



2024 Year-End Tax Planner



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What's on Our Minds as 2024 Ends...

As the year winds down, our team at Perkins & Co has been reflecting on the key financial and tax considerations that could impact you or your business. In this section, we're sharing quick insights and tips from our experts—designed to help you navigate the close of 2024 with confidence. From tax planning strategies to emerging financial trends, here's what we believe should be on your radar as we head into 2025.

Tax Legislation

Brigitte Sutherland, CPA, Shareholder & Tax Practice Leader

With the expiration of the Tax Cuts and Jobs Act (TCJA) at the end of 2025, one of the most common questions from our clients is, "What's the future of the expiring TCJA provisions?" Now that the election is behind us, we have a better idea of where tax policy could go. President Elect Donald Trump has expressed support for making the TCJA provisions permanent as well as providing other tax policy proposals.



Business tax proposals include:

- Lower corporate rate from 21% to 20% (15% if manufacturing in the US)
- Extend present-law carried interest rule, treating as long term capital gain if held 3 years
- Qualified opportunity zone capital gain deferral extended
- Like Kind exchanges limited to real property would be extended
- 20% qualified business income deduction would be extended
- Limitation on excess business losses for non-corporate taxpayers would be repealed
- Bonus depreciation extended or made permanent
- Immediate expensing of research & development expenditures

Individual & estate/gift tax proposals include:

- Extension of higher estate and gift tax exemption amounts (\$13.61 million per person)
- Replacement of individual tax with tariffs
- Reduction of long term capital gains rate to 15%; index purchase price of assets
- Exempt from tax Social Security benefits, overtime and tips
- Remove SALT cap of \$10,000
- Increase child credit to \$5,000; new tax credit for caregivers; auto loan interest deductible
- Eliminate double taxation of Americans abroad

Significant tax reforms, such of those suggested above, take months of planning, negotiation, and legislative process before they can be enacted. While there's question as to the timing of tax legislation, rest assured that your team at Perkins & Co will stay on top of the latest developments. Reach out to your Perkins advisor if you have any questions as to how these changes could impact you.

State & Local Tax Changes on the Horizon in 2025

Sonja Barker, CPA, Shareholder

Many states are projecting budget shortfalls in 2025, and others are uncertain about the future. New taxes, expanding tax bases, and increased enforcement activities could all be on the horizon. Businesses should proactively address how they can remain compliant and prepare for uncertainty.

In their year-end planning, businesses should include an annual review of the nexus for state income tax, gross receipts tax, and sales tax. Many states have dedicated resources to analyzing data they receive from businesses and are focusing more on the economic nexus for both sales taxes and income taxes. Some states require businesses collecting sales tax to file income tax returns even though the business's activities may be protected from income tax under Public Law 86-272. States are sending out questionnaires and audit notices more frequently to verify activities and protections.

Businesses should evaluate the taxability of their products annually, regardless of their status as a service provider or a history of only making nontaxable sales. More states are looking to expand their tax base to include frequently nontaxable items such as services. States are also becoming stricter about the requirements for exemption certificates and assessing large sums if the business is unprepared.



Does Your Business Claim the Research & Development Tax Credit?

Sean Wallace, CPA, Shareholder

Halfway through 2024, the IRS released a new draft version of Form 6765, Credit for Increasing Research Activities, also known as the R&D tax credit. Here's what you need to know:

Before this year, taxpayers claiming the R&D tax credit only needed to provide categorized expenses of qualified wages, supplies, computer rental or lease costs, contractor costs, and the base period calculation when completing Form 6765. With the rollout of the new draft form, the IRS will require significantly more detailed information.

Effective for 2024 tax returns, the requirements for original filings include, but are not limited to:

1. Identifying business components accounting for 80% of qualified research expenses to which the Section 41 research credit claim relates to for that year.
2. For each business component, identify:
 - » Direct research wages for qualified services
 - » Direct supervision wages for qualified services
 - » Direct support wages for qualified services



- » Total qualified wages (sum of 50, 51, 52)
- » Cost of supplies
- » Rental or lease cost of computers
- » Applicable amount of contract research expenses

3. Disclosure of officer's compensation related to qualified research expenses

Not all new reporting will be required in 2024, as the IRS provided for a transition year, but it will be in 2025. Qualified small businesses and other taxpayers meeting certain requirements will not be subject to all increased reporting.

Businesses that plan to claim the R&D tax credit should review their internal procedures related to recordkeeping to ensure their credit will meet the new substantiation requirements for 2024 and beyond.

Bonus Depreciation & Year-End Planning Ideas for Partnerships

Trina Headley, CPA, Shareholder

As we head into 2025, bonus depreciation continues to phase out. For 2024, the applicable bonus depreciation percentage is 60% for eligible property placed in service before year-end. In 2025, that bonus depreciation percentage will be adjusted to 40%, as the law reads now.

It is recommended to scrub fixed assets to evaluate the current year's costs and determine whether businesses can expense them under the repairs and maintenance regulations instead of capitalizing them.

It's also important to remember that Congress has retroactively changed bonus depreciation percentages in the past and to watch for changes this month or early next year.

The IRS is scrutinizing partnership transactions and requires additional information to be filed or provided to the transferee or transferor of a transaction. It's essential to recognize the specific documentation needed and deadlines applicable to different types of transactions:

1. If a partner sells their interest in a partnership, they may be required to provide the transferee or transferor a copy of form 8308. A copy of form 8308 is required if the partner's share of gain or loss includes any "hot" assets (e.g., accounts receivable, inventory, or unrecaptured section 1250 gain). The form is due to the transferee and transferor by January 31 of the following year from the transaction or 30 days after completing the transaction—whichever is later.
2. When a property distribution occurs from a partnership to a partner, filing form 7217 with the tax return is required to report the property distribution and whether it is a liquidating or non-liquidating distribution. The form also requires the disclosure of the basis of the property. The good news is that the form isn't required if the only distributions from the partnership are cash or marketable securities. Form 7217 remains in draft format from the IRS.

If you have either of these transactions, be sure to inform your Perkins tax advisor as soon as possible so they can promptly gather all necessary information and ensure everything is reported on time.





2024 Year-End Tax Planning for Individuals

With rising interest rates, inflation, and continuing market volatility, tax planning is as essential as ever for taxpayers looking to manage cash flow while paying the least amount of taxes possible over time. As we approach the end of the year, now is the time for individuals, business owners, and family offices to review their 2024 and 2025 tax situations and identify opportunities for reducing, deferring, or accelerating their tax obligations.

The information contained in this article is based on federal laws and policies in effect as of the publication date. This article discusses tax planning for U.S. federal income taxes. Applicable state and foreign taxes should also be considered. Taxpayers should consult with a trusted advisor when making tax and financial decisions regarding any of the items below.

Individual Tax Planning Highlights

2024 Federal Income Tax Rate Brackets

Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
10%	\$0 – \$23,200	\$0 – \$11,600	\$0 – \$16,550	\$0 – \$11,600	\$0 – \$3,100
12%	\$23,201 – \$94,300	\$11,601 – \$47,150	\$16,551 – \$63,100	\$11,601 – \$47,150	-
22%	\$94,301 – \$201,050	\$47,151 – \$100,525	\$63,101 – \$100,500	\$47,151 – \$100,525	-
24%	\$201,051 – \$383,900	\$100,526 – \$191,950	\$100,501 – \$191,950	\$100,526 – \$191,950	\$3,101 – \$11,150
32%	\$383,901 – \$487,450	\$191,951 – \$243,725	\$191,951 – \$243,700	\$191,951 – \$243,725	-
35%	\$487,451 – \$731,200	\$243,726 – \$609,350	\$243,701 – \$609,350	\$243,726 – \$365,600	\$11,151 – \$15,200
37%	Over \$731,200	Over \$609,350	Over \$609,350	Over \$365,600	Over \$15,200

2025 Federal Income Tax Rate Brackets

Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
10%	\$0 - \$23,850	\$0 - \$11,925	\$0 - \$17,000	\$0 - \$11,925	\$0 - \$3,150
12%	\$23,851 - \$96,950	\$11,926 - \$48,475	\$17,001 - \$64,850	\$11,926 - \$48,475	--
22%	\$96,951 - \$206,700	\$48,476 - \$103,350	\$64,851 - \$103,350	\$48,476 - 103,350	--
24%	\$206,701 - \$394,600	\$103,351 - \$197,300	\$103,351 - \$197,300	\$103,351 - 197,300	\$3,151 - \$11,450
32%	\$394,601 - \$501,050	\$197,301 - \$250,525	\$197,301 - \$250,500	\$197,301 - \$250,525	--
35%	\$501,051 - \$751,600	\$250,526 - \$626,350	\$250,501 - \$626,350	\$250,526 - \$375,800	\$11,451 - \$15,650
37%	Over \$751,600	Over \$626,350	Over \$626,350	Over \$375,800	Over \$15,650

Timing of Income & Deductions

Taxpayers should consider whether they can reduce their tax bills by shifting income or deductions between 2024 and 2025. Ideally, income should be received in the year with the lower marginal tax rate, and deductible expenses should be paid in the year with the higher marginal tax rate. If the marginal tax rate is the same in both years, deferring income from 2024 to 2025 will produce a one-year tax deferral, and accelerating deductions from 2025 to 2024 will lower the 2024 income tax liability.

Actions to consider that may result in a reduction or deferral of taxes include:

- Delaying closing capital gain transactions until after year-end or structuring 2024 transactions as installment sales so that gain is deferred past 2024 (*see also Long-Term Capital Gains*).
- Triggering capital losses before the end of 2024 to offset 2024 capital gains.
- Delaying interest or dividend payments from closely held corporations to individual business-owner taxpayers.
- Deferring commission income by closing sales in early 2025 instead of late 2024.

- Accelerating deductions for expenses such as mortgage interest and charitable donations (including donations of appreciated property) into 2024 (subject to adjusted gross income (AGI) limitations).
- Evaluating whether non-business bad debts are worthless—and should be recognized as a short-term capital loss—by the end of 2024.
- Shifting investments to municipal bonds or investments that do not pay dividends to reduce taxable income in future years.

Taxpayers that will be in a higher tax bracket in 2025 may want to consider potential ways to move taxable income from 2025 into 2024, so that the taxable income is taxed at a lower tax rate.

Current-year actions to consider that could reduce 2025 taxes include:

- Accelerating capital gains to 2024 or deferring capital losses until 2025.
- Electing out of the installment sale method for 2024 installment sales.
- Deferring deductions such as large charitable contributions to 2025.



Long-Term Capital Gains

The long-term capital gains rates for 2024 and 2025 are shown below. The tax brackets refer to the taxpayer's taxable income. Capital gains also may be subject to the 3.8% net investment income tax.

2024 Long-Term Capital Gains Rate Brackets

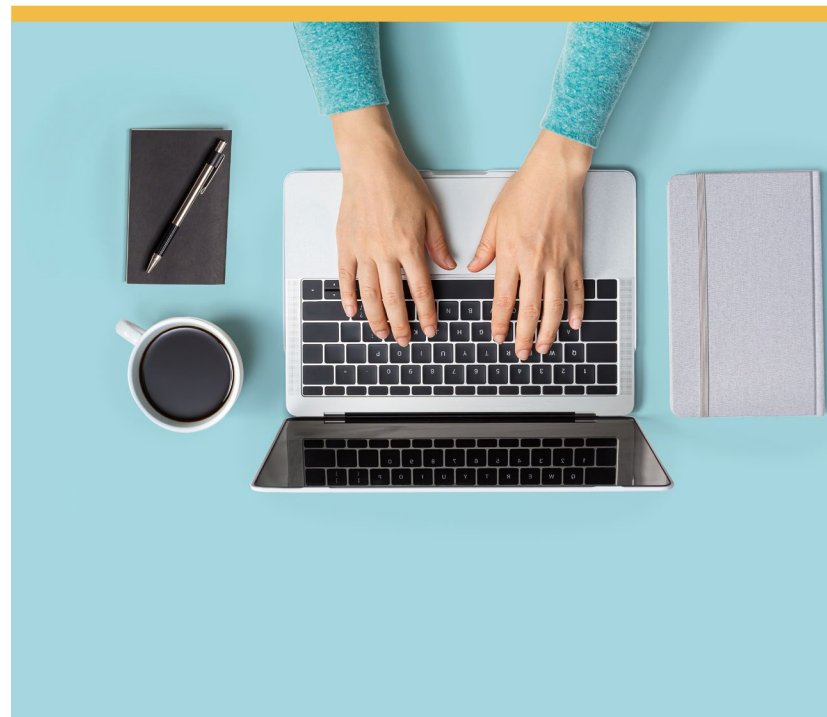
Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
0%	\$0 - \$94,050	\$0 - \$47,025	\$0 - \$63,000	\$0 - \$47,025	\$0 - \$3,150
15%	\$94,051 - \$583,750	\$47,026 - \$518,900	\$63,001 - \$551,350	\$47,026 - \$291,850	\$3,151 - \$15,450
20%	Over \$583,750	Over \$518,900	Over \$551,350	Over \$291,850	Over \$15,450

2025 Long-Term Capital Gains Rate Brackets

Tax Rate	Joint/Surviving Spouse	Single	Head of Household	Married Filing Separately	Estate & Trusts
0%	\$0 - \$96,700	\$0 - \$48,350	\$0 - \$64,750	\$0 - \$48,350	\$0 - \$3,250
15%	\$96,701 - \$600,050	\$48,351 - \$533,400	\$64,751 - \$566,700	\$48,351 - \$300,000	\$3,251 - \$15,900
20%	Over \$600,051	Over \$533,400	Over \$566,700	Over \$300,000	Over \$15,900

Long-term capital gains (and qualified dividends) are subject to a lower tax rate than other types of income. Investors should consider the following when planning for capital gains:

- Holding capital assets for more than a year (more than three years for assets attributable to carried interests) so that the gain upon disposition qualifies for the lower long-term capital gains rate.
- Considering long-term deferral strategies for capital gains such as reinvesting capital gains into designated qualified opportunity zones.
- Investing in, and holding, "qualified small business stock" for at least five years.
- Donating appreciated property to a qualified charity to avoid long-term capital gains tax (see also [Charitable Contributions](#), below).



Net Investment Income Tax

An additional 3.8% net investment income tax (NIIT) applies on net investment income above certain thresholds. The NIIT does not apply to income derived in the ordinary course of a trade or business in which the taxpayer materially participates. Similarly, gain on the disposition of trade or business assets attributable to an activity in which the taxpayer materially participates is not subject to the NIIT.

Impacted taxpayers may want to consider deferring net investment income for the year, in conjunction with other tax planning strategies that may be implemented to reduce income tax or capital gains tax.

Social Security Tax

The Old-Age, Survivors, and Disability Insurance (OASDI) program is funded by contributions from employees and employers through FICA tax. The FICA tax rate for both employees and employers is 6.2% of the employee's gross pay, but it is

imposed only on wages up to \$168,600 for 2024 and \$176,100 for 2025. Self-employed persons pay a similar tax, called SECA (or self-employment tax), based on 12.4% of the net income of their businesses.

Employers, employees, and self-employed persons also pay a tax for Medicare/Medicaid hospitalization insurance (HI), which is part of the FICA tax, but is not capped by the OASDI wage base. The HI payroll tax is 2.9%, which applies to earned income only. Self-employed persons pay the full amount, while employers and employees each pay 1.45%.

An extra 0.9% Medicare (HI) payroll tax must be paid by individual taxpayers on earned income that is above certain AGI thresholds: \$200,000 for individuals, \$250,000 for married couples filing jointly, and \$125,000 for married couples filing separately. However, employers do not pay this extra tax.



Long-Term Care Insurance & Services

Premiums an individual pays on a qualified long-term care insurance policy are deductible as a medical expense. The maximum deduction amount is determined by an individual's age. The following table sets forth the deductible limits for 2024 and the estimated deductible limits for 2025 (the limitations are per person, not per return):

Age	Deduction Limitation 2024	Deduction Limitation 2025
40 or under	\$470	\$480
Over 40 but not over 50	\$880	\$900
Over 50 but not over 60	\$1,760	\$1,800
Over 60 but not over 70	\$4,710	\$4,810
Over 70	\$5,880	\$6,020

Retirement Plan Contributions

Individuals may want to maximize their annual contributions to qualified retirement plans and individual retirement accounts (IRAs).

