Quickfinder®

Individuals—Special Tax Situations Quickfinder® Handbook (2023 Tax Year)

Post-publication Updates

Instructions: This packet contains "marked up" changes to the pages in the *Individuals—Special Tax Situations Quickfinder® Handbook* that were affected by developments after the *Handbook* was published. To update your *Handbook*, you can make the same changes in your *Handbook* or print the revised page and paste over the original page.

Example: In 2023, Tom's income subject to SE tax is $200,000. Tom's wife Faye is involved in his direct selling business, but Tom has always filed his tax returns showing all the income on his Schedule C, along with a single Schedule SE for himself. The IRS examines their return and determines that Faye is actually Tom's equal partner. Thus, each of them will report half of the SE earnings on their own Schedule SE. The effect of this adjustment is as follows:

	All Income Reported by Tom	*Half Reported by Tom*	*Half Reported by Faye*
Income..	$ 200,000	$ 100,000	$ 100,000
Tax on $173,470 at 15.3% after multiplying income by 92.35% (A) ..	$ 24,511	$ 14,130	$ 14,130
Income over $173,470...................	$ 26,530	$ 0	$ 0
Tax at 2.9% after multiplying income by 92.35% (B)................................	$ 711	$ 0	$ 0
Total Tax (A + B)	$ 25,222	$ 14,130	$ 14,130

The total SE tax under the IRS income allocation is $28,260 ($14,130 × 2). This is $3,038 ($28,260 – $25,222) more than if Tom reports all the SE income.

Formalizing the arrangement between the spouses can help prevent the IRS from successfully arguing that the business is a partnership and splitting the income between the spouses. For example, the less-involved spouse could sign an employment agreement as an employee of the more-involved spouse's business. It may also be advisable to ensure that the more-involved spouse is solely responsible for major business decisions.

Community Property States

If the spouses live in a community property state and any income derived from a trade or business is community income (under that state's community property laws), the SE income (or loss) from that business is treated as income of the spouse carrying on business. If only one spouse participates in the business, all of the income from that business is treated as that spouse's SE earnings. If both spouses operate the business, the SE income is allocated based on each spouse's participation in the business [IRC Sec. 1402(a)(5)(A)]. If the business is operated as a partnership, each partner reports his distributive share of income as SE income.

Determining whether a partnership exists is different for taxpayers in community property states than in separate property states. In community property states, the IRS will respect whichever treatment (sole proprietorship or partnership) the taxpayers use (as indicated by how they file their tax return) (Rev. Proc. 2002-69). Thus, the taxpayers can select the treatment they prefer. In separate property states, this determination is based on the facts and circumstances.

However, as is the case in separate property states, these rules for reporting trade or business income either as a partnership between the spouses or as a proprietorship do not apply if one spouse is a genuine employee of the other spouse's sole proprietorship.

Reporting Requirements

Form 1099

1099s issued. Direct sellers must file an information return if they make direct sales of at least $5,000 of consumer products to a buyer for resale anywhere other than a permanent retail establishment. The information return, Form 1099-MISC or Form 1099-NEC, must show the name, address, and identification number of the buyer (recipient). Check box 7 of Form 1099-MISC and box 2 of Form 1099-NEC to show these sales. Do not enter a dollar amount.

The direct seller must also provide a statement to the buyer by January 31 of the year following the calendar year for which the information return is filed, showing his name, address, phone number and identifying number. The statement given to the buyer for these direct sales may be in the form of a letter showing this information along with commissions, prizes, awards, etc.

Note: A Form 1099-NEC must also be issued to any noncorporate service providers to whom the direct seller pays $600 or more during the year.

1099s received. Direct sellers who purchase at least $5,000 of consumer products for resale during the year may receive a Form 1099-MISC or a Form 1099-NEC from the person who sold them the goods (often the company whose products they sell). They may also receive Form 1099-NEC if they are the recipients of commissions, prizes, awards, etc.

Direct sellers may also receive Form 1099-K if they use a payment settlement entity (PSE) to process credit card sales. The Form 1099-K will include the gross amount of the payment, including sales tax. The direct seller will need to maintain good records to determine what amounts may reduce gross sales. See *Form 1099-K Reporting* on Page 9-23 for additional information.

Observation: The de minimis exception for Third Party Settlement Organizations (TPSO) was significantly reduced to $600 per year with no minimum transaction requirement. As a result, more taxpayers can anticipate receiving a Form 1099-K since a single transaction for $600 or more settled through a TPSO is now considered to be reportable. ~~These new requirements apply to payments made beginning in 2023, which will be reported on 2023 Form 1099-K issued in January 2024.~~

The reduced 1099-K filing threshold was supposed to take effect beginning in 2022. However, the IRS provided relief for TPSOs by declaring 2022 and 2023 transition periods for implementation of the lowered minimum reporting requirements and allowed the TPSOs to use the threshold in place prior to the changes brought about by the American Rescue Plan Act of 2021 (ARPA) (Notices 2023-10 and 2023-74).

