharge and, in a plan, have to be paid in full.

How do you get those type of claims, or how do you avoid them? Well, for the IRS to have a secured claim, they need two things before bankruptcy. They need to file what's called a notice of federal tax lien. Now, once the IRS makes an assessment against somebody, which could be based on a filed return, a self-assessment, or it could be based on an audit adjustment. Once they have that assessment, they actually have a lien on everything and they can pursue collection. However, in bankruptcy, for them to be considered a secured creditor, they have to have more than just that assessment. They have to file a notice of federal tax lien prior to the bankruptcy being filed. That's number one. And their lien's unique; it attaches to absolutely everything anybody owns, everything! Unlike a bank that the mortgage says what property it's on or a UCC filing that identifies the assets, the federal tax lien is on everything. For them to be secured though, they have to have equity for that lien to attach to. So, they need two things before bankruptcy to be a secured creditor—the filing of that lien and some equity for that lien to attach to.

I want to point out that all the rules I'm talking about in bankruptcy regarding taxes apply to the IRS as well as all the states. I've been saying New York because I'm from New York; but we do a national practice so it could be any state tax. The same rules are applying here as far as priority. So what priority is… If it's secured, that's where the taxing authority would rather be just like any other creditor. But unlike other creditors who will fall to the general unsecured category, the taxing authorities can fall not that far. They fall to the priority category first, and they are in a beneficial situation unlike other unsecured creditors, because priority debt is not dischargeable and must be paid in full in a plan. So, what's a priority tax? Again, as I said, the trust fund type of tax I mentioned is always priority. But income tax? This is where the strategy comes in and where the mistakes are made.

Mr. Redpath

The three-year or the 240-day rule. Yes, that's one that's missed a lot. So, help us with that. What exactly does that mean?

Mr. Bluestein

I keep saying to people that timing is everything. There are these hurdles you've got to get through to make it non-priority. I'm going to go through each one, and there's three. The first one is if the tax return for the year in issue was due within three years of filing bankruptcy, it will be a priority tax and nondischargeable. Bright-line timing test. Now, you've also got to know, it says plus extension. So the due date could be either April 15th or October 15th. You've got to know. And all these answers a bankruptcy lawyer can get by getting a transcript from the IRS. Without doing that, you're really on shaky ground. You've got to get a transcript, and it'll tell you was the return filed on extension and will give you all the other information I'm going to go through for dischargeability. So, to determine if it's priority, if the return was due within three years of bankruptcy including extension, it'll be a priority.

If I had, for example, the 2018 tax return, no extension, that would be due April 15th, 2019. Count three years from that; you're at April 15th, 2022. We just passed that. So, 2018 is now non-priority under that rule. And every year before that would be non-priority under that rule. If I filed early, I made a terrible mistake because I've got to wait eight years to file again. That's why the timing is everything. Let's say you get through that three year old; you're not out of the woods yet. Then you go to the next rule. And the next rule says if the tax in question was assessed within 240 days, it'll be a priority—240 days of bankruptcy, another bright-line timing test. So, if I'm thinking of bankruptcy, I've got to know when that assessment date was; and that's on the transcript. I've got to make sure I count more than 240 days before I pull the trigger on a bankruptcy or again, I really messed up.

Now, there's a little more to that section. It says if an offer in compromise is submitted during that 240 days, whatever time was remaining is frozen while the offer is pending until it's rejected or withdrawn plus 30 days. So, you've got to take that into account, and that's on the transcript. Now, what's an offer in compromise? I'm sure many of you accountants have heard of that. It's a tool we use all the time to settle with the IRS or the states that have offered programs where you reach a settlement with them. It's beyond the scope of this discussion to go into detail on offers. I just want to say though, it's a great tool when it works; but there's so much misleading information and false advertising. Unfortunately, a lot of scam companies will say "We'll settle for pennies on the dollar. We can just wipe out your debt for $500." All of those commercials that say it like that are misleading at best. And the reason is the IRS doesn't just say we're going to cut you a break, we like you. They have a very objective formula they have to follow based on assets, income, and allowable expenses. And sometimes, it works phenomenally well. I've compromised literally millions of dollars for people for a very small amount. And many times, it won't work. Bankruptcy is sometimes a great tool to use if an offer in compromise won't work. And I use both of them interchangeably sometimes. Bankruptcy's also a global solution because an offer in compromise obviously is only going to address the tax liability. Bankruptcy will address all of that, including other taxing authorities; but they're both incredibly useful tools.

So back to the 240-day rule; you have to wait the 240 days out; and you've got to be sure if an offer was submitted, you take that into account. If you get by those two rules, then it's not a priority tax. Now, I'm going to deviate real quick on the third rule, which is rare. The third rule is where the tax is not assessed yet, but is still legally assessable. To understand that rule, you've got to know how long does the IRS have to assess a tax? And those accountants out there probably know the answer to this. Generally, the IRS says three years from the date the return is filed or due to assess a tax. There are exceptions to that. For example, if there's a 25% omission of income, they have six years. So if they had that situation, you've got to wait that whole time out, or it's going to be a priority.

Another situation they have more than three years would be where you sign one of those extensions. You're client's being audited, and the auditor says, "Will you extend the statute?" If you do that, they have more than three years. So, you've got to know that because if it's not assessed yet and you don't wait that time period out, then it's not going to be dischargeable. Now, there's two other reasons why it could have longer than the three-year rule—fraud or non-filing; because if you don't file a return, it runs from the day of the return, or a delinquent return. Those are the reasons that it's assessable beyond the three years. Those will not be priority. It's carved out specifically in the statute. Now, why would Congress do that? Well, actually they did it because they were doing a double whammy to a bad debtor or bad taxpayer.

What they're saying is we're not going to make it a priority because you committed fraud or because you didn't file your return on time. We're going to say it's not a priority for that reason if that's why it hasn't been assessed yet. But in a separate section, and we're talking about the next section, it's excepted from discharge.

Why is that a double whammy? Well, priority taxes get paid ahead of the unsecured creditors. So I use this example. Let's say I had a situation where somebody has an unfiled return that they're going to owe $50,000 for. And they have $50,000 of assets, and they owe Visa $50,000. If they filed a Chapter 7 and the IRS was a priority, the $50,000 of assets would go pay off the IRS. And Visa? They have no special status. They would just be discharged. Guy gets a fresh start. But because Congress said, if your return was late or fraudulent, it won't be a priority, what happens? Well, the IRS falls to the bottom category that Visa is in and they share pro rata. So, the IRS only gets $25,000; Visa gets the other $25,000 because they're on the same level. So, then what happens? Well, Visa's gone. But the other $25,000 that's owed to the IRS is excepted from discharge under 523 of the bankruptcy code because you didn't file on time or you committed fraud. So, you're not getting your fresh start. They inhibited your fresh start on purpose.

So, those are the rules for priority. The last one is rare. It comes up occasionally, but the first two come up all the time, the three-year rule and the 240-day rule. And you've got to be sure you get past that. Now, that's all under 507 of the bankruptcy code. Even if you do get past that, if we then go to 523 which I just referenced, that's where the exceptions to the discharge are. And one of them is priority taxes. That's where it says they won't be discharged. So you want to be sure you time it right so they're now priority. That's also where it says if you don't file a return, it's never dischargeable. And it's also where it says that if you commit fraud, it's never dischargeable. There's a lot of complications to the rules I'm giving you. For example, if you file a return late, then it says you have to wait two years before it can be dischargeable. Even if you're past the priority periods, you have to wait two years from the date the late return is filed. Now, if that's not complicated enough, this is a hotly debated topic throughout the country because what ended up happening, they changed the bankruptcy laws. Now, it's kind of a long time ago in 2005; and Congress put in a definition of a tax return, and it's this long paragraph.

And this paragraph defines a tax return as basically a document that meets all the requirements under the law. And the state of Mississippi many years ago—well, probably about seven, eight years ago—decided to challenge a discharge because the person filed late. They said you didn't meet all the requirements. Well, because of that, there's cases all over the country going all over the place where some circuits have held that—it's called the one-day-late rule—if you file the return one day late, it can never be discharged, which contradicts the reading of the statute where it says you've got to wait two years from a late return. The IRS, fortunately, doesn't think that's correct, but many states do. So, when you're looking at a bankruptcy with a late return, you've got to take that into potential account. Our circuit—where we are is the Second Circuit—has never ruled on that issue; but many circuits have, and there's a split in the circuits.