- The maximum amount in elective contributions that an employee can make in 2024 to a 401(k) or 403(b) plan is \$23,000 (\$30,500 if age 50 or over and the plan allows "catch-up" contributions). For 2025, these limits are \$23,500 and \$31,000, respectively.
- The SECURE Act permits a penalty-free withdrawal of up to \$5,000 from traditional IRAs and qualified retirement plans for qualifying expenses related to the birth or adoption of a child after December 31, 2019. The \$5,000 distribution limit is per individual, so a married couple could each receive \$5,000.
- Under the SECURE Act, individuals are now able to contribute to their traditional IRAs in or after the year in which they turn 70½.
- Beginning in 2023, the SECURE Act 2.0 raised the age at which a taxpayer must begin taking required minimum distributions (RMDs) to 73. If the individual reaches age 72 in 2024, the required beginning date for the first 2025 RMD is April 1, 2026.
- Individuals age 70½ or older can donate up to \$105,000 in 2024 (\$108,000 in 2025) to a qualified charity directly from a taxable IRA.
- The SECURE Act generally requires that designated beneficiaries of persons who died after December 31, 2019, take inherited plan benefits over a 10-year period. Eligible designated beneficiaries (i.e., surviving spouses, minor children of the plan participant, disabled and chronically ill beneficiaries, and beneficiaries who are less than 10 years younger than the plan participant) are not limited to the 10-year payout rule. Special rules apply to certain trusts.
- Under final Treasury regulations (issued July 2024) that address RMDs from inherited retirement plans of persons who died after December 31, 2019, and after their required beginning date, designated and non-designated beneficiaries will be required to take annual distributions, whether subject to a 10-year period or otherwise.
- Small businesses can contribute the lesser of (i) 25% of employees' salaries or (ii) an annual maximum amount set by the IRS each year to a simplified employee pension (SEP) plan by the extended due date of the employer's federal income tax return for the year that the contribution is made. The maximum SEP contribution for 2024 is \$69,000. The maximum SEP contribution for 2025 is \$70,000. The calculation of the 25% limit for self-employed individuals is based on net self-employment income, which is calculated after the reduction in income from the SEP contribution (as well as for other things, such as self-employment taxes).



Foreign Earned Income Exclusion

The foreign earned income exclusion is \$126,500 in 2024 and increases to \$130,000 in 2025.

Alternative Minimum Tax

A taxpayer must pay either the regular income tax or the alternative minimum tax (AMT), whichever is higher. The established AMT exemption amounts for 2024 are \$85,700 for unmarried individuals and individuals claiming head of household status, \$133,300 for married individuals filing jointly and surviving spouses, \$66,650 for married individuals filing separately, and \$29,900 for estates and trusts. The AMT exemption amounts for 2025 are \$88,100 for unmarried individuals and individuals claiming head of household status, \$137,000 for married individuals filing jointly and surviving spouses, \$68,500 for married individuals filing separately, and \$30,700 for estates and trusts.

Kiddie Tax

The unearned income of a child is taxed at the parents' tax rates if those rates are higher than the child's tax rate.

Limitation on Deductions of State & Local Taxes (SALT Limitation)

For individual taxpayers who itemize their deductions, the Tax Cuts and Jobs Act introduced a

\$10,000 limit on deductions of state and local taxes paid during the year (\$5,000 for married individuals filing separately). The limitation applies to taxable years beginning on or after December 31, 2017, and before January 1, 2026. Various states have enacted new rules that allow owners of pass-through entities to avoid the SALT deduction limitation in certain cases.

Charitable Contributions

Cash contributions made to qualifying charitable organizations, including donor-advised funds, in 2024 and 2025 will be subject to a 60% AGI limitation. The limitations for cash contributions continue to be 30% of AGI for contributions to non-operating private foundations.

Tax planning around charitable contributions may include:

- Creating and funding a private foundation, donor-advised fund, or charitable remainder trust.
- Donating appreciated property to a qualified charity to avoid long-term capital gains tax.

Estate & Gift Taxes

For gifts made in 2024, the gift tax annual exclusion is \$18,000 and for 2025 it is \$19,000. For 2024, the unified estate and gift tax exemption and generation-skipping transfer tax exemption is \$13,610,000 per person. For 2025, the unified estate and gift tax exemption and generation-skipping transfer tax exemption is \$13,990,000. All outright gifts to a spouse who is a U.S. citizen are free of federal gift tax. However, for 2024 and 2025, only the first \$185,000 and \$190,000, respectively, of gifts to a non-U.S. citizen spouse is excluded from the total amount of taxable gifts for the year.

Tax planning strategies may include:

- Making annual exclusion gifts.
- Making larger gifts to the next generation, either outright or in trust.
- Creating a spousal lifetime access trust (SLAT) or a grantor retained annuity trust (GRAT) or selling assets to an intentionally defective grantor trust (IDGT).

Net Operating Losses & Excess Business Loss Limitation

Net operating losses (NOLs) generated in 2024 are limited to 80% of taxable income and are not permitted to be carried back. Any unused NOLs are carried forward subject to the 80% of taxable income limitation in carryforward years.

A non-corporate taxpayer may deduct net business losses of up to \$305,000 (\$610,000 for joint filers) in 2024. The limitation is \$313,000 (\$626,000 for joint filers) for 2025. A disallowed excess business loss (EBL) is treated as an NOL carryforward in the subsequent year, subject to the NOL rules. With the passage of the Inflation Reduction Act, the EBL limitation has been extended through the end of 2028.





2024 Year-End Tax Planning for Businesses

As businesses pursue transformational changes to their operational strategies, they must consider the tax implications of those decisions from the outset. Whether considering supply chain shifts, pursuing M&A, implementing ESG strategies, or adjusting your workforce, you need to model the tax impacts of those business decisions. Failure to consider tax in planning could result in unintended, adverse tax impacts or missed savings. This issue is at the center of a total tax mindset. Working with tax professionals who understand the interplay between changing laws, economic forces, and the tax implications of all business decisions positions companies for success.

Tax planning is as essential as ever for businesses searching for ways to optimize cash flow by managing their long-term tax liabilities. Perkins & Co's 2024 Year-End Tax Guide identifies tax strategies and considers how they may be influenced by recent administrative guidance and potential legislative changes that remain under consideration.

The information contained within this article is based on information as of December 4, 2024. Taxpayers should consult their trusted advisors when making tax and financial decisions regarding any items in this piece.



State & Local Taxes

With thousands of taxing jurisdictions from school boards to states and many different types of taxes, state and local taxation is complex. Each tax type comes with its own set of rules — by jurisdiction — all of which require a different level of attention.

This SALT guide can help companies with 2024 year-end planning considerations, and it provides guidance on how to hit the ground running in 2025.

State PTET Elections

Roughly 36 states now allow pass-through entities (PTEs) to elect to be taxed at the entity level to help their residents avoid the \$10,000 limit on federal itemized deductions for state and local taxes (the “SALT cap”). Those PTE tax (PTET) elections are much more complex than simply checking a box to make an election on a tax return. Although state PTET elections are meant to benefit the individual members, not all elections are alike, and they are not always advisable.

Before making an election, a PTE should model the net federal and state tax benefits and consequences for every state where it operates, as well as for each resident and nonresident member, to avoid unintended tax results. Before the end of the year, taxpayers should thoroughly consider whether to make a state PTET election, modeling the net tax benefits or costs, and evaluate timing elections, procedures, and other election requirements. If

those steps are completed ahead of time, the table has been set to make the election in the days ahead.

When considering a state PTET election, a key question is whether members who are nonresidents of the state for which the election is made can claim a tax credit for their share of the taxes paid by the PTE on their resident state income tax returns. If a state does not offer a tax credit for elective taxes paid by the PTE, a PTET election could result in an additional state tax burden that exceeds some members’ federal itemized deduction benefit.

Therefore, as part of the pre-year-end evaluation and modeling exercise, PTEs should consider whether the election would result in members being precluded from claiming other state tax credits—which ordinarily would reduce their state income tax liability dollar for dollar—in order to receive federal tax deductions that are less valuable.

Liquidity Events

Liquidity events take the form of IPOs; financings; sales of stock, assets, or businesses; and third-party investments. Those events involve different forms of transactions, often driven by business or federal tax considerations; unfortunately, and far too often, the SALT impact is ignored until the 11th hour—or later.

A liquidity event is not an occasion for surprises. When contemplating any form of transaction, state

and local taxes can't be overlooked; doing so can result in a shock for the client and, at the least, embarrassment for the practitioner. SALT experts can identify planning opportunities and point out potential pitfalls, and it is never too early to involve them. If you don't consult them until after the transaction occurs or the state tax returns are being prepared, you've left it too late.

From state tax due diligence to understanding the total state tax treatment of a transaction to properly reporting and documenting state tax impacts, addressing SALT at the outset of a deal is critical. If involved before the year-end liquidity event, SALT professionals can suggest tweaks to the transaction that may be federal tax neutral but could identify significant state tax savings or costs now rather than later. After the liquidity event, because the state tax savings or costs already have been identified, they can be properly documented and reported post-transaction. Further, because SALT expertise was involved at the front end, state tax post-transaction integration, planning, and remediation can be pursued more seamlessly.

Income/Franchise Taxes

If anything has been learned from the last seven years of federal tax legislation, it's that state income tax conformity cannot be taken for granted. While states often conform to many federal tax provisions, are you certain an S corporation is treated as such by all the states where it operates? Is that federal disregarded entity disregarded for state income tax purposes as well? Not asking the question can lead to the wrong result.

Several states don't conform to federal entity tax classification regulations. Some, including New York, require a separate state-only S corporation election. New Jersey now allows an election out of S corporation treatment. Making those elections—or not—can lead to different state income tax answers, but you should make that decision before the transaction, not when the tax return is being prepared.

- If the liquidity event will result in gain, how is the gain going to be treated for state income tax purposes?
- Is it apportionable business gain or allocable nonbusiness gain?
- Is a partnership interest, stock, or asset being sold?
- How will the gain be apportioned?
- Was the seller unitary with the partnership or subsidiary, or did the assets serve an operational or investment function for the seller?
- Will the gross receipts or net gain from the sale be included in the sales factor, and, if so, how will they be apportioned?

Those are just some of the questions that are never asked on the federal level because they don't have to be. But they are material on the state level and can lead to unwelcome surprises if not addressed.





Sales/Use Taxes

Most U.S. states require a business to collect and remit sales and use taxes even if it has only economic, not physical, presence. Remote sellers, software licensors, and other businesses that provide services or deliver their products to customers from remote locations must comply with state and local taxes.

Left unchecked, those state and local tax obligations—and the corresponding potential liability for tax, interest, and penalties—will grow. Moreover, neglecting your sales and use tax obligations could result in a lost opportunity to pass the tax burden to customers as intended by state tax laws.

A company could very well experience material sales and use tax obligations resulting from a sale even though the transaction or reorganization is tax free for federal income tax purposes. To avoid any material issues, the following steps should be taken:

- Determine nexus and filing obligations;
- Evaluate product and service taxability;

- Quantify potential tax exposure;
- Mitigate and disclose historical tax liabilities;
- Consider implementing a sales tax system; and
- Maintain sales tax compliance.

Real Estate Transfer Taxes

Most states impose real estate transfer taxes or conveyance taxes on the sale or transfer of real property, or controlling interest transfer taxes on the sale of an interest in an entity holding real property. Few taxpayers are familiar with real estate transfer taxes, and the complex rules and compliance burdens associated with those state taxes could prove costly if they are not considered up front.

Property Taxes

For many businesses, property tax is the largest state and local tax obligation and a significant recurring operating expense that accounts for a substantial portion of local government tax revenue. Unlike other taxes, property tax assessments are *ad valorem*, meaning they are based on the estimated value of the property. Thus, they could be confusing for taxpayers and subject to differing opinions by appraisers, making them vulnerable to appeal. Assessed property values also tend to lag true market value in a recession.

Property tax reductions can provide valuable above-the-line cash savings, especially during economic downturns when assessed values may be more likely to decrease. The current economic environment amplifies the need for taxpayers to avoid excessive property tax liabilities by making sure their properties are not overvalued.

Annual compliance and real estate appeal deadlines can provide opportunities to challenge property values. Challenging a jurisdiction's real property assessment within the appeal window could reduce related tax liabilities. Taking appropriate positions related to any detriments to value on personal property tax returns could reduce those tax liabilities. Planning for and attending to property taxes can help a business minimize its total tax liability.

P.L. 86-272

P.L. 86-272 is a federal law that prevents a state from imposing a net income tax on any person's net income derived within the state from interstate commerce if the only business activity performed in the state is the solicitation of orders of tangible personal property. Those orders are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the state.

The Multistate Tax Commission (MTC) adopted a [revised statement](#) of its interpretation of P.L. 86-272 which, for practical purposes, largely nullifies the law's protections for businesses that engage in activities over the internet. To date, California and New Jersey have formally adopted the MTC's revised interpretation of internet-based activities, while Minnesota and New York have proposed



the interpretation as new rules. Other states are applying the MTC's interpretation on audit without any notice of formal rulemaking.

Online sellers of tangible personal property that have previously claimed protection from state net income taxes under P.L. 86-272 should review their positions. Online sellers that use static websites that don't allow them to communicate or interact with their customers — a rare practice — seem to be the only type of seller that the MTC, California, New Jersey, and other states still consider protected by P.L. 86-272.

The effect of the MTC's new interpretation on a taxpayer's state net income tax exposure should be evaluated before the end of the year. Structural changes, ruling requests, or plans to challenge states' evolving limitation of P.L. 86-272 protections applicable to online sales can be put into place.

However, nexus or loss of P.L. 86-272 protection can be a double-edged sword. For example, in California, if a company is subject to tax in another state using California's new standard, it is not required to throw those sales back into its California numerator for apportionment purposes.

Conclusion: There are 50 states and thousands of local taxing jurisdictions that impose multiple different tax types. Ensuring that your company is in compliance with those state and local taxes—and only paying the amount of tax legally owed—can help reduce your total tax liability. As a taxpayer, it is more efficient to be proactive, rather than reactive, when it comes to state and local taxes. Being proactive will help identify issues and solutions that can be applied to other taxing jurisdictions, as well as helping limit audits, notices, penalties, and interest.



Partnerships

The IRS in the past year has continued to ramp up its scrutiny partnerships' tax positions, including several pieces of new guidance taking a multiprong approach to partnership "basis shifting" transactions that the agency views as having the potential for abuse. At the same time, IRS is dedicating new funding and resources to examining partnerships.

These developments, along with some new reporting and regulatory changes, mean there are a number of tax areas partnerships should be looking into as they plan for year end and the coming year:

- Evaluate Partnership 'Basis Shifting' Transactions That Are Subject of New IRS Scrutiny
- Plan for Partnership Form 8308 Expanded Reporting and January 31 Deadline
- Review Limited Partner Eligibility for SECA Tax Exemption
- Consider Effect of Proposed Rules on Transactions Between Partnerships and Related Persons
- Double-Check Positions on Inventory Items and Unrealized Receivables Under Section 751(a)
- Keep an Eye on Challenges to IRS Rules, Including Partnership Anti-Abuse Rules, Under Loper Bright
- Watch for New Form for Partners to Report Partnership Property Distributions

- Prepare for Partnership Obligations Under Corporate Alternative Minimum Tax Regulations

Evaluate Partnership 'Basis Shifting' Transactions That Are Subject of New IRS Scrutiny

The IRS and Treasury have made clear that they intend to take a harder stance on transactions involving basis shifting between partnerships and related parties. On June 17, 2024, the IRS launched a multiprong approach to curtail inappropriate use of partnership rules to inflate the basis of assets without causing meaningful changes to the economics of a taxpayer's business.

The guidance focuses on complex transactions involving related-party partnerships through which taxpayers "strip" basis from certain assets and shift that basis to other assets where the increased basis is intended to generate tax benefits—through increased cost recovery deductions or reduced gain (or increased loss) on asset sales—in transactions that have little or no economic substance.

To address what it deems the inappropriate use of such transactions to generate tax benefits, the IRS has taken several steps:

1. [Notice 2024-54](#) describes two sets of upcoming proposed regulations addressing the treatment of basis shifting transactions involving partnerships and related parties.

2. Additional proposed regulations ([REG-124593-23](#)), issued concurrently with Notice 2024-54, identify certain partnership basis shifting transactions as reportable Transactions of Interest.
3. [Revenue Ruling 2024-14](#) notifies taxpayers that engage in three variations of these related-party partnership transactions that the IRS will apply the codified economic substance doctrine to challenge inappropriate basis adjustments and other aspects of these transactions.

