Hot Topics for Closely Held Businesses

ABA Tax Section Joint Fall Meeting
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Hot Rulings

*Kress and Kaestner Trust*

Justin Miller
Kress v. U.S. ¹

Valuation of Gifts of Minority Interests in Pass-Through Entities

• Discounts for lack of control and lack of marketability
• Tax affecting earnings on C corporation equivalent basis—the “C to S Method”
  • C corps. have two levels of tax
    • Corporate level tax up to 35% (21% beginning on 1/1/2018 after 2017 TCJA)—earnings valued on an after-tax basis
  • S Corps., LLCs, and Partnerships (pass-throughs) have one level of tax
    • No corporate level tax—fictitiously reduce value by C corp. tax

• Why is this important?²
  • Court and IRS expert accepted tax affecting
  • Court found no S Corp. premium—neutral consideration
  • District Court ruling persuasive, but not binding precedential authority
  • Recent Tax Court ruling—Estate of Jones (Aug. 2019)

State Income Taxation of Trusts—Kaestner Trust

1. Income from State Sources
   • E.g., real estate and rental income in the state

2. Governing Law Designated in Trust Instrument (Louisiana, Idaho, North Dakota)

3. Residence of “Fiduciary”/Location of Administration
   • Could be broader definition than trustee—e.g., trust protector
   • Corporate fiduciary—major portion of trust administration

4. Residence of Beneficiary
   • North Carolina Dept. of Revenue v. Kaestner Trust (Jun. 2019)¹
     - SCOTUS: Must be a non-contingent—vested—beneficiary
   • Beware of throwback rules (CA and NY)

5. Residence of Testator/Settlor—”Founder State”?

The Taxpayer First Act  
(P.L. 116-25; 7/1/19)

Masha Yevzelman
Overview of Taxpayers First Act

• Independent Appeals Office
• Improve “customer service”
• “Sensible enforcement”
  • Seizure requirements
  • Joint liability equitable relief
  • Modernize National Taxpayer Advocate office
• Improve cybersecurity and technology
• Expand use of electronic systems
• Exempt organization provisions
Independent Appeals Office - History

• 1927: IRS Office of Appeals created

• 1988: IRS Restructuring and Reform Act of 1998 made "independent appeals function" within IRS a statutory requirement
  • Rights to hearings in Office of Appeals in specific circumstances (e.g. when IRS files a notice of lien)
  • Did not generally provide a "right" to an administrative appeal

• Rev. Proc. 2016-22: IRS Chief Counsel will not refer to Appeals:
  • Any docketed case or issue “designated for litigation by Counsel”
  • Non-designated cases or issues “if Division Counsel or a higher level Counsel official determines referral is not in the interest of sound tax administration.”
    • “Sound tax administration” standard not defined
    • Explanation to affected taxpayer not required
Independent Appeals Office - TFA

• Access to appeals process is now a **generally available right**

• **Procedures for IRS denials of referrals to Appeals**
  • Written determination, including detailed description of facts, basis for denial, and explanation of the application of the basis of denial to the facts
  • Protest procedures for denial of referral to appeals
  • Annual report to Congress with number of denied requests and reasons for denials
  • *Note: these procedures only apply to taxpayers seeking to administratively challenge a Notice of Deficiency*
Independent Appeals Office - TFA

• Access to Case Files
  • Pre-TFA: FOIA request (burdensome and time consuming)
  • TFA: access to case file at least 10 days before appeals conference for
    • Individuals with AGI of less than $400,000
    • Entities with gross receipts of less than $5,000,000
    • Note: generally does not impact LB&I audits

• Appeals Office Independence
  • Pre-TFA: mission of office “fair and impartial” (continues)
  • TFA: Chief Counsel lawyers providing legal assistance and advice to Appeals shall ("to the extent practicable") be lawyers who were not involved in the case previously and who are not preparing the case for litigation
    • Concern: Appeals is not “independent” when same attorneys that advised at exam also advise during the appeal.
Independent Appeals Office – TFA

• *Ex Parte* Communications — No Change
  • Since 1998: *ex parte* communications prohibited by statute "to the extent that such communications appear to compromise the independence of the appeals officers”
  • IRM and revenue procedures provide guidelines for communications between appeals and exam:
    • Not *ex parte* if taxpayer has opportunity to participate
    • If written, not *ex parte* if taxpayer provided a copy and given a chance to respond

• Appeals Conferences — No Change
  • No guidance on which IRS personnel can participate
  • No rules regarding timing
“Customer Service” and “Sensible Enforcement”

**Customer Service**
- By July 1, 2020, IRS to submit “comprehensive” customer service strategy
- By July 1, 2021, IRS to update guidance and training materials
- Provide helpful information while taxpayers are on hold

**Sensible Enforcement**
- Revised property seizure provisions with respect to structuring transactions
- Innocent Spouse Provisions:
  - De Novo Tax Court review
  - Equitable relief from joint liability, which takes into account “all facts and circumstances,” allowed anytime before expiration of collections period
- Third-party summons requests
  - Must be narrowly-tailored, essentially precluding overly-broad use of John Doe summons
  - ANY third-party contact only allowed following 45-day notice to taxpayer
  - Third-party must be contacted within 1 year of notice to taxpayer
Organizational Modernization and Other Miscellaneous Provisions