Schedule C

Unless the business is a partnership, income and expenses from direct selling are reported on Schedule C. The *Tax Organizer—Direct Sellers* on Page 3-25 can be used to gather the pertinent information.

When filing Schedule C, the direct seller should input a six-digit NAICS code. While there are several codes that relate to nonstore retailers, NAICS #454390 is generally the most appropriate code for direct selling businesses.

Qualified Business Income Deduction

From 2018 through 2025, direct sellers are eligible for the Section 199A deduction for qualified business income. The deduction is equal to 20% of the taxpayer's qualified business income but is subject to limits and phase-out when the taxpayer's taxable income exceeds certain thresholds, and different rules apply to service and non-service businesses. See *Qualified Business Income (QBI) Deduction* on Page 10-5 for coverage of the deduction.

IRS examiners are directed to determine whether any funds remaining in the trust account at year end represent fees that have been earned on settled cases but not yet recognized as income because the fees are retained within the trust account.

Client Expense Advances By Attorneys

Attorneys often pay litigation expenses on behalf of their clients. These costs are typically recovered when the settlement or court award is received. This practice is often used by lawyers that accept cases on a contingency basis.

Loan or Expense?

Whether these advances are currently deductible depends on if the advance is a loan to the client. If the attorney expects that the client will repay the amounts advanced, they are not deductible when advanced.

Net fee billing. Under this arrangement, the proceeds of a lawsuit are first applied to reimburse the lawyer for any expenses advanced. The firm then receives a percentage of the remaining proceeds.

> **Court Case:** The lawyer represented clients in personal injury lawsuits on a contingent fee basis. The lawyer paid many of the expenses of the litigation, which would be reimbursed out of any settlement or award. The lawyer then received a percentage of the remaining settlement (net fee billing). However, if nothing was recovered, the lawyer would receive nothing. The lawyer screened prospective clients and accepted cases only when there was a good prospect of recovery. The court found that the expenses that the lawyer paid on the clients' behalf were loans because the lawyer expected that they would be reimbursed, even though there was a possibility that the lawyer could receive nothing [*Canelo*, 53 TC 217 (1969)].

Lawyers using a net fee arrangement should treat the client expense advances as loans until the costs are recovered. If the law firm is not eventually reimbursed by the client, or the amount reimbursed is less than the amount advanced, the lawyer can deduct the unreimbursed expenses as a bad debt. The bad debt deduction is claimed in the year the taxpayer determines that the loan has become worthless [Reg. 1.166-2(b)].

Hourly billing. Client expense advances are nondeductible when the lawyer bills the clients for the costs advanced on their behalf.

> **Court Case:** A law firm billed its clients based on a standard hourly rate. In addition, the firm billed clients (sometimes on a separate bill and sometimes along with the bill for services rendered) for the litigation costs it incurred on the case. The expense advances were loans to the client, not deductible expenses, because the firm was reimbursed dollar-for-dollar (*Pelton & Gunther, P.C.*, TC Memo 1999-339).

Gross fee billing. Under this contractual arrangement, the lawyer receives a flat percentage of the settlement or award. Expenses are not specifically repaid before the percentage is applied.

> **Court Case:** The lawyer represented clients in personal injury lawsuits on a contingent fee basis. The lawyer paid many of the expenses of the litigation. If the case was successful, the lawyer received a percentage of the proceeds, before any repayment of expenses (gross fee billing). If there was no recovery, the lawyer received nothing. The court found that since the expenses were not specifically reimbursed out of the settlement, they were more like the normal overhead any business incurs to make a profit. Therefore, even though the lawyer recovered approximately 90% of the expenses advanced, the court found that the advances were not loans to clients. The lawyer could deduct them in the year paid [*Boccardo*, 75 AFTR 2d 95-2244 (9th Cir. 1995)].

Reporting Payments to Attorneys

Anyone engaged in a trade or business who, in the course of that activity, makes payments totaling at least $600 for legal services to attorneys must report the amount paid on Form 1099-NEC or Form 1099-MISC unless payment was made by credit card, in which case, Form 1099-K may be issued by the payment settlement entity [IRC Sec. 6045(f)]. Reporting is required regardless of whether the legal practice operates as a proprietorship, partnership, LLC or corporation.

Observation: The de minimis exception for Third Party Settlement Organizations (TPSO) was significantly reduced to $600 per year with no minimum transaction requirement. As a result, more taxpayers can anticipate receiving a Form 1099-K since a single transaction for $600 or more settled through a TPSO is now considered to be reportable. ~~These new requirements apply to payments made beginning in 2023, which will be reported on 2023 Form 1099-K issued in January 2024.~~

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Note: Non-employee compensation is reported on Form 1099-NEC.