The IRS stated that the types of related-party partnership basis shifting transactions described in the current guidance cut across a wide variety of industries and individuals. It stated that Treasury estimates the transactions could potentially cost taxpayers more than \$50 billion over a 10-year period. The IRS added that it currently has “tens of billions of dollars of deductions claimed in these transactions under audit.”

BASIS SHIFTING TRANSACTIONS UNDER IRS SCRUTINY

An IRS Fact Sheet released concurrently with the basis shifting guidance states that there are generally three categories of basis shifting transactions that are the focus of the new guidance. It describes these three categories of transactions as:

1. ***Transfer of partnership interest to related party:*** A partner with a low share of the partnership’s inside tax basis and a high outside tax basis transfers the interest in a tax-free transaction to a related person or to a person who is related to other partners in the partnership. This related-party transfer generates a tax-free basis increase to the transferee partner’s share of inside basis.
2. ***Distribution of property to a related party:*** A partnership with related partners distributes a high-basis asset to one of the related partners that has a low outside basis. The distributee partner then reduces the basis of the distributed asset, and the partnership increases the basis of its remaining assets. The related partners arrange this transaction so that the reduced tax basis of the distributed asset will not adversely impact the related partners, while the basis increase to the partnership’s retained assets can

produce tax savings for the related parties.

3. ***Liquidation of related partnership or partner:*** A partnership with related partners liquidates and distributes (1) a low-basis asset that is subject to accelerated cost recovery or for which the parties intend to sell to a partner with a high outside basis and (2) a high-basis property that is subject to longer cost recovery (or no cost recovery at all) or for which the parties intend to hold to a partner with a low outside basis. Under the partnership liquidation rules, the first related partner increases the basis of the property with a shorter life or which is held for sale, while the second related partner decreases the basis of the long-lived or non-depreciable property. The result is that the related parties generate or accelerate tax benefits.

NOTICE 2024-54: FORTHCOMING PROPOSED RULES GOVERNING COVERED TRANSACTIONS

Notice 2024-54 describes two sets of proposed regulations that the IRS plans to issue addressing certain partnership basis-shifting transactions (covered transactions):

- Proposed Related-Party Basis Adjustment Regulations. Proposed regulations under Sections 732, 734, 743, and 755 would provide special rules for the cost recovery of positive basis adjustments or the ability to take positive basis adjustments into account in computing gain or loss on the disposition of basis adjusted property following certain transactions.
- Proposed Consolidated Return Regulations. Proposed regulations under Section 1502 would provide rules to clearly reflect the taxable income and tax liability of a consolidated group whose members own interests in a partnership.

Generally, for purposes of the notice and planned proposed rules, covered transactions:

1. Involve partners in a partnership and their related parties,
2. Result in increases to the basis of property under Section 732, Section 734(b), or Section 743(b), and

3. Generate increased cost recovery allowances or reduced gain (or increased loss) upon the sale or other disposition of the basis-adjusted property.

The IRS intends to propose that the Proposed Related-Party Basis Adjustment Regulations, when adopted as final regulations, would apply to tax years ending on or after June 17, 2024.

The IRS states that the proposed applicability date for the Proposed Consolidated Return Regulations will be set forth in the proposed regulations once issued.

PROPOSED RULES IDENTIFYING BASIS SHIFTING AS TRANSACTION OF INTEREST

The proposed regulations issued concurrently with Notice 2024-54 identify related-partnership basis adjustment transactions and substantially similar transactions as reportable Transactions of Interest.

Under the proposed rules, disclosure requirements for these transactions would apply to taxpayers

and material advisers with respect to partnerships participating in the identified transactions, including by receiving a distribution of partnership property, transferring a partnership interest, or receiving a partnership interest.

Generally, the identified Transactions of Interest would involve positive basis adjustments of \$5 million or more under subchapter K of the Internal Revenue Code in excess of the gain recognized from such transactions, if any, on which tax imposed under subtitle A is required to be paid by any of the related partners (or tax-indifferent party) to such transactions – specifically, Section 732(b) or (d), Section 734(b), or Section 743(b) – for which no corresponding tax is paid.

NOTIFICATION THAT IRS WILL CHALLENGE BASIS STRIPPING

In Revenue Ruling 2024-14, the IRS notifies taxpayers and advisors that the IRS will apply the codified economic substance doctrine to challenge basis adjustments and other aspects of certain transactions between related-party partnerships.

The IRS will raise the economic substance doctrine with respect to transactions in which related parties:

1. Create inside/outside basis disparities through various methods, including the use of partnership contributions and distributions and allocation of items under Section 704(b) and (c),
2. Capitalize on the disparity by either transferring a partnership interest in a nonrecognition transaction or making a current or liquidating distribution of partnership property to a partner, and
3. Claim a basis adjustment under Sections 732(b), 734(b), or 743(b) resulting from the nonrecognition transaction or distribution.

PLANNING CONSIDERATIONS

The IRS guidance package highlights a ramping up of IRS scrutiny of the described partnership basis shifting transactions, but there are still questions with respect to how specifically the final rules will aim to address these transactions. Additional detail should become available when the IRS issues the proposed regulations described in Notice 2024-54. In drafting those rules, the IRS will have



the opportunity to take into account comments submitted on the Notice.

Moreover, particularly in light of the Supreme Court's recent decision to overturn Chevron deference in *Loper Bright Enterprises v. Raimondo*, taxpayers are likely to challenge the IRS's authority to issue the planned regulations.

Nonetheless, taxpayers that have structured partnership basis shifting transactions or transactions that merely fall under the mechanical rules like those described in the guidance should evaluate the effects of the anticipated rules on their transactions and consider next steps for compliance.

Plan for Partnership Form 8308 Expanded Reporting & January 31 Deadline

The IRS in October 2023 released a revised Form 8308, "Report of a Sale or Exchange of Certain Partnership Interests" seeking additional information on partnership interest transfers. The revised form was initially required for transfers occurring on or after January 1, 2023, affecting 2024 filings.

However, the IRS in January 2024 provided some penalty relief with respect to 2023 transfers, provided certain action was taken by January 31, 2024. It is unclear if the IRS will provide such relief again in 2025 with respect to 2024 transfers.

The IRS relief provided in the past year responded to concerns, which are still relevant, that partnerships will not have the information necessary to complete the new Part IV of Form 8308 in time to meet the January 31 deadline for furnishing information to the transferor and transferee.

EXPANDED FORM 8308 REPORTING

Partnerships file Form 8308 to report the sale or exchange by a partner of all or part of a partnership interest where any money or other property received in exchange for the interest is attributable to unrealized receivables or inventory items (that is, where there has been a Section 751(a) exchange).

The IRS significantly expanded the Form 8308 reporting requirements in the revised form released in October. For transfers occurring on or after January 1, 2023, the revised Form 8308 includes expanded Parts I and II and new Parts III and IV.

New Part IV is used to report specific types of partner gain or loss when there is a Section 751(a) exchange, including the partnership's and the transferor partner's share of Section 751 gain and loss, collectibles gain under Section 1(h)(5), and unrecaptured Section 1250 gain under Section 1(h)(6).

FURNISHING INFORMATION TO TRANSFERORS & TRANSFEREES

Partnerships with unrealized receivables or inventory items described in Section 751(a) (Section 751 property or "hot assets") are also required to provide information to each transferor and transferee that are parties to a Section 751(a) exchange.

Under the regulations, each partnership that is required to file a Form 8308 must furnish a statement to the transferor and transferee by the later of (1) January 31 of the year following the calendar year in which the Section 751(a) exchange occurred or (2) 30 days after the partnership has received notice of the exchange.

Generally, partnerships must use the completed Form 8308 as the required statement, unless the form covers more than one Section 751 exchange. If the partnership is not providing the Form 8308 as the required statement, then it must furnish a statement with the information required to be shown on the form with respect to the Section 751(a) exchange to which the person is a party.

A penalty applies under Section 6722 for failure to furnish statements to transferors and transferees on or before the required date, or for failing to include all the required information or including incorrect information.

PENALTY RELIEF WITH RESPECT TO 2023 TRANSFERS

The IRS issued guidance (Notice 2024-19) providing penalty relief for partnerships with unrealized receivables or inventory items that would fail to furnish Form 8308 by January 31, 2024, to the transferor and transferee in certain partnership interest transfers that occurred in 2023. To qualify for the relief, among other requirements, partnerships generally still had to furnish to the transferor and transferee Parts I–III of Form 8308 by the January 31, 2024, deadline.



Notice 2024-19 stated that, with respect to Section 751(a) exchanges during calendar year 2023, the IRS would not impose penalties under Section 6722 for failure to furnish Form 8308 with a completed Part IV by the regulatory due date (i.e., generally, January 31, 2024).

To qualify for last year's relief, the partnership was required to:

- Timely and correctly furnish to the transferor and transferee a copy of Parts I, II, and III of Form 8308, or a statement that includes the same information, by the later of January 31, 2024, or 30 days after the partnership is notified of the Section 751(a) exchange, and
- Furnish to the transferor and transferee a copy of the complete Form 8308, including Part IV, or a statement that includes the same information and any additional information required under the regulations, by the later of the due date of the partnership's Form 1065 (including extensions) or 30 days after the partnership is notified of the Section 751(a) exchange.

PLANNING CONSIDERATIONS

While the requirement of furnishing Form 8308 statements is not new, the inclusion of actual "hot

asset" (i.e., unrealized receivables or inventory items) information within Form 8308 for transfers in 2023 and later has created difficulties.

Prior to 2023, this requirement could be satisfied by providing a taxpayer with a Form 8308 that merely notifies the transferor that they will have some amount of hot asset recharacterization. With the new form, partnerships are now required to provide actual recharacterization amounts.

The penalty relief for furnishing information in 2024 on 2023 transfers was welcome. However, it is unclear if the IRS will extend the relief for an additional year or otherwise address concerns about the availability of the information necessary to timely meet the requirement.

Review Limited Partner Eligibility for SECA Tax Exemption

There is some additional clarity in the ongoing dispute between the IRS and some partnerships over whether an active "limited partner" is eligible for the statutory exemption from self-employment (SECA) tax.

The U.S. Tax Court on November 28, 2023, responding to a Motion for Summary Judgment, held that nominally being a "limited partner" in

a state law limited partnership is insufficient to qualify for the statutory exemption from SECA tax for limited partners (*Soroban Capital Partners v. Commissioner*, 161 T.C. No. 12). The court agreed with the government that the statutory exemption requires a functional analysis of whether a partner was, in fact, active in the business of the partnership and a “limited partner” in name only.

SECA TAX EXEMPTION FOR LIMITED PARTNERS

Under Internal Revenue Code Section 1402(a)(13), the distributive share of partnership income allocable to a limited partner is generally not subject to SECA tax, other than for guaranteed payments for services rendered. However, the statute does not define “limited partner,” and proposed regulations issued in 1997 that attempted to clarify the rules around the limited partner exclusion have never been finalized.

In recent years, courts have held – in favor of the IRS – that members in limited liability companies (LLCs) and partners in limited liability partnerships (LLPs) that are active in the entity’s trade or business are ineligible for the SECA tax exemption.

Despite these IRS successes, some – including the taxpayer in the *Soroban* case – continued to claim that state law controls in defining “limited partner” in the case of a state law limited partnership. This specific issue – i.e., the application of the exemption in the case of a state law limited partnership – had not previously been addressed by the courts.

SOROBAN CAPITAL PARTNERS’ POSITION & IRS CHALLENGE

The *Soroban Capital Partners* litigation filed with the Tax Court involved a New York hedge fund management company formed as a Delaware limited partnership. The taxpayers challenged the IRS’s characterization of partnership net income as net earnings from self-employment subject to SECA tax. According to the facts presented, each of the three individual limited partners spent between 2,300 and 2,500 hours working for *Soroban*, its general partner and various affiliates – suggesting that the limited partners were “active participants” in the partnership’s business. For the years at issue, *Soroban* was subject to the TEFRA audit and litigation procedures.

The government contended that the term “limited partner” is a federal tax concept that is determined based on the actions of the partners – not the type of state law entity. Citing previous cases, the government asserted that the determination of limited partner status is a “facts and circumstances inquiry” that requires a “functional analysis.” The taxpayers in *Soroban*, on the other hand, argued that such a functional analysis does not apply in the case of a state law limited partnership and that, in the case of these partnerships, limited partner status is determined by state law.

Under the functional analysis adopted by the Tax Court in previous cases (not involving state law limited partnerships), to determine who is a limited partner, the court looks at the relationship of the owner to the entity’s business and the factual nature of services the owner provides to the entity’s operations.

TAX COURT’S ANALYSIS

To answer the question of whether *Soroban*’s net earnings from self-employment should include its limited partners’ distributive shares of ordinary business income, the court turned first to two preliminary questions:

1. What is the scope of the Section 1402(a)(13) SECA tax exemption for “a limited partner, as such”?
2. If the exemption requires looking through to the limited partner’s role in the partnership, does that inquiry concern a partnership item to be resolved in a TEFRA partnership-level proceeding?

With respect to the scope of the exemption – noting that neither the statute nor regulations define “limited partner” – the court highlighted that the statute expressly applies the exemption to “a limited partner, as such”. In interpreting statutes, the court explained that it looks at the ordinary meaning of the terms and that it must avoid rendering any words or clauses to be meaningless. Thus, the court interpreted the addition of the words “as such” to signify that Congress intended the exemption to apply to something more specific than a “limited partner” in name only.



Having concluded that a functional analysis is necessary to determine limited partner status for purposes of the exemption, the court turned to whether this inquiry concerned a “partnership item” under the applicable TEFRA procedures. The court explained that partnership items are those that (1) are required to be taken into account for the partnership tax year under subtitle A of the Internal Revenue Code and (2) are more properly determined at the partnership level.

The court stated the first prong is easily resolved – subtitle A generally requires partnerships to state the amounts of income that would be net earnings from self-employment in the hands of the recipients. The court further determined the second prong was satisfied, stating that a functional analysis of the partners’ activities involves factual determinations that are necessary to determine Soroban’s aggregate amount of net earnings from self-employment.

Accordingly, the court held that a functional analysis applies to determine whether a partner in a state law limited partnership is a “limited partner” for SECA tax exemption purposes, and, for a TEFRA partnership, that inquiry concerns a partnership item subject to a TEFRA proceeding.

PLANNING CONSIDERATIONS

This Soroban case appeared to be a big win for the government. By denying Soroban’s Motion for Summary Judgment and granting the government’s Motion for Partial Summary Judgment, the Tax Court cleared the way for this case to continue. Once the court proceeds with a functional analysis based on the facts, it can rule on whether the government’s Final Partnership Administrative Adjustments for tax years 2016 and 2017 should be upheld.

Based on prior court cases, the functional analysis will likely center around the roles and activities of the individual partners. If they are merely passive investors, then the analysis likely results in them being classified as limited partners under the SECA statute. However, if they are active in the business and/or are able to contractually bind the business under state law, the court is likely to reach the opposite conclusion.

The Soroban case involves a partnership subject to TEFRA. Although self-employment tax is not covered under the centralized partnership audit regime enacted by the Bipartisan Budget Act of 2015 (BBA), it’s unclear how the IRS will attempt to address this treatment in audits of partnerships subject to the BBA rules instead of TEFRA.

Consider Effect of Proposed Rules on Transactions Between Partnerships & Related Persons

The Department of the Treasury and IRS in November 2023 issued proposed regulations (REG-131756-11) relating to the tax treatment of transactions between partnerships and related persons. The proposed amendments to the regulations under Sections 267 and 707 relate to the disallowance or deferral of deductions for losses and expenses in certain transactions with partnerships and related persons.

TAX TREATMENT OF TRANSACTIONS WITH RELATED PARTIES UNDER CURRENT REGULATIONS

In general, Section 267(a)(1) provides that a taxpayer may not deduct a loss on the sale or exchange of property with a related person as defined in Section 267(b). Section 267(a)(2) sets forth a “matching rule” that provides that if because of a payee’s method of accounting, an amount is not (unless paid) includible in the payee’s gross income, the taxpayer (payor) may not deduct the otherwise deductible amount until the payee includes the amount in gross income if the taxpayer and payee are related persons within the meaning of Section 267(b) on the last day of the taxpayer’s taxable year in which the amount otherwise would have been deductible.