• **Taxpayer Advocate Directives**: IRS must modify, rescind, or ensure compliance with any directive within 90 days

• **IRS Reorganization**: By September 30, 2020, IRS shall submit to Congress a comprehensive written plan to redesign the organization of the IRS

• **Whistleblower Disclosure Rules**:
  • Permits limited disclosures of information to whistleblowers
  • Provides anti-retaliation provisions and processes for enforcement actions

• **Low-Income Exceptions for Offers in Compromise Application Fees and Partial Payments**
Cybersecurity, Identity Protection, and Technology

• Single point of contact for tax-related identity theft victims
• Procedures for notification of identity theft
• Guidelines for stolen identity refund fraud cases
• Increased penalties for improper disclosure or use of information by return preparers
• Expanded Use of Identity Protection Personal Identification Numbers
• Creates Chief Information Officer role
• Expanded use of electronic systems
• Allows acceptance of credit card payments for taxes
• Uniform standards for electronic signatures
Exempt Organizations

- Mandatory electronic filing
- Exception for “small organizations” (less than $200,000 annual gross receipts) if e-filing would cause undue burden
- Notice required before revocation of tax-exempt status for failing to file a return for two consecutive years
Retirement Bill with Bipartisan Support

• H.R.1994 - To amend the Internal Revenue Code of 1986 to encourage retirement savings, and for other purposes
  • Setting Every Community up for Retirement Enhancement (SECURE) Act of 2019
  • Passed in House on 5/23/19 (417-3)
      • Note: Some amendments made such as removing option for using 529 plans for homeschooling and private K-12 or religious schools
H.R.1994, SECURE Act Highlights

- Expand retirement savings by increasing auto enrollment safe harbor cap
- Simplify safe harbor 401(k) rules
- Increase credit limitation for small employer pension plan start-up costs
- New tax credit of up to $500/year to small employers for startup costs for plans
- Treat certain taxable non-tuition fellowship and stipend payments as comp for IRA purposes
- Repeal prohibition on contributions to traditional IRA (currently 70 ½)
- Prohibit distribution of plan loans thru credit cards and similar
- Portability of lifetime income options
- Allow long-term part-time workers to participate in 410(k) plans
- Penalty-free withdrawals from retirement plans for any “qualified birth or adoption distributions”.
- Increase RMD age from 70 ½ to 72
- Benefit statements provided to defined contribution plan participants must include lifetime income disclosure at least once during any 12-month period.
- Expand 529 education savings accounts to cover costs associated with registered apprenticeships; up to $10,000 of qualified student loan repayments (including those for siblings)
- Plus some revenue raisers.
What about expired and expiring provisions?

H.R. 3301, Taxpayer Certainty and Disaster Tax Relief Act of 2019

Generally, extends items that expired at end of 2017 through 2020.

Permanent disaster relief.

Markup in House Ways and Means Committee on 6/20/19

Most costly item is biodiesel and renewable diesel incentives at $8.9 billion. Extending 7.5% AGI threshold for medical costs $3.6 billion.
Extenders Including TCJA Items

A few provisions of TCJA had very short life, such as just for 2018 and 2019.

• H.R. 1175, Craft Beverage Modernization and Tax Reform Act of 2019 – would make temporary provisions of TCJA related to craft beverage permanent including for beer, wine and distilled spirits, not treating aging period as part of production period for interest capitalization purposes under §263A(f).


https://www.congress.gov/
H.R. 593 - Small Business Owners' Tax Simplification Act of 2019

• Per CRS summary – H.R. 593 would:
  • align the deadlines for quarterly estimated tax payments with the calendar year quarters;
  • modify the dollar thresholds for various information reporting requirements [$1,500 for 6041 (1099-MISC) and 6050W (1099-K for third party settlement orgs; remove transaction threshold)];
  • allow certain self-employed individuals to participate in cafeteria benefit plans;
  • exclude from self-employment income net earnings that are less than the amount required under the Social Security Act for a quarter of coverage for the calendar year in which the tax year began;
  • allow certain health insurance costs of self-employed individuals to be deducted for self-employment tax purposes; and
  • specify that voluntary tax withholding agreements, training, or group discount programs have no effect on whether an individual is classified as an employee or an employer.