The Supreme Court, unfortunately, has denied certiorari, meaning they haven't listened to the issue, twice now. Someday, I hope they will settle this, but it's a complicated mess. The only other thing I'll say about this is something you've got to know. If your client doesn't file a tax return, there are times the IRS can do it for your client. They call that a substitute for return [(SFR)]; that is never considered an actual tax return for bankruptcy purposes. So, if the IRS assessed the tax based on a substitute for return, and you think you waited out all the timing periods I'm talking about, it will never be dischargeable because that doesn't count. So, that's in a nutshell and it's very common.

Mr. Redpath

Now, Gary, with that substitute for return, what if I tell my client, "Let's file a return now. They did the substitute, but let's just file a return."

Mr. Bluestein

Okay. That's a great question, Ian. And it's funny you should bring that up because I write for Thompson Reuters. I'm addressing that in a chapter I'm writing right now. That issue is also being hotly debated. Now the IRS agrees, fortunately, that the courts who have held that the one-day-late rule, the IRS says that's not correct. They don't follow that. But they say if, however, we do a substitute for return for you, you can never fix that by filing a return and waiting two years. That's something I've done before; and the IRS changed their policy since I've done it. And there's nothing in the law that I can find that says the IRS is right about that. Unfortunately, the majority of cases would agree with them. Although one just came down recently. Actually, there's a few that side with the debtor taxpayer—and this is what it comes down to. The one-day-late rule—in those circuits, you're going to lose. But the other circuits, as far as the IRS's position about, "Can you fix a substitute for return by filing, waiting two years," they look at this tax court case called *Beards*, and it's called the Beards Test. And basically, what it says is if it was a good faith filing, then it should be allowed. And there's cases going all over the place, and it's fact specific. Most of the cases, unfortunately, will hold it's not a good faith filing. If you're doing a return that pretty much mirrors the substitute return, there was no good faith to it. Although a case that recently came down, the court did hold. The person was late because of circumstances that were beyond their control. And they did find it to be a good faith filing, and they did allow it to be discharged. So right now, that is also a gray area. I'm probably reluctant to challenge that because the IRS will fight that all the way up to the circuit level, and not too many Chapter 7 clients can afford that. But it is something that has been litigated all over the place, these issues. And hopefully, someday we'll have a Supreme Court case that will address that.

Mr. Redpath

Gary, you mentioned something, and I don't want it to go by because you brought up the transcript. So often, we don't look at that, when you've talked about several things dealing with tolling of the statute and actually making sure exactly what's on that transcript. Sometimes, we just kind of take the taxpayer's word. I know we were actually involved with a case together, if you recall, an individual who had a place on Park Avenue. And the IRS blew the statute, but it was so convoluted because they had offers in compromise, and then they didn't follow it. And somehow it was going back, but it was very careful. You've got to really go through that and make sure because the IRS is known to blow the statute many times. You just have to make sure that you go through it very carefully; and you need the transcript to do it.

Mr. Bluestein

Well, that's an excellent point. And just to clarify when you say statute, you're now deviating from bankruptcy law. We're talking about the statute of limitations on collection, which is 10 years from the date of assessment. And because there's certain things that stop that time period from running, such as a bankruptcy will stop the time period from running, while you're in bankruptcy plus six months.

Mr. Redpath

And as you mentioned though, the tolling for an offer in compromise will toll the 240-day rule.

Mr. Bluestein

Well, yes. Sometimes, this statute is very complex to calculate, and the IRS does make mistakes. Going back to bankruptcy, you're absolutely right. There's certain things, and there is one very key thing in addition to what you just said, Ian. In addition to the offer in compromise, there's a remedy we use all the time. The IRS is required before they can levy on somebody's assets, they are required to serve what's called a final notice of intent to levy. And you have a right or a taxpayer has a right to file what's called the collection due process appeal in response to that. That freezes collection, and you get to go to an appeals officer who's supposedly independent from collection, and you get to ask for a less invasive remedy. You can ask for an installment agreement, better than them taking your stuff. Or you can ask for an offer in compromise or other potential remedies. Great tool!

Here's the problem. If you do that, since it freezes collection—Congress changed the law many years ago, back in 2005 and said, since it's freezing collection, it's going to freeze those timing periods I just described. It freezes the three-year rule and it freezes the 240-day rule while that appeal is pending, plus 90 days. So it's critical you get a transcript because you could think, okay, like I said as an example, 2018 return timely filed. Three-year rule clearly up; 240 days was up 240 days after it was assessed with the return. So all long gone. But what I didn't know is they filed one of these collection due process appeals. I will make a big mistake if I file early. So you've got to know that. That's on the transcript.

Now I'll give you a little secret, which isn't a secret anymore. There's articles about it. Before they changed the law to freeze that, it was easy to help somebody. I'd sit in a conference room. They'd come in with this final notice of intent to levy. And I'd say, "I've got good news for you. You're never going to have to pay this." They would look at me, surprised, "What do you mean?" I said, "Because we're going to file an appeal. And I know they're going to take a year and a half before we get a conference, and they're going to freeze all collection. And the bankruptcy timing periods are going to run out. And if they don't give us what we want, we're just going to file bankruptcy, and we're going to win." And that worked every time.

Unfortunately, I wasn't the only one probably who thought of that. So that's why Congress changed the law and said it would freeze that time plus 90 days. Here's the thing, though. There is another solution. If you don't file within 30 days—that's how long you have to do a timely CDP. It's called collection due process appeal. Now, if you file within 30 days, not only do you get all the benefit of the freezing, and the appeals conference, and everything I said. But if you don't like what the appeals conference determination is, you have the right to go to the tax court and challenge the determination. That right isn't used successfully that often, because you have to prove that the IRS abused its discretion—very difficult, but it is a right you have. However, if you file late, if you file 35 days or as long as it's within one year, the IRS will still give you that hearing. They call it an equivalency hearing. You have no right to go to tax court.

But like I said, that right often isn't that useful because it's very hard to use abusive discretion. So you still get the same hearing, not by statute, but by policy; and by policy, they hold collection. But because the bankruptcy code specifically refers to the statute, Section 6330 of the Internal Revenue Code, and you're not using that, that timing period in bankruptcy keeps running. So, there are a lot of practitioners who will intentionally file an appeal late to get the benefit of the hearing, but the bankruptcy clock keeps running. So, you want to think twice. If bankruptcy's going to be a tool that you want to use, you may not want to file a timely collection [due process appeal].

Mr. Redpath

Yes. And I think, as you said in the beginning, a lot of bankruptcy attorneys don't know all the intricacies of tax as it relates to bankruptcy. One last area I'd like to cover, because this is often misunderstood, is this idea that you file bankruptcy. Well, what happens after that? Is there a separate estate for tax purposes? This so-called split year. What exactly is that?

Mr. Bluestein

Okay. That's a very important thing in some cases. We've talked about collection defenses and how to stop the IRS and discharge their debt. There's also substantive tax issues that come up with bankruptcy. The one you're alluding to is very important in certain cases. It only applies in a Chapter 7 and an individual 11, not in a 13, but what it is… There's situations—and this could happen a lot post-COVID—where people have things that cause tax liability, but they don't really have any money from it. And this can come up. Situations would be, you could have a foreclosure where you have debt forgiveness income, and you also have capital gain; but if whatever, if the tax liability occurred in the year of bankruptcy, the IRS will not sever the tax year.

So, let's say I have an event that happens. I'm really destitute. I lose my property to foreclosure. It generates a tax liability, or just generally I have a tax liability that year. If I file bankruptcy, even December 31st, that entire tax liability will not be considered pre-petition bankruptcy. It's post-petition because they won't split the year. Let's say I have some assets. Say I have $100,000 of assets and I'm going to have a $100,000 taxable event. That tax liability's going to be created in December of that year or some point during that year. If I file bankruptcy, my $100,000 asset's going to go to my other creditors. I'm going to come out of bankruptcy still owing the IRS post-bankruptcy $100,000 where they could have been paid as a priority if there was something I could do about it. And there is something. What you're saying, Ian, is right on. There's this Section 1398 of the Internal Revenue Code that allows you to make a split-year election.

You may have two short years. And what happens is the first half, the tax year ends the day before the bankruptcy. So, all of that tax liability that was generated that year, if I make a 1398 election, will be pre-petition and can be paid out of my assets from the estate. So, if I make that election, then my assets go to pay the IRS. And the other creditors? They get discharged anyway; they have no special status. So, I get a fresh start. If I don't make that election, unfortunately, the IRS is waiting for me after bankruptcy. So, that's part one.