As part of enacting the Internal Revenue Code of 1954, Congress added Section 707(b)(1) to the Code to address the sale or exchange of property between a partnership and a partner owning, directly or indirectly, more than 50% of the capital or profit interest in the partnership. Given a lack of statutory and regulatory guidance addressing transactions between a partnership and a related person who was not a partner, the Treasury Department and the IRS issued Reg. §1.267(b)-1(b) in 1958.

Reg. §1.267(b)-1(b) applies an aggregate theory of partnerships to provide that any transaction described in Section 267(a) between a partnership and a person other than a partner is considered as occurring between the other person and the members of the partnership separately. Specifically, Reg. §1.267(b)-1(b) provides that if the other person

and a partner are within any of the relationships specified in Section 267(b), no deductions with respect to the transaction between the other person and the partnership will be allowed: (i) to the related partner to the extent of the related partner’s distributive share of partnership deductions for losses or unpaid expenses or interest resulting from the transactions, and (ii) to the other person to the extent the related partner acquires an interest in any property sold to or exchanged with the partnership by the other person at a loss, or to the extent of the related partner’s distributive share of the unpaid expenses or interest payable to the partnership by the other person as a result of the transaction.

CONFLICT WITH STATUTE & PROPOSED AMENDMENTS

Although the U.S. Tax Court upheld the validity of Reg. §1.267(b)-1(b) and its use of the aggregate theory, subsequent statutory changes to Sections 267 and 707(b) have made Reg. §1.267(b)-1(b) inconsistent with the statute.

The statutory changes to Sections 267 and 707(b) enacted since 1982 indicate that Congress intended for a partnership to be viewed as an entity, rather than as an aggregate of its partners, in applying the rules of Sections 267 and 707(b).

Therefore, the loss disallowance rules of Sections 267(a)(1) and 707(b)(1), the gain recharacterization rules of Section 707(b)(2), and the matching rule of Section 267(a)(2) similarly should be applied at the partnership level and not the partner level.

Accordingly, the IRS proposed changes to the regulations under Section 267, including removing Reg. §1.267(b)-1(b), to conform the regulations with the current statute.

APPLICATION OF PROPOSED REGULATIONS

Once the proposed regulations are finalized, Reg. §1.267(b)-1(b) will be stricken. This means that transactions described in Section 267(a) between a partnership and a person other than a partner will no longer be considered as occurring between the other person and each partner separately.

See below for an example from the current Reg. §1.267(b)-1(b).

Reg. §1.267(b)-1(b) in Action

Example (1). A, an equal partner in the ABC partnership, personally owns all the stock of M Corporation. B and C are not related to A. The partnership and all the partners use an accrual method of accounting, and are on a calendar year. M Corporation uses the cash receipts and disbursements method of accounting and is also on a calendar year. During 1956 the partnership borrowed money from M Corporation and also sold property to M Corporation, sustaining a loss on the sale. On December 31, 1956, the partnership accrued its interest liability to the M Corporation and on April 1, 1957 (more than 2½ months after the close of its taxable year), it paid the M Corporation the amount of such accrued interest. Applying the rules

of this paragraph, the transactions are considered as occurring between M Corporation and the partners separately. The sale and interest transactions considered as occurring between A and the M Corporation fall within the scope of section 267(a) and (b), but the transactions considered as occurring between partners B and C and the M Corporation do not. The latter two partners may, therefore, deduct their distributive shares of partnership deductions for the loss and the accrued interest. However, no deduction shall be allowed to A for his distributive shares of these partnership deductions. Furthermore, A's adjusted basis for his partnership interest must be decreased by the amount of his distributive share of such deductions. See section 705(a)(2).

Once the proposed regulation is finalized, the transactions would be treated as occurring between the ABC Partnership (as an entity) and M Corporation. Under Section 267(b)(10), a corporation and a partnership are related if the same persons own (A) more than 50% in value of the outstanding stock of the corporation, and (B) more than 50% of the capital interest, or the profits interest, in the partnership. In this case, A owns 100% of M Corporation and only 33-1/3% of ABC Partnership. Accordingly, since the partnership and corporation are unrelated, the partners can deduct the accrued interest liability to M corporation, and the partners can also deduct the loss on sale of property to M Corporation.

PLANNING CONSIDERATIONS

Given the fact that Treasury and IRS have stated in the Notice of Proposed Rulemaking that statutory changes in the 1980s indicate that Congress intended for a partnership to be viewed as an entity, rather than as an aggregate of its partners, there may be reasonable basis to take such a position even before the proposed regulations are issued in final form, as long as a disclosure is made.

Taxpayers should consult with their Perkins advisor if considering relying on the proposed regulations.



Double-Check Positions on Inventory Items and Unrealized Receivables Under Section 751(a)

On appeal from the Tax Court, the U.S. Court of Appeals for the D.C. Circuit has clarified the application of the recharacterization provision under Section 751(a).

Reversing the Tax Court, the circuit court held that gain attributable to inventory (Section 751(a) property) in the sale of a partnership interest by a nonresident alien is still the sale of a partnership interest under Section 751(a) and not taxable as U.S. source income under the law applicable in the year at issue ([Rawat v. Commissioner](#), July 23, 2024).

TAXATION OF GAIN ON PARTNERSHIP DISPOSITIONS BY NONRESIDENT ALIENS

Gain or loss on the sale of partnership interests is generally taxed as a capital gain or loss under Section 741. However, to the extent the gain or loss is attributable to inventory and unrealized receivables – “Section 751(a) property” – the gain or loss is recharacterized as ordinary.

Specifically, Section 751(a) states that an amount realized on the sale of a partnership interest that is attributable to inventory items of the partnership “shall be considered as an amount realized from the sale or exchange of property other than a capital asset.”

Section 864(c)(8), enacted by the Tax Cuts and Jobs Act of 2017 (TCJA), treats a nonresident alien’s gain or loss from the sale of an interest in a U.S. partnership as taxable U.S.-source income. However, before the enactment of the TCJA, personal property law controlled, and a nonresident alien’s gain or loss from the sale of personal property was generally treated as foreign-source but could be treated as U.S.-source under certain exceptions, including for inventory. A U.S. partnership interest is personal property for purposes of this rule.

IS GAIN FROM SECTION 751(A) PROPERTY TREATED AS GAIN FROM SELLING INVENTORY?

Rawat, a nonresident alien, sold her interest in a U.S. partnership in 2008 for \$438 million, with \$6.5 million of her gain attributable to the sale of the company’s inventory. The IRS asserted that the

gain attributable to inventory was U.S.-source and taxable. Therefore, Rawat owed \$2.3 million in taxes on it. Rawat argued that the inventory-attributed gain was foreign-source and nontaxable. The Tax Court agreed with the government.

The dispute centered on the interpretation of Section 751(a): whether it causes gain from a partnership interest sale that is attributable to inventory merely to be taxed as ordinary income or actually to be treated as the sale of inventory and therefore potentially U.S. source in the hands of a nonresident alien.

There was no dispute that the statute required gain attributable to Section 751(a) property to be taxed as ordinary income if it was taxable to Rawat as U.S.-source income.

D.C. CIRCUIT FINDS NARROW INTERPRETATION OF SECTION 751(A)

The D.C. Circuit Court found relevant that the definition of “ordinary income” in Section 64 parallels the language in Section 751(a), with both Code sections referring to gain from the sale or exchange of property that is not a capital asset. It follows, the court reasoned, that the language of Section 751(a) that states that gain (or an amount realized) attributable to inventory “shall be considered as an amount realized from the sale or exchange of property other than a capital asset” may be read more plainly to mean “shall be considered as ordinary income.”

The court stated that this interpretation is further supported by the fact that Section 751(a) operates as a carveout to the general rule in Section 741 that gain on the sale of a partnership interest is treated as capital gain. The court further pointed to legislative history indicating Section 751(a) was enacted to end efforts to evade taxation as ordinary income.

On the contrary, the government argued that, under the statute, gain on the sale of a partnership interest from inventory or Section 751(a) property is not just taxed as ordinary income but is taxed as a sale of inventory rather than as of a partnership interest. The result being that the gain could be U.S.-source income to a nonresident alien under the pre-TCJA law.

However, the D.C. Circuit rejected the argument put forth by the government and previously accepted by the Tax Court. The D.C. Circuit noted that Section 751(a) states that the applicable gain



is to be treated as ordinary income, nothing more, and that Congress would have stated more if it meant more. The broader reading of Section 751(a) is not supported by other sections of the Code using similar language or the legislative history, the court concluded.

Accordingly, the court held that the sale by Rawat of the partnership interest attributable to inventory was still the sale of a partnership interest, and accordingly, under the law applicable at the time, was foreign-source income and non-taxable.

PLANNING CONSIDERATIONS

This court case has limited direct applicability after the TCJA enacted Section 864(c)(8). However, the court case is instructive in that it supports the idea that, absent a specific statutory exception, the entity theory of partnerships (rather than the aggregate theory) controls with respect to the sale of a partnership interest. Section 751(a) is merely a recharacterization provision and it does not operate to dictate that a partnership interest sale be deemed to be an actual sale of inventory.

Because the Tax Court's judgment has now been reversed by the circuit court, taxpayers that have relied on a similar theory as that adopted by the Tax Court in Rawat should review their positions. Although the reversal of the Tax Court in Rawat was a win for the taxpayer in the current case, taxpayers have taken other taxpayer-friendly positions based

on a similar interpretation of Section 751(a) as argued by the government and originally accepted by the Tax Court in Rawat.

Keep an Eye on Challenges to IRS Rules, Including Partnership Anti-Abuse Rules, Under Loper Bright

In its June 2024 decision in Loper Bright, the Supreme Court overturned the longstanding Chevron doctrine, which gave deference to agency interpretations of silent or ambiguous statutes if the interpretation was reasonable. In overturning this principle, the Supreme Court held that courts must exercise independent judgment.

In light of the Loper Bright decision, taxpayers are bringing new challenges to IRS regulations, including in the Tribune Media case involving the application of a liability allocation anti-abuse rule under Treas. Reg. §1.752-2(j) and the general partnership anti-abuse rule under Treas. Reg. §1.701-2.

Generally, in the Tribune Media case, the government appeals a Tax Court decision that it views as paving the way for inappropriate income tax planning, potentially enabling taxpayers to follow the roadmap created by the taxpayer in Tribune Media to implement leveraged partnership transactions without triggering taxable gain while avoiding incurring meaningful economic risk.

LOPER BRIGHT ARGUMENTS IN TRIBUNE MEDIA

Tribune Media and the government have supplemented their arguments in their pending appeal before the Seventh Circuit on leveraged partnership transactions and the application of partnership anti-abuse rules. Tribune Media has submitted a letter to the court arguing that the U.S. Supreme Court's decision in Loper Bright reinforces its argument that the general anti-abuse rule in question is invalid.

In its letter to the Seventh Circuit regarding the effect of Loper Bright in its case, Tribune Media challenges the validity of the general anti-abuse rule. It notes that, although the government does not expressly claim Chevron deference for the rule, the Loper Bright decision instructs the court to carefully scrutinize whether the IRS had the authority to issue the rule, which Tribune Media argues is regulatory overreach as "the agency even contends that it can invalidate a transaction that follows 'the literal words' of a statute that Congress enacted."

In its response, the government contends that the anti-abuse rule does not rely on Chevron deference, is based on established case law, and was promulgated within the bounds of authority granted to the IRS by Congress.

PLANNING CONSIDERATIONS

The decision in Loper Bright has opened the door for taxpayers to make fresh challenges to the validity of Treasury regulations. The Tribune Media case is an example of the type of challenge that taxpayers are making to the government's authority to promulgate its interpretation of statutes in existing regulations. The issue in this specific case is whether the government can write broad anti-abuse regulations that change the taxation of transactions that follow a strict reading of the statute, but that the IRS and Treasury contend are abusive or argue aren't in line with the intent of the statute.

Watch for New Form for Partners to Report Partnership Property Distributions

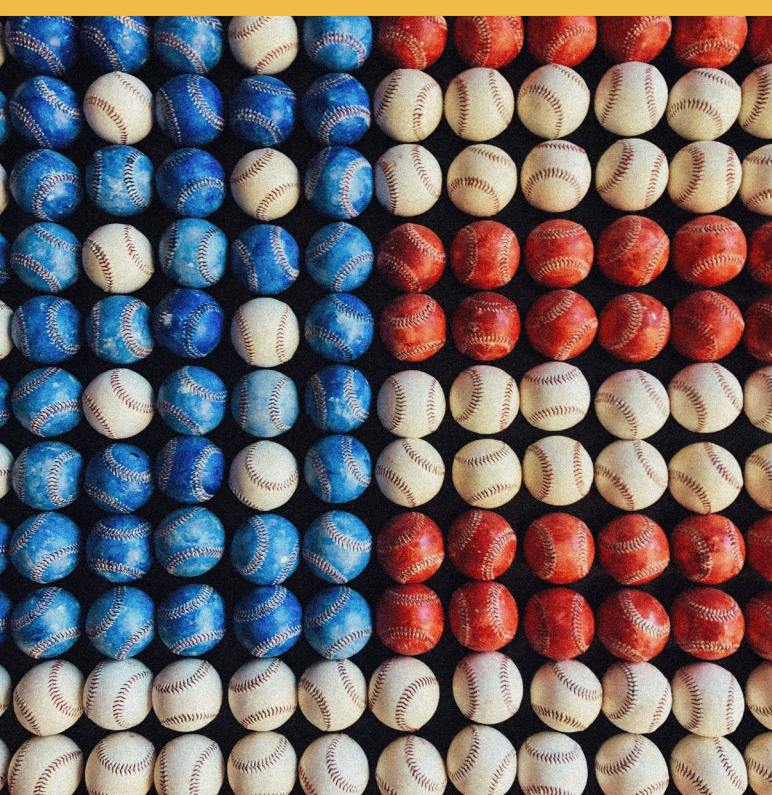
The IRS has released a draft of new [Form 7217](#), "Partner's Report of Property Distributed by a Partnership," and related [instructions](#).

The form is to be filed by any partner receiving a distribution of property from a partnership in a non-liquidating or liquidating distribution. However, partners do not have to file the form for:

- Distributions that consist only of money or marketable securities treated as money,
- Payments to the partner for services other than in their capacity as a partner under Section 707(a)(1), or
- Payments for transfers that are treated as disguised sales under Section 707(a)(2)(B).

The partner uses the form to report the basis of distributed property, including any basis adjustments to the property required by Section 732(a)(2) or (b). The two-page draft Form 7217 is broken into two parts, with Part I used for reporting the aggregate basis of the distributed property on the distribution date and Part II covering the allocation of basis of the distributed property.

Partners are to file a separate Form 7217 for each date during the tax year that they actually (not constructively) receive distributed property subject to Section 732 – even if property distributions received on different days were part of the same transaction.



The instructions state that Forms 7217 are to be due when the partner's tax return is due, including extensions. They add that partners should file their Forms 7217 attached to their annual tax return for the tax years in which they actually received distributed property subject to Section 732.

PLANNING CONSIDERATIONS

The draft form is a continuation of the IRS's recent efforts to expand required disclosures from partnerships. Based on an initial review of the draft version of the form, it appears likely they IRS will need to make some modifications to appropriately capture the information being requested by the form.

Prepare for Partnership Obligations Under Corporate Alternative Minimum Tax Regulations

The IRS on September 12, 2024, issued proposed regulations on the corporate alternative minimum tax (CAMT), enacted by the Inflation Reduction Act, that include significant new provisions for partnerships with corporate partners subject to the CAMT.

For tax years beginning after December 31, 2022, the CAMT imposes a 15% minimum tax on the adjusted financial statement income (AFSI) of large corporations (generally, those with average annual AFSI exceeding \$1 billion).

The proposed regulations set out rules for determining and identifying AFSI, including applicable rules for partnerships with CAMT entity partners. For a general discussion of the CAMT proposed regulations, see the Corporate Tax section of this guide.

CAMT STATUTE, AFSI ADJUSTMENTS & PARTNERSHIPS

Generally, the CAMT is imposed on AFSI – as determined under Section 56A – of an applicable corporation. Under Section 56A, AFSI means, with respect to any corporation for any tax year, the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement for that tax year, adjusted as further provided within that Code section.