Observation: Form 1099-MISC is generally not required when the payee is a corporation. However, payments to attorneys is an exception to this general rule, therefore, Form 1099-MISC must be filed even if the legal practice operates as a corporation.

Gross proceeds of $600 or more paid to an attorney in connection with legal services (regardless of whether the services are performed for the payer), but not for the lawyer's services, are reported on Form 1099-MISC, box 10. Attorneys' fees of $600 or more paid in the course of trade or business are reportable in box 1 of Form 1099-NEC.

Caution: A payer must report payments to an attorney even if the services are not performed for the payer. Thus, insurance companies paying a settlement on behalf of an insured are required to report the payment.

Often, an attorney will receive a check, some of which will be paid to other attorneys or to the attorney's client. The payer reports the entire amount to the first attorney listed on the check. If that attorney then makes a payment of $600 or more to another attorney, he must report that payment to the second attorney on Form 1099-NEC, under the same rules for payments to attorneys discussed in this section.

> **Example:** Fellows Corporation settles a suit brought by Matt Grayson by paying a check for $1 million to Matt's three attorneys, Adam, Zeke and Charles. (Zeke and Charles worked for Adam as outside legal consultants.) The check is delivered to Adam, who deposits it into a trust account and writes separate checks to Zeke for $100,000 and to Charles for $50,000 for their share of the attorney fees. Adam also makes a payment of $550,000 to his client, Matt.
>
> Because it does not know how much of the $1 million represents attorney's fees, Fellows reports the $1 million paid to Adam in box 10 of Form 1099-MISC. Adam then files Form 1099-NECs reporting $100,000 paid to Zeke and $50,000 paid to Charles. Adam reports the amounts paid to Adam and Charles in box 1 of Form 1099-NEC (since he knows that is the amount of their fees).

Planning Tip: In many cases, attorneys will receive Forms 1099 and 1099-NEC reporting gross payments, not all of which are taxable to them. These attorneys should be able to document the difference between the amounts reported to them on Form 1099 and the fees they report as income. Generally, the difference will consist of amounts paid to other attorneys, amounts paid to clients and amounts used to reimburse the attorney for advanced expenses (see *Attorney's Trust Accounts* on Page 8-20).

Cash includes U.S. coin and currency and foreign currency [IRC Sec. 6050I(d)]. Cashier's checks, bank drafts, traveler's checks and money orders having a face value of not more than $10,000 must be reported where meeting a designated reporting transaction test or received in a transaction in which the business knows the cash is being used in an attempt to avoid the reporting of the transaction. Designated reporting transactions include the retail sale of consumer durables, collectibles or travel and entertainment activities [Reg. 1.6050I-1(c)].

Observation: Digital assets, as defined in IRC Sec. 6045(g)(3)(D), will be considered the equivalent of *cash* for the purpose of Form 8300 filing requirements for all returns required to be filed after final regulations are issued (Ann. 2024-4). This would apply to transactions that occur within 15 days of year-end.

Example: Krooked has his daughter's wedding reception at the Indigestion Restaurant at a cost of $11,000. He pays for the reception with cash (U.S. currency). Since the reception occurs in Indigestion's trade or business and the payment involves cash in excess of $10,000, Indigestion must file Form 8300 for this transaction.

Variation: Now assume that Krooked pays for the reception with two $5,500 cashier checks and tells the Indigestion manager that he is doing so to avoid the Form 8300 filing requirement. Even though the checks individually are $10,000 or less, the restaurant knows that the transaction is structured to avoid the Form 8300 reporting requirements. Indigestion must file a Form 8300 reporting the transaction.

Depreciation and Amortization

Recovery Period for Certain Real Property

Qualified improvement property is depreciated over 15 years using straight line depreciation. To be qualified improvement property, the property must meet the following tests [IRC Sec. 168(e)(6)(A)]:

1) The improvement is to an interior portion of a building that is nonresidential real property.
2) The improvement is placed in service after the date the building was first placed in service.

Qualified improvement property does not include expenditures attributable to [IRC Sec. 168(e)(6)(B)]:

- Enlarging the building.
- Elevators or escalators.
- The internal structural framework of the building.

Note: Since qualified improvement property has a MACRS recovery period of less than 20 years, it is eligible for bonus depreciation.

Bonus Depreciation

Bonus depreciation is available for eligible qualified property placed in service from January 1, 2018, to December 31, 2026 (December 31, 2027, for certain long-production-period property and aircraft). Qualified property is any property having a recovery period of 20 years or less. Both new and used property qualify. Luxury vehicles subject to the Section 280F limitations are allowed an additional $8,000 over the $12,200 (for 2023) normally allowed such vehicles.