The other issue which kind of goes with this sometimes is debt forgiveness income. There's going to be a lot of situations where you could have debt forgiveness income when creditors are writing off debt. What happens under Section 108 is there's two reasons that there's exceptions to debt forgiveness income. One is insolvency. And the other is bankruptcy; Title 11 it's referred to, but that's bankruptcy. A lot of people don't realize though, bankruptcy, you don't have to be insolvent. And here's an example. I've had this happen a lot. Somebody comes to me. And this was back a while ago when there was the big crash. They lost their investment property in Florida to a foreclosure, and they were real upset about it. So here they're destitute; they're losing everything. And guess what? Now, they owe debt forgiveness income on top of that. If they tried to argue insolvency, they couldn't because they had a big IRA. And retirement accounts, although they're exempt from creditors—except for the IRS, by the way, there's no exemption to the IRS for retirement accounts—but other creditors they are. But they still count in the balance sheet for solvency. So, you're not insolvent. You're going to owe a big tax bill even though you just lost everything. However, bankruptcy's different. If I file bankruptcy and I discharge that debt to the bank or whatever, there is no debt forgiveness income, and my IRA is exempt from them. So, we are going to have situations where bankruptcy is a great tool for people who are looking at potential debt forgiveness income; and that also sometimes ties with 1398 if there is going to be a tax liability. These are two sections you want to know about, or the bankruptcy lawyer needs to know about.

And the last piece with taxes… it does involve not the dischargeability provisions I was talking about, but challenging a tax liability. There's situations where clients are going to come to a tax professional, an accountant or a lawyer, and they're going to have their head in the sand. We see it all the time. I have clients who come to me with unopened envelopes. And the situation could be what's called a notice of deficiency, for example, the IRS did an audit adjustment. You get 90 days if they issue a notice of deficiency to petition the tax court. If you miss that 90 days, you're out of luck. The tax court is your prepayment remedy to challenge the liability. If you miss that, which often happens, the remedy is to fully pay the liability and file a claim for refund. Well, a lot of people can't do that. One thing bankruptcy does allow you to do under Section 505 of the bankruptcy code if you have not previously adjudicated a tax issue—this could be an income tax audit, it could be a determination that you're liable for a trust fund tax, it could be a sales tax issue. The bankruptcy court, the statute says, may hear a tax case as long as it wasn't previously adjudicated. Now, the word 'may' is critical. They don't have to; it's their discretion. But we have challenged tax liabilities in the bankruptcy context; and bankruptcy court can sometimes be a good forum to do it where the clients have missed opportunities before.

So Ian, you're right on. You want to be aware of 1398 when you want to split the year. You want to be aware of the benefit for debt forgiveness income bankruptcy can offer. And also thirdly, bankruptcy can offer the ability to challenge a tax lien.

Mr. Redpath

Gary, what you've done is hopefully tell everybody you don't want to wade into these waters unless you really know what's in there, because there can be some alligators just offshore or some very large white sharks. So, you want to be very, very leery of entering this. It seems simple; and on its face, it is simple. Well, that's just very much on its face. I mean the rules are so complicated; and you and I have both been involved in situations, as you mentioned, where a week, even days, can mean hundreds of thousands of dollars in liability.

Gary, I want to thank you. Your expertise in this area is certainly well deserved and your reputation. So, thanks a lot. And you know, it's great to have you on the program. Hope to have you on the program again soon. Thanks, Gary.

Mr. Bluestein

Thank you.

Tax Issues in Bankruptcy

By Ian J. Redpath, JD, LLM

A. Introduction

Bankruptcy is a useful and important tool in dealing with tax liabilities. There are four types of bankruptcy that might be available to a taxpayer: Chapter 7 is a liquidation; Chapter 11 is a reorganization; Chapter 12 is for family farmers; and Chapter 13 allows a debtor to pay debts over a period of time, generally five years. There is also a Chapter 11, Subchapter V streamlined reorganization for small businesses. The debt limit for a Subchapter V bankruptcy is $3,024,725; but, due to COVID, the limit was increased for one year, to $7,500,000. While this expired in March, there is a bipartisan bill in Congress to make the increase permanent and retroactive. Code sections referenced are to the Bankruptcy Code unless otherwise noted.

B. The Automatic Stay and Dischargeability

IRC Section 362 provides for the stay of all collection activity on the filing of a bankruptcy petition. If the creditor has already seized or levied on a noncash asset that is necessary for a successful reorganization, the debtor generally can force the return of the asset or release of the levy. The secured creditor can demand adequate protection.

Both Chapters 11 and 13 allow the payment of taxes over time, sometimes without interest. Moreover, under certain circumstances, tax liabilities can be discharged in bankruptcy without full payment. There is an order in which creditors will be paid—secured creditors, administrative creditors, priority creditors, and unsecured creditors. The IRS will be secured if a notice of federal tax lien was filed prior to the bankruptcy. A federal tax lien attaches to all property and rights to property of the debtor. Generally, secured creditors must be paid the full value of the secured asset or given the asset. Administrative creditors are creditors whose claims came into existence after the bankruptcy filing, including taxes arising during the bankruptcy but prior to any plan confirmation. These claims are to be paid as a first priority.

C. Taxes in General

Tax claims are paid as an eighth priority. “Priority claims" are be paid before unsecured creditors and are not dischargeable in a Chapter 7; and full payment of priority taxes must be provided for in a Corporate 11 or Individual 13 plan. This generally applies to state taxes.

A Notice and Demand for Payment creates a lien on all assets belonging to the taxpayer. After assessment, the IRS can start the collection process. It is a "secret lien" since it is not publicly recorded. However, certain perfected interests, such as a secured creditor, will have priority [IRC §6323(a)] and are not considered secured in bankruptcy. To be a secured creditor, the IRS must properly file a Notice of Federal Tax Lien (NFTL) prior to bankruptcy; and it attaches to all property, both real and personal.

Section 724(a) states that "a recorded tax lien can be avoided in a Chapter 7 proceeding if it secures a claim for (a) any fine, penalty, or forfeiture; or (b) multiple exemplary or punitive damages arising before the earlier of: the order for relief or the appointment of the bankruptcy trustee, but only to the extent such amounts do not compensate the IRS for an actual pecuniary loss." If not secured, taxes are either a "priority" or "general unsecured" claim. Section 507(a)(8) specifies what tax claims qualify for priority status.

D. Income Taxes

Section 507(a)(8)(A)(i)-(iii) provides the rules for determining priority status in relation to income taxes. These rules are as follows:

“The Three-Year Rule”

The income tax liability will be a priority if the return for the year in issue was due within three years of the bankruptcy filing. If the return is on an extension, the "three-year rule" runs from the extended due date.

“**The 240-Day Rule”**

If the tax was assessed within 240 days of the bankruptcy petition, it will be a priority tax. If an offer in compromise is submitted during the 240-day period, any time remaining on the 240 days will be tolled while the offer in compromise is pending or in effect, plus 30 days. It should also be noted that the IRS takes the position that the term "in effect" would include the full five-year probationary period that applies after an offer in compromise is accepted.

“**Legally Assessable”**

An unassessed but still legally assessable tax will be a priority claim. This will follow the general rules on assessment by the IRS. If there is an unfiled return, delinquent return filed within two years of bankruptcy, or a fraudulent return, it is not a priority but is nondischargeable.

Federal and state withholding taxes, as well as state sales taxes, which are required to be collected or withheld, always have priority status. Non-trust fund employment and excise taxes are a priority under the general rules. [B. Code §§§507(a)(8)(C); (D) & (E)]. All other taxes are generally unsecured claims. The interest on a tax is treated the same as the tax liability.

“Exceptions to Discharge”

Section 523(a) provides for exceptions to discharge in relation to certain types of tax claims. Taxes that qualify for priority status, if not paid in full, are not discharged in a Chapter 7 or Chapter 11. In a Chapter 13, priority income taxes are dischargeable, but a plan will not be confirmed unless it provides for full payment within five years. Where the income tax is dischargeable, interest will not accrue. However, where the priority income tax is not discharged for another reason (i.e., a late return), or the tax is a priority trust fund tax, these liabilities are specifically excepted from discharge and, therefore, interest does accrue on the liabilities.