Adjustments to AFSI are set out in Section 56A(c). Regarding partnerships, Section 56A(c)(2)(D) states

that, except as provided by the Secretary, if the taxpayer is a partner in a partnership, the taxpayer's AFSI with respect to such partnership is adjusted to take into account only the taxpayer's distributive share of such partnership's AFSI. It adds that the AFSI of a partnership is the partnership's net income or loss set forth on that partnership's applicable financial statement, as adjusted under rules similar to the rules set forth in Section 56A.

PROPOSED RULES ON FOR PARTNER'S DISTRIBUTIVE SHARE OF PARTNERSHIP AFSI

The IRS sets out in Prop. Reg. §1.56A-5 rules under Section 56A(c)(2)(D) regarding a partner's distributive share of partnership AFSI. The IRS explains that it is proposing adopting a "bottom-up" method which it believes is consistent with the statute and is more conducive to taking into account Section 56A adjustments. Under the proposed "bottom-up" method, a partnership would calculate its AFSI and provide this information to its partners. Each partner would then need to determine its "distributive share" of the partnership's AFSI.

The proposed rules generally provide that, if a CAMT entity is a partner in a partnership, its AFSI with respect to its partnership investment is adjusted as required under the applicable regulations to take into account the CAMT entity's distributive share of the partnership's AFSI.

Under the proposed rules, a CAMT entity's distributive share amount is computed for each tax year based on four steps:

1. The CAMT entity determines its distributive share percentage,
2. The partnership determines its modified financial statement income,
3. The CAMT entity multiplies its distributive share percentage by the modified financial statement income of the partnership (as reported by the partnership), and
4. The CAMT entity adjusts the product of the amount determined in step (3) above for certain separately stated Section 56A adjustments.

There are also related reporting and filing requirements in the proposed rules. Because a CAMT entity may require information from the

partnership to compute its distributive share of a partnership's AFSI, the proposed regulations would require a partnership to provide the information to the CAMT entity if the CAMT entity cannot determine its distributive share of the partnership's AFSI without the information and the CAMT entity makes a timely request for the information.

PROPOSED RULES ON AFSI ADJUSTMENTS TO APPLY CERTAIN SUBCHAPTER K PRINCIPLES

The proposed regulations also include rules to provide for adjustments to carry out the principles of subchapter K regarding partnership contributions, distributions, and interest transfers. The rules, as proposed, would apply to most contributions to or distributions from a partnership, but not with respect to stock of a foreign corporation except in limited circumstances.

For both contributions and distributions of property, the IRS proposes a deferred sale method. Thus, for contributions, the proposed rules generally provide that, if property (other than stock in a foreign corporation) is contributed by a CAMT entity to a partnership in a non-taxable transaction, any gain or loss reflected in the contributor's financial statement income from the property transfer is included in the contributor's AFSI in accordance with the deferred sale approach set forth in the proposed rules.

The proposed regulations also include rules relating to the maintenance of books and records and reporting requirements for a partnership and each CAMT entity that is a partner in the partnership.

Global Employment Services

Wellness Plans Purporting to Avoid Payroll Taxes Might Be Too Good to Be True

On two different occasions, the IRS has alerted employers to beware of companies misrepresenting nutrition, wellness, and general health personal expenses as medical care expenses for health flexible spending arrangements (FSAs), health savings accounts (HSAs), health reimbursement arrangements (HRAs), or medical savings accounts (MSAs), collectively health spending plans.

A May 2024 IRS news release – IR 2024-65 – addressed a concern that people may be misled by promoters of health spending plans as to which general health and wellness expenses will be reimbursed to employees and points out that personal expenses are not considered medical expenses under IRC Section 213(d) and therefore are not deductible or reimbursable under FSAs and other health spending plans.

In Chief Counsel Advice (CCA) 202323006, issued on June 9, 2023, the IRS makes it clear that unless participants have qualifying Section 213(d) medical expenses, the cash benefits paid to them from these wellness plans will be taxable wage income, subject to both income and employment taxes. See IRS Pub. 502 for a discussion of what is and is not a Section 213(d) medical expense. Also, the IRS has provided frequently asked questions on medical expenses



related to nutrition, wellness, and general health to determine whether a food or wellness expense is a medical expense to help distinguish medical from personal expenses.

The news release reiterates the items covered in CCA 202323006 and emphasizes that only plans that pay or reimburse bona fide medical expenses as defined by IRC Section 213(d) qualify an employee to make pretax contributions to a health benefit account and that distributions not used for IRC Section 213(d) medical expenses are taxable. Thus, contributions to plans that provide for the payment of non-medical wellness expenses are not deductible and payments under the plans are not tax free under FSA, HSA, HRA, and MSA rules. If the plan does not satisfy the IRC requirements, **all payments made to all participants in the plan, even allowable reimbursements for actual medical expenses, are includible in income.**

The promoters, some of which are former employee retention credit promoters, typically provide seemingly credible materials that often include a reliable legal opinion on the validity of the tax savings generated when employees make elective deferrals to health care arrangements under IRC Section 125. However, the legal opinion usually does not opine on the type of expenses discussed by the promoter or address how the payment of "wellness" expenses impacts the intended tax benefits.

PLANNING CONSIDERATIONS

As noted in CCA 202323006 and IR-2024-65, wellness plans often do not provide the tax benefits represented by promoters. Moreover, once an employer begins operating a defective wellness plan that allows reimbursements that are not eligible for tax-free treatment, it may be years before this fact comes to light, creating significant problems for employers who must correct past Forms W-2, Forms 941, etc. for open tax years.

Accordingly, a review of the proposed wellness or any other plan offering FICA exemption by a trusted tax advisor should be obtained prior to adoption. If one of these plans has already been implemented, consideration should be given to terminating the plan. Continued operation of the plan carries the risk of an IRS payroll examination through which the IRS might seek to collect taxes, penalties, and interest related to the failure to withhold and remit taxes when due and assert penalties based on the employer's incorrect filing and issuing of its Forms W-2.

Typically, the statute of limitations is three years, but it could be six years for substantial understatements. Employee morale issues can also arise, because employees may be required to amend their past years' Forms 1040 individual income tax returns.



New Requirement to Cover Long-Term Part-Time Employees in 401(k) & 403(b) Plans

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act of 2019) and the SECURE 2.0 Act of 2022 (collectively, SECURE) enacted a new mandate that, starting in 2024, long-term, part-time (LTPT) employees must be allowed to make salary deferrals into their employer's 401(k) plan. Starting in 2025, 403(b) plans are subject to the LTPT rules and LTPT employee eligibility is reduced from three years of service to two years of service.

The systems used by many 401(k) and/or 403(b) plan service providers may not be ready for the required implementation starting with the first plan year beginning on or after January 1, 2024, for 401(k) plans (i.e., January 1, 2024, for calendar year 401(k) plans) and the first plan year beginning on or after January 1, 2025, for 403(b) plans (i.e., January 1, 2025, for calendar year 403(b) plans).

Some executives may view this change as an issue that does not require their attention and that will be handled by their human resources (HR) staff and the 401(k) plan service providers. But not complying with the rules might be costly for the employer if corrective contributions for LTPT employees who were not allowed to participate are required, along with ancillary costs.

NEW MANDATE

For decades, 401(k) plans could exclude employees who work fewer than 1,000 hours of service per year, even if the employee worked for the employer for many years. Employees who worked over 1,000 hours generally could not be excluded from the plan (with certain non-hours-based exceptions). In contrast, 403(b) plans are subject to the so-called "universal availability" rule, which makes almost all employees eligible to make elective deferrals into the plan, with certain exceptions.

To improve access to workplace retirement savings plans, the 2019 SECURE Act required 401(k) plans to allow employees who have worked at least 500 hours in three consecutive years (based on employment with the employer from January 1, 2021, onward) to make elective deferrals to the plan.

Thus, if an employee had 500 hours of service in





2021, 2022, and 2023 (but never had 1,000 hours of service per year); that employee must be allowed to make salary deferrals into the employer's 401(k) plans starting with the first plan year beginning on or after January 1, 2024.

For plan years beginning in 2025 and later, SECURE 2.0 of 2022 reduces the three-year measurement period to two years. In addition, 403(b) plans become subject to the LTPT employee rules starting with the first plan year beginning on or after January 1, 2025.

WHY SHOULD EMPLOYERS BE CONCERNED?

While employers are not required to match the LTPT employee deferrals and LTPT employees are excluded from the annual tests that otherwise apply to all employees (e.g., coverage, nondiscrimination, and top-heavy requirements), there might be some increased cost to the plan sponsor for including LTPT employees in the 401(k) plan.

PLANNING CONSIDERATIONS

While plan sponsors might rely on their plan service providers to identify eligible LTPT employees, liability for noncompliance remains on the employer. The risk associated with not allowing LTPT employees to make elective deferrals to a 401(k) or 403(b) plan can be avoided if the plan lowers the plan's eligibility rules or determines eligibility on the elapsed time method instead of the counting hours method of determining eligibility to make salary deferrals under the plan.

SECURE provides numerous exceptions from coverage, nondiscrimination, and top heaviness tests for employees who participate in the plan solely on account of the LTPT employee provisions. Any employee that satisfies the more generous plan document provisions will not qualify for the confusing rules that otherwise apply to LTPT employees. Still, avoiding LTPT employee status altogether might be cost effective.

IRS Drastically Expands Electronic Filing Requirement for Most Tax & Information Returns

Almost all federal tax and information returns filed on or after January 1, 2024, must be submitted to the IRS electronically instead of on paper.

Under the new rules, filers of 10 or more returns of any type for a calendar year generally will need to be filed electronically with the IRS. Previously, electronic filing was required if the taxpayer filed more than 250 returns of the same type for a calendar year.

Who is affected? Practically all filers with the IRS of 10 or more information returns—when counting any type, such as Forms W-2, Forms 1099, Affordable Care Act Forms 1094 and 1095 and Form 3921 (for incentive stock options) and other disclosure documents—are impacted by this change for 2023 returns that will be filed in 2024. Even workplace retirement plans may need to file Form 1099-Rs (for

benefit payments) and other forms electronically with the IRS starting in 2024, for the 2023 plan or calendar year.

Which returns are affected? In addition to the information returns that are the primary focus of this article, the new rules cover a broad variety of returns, including partnership returns, corporate income tax returns, unrelated business income tax returns, withholding tax returns for U.S.-source income of foreign persons, registration statements, disclosure statements, notifications, actuarial reports and certain excise tax returns.

How to count to 10? The 10-return threshold for mandatory electronic filing is determined on the aggregate number of different types of forms and returns. The aggregation rules are confusing because the filings included in the count change depending on which form the determination is made. Also, some filers must be aggregated with all entities within the controlled or affiliated service group to determine if 10 or more returns are being filed for the tax year. For instance, Form 5500 employee benefit plan filers (but not Form 8955-SSA employee benefit plan filers) must count the filings of the employer who is the “plan sponsor” and other entities in the employer’s controlled and affiliated service group.

Example 1: Company A is required to file five Forms 1099-INT (Interest Income) and five Forms 1099-DIV (Dividends and Distributions), for a total of 10 information returns. Because Company A is required to file a total of 10 information returns, Company A must file all of its 2023 Forms 1099-INT and 1099-DIV electronically, as well as any other return(s) that are subject to an electronic filing requirement. The reason for this result is that “specified information returns” such as Forms 1099 and W-2 must be aggregated when counting to determine whether the new 10-or-more threshold for electronic filing is met.

Example 2: Corporation X, a C corporation with a fiscal year end of September 30, was required to file one Form 1120 (U.S. Corporation Income Tax Return) during the calendar year ending December 31, 2023, six Forms W-2 (for employees), three Forms 1099-DIV (for dividend distributions), one Form 940 (Employer’s Annual FUTA Tax Return) and four Forms 941 (Employer’s Quarterly Federal Tax Return). Because the Form 1120 aggregation rules include

returns of any type during the calendar year that ends with or in the taxable year and Corporation X is required to file more than 10 returns of any type during calendar year 2023, Corporation X is required to file its Form 1120 electronically for its taxable year ending September 30, 2024.

PLANNING CONSIDERATIONS

The new mandatory electronic filing rules are complicated and penalty exposure may be significant.

Filers must, for the first time, pay particular attention to the total number of returns across all return types, because the new electronic filing threshold is determined based on the aggregate total, not the number of returns per return type. This might require coordination between different departments within an organization and immediate consultation with the IT department and/or software provider to ensure there is adequate time to implement technology solutions or software upgrades before the filing deadline.

Affected employers may need significant lead time to implement new software, policies, and procedures to comply with the new rules. Simply doing the “same as last year” will not work for many employers.

Perkins can help employers understand and comply with the new rules, which could include facilitating electronic filing.

Even if filers are not required to file electronically under the new rules, they may want to consider doing so, as electronic filing has become more common, accessible, and economical. Electronic filing may reduce administrative efforts compared to paper filing, increase accuracy, and improve record retention.

Business Incentives & Tax Credits

Credit for Increasing Research Activities: Proposed Changes to Form 6765

The IRS announced the release of a revised draft of Form 6765, Credit for Increasing Research Activities, on June 21, 2024, that reflects feedback from external stakeholders. This follows the IRS's efforts to tighten documentation requirements for claiming the research credit.

In September 2023, the IRS previewed proposed changes to Form 6765, adding new sections for detailed business component information and reordering existing fields. These changes aimed to improve information consistency and quality for tax administration but were criticized as overly burdensome.

The updated draft retains Section E from the previous version but requires additional taxpayer information. The "Business Component Detail" section, now Section G, is optional for Qualified Small Business (QSB) taxpayers and those with total qualified research expenditures (QREs) of \$1.5 million or less and gross receipts of \$50 million or less. Additionally, the IRS reduced the number of business components to be reported in Section G, requiring 80% of total QREs in descending order by amount, capped at 50 business components. Special

instructions will be provided for taxpayers using the ASC 730 directive. The revised Section G will be optional for all filers for tax year 2024 to allow taxpayers time to transition to the new format. As outlined by the IRS, Section G will be effective for tax year 2025.

EXAMINATION ENVIRONMENT

Currently, the IRS receives a significant number of returns claiming the research credit, which requires substantial examination resources from both taxpayers and the IRS. To ensure effective tax administration for this issue, the IRS aims to clarify the requirements for claiming the research credit by considering all feedback received from stakeholders before finalizing any changes to Form 6765.

In response to ongoing concerns of improper claims of the research credit, the IRS has intensified its focus on reviewing these claims for nonconformities, including conducting more audits. Navigating the complexities of the research credit can be challenging, especially with the increased scrutiny, recent case law, and the newly implemented IRS compliance measures in place.

PLANNING CONSIDERATIONS

It is important for taxpayers to accurately determine eligibility, validate and properly record contemporaneous documentation to support research credit claims, and defend against examinations. Taxpayers should partner with a trusted tax advisor to ensure compliance with IRS regulations and proper eligibility for the research credit.



Tax Credit Monetization

GENERAL IRA OVERVIEW

The signing of the Inflation Reduction Act (IRA) on August 16, 2022, marked the largest-ever U.S. investment committed to combat climate change, allocating significant funds to energy security and clean energy programs over the next 10 years, including provisions incentivizing the manufacturing of clean energy equipment and the development of renewable energy generation.

Overall, the act modifies many of the current energy-related tax credits and introduces significant new credits and structures intended to facilitate long-term investment in the renewables industry. Capital investments in renewable energy or energy storage; manufacturing of solar, wind, and battery components; and the production and sale or use of renewable energy are activities that could benefit from the over 20 new or expanded IRA tax credits. The IRA also introduced new ways to monetize tax credits and additional bonus credit amounts for projects that meet prevailing wage and apprenticeship, energy community, and domestic content requirements.

45X – ADVANCED MANUFACTURING PRODUCTION TAX CREDIT

The 45X advanced manufacturing production credit continues to be a valuable production tax credit meant to encourage the production and sale of energy components in the U.S., specifically related to solar, wind, batteries, and critical mineral components. To be eligible for the credit, components must be produced in the U.S. or U.S. possessions and be sold by the manufacturer to unrelated parties. The Department of Energy has released a full list of eligible components as defined in the IRA, with specific credit amounts that vary according to the component. Manufacturers can also monetize 45X credits through a direct payment from the IRS for the first five years under Internal Revenue Code Section 6417. They may also transfer a portion or all the credit to another taxpayer through the direct transfer system Section 6418 election. The 45X credit is a statutory credit with no limit on the amount of funding available; however, the credit will begin to phase out beginning in 2030 and will be completely phased out after 2033. Manufacturers cannot claim 45X credits for any facility that has claimed a 48C credit.