1. Expand section 179 to also include intangible assets
2. Further simplify accounting method rules for small businesses
3. Increase the deduction thresholds under sections 195, 248 and 709 and adjust them for inflation
4. Simplify retirement plan options and rules for self-employed individuals
5. Modernize the definition of tax shelter
6. Repeal the individual and estate and trust AMT
7. Relax the exclusive use requirement for a home office deduction
8. Allow a deduction for health insurance of self-employed individuals in computing self-employment tax
9. Increase the current, longstanding $400 self-employment earnings threshold
10. Provide similar treatment for all businesses with respect to deducting state and local income taxes
11. Limit section 461(l) and the 80% limitation on NOLs of section 172 for start-up businesses
12. Repeal section 465
13. Require all estimated tax payments to be due on the 15th day after quarter end

https://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/20190320-tec-small-business-modernization.pdf
S. 2156, S Corporation Modernization Act of 2019

• Per CRS summary:
  • “increase from 25% to 60% of S corp gross receipts the threshold for taxing S corps with passive investment income;
  • eliminate a provision terminating the status of S corps with excessive passive investment income for three consecutive years;
  • permit S corps to have individual retirement accounts as shareholders;
  • allow an adjustment to the basis of an S corp's assets upon the death of a shareholder, in the form of a 15-year amortization deduction; and
  • permit IRS to treat a late revocation of S corp status as timely if it finds there was reasonable cause for failure to make a timely revocation.”

Proposals to Change §280E

S. 597 & H.R. 1456, Marijuana Justice Act of 2019

Proposes to remove marijuana from Schedule of Controlled Substances.

Among many effects, Section 280E would no longer apply to marijuana businesses.

Sponsors include presidential candidates Booker, Gabbard, Gillibrand, Harris, Sanders and Warren.

H.R. 1893 and S. 697 are similar but with more criminal justice changes.

H.R. 1118 and S. 422, Small Business Tax Equity Act of 2019

Exempt a business legal under state law from §280E

https://www.congress.gov/
H.R. 3299 Pride Act

• “Promoting Respect for Individuals’ Dignity and Equality (PRIDE) Act of 2019.”
  • After *Windsor* and Rev. Rul. 2013-17, affected couples could only amend returns still open under the statute of limitations (back to 2010 generally).
    • Would extend this to all past affected returns, generally back to 2004.
  • Amend IRC “so that provisions that apply to married couples use gender-neutral language (for instance, by changing terms such as “husband and wife” to “any married couple”). These changes are meant to modernize the tax code and affirm the dignity of all married couples, including LGBTQ+ couples.”
• Markup on 6/20/19 in House Ways and Means Committee
• Passed in House on 7/24/19 by voice vote
Update PL 86-272 Dealing with Income Tax Nexus

• Typically there are regular proposals to update/modernize PL 86-272 in every session of Congress.

• Enacted 9/14/59 as temporary measure.
  • 60th Anniversary on 9/14/19!

• Update proposals usually called Business Activity Tax Simplification Act, such as H.R. 3063 (116th Congress)
  • Expand to more than sales of tangible personal property.
  • Expanding protected activities such as providing information.
  • Defines physical presence with a de minimis standard so must be 15 days or more in the year (or states can provide higher threshold).


• MTC Project to update MTC’s Statement of Information regarding P.L. 86-272
  • http://www.mtc.gov/Uniformity/Project-Teams/P-L-86-272-Statement-of-Information-Work-Group
Congressional Proposals Related to *Wayfair*

- **H.R. 379, Protecting Businesses from Burdensome Compliance Cost Act of 2019**
  - Protections for remote sellers, such as state may not require remitting to more than one location in the State.
    - “The term “remote seller” means a person that sells a good or service and that does not have a physical presence in the State in which purchaser is located at the time the purchase of such good or service occurs.”
    - Note: Still need to know if have physical presence.

- **S. 128, Stop Taxing Our Potential Act of 2019**
  - Generally supported by states w/o sales tax.
  - Require physical presence for seller collection obligations.
Congressional Proposals Related to *Wayfair* - more

- H.R. 1933, Online Sales Simplicity and Small Business Relief Act of 2019
  - “It is the sense of Congress that the States should develop an interstate compact for the collection of sales tax by remote sellers that identifies a clearly defined minimum substantial nexus between the remote seller and the taxing State, that simplifies registration, collection, remittance, auditing, and other compliance processes to the greatest extent possible in order to avoid undue burdens on interstate commerce, and that, due to such simplification, eliminates the need for the continuation of the small business remote seller exemption under section 4 [3].”
- Small seller exception – sales in U.S. in prior calendar year of $10 million or less
Definitions include:

• “(1) REMOTE SELLER.—The term “remote seller” means a person without a physical presence in the State who makes a sale in the State.

• (2) PHYSICAL PRESENCE.—
  • (A) IN GENERAL.—Except as provided in subparagraph (B), the term “physical presence” means, with respect to a person, that a person’s business activities in the State include any of the following during such person's taxable year:
    • (i) Being an individual physically in the State, or assigning one or more employees to be in the State.
    • (ii) Using the services of an agent (excluding an employee) to establish or maintain a market in the State, if such agent does not perform business services in the State for any other person during such taxable year.
    • (iii) The leasing or owning of tangible personal property (other than digital or alphanumeric data) or of real property in the State.
  • (B) EXCEPTION.—A person does not have physical presence in a State if the person’s physical presence in the State under subparagraph (A) was for less than 15 days in a taxable year (or a greater number of days if provided by State law), or if the person’s physical presence in the State was solely for the purpose of conducting limited or transient business activity.”
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