There are two scenarios for which courts have come to different conclusions in relation to delinquent returns. The IRS's position is that if a substitute for return (SFR) is assessed, then the liability cannot be discharged. [Notice 2010-016] The IRS has won the majority of cases on this issue. [In Re *Colson,* 446 F3d 836 (8th Cir. 2006)]

The second is the “One Day Late Rule.” Section 523’s definition of a return would not include a late return and, therefore, the tax relating thereto can never be dischargeable. [In Re *McCoy,* 666 F3d 924, 932 (5th Cir. 2012] The Third, Fourth, Sixth, Seventh, Eighth, Ninth, and Eleventh Circuits have held that the Beard's test governs what is a return. To qualify as a return, it must (l) purport to be a return; (2) be executed under penalty of perjury; (3) contain sufficient data to allow calculation of a tax; and (4) represent an honest and reasonable attempt to satisfy the requirements of tax law. [*Beard v. Commissioner*, 82 T.C 766 (1984)] The fourth requirement has given rise to the controversy among the circuits—the reasoning behind the delinquency is considered. A minority of circuits (First, Fifth, and Tenth Circuits) have applied the "One Day Rule;" a return filed one day late does not qualify as a tax return and, thus, is never dischargeable.

Under §523(a)(1)(C), a tax liability is excepted from discharge if it involves fraud or intentional evasion of tax. A fraud penalty assessed pursuant to IRC §6663 is nondischargeable. If the IRS asserts an intentional evasion of payment of tax, it is a factual determination on a case-by-case basis. The potential factors would also include the debtor's life style and attempts to conceal assets and avoid payment. [§§507(a)(8) and 523(a)]

Unsecured penalties can be discharged in a Chapter 7 or an Individual 11 if the transaction that gave rise to the penalties occurred prior to three years from the date the bankruptcy petition was filed. Unsecured penalties in a Chapter 13 are automatically dischargeable. Thus, a Chapter 13 can be very useful in discharging penalties, which often can be extremely onerous.

Although the successful assertion of fraud by the IRS will make the underlying tax and interest on the tax nondischargeable, the penalty itself can be discharged if it meets certain requirements.

Even if a bankruptcy is timed so that income tax liabilities no longer qualify for priority status, a filed Notice of Federal Tax Lien that attaches to exempt assets grants secured status to the extent of any equity. In a Chapter 7, although the asset may be exempt and the IRS's underlying liability extinguished, the lien will remain on the exempt assets even after discharge. Where appropriate, the petition should be filed before the IRS records a Notice of Federal Tax Lien.

Where a lien has been filed, pre-bankruptcy planning may be useful. For example, if a taxpayer has an IRA (or even an ordinary bank account) with a value of $50,000, and they owe a $50,000 tax liability for non-priority and $50,000 for a priority, with a timely return filed April 15th, the debtor could make a voluntary designated payment of those funds to the priority year. Absent this designation, the filing of a Chapter 7 will result in the IRS pursuing the asset that their lien attaches to after bankruptcy and applying it to the earlier dischargeable year, as the first year that is secured. Total cost to the debtor is $100,000. By designating the payment, the non-priority year is no longer secured and will be discharged without payment, the total cost thereby only being $50,000.

401(k)s and ERISA qualified plans are "excluded," not just exempt. However, the IRS has successfully argued that, unlike exempt assets, these never go into the estate, so the assessment lien is not affected by the bankruptcy and so there is still an assessment lien that can be pursued after bankruptcy. [*Wadleigh v. Commissioner*, 34 T.C. (2010)]

In relation to the means test, it should be noted that the vast majority of authority has determined that tax debt is not consumer debt. If there is a significant income tax liability that will be owed for the year of the bankruptcy filing, and there are assets to be distributed, it should be noted that the IRS will not split the tax year and consider the entire liability post-petition so that none of the assets will be applied towards the debt that survives bankruptcy. IRC §1398 allows the debtor to make a short-term election and split his tax year. As a result of this election, the tax liability that accrued up to the date before the bankruptcy petition will be a pre-petition claim and the assets can go toward that liability.

E. Conclusion

Bankruptcy may be a way to discharge tax liabilities. However, it is rife with pitfalls; and practitioners should be well versed in the rules before recommending this tactic.

GROUP STUDY MATERIALS

A. Discussion Problems

Your client, Sydney, has been experiencing financial problems. She has come to you to discuss the fact that the IRS has been attempting to collect some back taxes. She also indicates that she has recently filed tax returns for several back years.

Required:

1. Discuss the different types of creditors and how it applies to taxes.

2. Discuss the three-year rule, 240-day rule, and legally assessable.

3. Discuss exceptions to bankruptcy.

B. Suggested Answers to Discussion Problems

1. Tax claims can be secured, priority, or unsecured. Secured claims will be able to take the value of the secured property or the property itself. The IRS has a secured position if it has filed a Notice of Federal Tax Lien (NFTL) prior to the bankruptcy petition. Other tax claims are paid as an eighth priority. "Priority claims" are be paid before unsecured creditors and are not dischargeable in a Chapter 7. Full payment of priority taxes must be provided for in a Corporate 11 or Individual 13 plan. This generally applies to state taxes. A Notice and Demand for Payment creates a lien on all assets belonging to the taxpayer. It is a "secret lien" since it is not publicly recorded; however, certain perfected interests, such as a secured creditor, will have priority and are not considered secured in bankruptcy. Section 724(a) states that "a recorded tax lien can be avoided in a Chapter 7 proceeding if it secures a claim for (a) any fine, penalty, or forfeiture; or (b) multiple exemplary or punitive damages arising before the earlier of: the order for relief or the appointment of the bankruptcy trustee, but only to the extent such amounts do not compensate the IRS for an actual pecuniary loss."

2. An income tax liability will be a priority if the return for the year in issue was due within three years of the bankruptcy filing. If the return is on extension, the "three-year rule" runs from the extended due date. If the tax was assessed within 240 days of the bankruptcy petition, it will be a priority tax. An unassessed but still legally assessable tax will be a priority claim. This will follow the general rules on assessment by the IRS. If there is an unfiled return, delinquent return filed within two years of bankruptcy, or a fraudulent return, it is not a priority but is nondischargeable. Federal and state withholding taxes, as well as state sales taxes, which are required to be collected or withheld, always have priority status. Non-trust fund employment and excise taxes are a priority under the general rules. All other taxes are generally unsecured claims. The interest on a tax is treated the same as the tax liability.

3. Section 523(a) provides for exceptions to discharge in relation to certain types of tax claims. Taxes that qualify for priority status, if not paid in full, are not discharged in a Chapter 7 or Chapter 11. In a Chapter 13, priority income taxes are dischargeable; but a plan will not be confirmed unless it provides for full payment within five years. Where the income tax is dischargeable, interest will not accrue. However, where the priority income tax is not discharged for another reason (i.e., a late return), or the tax is a priority trust fund tax, these liabilities are specifically excepted from discharge and, therefore, interest does accrue on the liabilities. There are two scenarios for which courts have come to different conclusions in relation to delinquent returns. The IRS's position is that if a substitute for return (SFR) is assessed, then the liability cannot be discharged. [Notice 2010-016] The IRS has won the majority of cases on this issue. [In Re *Colson,* 446 F3d 836 (8th Cir. 2006)] The second is the "One Day Late Rule." Section 523's definition of a return would not include a late return and, therefore, the tax relating thereto can never be dischargeable. [In Re *McCoy,* 666 F3d 924, 932 (5th Cir. 2012)] Under §523(a)(1)(C), a tax liability is excepted from discharge if it involves fraud or intentional evasion of tax. A fraud penalty assessed pursuant to IRC §6663 is nondischargeable.

GLOSSARY OF KEY TERMS

Certiorari—A writ or order by which a higher court reviews a decision of a lower court.

Chapter 7—The chapter of the Bankruptcy Code providing for liquidation (the sale of a debtor's nonexempt property and the distribution of the proceeds to creditors).

Chapter 11—The chapter of the Bankruptcy Code providing (generally) for reorganization, usually involving a corporation or partnership. (A Chapter 11 debtor usually proposes a plan of reorganization to keep its business alive and pay creditors over time. People in business or individuals can also seek relief in Chapter 11.)

Chapter 13—The chapter of the Bankruptcy Code providing for adjustment of debts of an individual with regular income. (Chapter 13 allows a debtor to keep property and pay debts over time, usually three to five years.)