48E AND 45Y CLEAN ELECTRICITY INVESTMENT & PRODUCTION CREDITS

For energy property and qualified facilities placed in service after December 31, 2024, Sections 48E and 45Y will replace the longstanding investment tax credit and production tax credit under Sections 48 and 45. The new provisions adopt a technology-neutral approach, whereby qualification for the credits will generally not be based on specific technologies identified in the IRC, but rather on the ability to generate electricity without greenhouse gas emissions. This represents a significant departure from historical practices and is expected to expand the range of technologies eligible for tax credits. Other relevant provisions of the IRA, such as bonus credit additions and monetization options, will still apply to the new Sections 48E and 45Y.

45Z CLEAN FUEL PRODUCTION CREDIT

The clean fuel production credit under Section 45Z will become effective for transportation fuel produced at a qualified facility after December 31, 2024. On May 31, 2024, the IRS issued Notice 2024-49, providing guidance on the necessary registration requirements to claim the credit. Fuel that meets additional criteria to qualify as sustainable aviation fuel (SAF) will be eligible for an increased credit amount. As in the case of other renewable credits, the emissions rate is crucial for purposes of the 45Z credit, because the emissions factor for the fuel will directly impact the credit amount. Additionally, prevailing wage and apprenticeship rules will apply to Section 45Z qualified facilities, with certain exceptions.

PLANNING CONSIDERATIONS

With the passage of Section 6418 as part of the IRA, certain renewable energy tax credits can now be transferred by companies that generate eligible credits to any qualified buyer seeking to purchase tax credits. Through credit transfers, taxpayers have the option to sell all or a portion of their credits in exchange for cash as part of their overall renewable energy goals if they are not able to fully utilize the benefit. Companies with a high amount of taxable income and therefore a larger appetite for tax credits are able to purchase these credits at a discount, with the sale proceeds improving the economics of clean energy development.

The market rate for the sale of credits will be highly dependent on the type of credit being transferred,

as well as the substantiation and documentation related to the seller's eligibility for the credit taken and any bonus credit amounts claimed. The current rate seen in the market for transferring credits is around \$0.93 to \$0.96 per \$1 of credit, but these amounts are subject to change based on specific fact patterns for each individual transaction and the overall market trend.

Taxpayers considering buying or selling tax credits that are transferable under the IRA should be looking ahead and forecasting their potential tax liability and resulting appetite for buying and selling credits. These credits can be transferred and utilized against estimated quarterly payments as soon as transfer agreements are finalized. This expedited reduction in cash outlay for the buyer and monetization of credits for the seller is a consideration that should be taken into account for taxpayers interested in entering the market of transferring credits.

Bonus Credits

The Inflation Reduction Act not only introduced new and expanded credits for the investment in and production of renewable energy and its related components but also included provisions for bonus credit amounts subject to specific requirements.

The prevailing wage and apprenticeship (PWA) requirement is a 5x multiplier for certain credits that can bring the credit rate from 6% up to 30% by paying prevailing wages to all labor related to the construction, installation, alteration, and repair of eligible property. Additionally, taxpayers must ensure that a specific percentage of these labor hours is performed by qualified apprentices.

The IRS and the Treasury Department issued final regulations on the PWA requirements in June 2024, and projects starting in 2025 and after will be unable to utilize the beginning of construction exemption. Other common credit additions available for taxpayers meeting energy community



and domestic content requirements provide a 10% addition to the base rate of the credit. Taxpayer documentation will be required to substantiate the claim of these bonus credit amounts and will need to be presented to a buyer in the event that these credits are transferred under Section 6418.

PLANNING CONSIDERATIONS

Taxpayers that have current or proposed investments or activities for which they plan to utilize the PWA multiplier should be formulating a documentation strategy and procedure. In the event of an IRS audit or transfer of these credits, taxpayers will be required to substantiate the wages paid to laborers, as well as the number of hours performed by registered apprentices. Depending on the size and amount of labor involved in qualified investments or production, documentation for PWA purposes, as well as for the domestic content requirements, will likely be a highly burdensome task if not planned for at the outset of a project.

New Markets Tax Credit (NMTC)

The federal New Markets Tax Credit (NMTC) program was established in 2000 to subsidize capital investments in eligible low-income census tracts. The subsidy provides upfront cash in the form of NMTC-subsidized loans at below-market interest rates (3%-3.5%). The loan principal is generally forgiven after a seven-year term, resulting in a permanent cash benefit. Funding for these subsidized loans is highly competitive and expected to be depleted quickly.

The U.S. Treasury's Community Development Financial Institutions (CDFI) Fund recently announced that, for 2025 only, it will double its annual allocation of NMTC funds.

PLANNING CONSIDERATIONS

Taxpayers across multiple industries may be good candidates for the NMTC.

Applying for the NMTC program involves several steps that help ensure the funding is allocated to projects that will have a meaningful impact on low-income communities. Applicants for the credit are evaluated based on the community impact derived from the investments (such as job creation, community services provided, etc.). In a program as highly competitive as the NMTC, applying early can make the difference between securing a portion of the limited funds available or missing out on funding opportunities. Early applicants are often better positioned to take advantage of available opportunities, and additional benefits may be possible for those who act swiftly.

The following initial questions will help determine if a project is viable for NMTC:

- Address of the proposed project
- High-level project description (a few sentences)
 - » Status of construction/timeline of capital expenditures (midstream projects are permitted)
 - » Estimated number of direct jobs to be created by the project

Taxpayers with ongoing or planned capital investments for later in 2024 or 2025 that are eligible to receive NMTC financing should begin reaching out to CDEs. Early outreach provides QALICBs a strong advantage in securing this financing due to the competitive nature and limited funds of the program.



Tax Accounting Methods

Corporations and pass-through entities may have opportunities to effectively improve their federal income tax positions and, in turn, enhance their cash tax savings by strategically adopting or changing tax accounting methods. Companies that want to reduce their current year tax liability (or create or increase a current year net operating loss (NOL)) should consider accounting method changes that accelerate deductions and defer income recognition. On the other hand, for various reasons (for example, to utilize an NOL), companies may choose to undertake accounting methods planning to accelerate income recognition and defer deductions. Importantly, when undertaking any future tax planning, companies should also keep in mind current tax proposals as well as changes that could result based on the outcomes of the 2024 presidential and congressional elections.

The rules covering the ability to use or change certain accounting methods are often complex, and the procedure for changing a particular method depends on the mechanism for receiving IRS consent — i.e., whether the change is automatic or non-automatic. Many method changes require an application be filed with the IRS prior to the end of the tax year for which the change is requested.

The following are some of the many important issues and developments for companies to consider when reviewing their tax accounting methods in 2024:

- December 31st deadline for non-automatic method changes
- Modified procedural guidance for Section 174 R&E costs
- Claiming abandonment and casualty losses
- Tax rules for calculating percentage of completion revenue
- Tax accounting for sales of IRA credits
- Year-end opportunities to accelerate common deductions and losses
- IRS insights into treatment of transferable incentives

December 31st Deadline for Non-Automatic Method Changes

Although the IRS allows many types of accounting method changes to be made using the automatic change procedures, some common method changes must still be filed under the non-automatic change procedures. A calendar year-end taxpayer that has identified a non-automatic accounting method change that it needs or desires to make effective for the 2024 tax year must file the application on Form 3115 during 2024 (i.e., the year of change).

Notably, [Rev. Proc. 2024-23](#), released on April 30, 2024, removed from the IRS list of permissible automatic method changes any change made to comply with the Section 451 all-events test applicable for accrual method taxpayers. Effective for Forms 3115 filed on or after April 30, 2024, for a year of change ending on or after September 30, 2023, this method change may only be made using the non-automatic change procedures.

Among the other method changes that must be filed under the non-automatic change procedures are many changes to correct an impermissible method of recognizing liabilities under an accrual method (for example, using a reserve-type accrual), deferred compensation accruals, and long-term contract changes under Section 460. Additionally, taxpayers that do not qualify to use the automatic change procedures because they have made a change with respect to the same item within the past five tax years will need to file under the non-automatic change procedures to request their method change.

Generally, more information needs to be provided on Form 3115 for a non-automatic accounting method change, and the complexity of the issue and the taxpayer's facts may increase the time needed to gather data and prepare the application. Therefore, taxpayers that wish to file non-automatic accounting method changes effective for 2024 should begin gathering the necessary information and prepare the application as soon as possible.

IRS Releases Modified Procedural Guidance for Section 174 R&E Costs

On August 29, 2024, the IRS issued [Rev. Proc. 2024-34](#), which provides modified procedural guidance permitting taxpayers with short taxable years in 2022 or 2023 to file an automatic accounting method change for a 2023 year for specified research or experimental expenditures (SREs) under Internal Revenue Code Section 174. The revised procedures are effective for Forms 3115 filed on or after August 29, 2024.

Effective for tax years beginning in 2022, the Tax Cuts and Jobs Act requires taxpayers to capitalize SREs in the year the amounts are paid or incurred and amortize the amounts over five or 15 years. Due to this shift in treatment, taxpayers using a different method of accounting for Section 174 costs were required to file a method change to comply with the new rules for their first taxable year beginning after December 31, 2021.

REV. PROC. 2024-34 PROVIDES TAXPAYERS ADDITIONAL FLEXIBILITY

Taxpayers may want or need to file successive accounting method changes to comply with new technical guidance issued by the IRS or correct or otherwise deviate from the positions taken with the initial method change.

Prior to the issuance of Rev. Proc. 2024-34, taxpayers seeking to file successive automatic changes to comply with the updated Section 174 rules could only do so for changes made for the first and second tax years (including short tax years) beginning after December 31, 2021.

Thus, a taxpayer with two short taxable years in 2022 (for example, due to a transaction) that filed an automatic Section 174 method change for one or both of those years previously would not have been able to file another automatic Section 174 method change for its 2023 year.

Rev. Proc. 2024-34 provides taxpayers with additional flexibility to file an automatic Section 174 method change for any taxable year beginning in 2022 or 2023, regardless of whether the taxpayer has already made a change for the same item for a taxable year beginning in 2022 or 2023.

Therefore, taxpayers that have not yet filed a federal income tax return for 2023 or have timely filed their 2023 return and are within the extension period for such return (even if no extension was filed), may be able to file an automatic change for SREs even if an accounting method change has been filed for a year beginning after December 31, 2021.

Rev. Proc. 2024-34 also modifies the existing procedural rules to permit taxpayers that are in the final year of their trade or business to use the automatic procedures to change to the required accounting method for SREs for any tax year beginning in 2022 or 2023. Under the prior guidance, taxpayers could only file an SRE method change in the final year of their trade or business for their first or second taxable year beginning after December 31, 2021.

AUDIT PROTECTION MAY NOT BE AVAILABLE

Importantly, the updated guidance clarifies that if a taxpayer did not change its method of accounting in an effort to comply with Section 174 for its first taxable year beginning after December 31, 2021, the taxpayer will not receive audit protection for a change made in any taxable year beginning in 2022 or 2023.

With this revision, the IRS is effectively denying audit protection for all taxpayers (regardless of whether they had short periods or full 12-month years in 2022 and 2023) that did not originally file a change to comply with Section 174 with their first taxable year beginning after December 31, 2021, unless they defer filing a method change until a tax year beginning in 2024 or after.



Claiming Abandonment & Casualty Losses

A taxpayer may be able to claim a deduction for certain types of losses it sustains during a taxable year — including losses due to casualties or abandonment, among others — that are not compensated by insurance or otherwise. To be allowable as a deduction under Section 165, a loss must be:

- Evidenced by a closed and completed transaction,
- Fixed by an identifiable event, and
- Actually sustained during the taxable year.

The loss is allowed as a deduction only for the taxable year in which it is sustained. Further, the loss can be claimed on an originally filed tax return or on an amended tax return. It is important for businesses to be aware of any potential loss that has occurred, or may occur, in a taxable year, and to ensure that appropriate documentation and actions are taken within the taxable year to support the loss deduction.

ABANDONMENT LOSSES

To substantiate an abandonment loss, some act is required to evidence a taxpayer's intent to permanently discard or discontinue the use of an asset in its business. No deduction is allowed

if a taxpayer holds and preserves an asset for possible future use or for its potential future value. Suspending operations or merely not using an asset is not sufficient to establish an act of abandonment, nor is a decline in value of an asset sufficient to claim an abandonment loss. To demonstrate abandonment of an asset, a taxpayer must show both written evidence of an intention to irrevocably abandon the asset and an affirmative act of abandonment. Although some guidance exists on when a tangible asset is considered abandoned, showing abandonment of intangibles can be more challenging, and little guidance exists related to current technologies such as software, internet, or website-related intangibles.

CASUALTY LOSSES

The IRS defines a casualty broadly to include, for example, earthquakes, fires, floods, government-ordered demolitions or relocations of property deemed unsafe by reason of disasters, mine cave-ins, shipwrecks, sonic booms, storms (including hurricanes and tornadoes), terrorist attacks, vandalism, and volcanic eruptions. Importantly, casualty losses arise only from identifiable events that are sudden, unexpected, or unusual in nature, such as a natural disaster. A casualty loss does not include slow, progressive deterioration.

For a business taxpayer that needs to determine whether its gains or losses during the taxable year are treated as capital or ordinary under Section 1231, there is a special rule for involuntary

conversions, which include casualties. An involuntary conversion, in relevant part, is the loss by fire, storm, shipwreck, or other casualty, or by theft, of property used in the taxpayer's business or any capital asset that is held for more than one year. If losses from involuntarily converted property exceed gains from such property, Section 1231 does not apply to determine the character of the gain or loss. A net loss will be treated as an ordinary loss. If the taxpayer does not have losses from the involuntarily converted property, the general rules under Section 1231 must be followed.

Federally declared disasters. Generally, casualty losses are deducted only in the year in which the casualty event occurs. However, if the casualty loss is attributable to a federally declared disaster, a taxpayer may elect to take the deduction in the prior tax year. Disaster declarations are published on the Federal Emergency Management Agency ([FEMA website](#)). The IRS typically publishes notifications in the Internal Revenue Bulletin shortly after a declaration as well.

Note that for individuals that experience a casualty event between 2018 through 2025, casualty losses are deductible only to the extent they are attributable to a federally declared disaster.

Tax Rules for Calculating Percentage of Completion Revenue

The percentage of completion method (PCM) for long-term contracts, governed by Section 460 of the Internal Revenue Code, is often misapplied by taxpayers as a method of tax accounting. Taxpayers with qualifying construction or manufacturing contracts frequently follow their book methodologies with minimal, if any, adjustments for tax purposes; however, the rules governing PCM under Section 460 differ significantly from those governing over-time recognition under GAAP. Further, PCM method changes are typically non-automatic; thus, calendar-year taxpayers seeking to change their method for long term contracts must file a Form 3115 by December 31, 2024 in order to implement the change for their 2024 tax year.

DEFINING LONG-TERM CONTRACTS – ELIGIBILITY FOR PCM

Qualification as a PCM-eligible long-term contract is determined on a contract-by-contract basis and has two broad requirements: (i) the contract must



be for a qualifying activity (either construction or manufacturing), and (ii) the contract must qualify as long-term.

Construction is considered a qualifying activity if one of the following must occur to satisfy the taxpayer's contractual obligations:

- The building, construction, reconstruction, or rehabilitation of real property (i.e., land, buildings, and inherently permanent structures as defined in Treas. Reg. §1.263A-8(c)(3));
- The installation of an integral component to real property (property not produced at the site of the real property but intended to be permanently affixed to the real property); or
- The improvement of real property.

Manufacturing will satisfy the activity requirement if the item being produced (i) normally requires more than 12 calendar months to produce (regardless

of the actual time from contract to delivery); or (ii) is "unique." In this context, unique means far more than mere customization. The Section 460 regulations provide several safe harbors to assist taxpayers with determining whether the item being manufactured is unique.

To be considered long-term under the PCM rules, a contract must begin and end in two different taxable years. Therefore, in theory, even a two-day contract from December 31 to January 1 could qualify as a long-term contract.