Fixed Amortization Method—The annual payment for each year is determined by amortizing in level amounts the account balance over a specified number of years determined using the chosen life expectancy table and the chosen interest rate. Under this method, the account balance, the number from the chosen life expectancy table, and the resulting annual payment are determined once for the first distribution year and the annual payment is the same amount in each succeeding year.

Fixed Annuitization Method—The annual payment for each year is determined by dividing the account balance by an annuity factor that is the present value of an annuity of $1 per year beginning at the taxpayer's age and continuing for the life of the taxpayer (or the joint lives of the individual and beneficiary). The annuity factor is derived using the designated mortality table and using the chosen interest rate. Under this method, the account balance, the annuity factor, the chosen interest rate, and the resulting annual payment are determined once for the first distribution year and the annual payment is the same amount in each succeeding year.

Required Minimum Distribution Method—The annual payment for each year is determined by dividing the account balance for that year by the number from the chosen life expectancy table for that year. Under this method, the account balance, the number from the chosen life expectancy table, and the resulting annual payments are redetermined for each year. If this method is chosen, there will not be deemed to be a modification in the series of substantially equal period payments, even if the amount of payments changes from year to year to year, provided there is not a change to another method of determining the payments.

SEPP (Series of Substantially Equal Periodic Payments)—Payments are considered to be substantially equal periodic payments with the meaning of IRC Section 72(t)(2)(A)(iv) if they are made in accordance with one of the three calculations—the required minimum distribution method, the fixed amortization method, or the fixed annuitization method.

CUMULATIVE INDEX 2022

BY TOPIC

BY CITATION

BY SPEAKER

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

1. According to Ian Redpath, which of the following is correct regarding the false advertising claims against Intuit?

   A. The case has been settled with the FTC.
   B. The case has been settled with the FTC and all states.
   C. The case has been settled with the states and the District of Columbia.
   D. The case has not been settled with the FTC or any states.

2. According to Ian Redpath, in which of the following cases did the court rule that the taxpayer disguised the distributions of profit?

   A. *Aspro, Inc. v. Commissioner*
   B. *Christian Sezonov, et ux. v. Commissioner*
   C. *Josepha Castillo v. U.S.*
   D. *Treece Investment Advisory Corp. v. Commissioner*

3. According to Ian Redpath, in which of the following cases did the court rule that the taxpayer(s) did ***not*** provide sufficient documentation to support classification as a real estate professional?

   A. *Aspro, Inc. v. Commissioner*
   B. *Christian Sezonov, et ux. v. Commissioner*
   C. *Josepha Castillo v. U.S.*
   D. *Treece Investment Advisory Corp. v. Commissioner*

4. According to Ian Redpath, which of the following cases related to whether the Tax Court has jurisdiction regarding the voluntary settlement program for employment tax?

   A. *Aspro, Inc. v. Commissioner*
   B. *Douglas Mihalik, et ux. v. Commissioner*
   C. *Josepha Castillo v. U.S.*
   D. *Treece Investment Advisory Corp. v. Commissioner*

5. According to Ian Redpath, which of the following cases regarding the SALT cap did the Supreme Court refuse to review?

   A. *Aspro, Inc. v. Commissioner*
   B. *Douglas Mihalik, et ux. v. Commissioner*
   C. *Josepha Castillo v. U.S.*
   D. *New York v. Yellen*

Continued on next page

6. According to Ian Redpath and Larry Pon, the information from which of the following is used to calculate a taxpayer's basis in their IRA?

   A. Form 1040
   B. Form 1040, Schedule 1
   C. Form 5329
   D. Form 8606

7. According to Ian Redpath and Larry Pon, which of the following is ***not*** a method to avoid the early withdrawal penalty from an IRA?

   A. Designated distribution method
   B. Fixed annuitization method
   C. Fixed amortization method
   D. Required minimum distribution method

8. According to Ian Redpath and Larry Pon, a 2022 RMD calculated using the RMD method would be based on the IRA balance as of what date?

   A. January 1, 2021
   B. June 30, 2021
   C. December 31, 2021
   D. January 1, 2022

9. According to Ian Redpath and Larry Pon, a 40-year-old taxpayer utilizing Section 72(t) in 2021 to avoid the early distribution penalty must continue to take distributions until approximately what year?

   A. 2022
   B. 2026
   C. 2030
   D. 2040

10. According to Ian Redpath and Larry Pon, which table generally produces the lowest distribution amount?

   A. Uniform Lifetime Table
   B. Single Life Expectancy Table
   C. Required Minimum Distribution Table
   D. Joint and Survivor Expectancy Table

Continued on next page

11. According to Ian Redpath and Gary Bluestein, which of the following types of bankruptcy is a liquidation, is not very expensive, and is available to individuals?

    A. Chapter 7 or 13
    B. Chapter 7
    C. Chapter 11
    D. Chapter 13

12. According to Ian Redpath and Gary Bluestein, which of the following is recommended for individuals wanting to keep their assets and pay their debts over time?

    A. Chapter 7 or 13
    B. Chapter 11
    C. Chapter 13
    D. Chapter 13, 11, or 7

13. According to Ian Redpath and Gary Bluestein, which type of bankruptcy is generally utilized by corporations?

    A. Chapter 7 or 13
    B. Chapter 11
    C. Chapter 13
    D. Chapter 13, 11, or 7

14. According to Ian Redpath and Gary Bluestein, Subchapter V relates to which of the following types of bankruptcy?

    A. Chapter 7
    B. Chapter 11
    C. Chapter 13
    D. Chapter 7, 11, and 13

15. According to Ian Redpath and Gary Bluestein, a taxpayer has how many days to petition the Tax Court in response to a notice of deficiency?

    A. 9 months
    B. 6 months
    C. 90 days
    D. 30 days

CPE Network®
Tax Report
Volume 35, Issue 5 **June 2022**

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

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Experts' Forum	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
IRS Notice 2022-6 and IRC Section 72(t)	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|
Tax Issues Related to Bankruptcy	|_______|	|_______|	|_______|	|_______|	|_______|	|_______|

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

____

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

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

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

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

	Overall	Knowledge of Topic	Presentation Skills
Ian Redpath	|______|	|______|	|______|
Lawrence Pon	|______|	|______|	|______|
Gary Bluestein	|______|	|______|	|______|

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

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

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

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

Were program materials accurate? Yes ☐ No ☐ ________________________

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

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

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

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

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

Specific Comments: ____

____

Name/Company ____

Address ____

City/State/Zip ____

Email ____

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

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: ____________________

Account #: ____________________

Location: ____________________

Program Title: CPE Network Tax Report, June 2022 Date: __________

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

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

Instructor Name: ____________________ Date: __________

E-mail address: ____________________

License State and Number: ____________________

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

CPE Network/Webinar Delivery Tracking Report

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

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

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED SEPTEMBER 3, 2021

Welcome to CPE Network!

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

This User Guide has the following sections:

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

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

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

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

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

Copyrighted Materials

“Group Live” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance

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

Use the **attendance sheet.** This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant's CPE certificate.

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

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

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

Requesting Participant CPE Certificates

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

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

Email: **CPLgrading@tr.com**

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance in a Webinar

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

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

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

Examples of polling questions:

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

Additional Notes on Monitoring Mechanisms:

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

Real Time Moderator During Program Presentation

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

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

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

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

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

Requesting Participant CPE Certificates

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

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

Email: **CPLgrading@tr.com**

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Self-Study” Format

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

Self-Study—Print

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

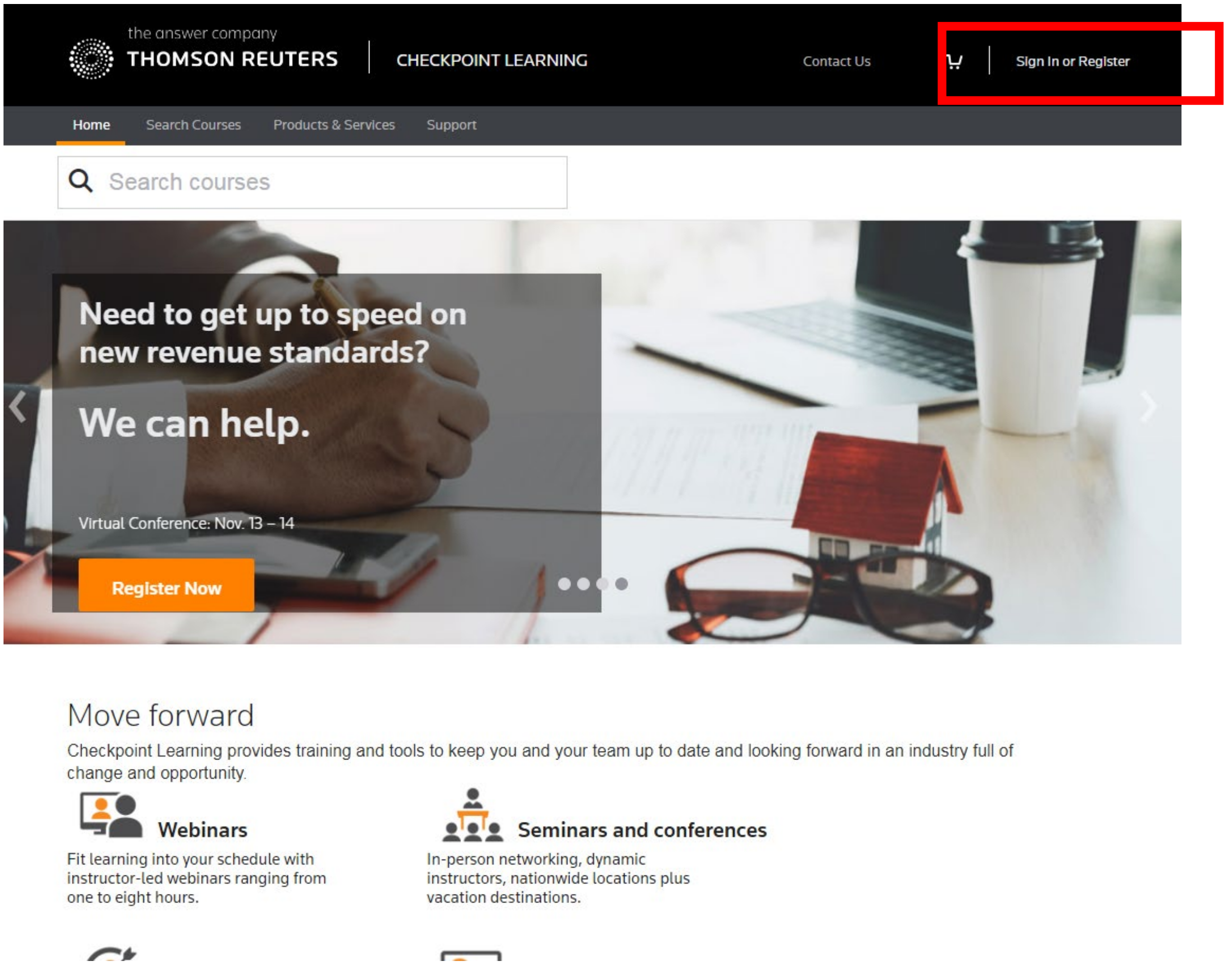
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

  Thomson Reuters
  PO Box 115008
  Carrollton, TX 75011-5008

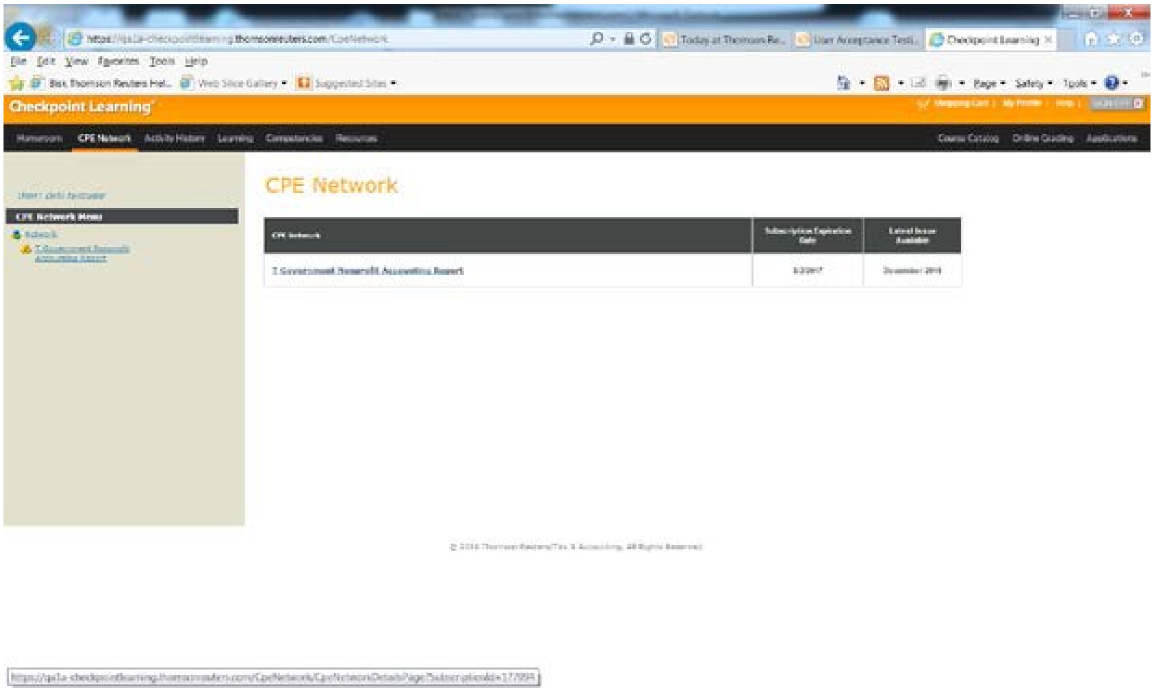
Self-Study—Online

Follow these simple steps to use the online program:

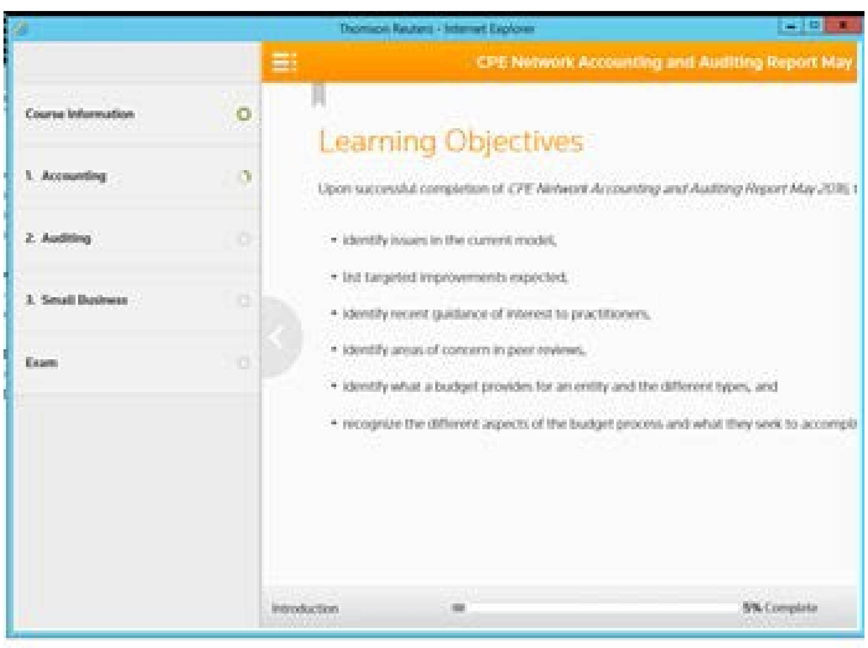
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Sign In or Register”).


the answer company
THOMSON REUTERS
CHECKPOINT LEARNING
Contact Us
Sign In or Register
Home
Search Courses
Products & Services
Support
Search courses
Need to get up to speed on new revenue standards?
We can help.
Virtual Conference: Nov. 13 – 14
Register Now
Move forward
Checkpoint Learning provides training and tools to keep you and your team up to date and looking forward in an industry full of change and opportunity.
Webinars
Fit learning into your schedule with instructor-led webinars ranging from one to eight hours.
Seminars and conferences
In-person networking, dynamic instructors, nationwide locations plus vacation destinations.

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

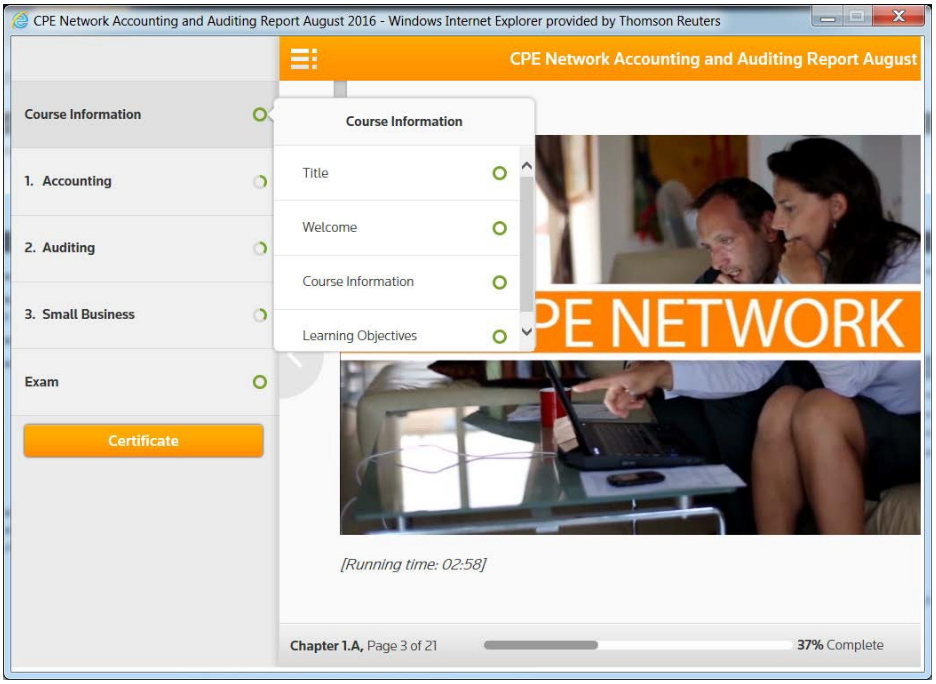


The Chapter Menu is in the gray bar at the left of your screen:

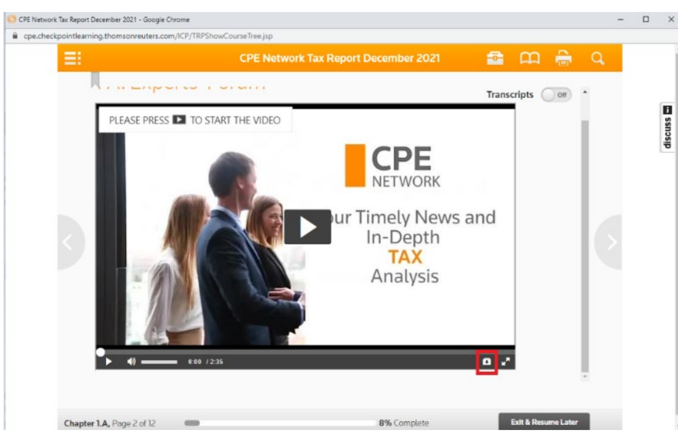


Click down to access the dropdown menu and move between the program Chapters.

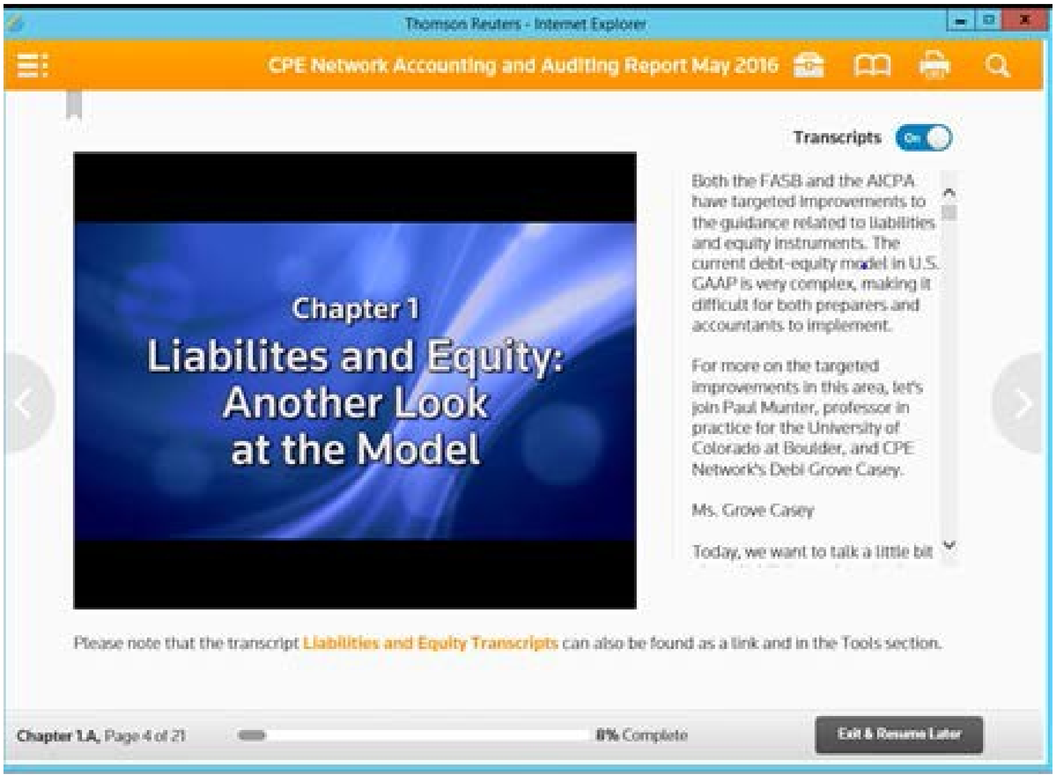
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



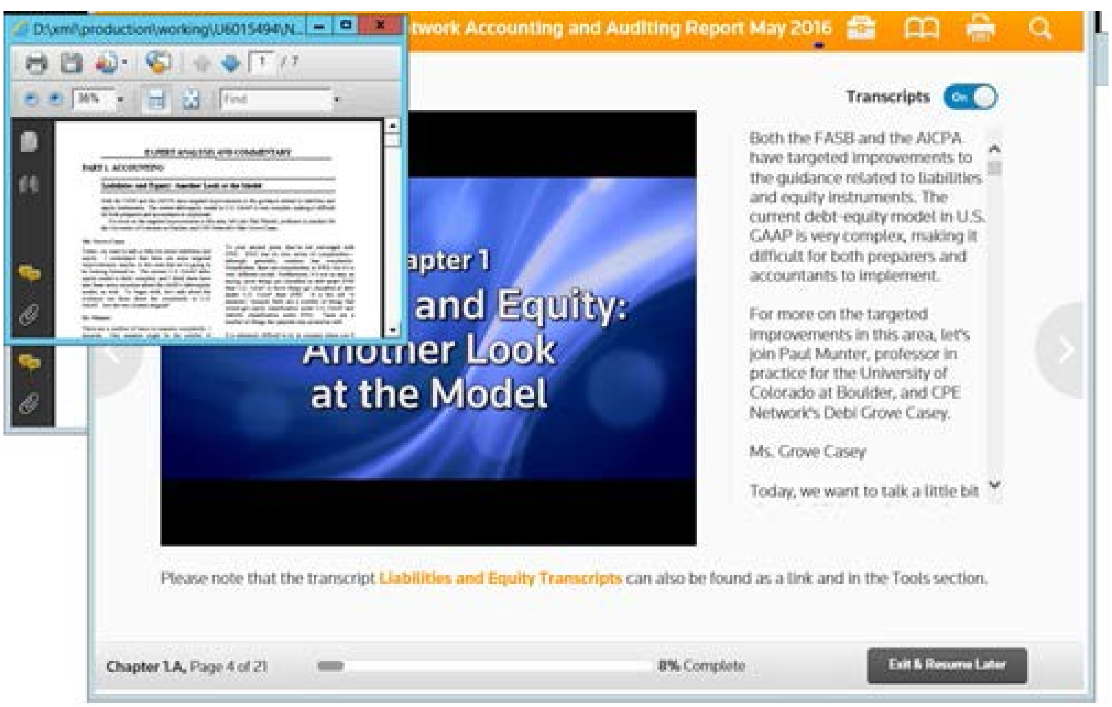
- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental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