PCM CALCULATION

For tax purposes, the taxpayer's inception-to-date contract revenue corresponds to the ratio of inception-to-date contract costs incurred to total estimated contract costs. With respect to expense recognition, Section 460 mandates the accrual method for contract costs, such that deduction generally occurs in the same year the costs are taken into account in the PCM ratio's numerator. As previously noted, the tax rules governing PCM likely deviate from the book treatment of income/expenses in several aspects. For instance, under Section 460, taxpayers must follow how to determine the types and amounts of costs that are considered in the project completion rule. Further, there are specific rules pertaining to the treatment of pre-contracting costs (e.g., bidding and proposal costs), as well as look-back rules, which require a taxpayer, after the completion of a long-term contract, to perform a hypothetical recalculation of its prior years' income using the actual total contract price and actual total contract costs, rather than the estimated total contract price and estimated total contract costs used for its prior year returns.

INTERPLAY WITH SECTION 174

Many taxpayers with long-term contracts may be impacted by the requirement to capitalize Section 174 R&E expenditures. Taxpayers with significant contract-specific R&E expenditures may see some opportunity to defer the recognition of income in line with the deferral of R&E expense based on the IRS's requirements for including R&E costs within the numerator and denominator of the completion percentage formula. Notice 2023-63 has clarified that the numerator of the completion percentage formula contains only the amortization of the capitalized R&E costs, not the gross amount of the year's R&E expenditures. More recent guidance



(Rev. Proc. 2024-09, released on December 22, 2023) provides some limited flexibility concerning the inclusion of Section 174 costs in the denominator.

Tax Accounting Considerations for Sales of IRA Tax Credits

Taxpayers either purchasing or selling certain federal income tax credits under the Inflation Reduction Act of 2022 (IRA) should be aware of specific tax accounting rules governing the treatment of amounts paid or received for those credits. These special rules are provided in Section 6418 of the Internal Revenue Code, as well as in final Treasury regulations published in the Federal Register on April 30, 2024.

Taxpayers unaware of the new rules might overlook them and mistakenly apply the more familiar general rules instead, potentially resulting in sellers overstating their taxable income and purchasers claiming impermissible deductions.

The special tax accounting rules apply in preparing federal income tax returns of taxpayers engaging in qualifying transfers of eligible credits in 2023 or later years.

ELIGIBLE CREDITS

The new tax accounting rules apply to qualifying sales of “eligible credits,” which Section 6418(f)(1) defines as the following tax credits:

- The portion of the credit for alternative fuel vehicle refueling property allowed under Section 30C that is treated as a credit listed in Section 38(b);
- The renewable electricity production credit determined under Section 45(a);
- The credit for carbon oxide sequestration determined under Section 45Q(a);
- The zero-emission nuclear power production credit determined under Section 45U(a);
- The clean hydrogen production credit determined under Section 45V(a);
- The advanced manufacturing production credit determined under Section 45X(a);
- The clean electricity production credit determined under Section 45Y(a);
- The clean fuel production credit determined under Section 45Z(a);
- The energy credit determined under Section 48;
- The qualifying advanced energy project credit determined under Section 48C; and
- The clean electricity investment credit determined under Section 48E.

Section 6418 allows taxpayers to elect to transfer eligible credits to an unrelated person (but an eligible credit can only be transferred one time). Specific requirements and procedures apply in making such an election.



SPECIAL TAX ACCOUNTING REQUIREMENTS

Qualifying transfers of eligible credits are subject to specific tax accounting rules that differ from tax accounting principles generally applicable to the sale or exchange of property. Section 6418(b) provides that with respect to consideration paid for the transfer of an eligible credit, that amount:

- Must be “paid in cash”;
- Is not includible in the seller’s gross income; and
- Is not deductible by the purchaser of the eligible credit.
- In the case of eligible credits determined with respect to any facility or property held directly by a partnership or S corporation, if the partnership or S corporation makes a qualifying election to transfer an eligible credit:
- Any amount received as consideration for the transfer of the credit is treated as tax-exempt income for purposes of Section 705 (dealing with the basis of a partner’s interest in a partnership) and Section 1366 (dealing with pass-through of items to S corporation shareholders); and
- A partner’s distributive share of the tax-exempt income must be based on the partner’s distributive share of the otherwise eligible credit for each taxable year.

Just as the seller would not have realized income had it used the eligible credit to reduce its own federal tax liability rather than selling the credit, the final regulations provide a step-in-the-shoes rule for the eligible credit’s purchaser. The purchaser will not realize income upon its use of the credit to reduce its federal tax liability, even if the tax savings exceed the consideration paid to acquire the eligible credit.

For any eligible credit (or portion of an eligible credit) that the taxpayer elects to transfer in accordance with Section 6418, the purchaser takes the credit into account in its first taxable year ending with, or after, the seller’s taxable year with respect to which the credit was determined.

BASIS ADJUSTMENT RULES

Under Section 6418 and the final regulations, if a Section 48 energy credit, Section 48C qualifying

advanced energy project credit, or a Section 48E clean electricity investment credit is transferred, the basis reduction rules of Section 50(c) apply to the applicable investment credit property as if the transferred eligible credit was allowed to the seller, rather than to the purchaser. Section 50(c) generally provides that if a credit is determined with respect to any property, the basis of the property is reduced by the amount of the credit (subject to certain recapture rules).

The basis adjustment will affect the computation of the seller’s available cost recovery deductions for the investment property with respect to which the transferred credits arose, and so must be considered in preparing the returns of taxpayers engaged in the sale of eligible credits.

APPLICABILITY DATES

Section 6418 applies to taxable years beginning after December 31, 2022. Sellers must elect to transfer all or a portion of an eligible credit on the seller’s original return for the taxable year for which the credit is determined by the due date of that return (including extensions), but not earlier than February 13, 2023.



The final regulations are applicable for taxable years ending on or after April 30, 2024. Taxpayers may apply the final regulations to taxable years ending prior to that date but must apply them in their entirety if they choose to do so.

Year-End Opportunities to Accelerate Common Deductions & Losses

Heading into year-end tax planning season, companies may be able to take some relatively easy steps to accelerate certain deductions into 2024 or, if more advantageous, defer certain deductions to one or more later years. The key reminder for all of the following year-end “clean-up” items is that the taxpayer must make the necessary revisions or take the necessary actions before the end of the 2024 taxable year. (Unless otherwise indicated, the following items discuss planning relevant to an accrual basis taxpayer.)

Deduction of accrued bonuses. In most circumstances, a taxpayer will want to deduct bonuses in the year they are earned (the service year), rather than the year the amounts are paid to the recipient employees. To accomplish this, taxpayers may wish to:

- Review bonus plans before year end and consider changing the terms to eliminate any contingencies that can cause the bonus liability not to meet the Section 461 “all events test” as of the last day of the taxable year. Taxpayers may be able to implement strategies that allow for an accelerated deduction for tax purposes while retaining the employment requirement on the bonus payment date. These may include using (i) a “bonus pool” with a mechanism for reallocating forfeited bonuses back into the pool; or (ii) a “minimum bonus” strategy that allows some flexibility for the employer to retain a specified amount of forfeited bonuses.

It is important that the bonus pool amount is fixed through a binding corporate action (e.g., board resolution) taken prior to year end that specifies the pool amount, or through a formula that is fixed before the end of the tax year, taking into account financial data as of the end of the tax year. A change in the bonus plan would be considered a change in underlying facts, which would allow the

taxpayer to prospectively adopt a new method of accounting without filing a Form 3115.

- Schedule bonus payments to recipients to be made no later than 2.5 months after the tax year end to meet the requirements of Section 404 for deduction in the service year.

Deductions of prepaid expenses. For federal income tax purposes, companies may have an opportunity to take a current deduction for some of the expenses they prepay, rather than capitalizing and amortizing the amounts over the term of the underlying agreement or taking a deduction at the time services are rendered. Under the so-called “12-month rule,” taxpayers can deduct prepaid expenses in the year the amounts are paid (rather than having to capitalize and amortize the amounts over a future period) if the right/benefit associated with the prepayment does not extend beyond the earlier of i) 12 months after the first date on which the taxpayer realizes the right/benefit, or ii) the end of the taxable year following the year of payment. Note that accrual method taxpayers must first have an incurred liability under Section 461 in order to accelerate a prepayment under the 12-month rule.

The rule provides some valuable options for accelerated deduction of prepaids for accrual basis companies – for example, insurance, taxes, government licensing fees, software maintenance contracts, and warranty-type service contracts. Identifying prepaids eligible for accelerated deduction under the tax rules can prove a worthwhile exercise by helping companies strategize whether to make prepayments before year end, which may require a change in accounting method for the eligible prepaids.

Inventory write offs. Often companies carry inventory that is obsolete, unsalable, damaged, defective, or no longer needed. While for financial reporting inventory is generally reduced by reserves, for tax purposes a business normally must dispose of inventories to recognize a loss, unless an exception applies. Thus, a best practice for tax purposes to accelerate losses related to inventory is to dispose of or scrap the inventory by year end.

An important exception to this rule is the treatment of “subnormal goods,” which are defined as goods that are unsaleable at normal prices or unusable in the normal way due to damage, imperfections, shop



wear, changes of style, odd or broken lots, or other similar reasons. For these types of items, companies may be able to write down the cost of inventory to the actual offering price within 30 days after year end, less any selling costs, even if the inventory is not sold or disposed of by year end.

Continued phase-out of bonus depreciation.

For eligible property placed in service during 2024, the applicable bonus percentage is 60%. As such, year-end tax planning for fixed assets emphasizes cash tax savings through scrubbing fixed asset accounts for costs that can be deducted currently under Section 162 (e.g., as repairs and maintenance costs) rather than being capitalized and recovered through depreciation, assessing eligibility for immediate Section 179 expensing, and reducing the depreciation recovery periods of capital costs where possible.

CCA Provides Insight into Treatment of Transferable Incentives

CCA 202304009 addresses whether a pharmaceutical or biotechnology company must capitalize costs incurred to purchase from a third party a priority review voucher (PRV) issued by the U.S. Food & Drug Administration (FDA). A PRV is a voucher entitling its holder to prioritized FDA review

of a new medical treatment the applicant seeks to offer to the public. PRVs are considered valuable assets because their use can significantly reduce the time it would otherwise take to bring a new drug to market. A PRV can be held for use with a future FDA drug application or sold without restriction to another company for their use. PRVs have no expiration date and can be transferred an unlimited number of times.

In CCA 202304009, the IRS concluded that a taxpayer must capitalize the amount spent to purchase a PRV either as a cost incurred to facilitate obtaining a franchise right or as a cost incurred to acquire a new intangible asset, depending on the intended use of the voucher. The IRS also provided guidance on how the capitalized costs should be recovered.

While CCA 202304009 discusses costs to acquire PRVs, the guidance might help forecast the tax accounting treatment of various other non-tax government incentives as well.

Corporate & M&A

During 2024, the U.S. Department of the Treasury and the IRS issued important tax guidance for U.S. corporations — including long-awaited proposed regulations on the corporate alternative minimum tax and final procedural regulations on the stock repurchase excise tax. These and other key tax developments corporate taxpayers should consider when planning for 2024 and beyond include:

- Corporate Alternative Minimum Tax Guidance Includes Detailed Proposed Regulations
- IRS, Treasury Issue Final Procedural Regulations on Stock Repurchase Excise Tax
- Tax Court Rules for Taxpayer on Related Party Advances
- IRS Rules Stock Contributions Will Not Result in Deemed Dividends or Application of Gift Tax
- Uncertainties Surround Treatment of S Corporation State Law Conversions
- IRS Rules Professional Corporation Arrangement Requires Consolidation

Corporate Alternative Minimum Tax Guidance Includes Detailed Proposed Regulations

The Inflation Reduction Act of 2022 (IRA) created a new corporate alternative minimum tax (CAMT) for taxable years beginning after December 31, 2022. Since being signed into law, the U.S. Department of the Treasury and the Internal Revenue Service have released multiple pieces of guidance culminating in [proposed regulations](#).

PRIOR GUIDANCE

Prior to issuing proposed regulations, the following notices addressed the application of the CAMT:

- **Notice 2023-7** announced the intent to issue proposed regulations on the CAMT treatment of consolidated groups, depreciation of property under Section 168, troubled corporations, and the determination of applicable corporation status. Importantly, this Notice contained a first-year safe harbor that allowed taxpayers to use a simplified method to determine applicable corporation status.

- **Notice 2023-20** provided interim guidance on the CAMT treatment of variable contracts, certain reinsurance and coinsurance agreements, and adjustments for fresh start accounting.
- **Notice 2023-42** provided penalty relief for underpayments of estimated taxes relating to a taxpayer's CAMT liability for any tax year that begins after December 31, 2022, and before January 1, 2024.
- **Notice 2023-64** provided interim guidance on the determination of a taxpayer's applicable financial statement and adjusted financial statement income (AFSI), including as it relates to consolidated groups and certain foreign corporations.
- **Notice 2024-10** provided targeted relief to reduce double-counting of AFSI for a controlled foreign corporation that pays a dividend to a U.S. shareholder.
- **Notice 2024-33** extended the relief for CAMT liability estimated tax payments due on or before April 15, 2024.



- **Notice 2024-47** further extended the relief for CAMT liability estimated tax payments due on or before August 15, 2024.

Taxpayers may generally rely on these notices from their publication date to the publication of the proposed regulations (discussed below).

In the above-mentioned guidance, the Service released Form 4626, Alternative Minimum Tax—Corporations and accompanying instructions for corporate taxpayers to report their applicable corporation calculations and CAMT liability.

In addition, Schedule K to Form 1120, U.S. Corporation Income Tax Return, was modified to add Line 29 relating to CAMT.

PROPOSED REGULATIONS

The proposed regulations conform to many aspects of the prior notices but expand on the interim guidance in noteworthy ways, some of which are described below. The length and detail of the proposed regulations highlight the technical complexity of administering and complying with the CAMT regime.

Effective Dates. The proposed regulations are prospective in nature. In general, the proposed regulations apply to tax years and transfers ending or occurring, respectively, after September 13, 2024 (i.e., the date the proposed regulations were published in the Federal Register). However, certain aspects of the proposed regulations have different effective dates tied to the date the final regulations are published in the Federal Register, or to the period between September 13, 2024, and the date the final regulations are published in the Federal Register.

Taxpayers may rely on the proposed regulations, subject to a consistency requirement.

Safe Harbor. Notice 2023-7 contained a safe harbor that allowed a taxpayer to use a simplified method with fewer adjustments to calculate its AFSI for purposes of determining its applicable corporation status, which dictates whether the corporation is subject to the CAMT regime. The safe harbor reduced the threshold AFSI needed to be an applicable corporation from \$1 billion to \$500 million (and from \$100 million to \$50 million for the U.S.-specific prong of the foreign-parented multinational group test). The original safe

harbor was only available for the first taxable year beginning after December 31, 2022.

The proposed regulations contain a slightly modified version of the \$500 million (or \$50 million) safe harbor that is available for years not covered by the original safe harbor.

Other Noteworthy Areas. The following are key areas in which the proposed regulations provide new or more detailed guidance:

- Calculating a corporate partner's distributive share of partnership AFSI;
- Creating deemed foreign-parented multinational groups when there is a non-corporate parent;
- Addressing purchase accounting and other AFSI impacts resulting from M&A transactions;
- Adjusting AFSI for financial statement loss carryforwards;
- Allowing corporations to cease being applicable corporations; and
- Providing relief for bankruptcy or insolvency transactions.

PENALTY WAIVER: NOTICE 2024-66

In addition to the proposed regulations, the Service issued [Notice 2024-66](#), which provides a waiver for additional taxes imposed on a corporation that fails to make estimated tax payments related to its CAMT liability for tax years beginning after December 31, 2023, and before January 1, 2025.

As with the previous waivers, this waiver only covers taxes imposed under Section 6655 and does not waive additional taxes for underpayments under other Code Sections, such as Section 6651, which imposes additional tax for payments not made by the due date of the corporation's return (without extension).

PLANNING CONSIDERATIONS

The proposed CAMT regulations are substantial in detail, technical complexity, and length and include guidance on many areas applicable to M&A transactions. For example, the proposed regulations address certain effects of M&A transactions on the calculation of AFSI.

The proposed regulations also significantly increase the scope of the definition of a foreign-parented multinational group to include some common investment structures.

Taxpayers should carefully review the potential impact of the proposed regulations when engaging in M&A transactions and restructurings.