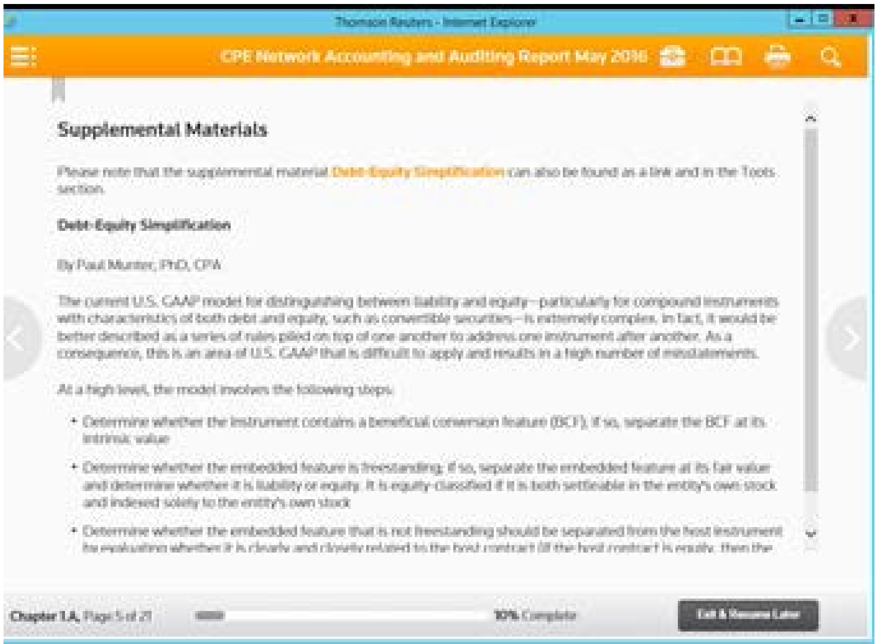
Video segments may be downloaded from the CPL player by clicking on the download button.

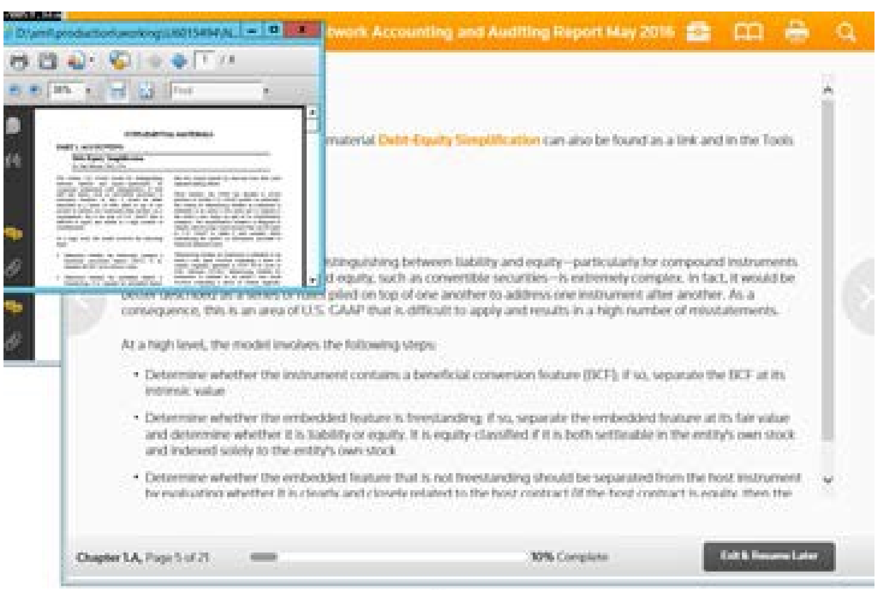


Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.



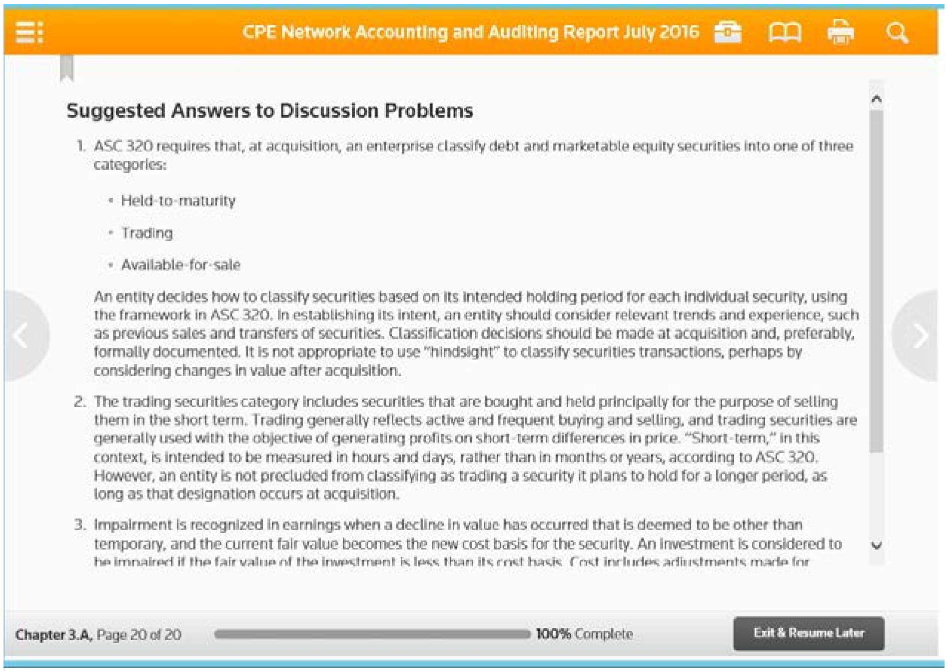
Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.





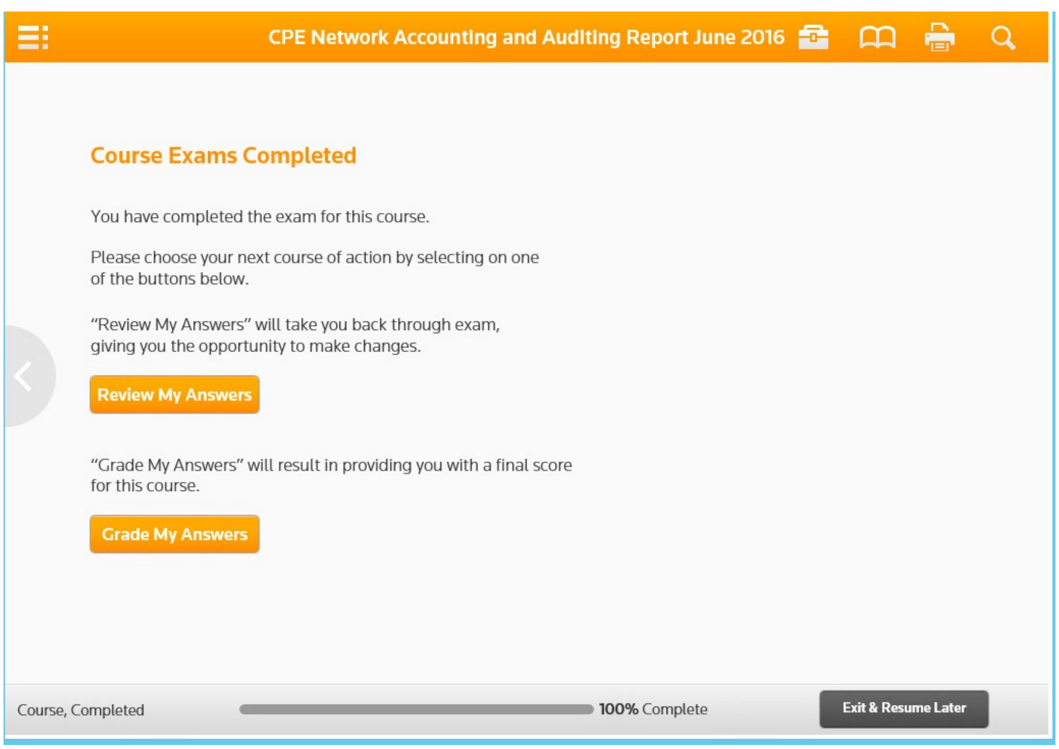
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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



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

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



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

Additional Features Search

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

Search Results are displayed with the number of hits.

Print

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

What Does It Mean to Be a CPE Sponsor?

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

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

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

CPE Sponsor Requirements

Determining CPE Credit Increments

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

Program Presentation

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

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

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

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

Appendix: Forms

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

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

Getting Help

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

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