IRS, Treasury Issue Final Procedural Regulations on Stock Repurchase Excise Tax

Under the new corporate excise tax, a 1% corporate-level tax is imposed on net stock repurchases occurring after December 31, 2022. The excise tax applies to “covered corporations,” which are generally publicly traded domestic corporations, with certain foreign-owned domestic structures being included as well.

The excise tax was enacted as part of the Inflation Reduction Act of 2022, and the Service provided interim guidance in the form of Notice 2023-2 in December 2022. In April 2024, Treasury released proposed regulations incorporating the operating rules set forth in the notice, proposing additional guidance on foreign stock acquisitions, and responding to feedback received with respect to the notice. Separately but on the same day, Treasury also released proposed procedural regulations that articulate how to report and pay the excise tax.

Specifically for the procedural regulations, the Department of the Treasury and the IRS released [final regulations](#) on June 28, 2024. The final regulations largely adopt the proposed regulations. For taxable years ending on or before June 28, 2024, stock repurchase excise tax returns were required to be filed by October 31, 2024 (the due date for Form 720 for the third quarter of calendar year 2024). If a covered corporation has more than one taxable year ending after December 31, 2022, and on or before June 28, 2024, it should file a single Form 720 with a separate Form 7208 attached for each year.

Consistent with the proposed regulations, future stock repurchase excise tax returns must be filed by the due date of Form 720 for the first full calendar quarter after the end of the taxable year of the covered corporation. For example, a covered corporation with a tax year ending on December 31, 2024, must file its return by April 30, 2025 (the due date for a first-quarter Form 720).

PLANNING CONSIDERATIONS

Taxpayers should be aware that in certain leveraged transactions – those involving third-party debt – there may be ambiguity in the application of the excise tax depending on the nature of the funding and the obligors on the facility. Any transactions involving exchanges of public company stock should consider these rules and their impact on structuring.



Tax Court Rules for Taxpayer on Related-Party Advances

In *Estate of Thomas H. Fry v. Commissioner of Internal Revenue*, TC Memo 2024-8 (2024), the Tax Court held Section 385(c), which generally binds a taxpayer to its initial characterization of an investment as either debt or equity, did not apply to cash advances where no formal instruments had been issued. This case may have implications for corporations with undocumented related party advances.

DETERMINING DEBT OR EQUITY TREATMENT FOR TAX PURPOSES

Determining whether an interest in a corporation is debt or equity is a fact-intensive inquiry. Courts have traditionally applied multi-factor tests that look at the intent and relationship of the parties, the financial condition of the corporation, and each party's legal and economic rights. As these factors are weighted in each case, and the form or name of the instrument is not necessarily determinative of its treatment, taxpayers face uncertainty as to whether the IRS will agree with their chosen characterization.

In addition, Section 385(c) binds taxpayers to their characterization of an interest in a corporation once a position is taken. The IRS, on the other hand, is not bound by the taxpayer's characterization and has the ability to reclassify an instrument from debt to equity, and vice versa. As a result, taxpayers should perform a detailed assessment to determine the correct treatment before reporting a position on a return. In practice, however, this does not always occur, and later discovery that an instrument's treatment may be questionable often results in taxpayers' performing this assessment after the fact, thereby potentially triggering the application of the Section 385(c) rules.

ESTATE OF FRY V. COMMISSIONER

Mr. Fry was the sole shareholder of two S corporations, Crown and CR Maintenance. CR Maintenance encountered financial difficulties, and Crown provided financial assistance that allowed CR Maintenance to continue operations. In particular, Crown transferred money directly to CR Maintenance and paid bills on CR Maintenance's behalf. The amounts were accounted for as loans on both parties' general ledgers and tax returns but were not otherwise documented. CR

Maintenance did not claim interest deductions and Crown did not report interest income related to the amounts. In a dispute concerning Mr. Fry's basis in his CR Maintenance stock, Mr. Fry argued that these transactions should not be considered debt but, instead, should be treated as constructive equity contributions and distributions. The Service disagreed with Mr. Fry, asserting that Section 385(c) precluded him from recharacterizing the transactions as equity contributions.

TAX COURT HOLDINGS

In its memorandum opinion, the Tax Court held that Section 385(c) did not apply in this case because there was "no formal issuance of any instrument evidencing the creation of an interest in stock or equity." In addition, the Tax Court suggested that Section 385 might not apply to S corporations based on the exclusion of S corporations from the regulations promulgated under Section 385(a) in 2016. The court further held that the transfers and payments more likely than not failed to constitute debt based on an analysis using traditional debt-equity factors. The court then determined that the transfers and payments primarily benefited Mr. Fry and, as a result, held they should be considered deemed distributions to Mr. Fry and subsequent contributions to CR Maintenance.

PLANNING CONSIDERATIONS

Estate of Fry appears to limit the application of Section 385(c) where no formal notes or stock instruments are issued. However, the broader implications of the ruling and its reasoning are unclear. In non-precedential guidance, the Service has inconsistently applied Section 385(c) in circumstances where the issuer reports an instrument on its tax return differently from the label given to the legal documents. The Service has also indicated that Section 385(c)(1) precludes a taxpayer from arguing that undocumented cash transfers were equity transactions when the transfers were reported as loans on the taxpayer's books, records, and tax return balance sheets. In Estate of Fry, however, the Tax Court appears to shed some light on what actions constitute a characterization for purposes of Section 385(c). In particular, where there has been no formal issuance of an instrument that purports to be either debt or equity, the application of Section 385(c) may be precluded.

Estate of Fry may support the proposition that related party advances are not characterized as either debt or equity for purposes of Section 385(c) unless there has been a formal issuance of an instrument that purports to be either debt or equity, even if the taxpayer has reported the transaction as debt or equity on its books, records, or tax return balance sheets. However, taxpayers are reminded that memorandum opinions are not binding on the Tax Court, although they can be used as persuasive authority. Taxpayers should exercise caution in attempting to rely on Estate of Fry, particularly in cases that involve distinguishable fact patterns (for example, if one party to the cash transfer accrues or deducts interest on the advance), due to the lack of reasoning in support of the Tax Court's holding regarding Section 385(c) and the limited precedential value inherent in a memorandum opinion.

IRS Rules Stock Contributions Will Not Result in Deemed Dividends or Application of Gift Tax

A shareholder may, for valid business reasons (e.g., to improve the marketability of an investment), voluntarily surrender shares to the capital of a corporation, which raises questions of how the surrender impacts the other shareholders in the corporation. In [PLR 202406002](#), the IRS ruled that a proposed voluntary surrender of shares to the capital of a corporation will not create deemed dividend income for the noncontributing shareholders and will not result in a taxable gift to the noncontributing shareholders.

In the proposed transaction, an executive of the company and a series of trusts established by that executive will contribute a proportionate amount of their common shares to the company for no consideration. The contribution of the shares may occur in one or more installments. The company has in place a share repurchase program, but neither the executive nor the trusts have participated in the program. The share repurchase program and the proposed contribution each have separate independent business purposes.

INCOME TAX RULINGS

Citing *Commissioner v. Fink*, 483 U.S. 89 (1987), the Service ruled in [PLR 202406002](#) that the executive and the trusts will not recognize gain or loss as



a result of the contribution and that the basis in the shares contributed will be preserved in the basis of the executive's and the trusts' respective retained shares. In addition, the Service ruled that the contribution will be a contribution to the capital of the company and, therefore, will not be taxable to the company under Internal Revenue Code (IRC) Section 118(a).

The Service also indicated that the noncontributing shareholders will not recognize income as a result of the contribution and specifically provided that the contribution will not be treated as a distribution of property to the noncontributing shareholders.

The ruling is subject to many key representations, including that (i) there is no belief that any purchase pursuant to the share repurchase program will be taxed as a dividend to the participating shareholder or is a dividend within the meaning of IRC Sections 301 and 302; (ii) the contribution is an isolated transaction; and (iii) the contribution is not part of a plan to periodically increase the proportionate share of any shareholder in the assets or earnings and profits of the company.

Nevertheless, the contribution will have the economic effect of increasing the noncontributing

shareholders' proportionate interest in the assets and earnings and profits of the company.

IRC Section 305(c) provides a broad rule that creates a deemed distribution of stock in certain transactions involving a corporation and its shareholder(s) (e.g., recapitalizations), which may be taxable under the general distribution rules of Section 301.

By ruling that the contribution will not result in a deemed distribution to the noncontributing shareholders (likely because no deemed dividend results when a recapitalization is not undertaken pursuant to a plan to increase a shareholder's proportionate interest in the assets or earnings and profits of the corporation), the IRS eliminated any potential taxation of the economic benefit conferred on the noncontributing shareholders under Section 305 or Section 301.

GIFT TAX RULINGS

The Service also ruled that gift tax will not apply to the increase in value bestowed on the noncontributing shareholders by the executive and the trusts as a result of the contribution, because the contribution is a transaction occurring in the ordinary course of business (i.e., it is undertaken for bona fide business reasons, it is an arm's length transaction, and the executive and the trusts lack donative intent).

The Service also recognized that the executive and the trusts are conferring an economic benefit on each other and between each of the trusts. However, the Service ruled that these are effectively value-for-value exchanges and, therefore, will not be subject to gift tax.

PLANNING CONSIDERATIONS

PLR 202406002 closes the loop started by Commissioner v. Fink and provides answers that avoid adding unintended tax consequences and complexity to a transaction that is usually undertaken for independent, nontax business reasons.

In Fink, the Supreme Court denied a loss to a corporation's dominant shareholder following the shareholder's voluntary surrender of shares to the corporation, viewing the surrender as a contribution to capital. Instead, the Court held that the basis in the contributed shares must be added to the shares retained by the shareholder.

The Supreme Court case serves as authority for the shareholder's gain or loss and basis consequences resulting from a stock surrender. The classification of the transaction as a contribution to the capital of a corporation supports the application of IRC Section 118(a) to prevent the transferee corporation from including any amount in its gross income.



With the issuance of PLR 202406002, taxpayers and practitioners now have an indication of the Service's view of the other aspects of a stock surrender—namely, the treatment to the noncontributing shareholders.

Taxpayers considering surrendering shares to the capital of a corporation should consult with their advisors regarding the application of PLR 202406002 to their facts.

Uncertainties Surround Treatment of S Corporation State Law Conversions

Comments submitted on behalf of the American Bar Association Section of Taxation (ABA tax section) in a [letter](#) dated July 2, 2024, suggest the IRS should supplement or expand its 2008 guidance on F reorganizations involving S corporations and qualified subchapter S subsidiaries (QSubs) to include consequences of an F reorganization accomplished by state law conversion to a limited liability company (LLC). The additional guidance is needed to address uncertainties in planning and other transactions commonly used by S corporations and their shareholders.

SUMMARY OF 2008 IRS GUIDANCE

[Rev. Rul. 2008-18](#) provides guidance on whether, in an F reorganization involving an S corporation, the historic Subchapter S election and employer identification number (EIN) continue for the reorganized (surviving) entity. The revenue ruling addresses two specific transactions, each of which meet the requirements of an F reorganization under Section 368(a)(1)(F):

Situation 1: The shareholder of an S corporation contributes all of the S corporation stock to a newly formed corporation (Newco). A valid QSub election is made for the contributed corporation, causing it to be a disregarded entity treated as a division of Newco.

Situation 2: In a plan of reorganization, an S corporation creates a newly formed corporation (Newco), which also creates a newly formed corporation (Mergeco). Mergeco merges into the S corporation, with the S corporation's shareholder receiving the stock of Newco. A valid QSub election is made for the S corporation (now a subsidiary of Newco), causing it to be a disregarded entity treated as a division of Newco.

The 2008 ruling concludes that under these two fact patterns, the historic S corporation election does

not terminate but continues for the corporation that is the survivor of the reorganization (Newco). However, Newco must obtain a new EIN.

UNCERTAINTIES SURROUNDING S CORPORATION STATE LAW CONVERSIONS

Rev. Rul. 2008-18 does not address the continuation of an S corporation election or EIN when the S corporation undergoes an F reorganization (with or without a QSub election made for the contributed corporation) through a state law "conversion" to an LLC.

Whether a QSub election is necessary in a state law conversion is also unclear, since – assuming no entity classification election is made to treat the LLC as a regarded corporation – the surviving LLC would be disregarded under Treas. Reg. §301.7701-3. If a QSub election is required by the IRS, the election would not be valid if made after the corporation converts to an LLC.

In addition, any delay by the state in processing the conversion raises questions about whether the subsidiary loses its S corporation status in the reorganization transaction and, therefore, reverts to C corporation status for a period of time. If so, the corporation could be subject to built-in gains tax under Section 1374.

COMMENT LETTER RECOMMENDATIONS

To address the uncertainties for S corporations surrounding F reorganizations accomplished by state law conversions, the ABA tax section in its comment letter recommends the IRS supplement or expand Rev. Rul. 2008-18 to address a third situation:

Situation 3: The shareholder of an S corporation contributes all of the S corporation stock to a newly formed corporation (Newco). The contributed corporation is converted under state law from a corporation to an LLC for which no entity classification election is made. In addition, no QSub election is made for the contributed corporation.

The comment letter concludes that this fact pattern should have the following consequences:

- The historic S corporation election would not terminate but would continue for the newly formed corporation as the survivor of the reorganization.
- The LLC (formerly the S corporation) would retain its historic EIN.

- The newly formed survivor corporation would need to obtain a new EIN.
- The LLC would be respected as a disregarded entity, eliminating the need to make a QSub election, and would not be treated as a C corporation for federal income tax purposes for any period of time during the reorganization transaction, including for purposes of taxing built-in gains under Section 1374.

Should the IRS not accept the comment letter's suggestions to update or supplement their 2008 guidance, the ABA tax section alternatively recommends the IRS provide a streamlined procedure for curing a timely but invalid QSub election. This would be similar to [Rev. Proc. 2013-30](#), where an election has been deemed invalid because the subsidiary did not meet the domestic corporation requirement at the time the election was made.

PLANNING CONSIDERATIONS

A QSub can provide tax planning opportunities where there is a business reason to maintain S corporation operations in a separate subsidiary.

For example, since a QSub is a disregarded entity, the sale of an interest in a QSub is treated as a sale of its assets for federal income tax purposes, which provides the buyer with a step-up in the tax basis of the acquired assets. There may be other benefits as well, and F reorganizations may be used in pre-transaction planning structuring.

IRS Rules Professional Corporation Arrangement Requires Consolidation

Many states, through licensing and regulation of professions like medicine or law, restrict or prohibit business ownership by unlicensed individuals or entities. To invest in these types of businesses without violating state law, investors often must enter into contractual arrangements pursuant to which the investor acquires economic rights without changing the ownership of legal title.

In [PLR 202417008](#), the IRS ruled that a professional corporation must join an investor's existing consolidated group as a result of legal agreements that granted the investor beneficial ownership of the professional corporation's stock.

In the PLR, two professional corporations, PC1 and PC2 (together, the PCs), entered into agreements with a member of an existing consolidated group (Sub), either directly or indirectly through a disregarded entity of Sub, for administrative and management support services. In addition, the PCs and their respective shareholders entered into agreements with Sub (or its disregarded entity) restricting (i) the transferability of the shares in the PCs and (ii) the ability of the PCs to undertake certain corporate actions.

Citing IRC Section 1504(a) and Rev. Rul. 84-79, the IRS ruled that upon executing the above-mentioned agreements, PC1 and PC2 will join the consolidated group with respect to which Sub is a member. For a corporation (other than a common parent) to join a consolidated group, Section 1504(a) requires that members of a consolidated group directly own a certain amount of stock in the corporation.

Case law and IRS guidance (including Rev. Rul. 84-79) indicate that direct ownership for purposes of Section 1504(a) means beneficial ownership (which is generally determined based on the economic substance of the arrangement), not mere possession of legal title.

The IRS found that the legal agreements between the PCs, the shareholders of the PCs, and Sub (or its disregarded entity) separated legal title (i.e., legal ownership) from the economic rights (i.e., beneficial ownership), the latter of which Sub (or its disregarded entity) obtained as result of the contractual arrangements.

PLANNING CONSIDERATIONS

The PLR is consistent with similar rulings previously issued by the IRS, all of which are predicated on state law not prohibiting beneficial ownership by non-professionals and underscore the beneficial ownership aspect of the Section 1504(a) test. PLR 202417008 highlights the contractual arrangements involved in the transfer or acquisition of beneficial ownership, giving investors interested in participating in the economics of certain regulated businesses a view of the key legal documents and provisions the IRS evaluated in applying Section 1504(a).