Phase-out. For eligible property placed in service after 2022 (2023 for certain long-production-period property and aircraft), the following bonus depreciation percentages apply (each delayed one year for certain long-production-period property and aircraft) [IRC Sec. 168(k)(6)]:

- 80% for property placed in service in 2023.
- 60% for property placed in service in 2024.
- 40% for property placed in service in 2025.
- 20% for property placed in service in 2026.
- 0% for property placed in service after 2026.

Section 179 Expense

Section 179 property can be expensed in the year the asset is placed in service. However, the total annual Section 179 deduction is subject to a dollar limit, which decreases (dollar for dollar) by the amount of Section 179 property placed in service during the year over the qualifying property threshold. For 2023, these amounts are $1.16 million and $2.89 million, respectively.

Property eligible for Section 179 expensing includes tangible personal property, off-the-shelf computer software and qualified real property and must be used in the taxpayer's trade or business [IRC Sec. 179(d)(1)].

Observation: *Eligible property* includes certain tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging [for example, beds and other furniture, refrigerators, ranges and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory or any other facility (or part of a facility) where sleeping accommodations are provided and let]. *Qualified real property* eligible for Section 179 expensing includes any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation and air-conditioning property; fire protection and alarm systems and security systems.

Amortizing Intangibles

A significant portion of the restaurant industry is comprised of franchised restaurants. The acquisition of a franchise is governed by IRC Sec. 197 and therefore the cost of a franchise is amortized ratably over 15 years. The 15-year amortization period applies regardless of the actual useful life of the Section 197 intangible. Franchise renewals must also be amortized over 15 years. For purposes of IRC Sec. 197, a franchise is defined as the right to distribute, sell or provide goods, services or facilities within a specified area.

Example: In January 2018, Little Restaurant purchases an exclusive franchise from Big Restaurants, Inc. to operate in Anytown, Texas, for five years for the sum of $100,000. The $100,000 franchise fee must be amortized over 15 years. In January 2023, Little Restaurant renews its franchise agreement with Big Restaurants, Inc. for five additional years at a cost of $150,000. The original $100,000 cannot be written off in 2023; instead, it will continue to be amortized over the 15-year period that began in January 2018. The $150,000 renewal fee will be amortized over a 15-year period beginning in January 2023.

Note: Liquor licenses are also governed by IRC Sec. 197 and therefore amortizable over 15 years [IRC Sec. 197(d)(1)(D)].

MACRS Recovery Periods

When a restaurant is acquired or built, some of the property may be eligible for five or seven year recovery periods. The IRS issued the *Cost Segregation Audit Technique Guide* (ATG) that provides guidance to agents auditing cost segregation issues in the restaurant industry. See an excerpt of this IRS document in the *Guide to Assets Used in the Restaurant Industry* on Page 9-25 for Section 1245 property qualifying for shorter recovery periods. See Tab 7 in the *Depreciation Quickfinder® Handbook* for the entire table reproduced and discussion of cost segregation studies. In addition, Chapter 7B of the ATG Cost Segregation Guide provides other guidance specific to the restaurant industry.

Refresh and Remodel

In Rev. Proc. 2015-56, the IRS has provided a safe harbor method that taxpayers engaged in the trade or business of operating a retail establishment or a restaurant may use to determine whether costs paid or incurred to *refresh or remodel* a qualified building are deductible or must be capitalized. See *Costs to Refresh or Remodel* on Page 10-11.

Tip Reporting Requirements

General Rules

- All tipped employees must report tip income to the employer if they receive at least $20 per month in tips.
- All tips are includable in the employee's income.

Employment Eligibility Verification

All employees must complete Form I-9 (Employment Eligibility Verification). The employer is responsible for ensuring that this form is filled out completely and in a timely manner. The employee completes section 1. This section discloses personal information on the new hire and must be completed upon the commencement of employment. It also provides for certification of the information if it is completed by someone other than the employee, such as a translator.

The employer completes sections 2 and 3. Section 2 is the employer review and verification section. The employer must review acceptable documents for employment verification. These documents must meet the identity and employment eligibility requirement as modified and defined by the IRA. This review must be performed within three business days of the date of commencement of work. For employees who are hired for fewer than three days, this section must be completed on the first day of employment.

A copy of the most recent version of Form I-9 is the only version of the form that is valid for current use. Form I-9 is available at **www.uscis.gov/sites/default/files/document/forms/i-9-paper-version.pdf**. Employers only need to complete the latest version for new employees and not for existing employees. However, employers must use the most current version of Form I-9 when existing employees require reverification.

Record-keeping requirements. Employers should make copies of the documents presented and retain such copies with the Form I-9 (to demonstrate compliance with the law). However, copies should not be maintained in the employee's personnel file (use a separate file instead) to avoid giving the U.S. Citizenship and Immigration Services access to information it is not legally entitled to see. The employer should retain any completed Form I-9 (and any copies of relevant documents) for the period ending three years after the hire date or one year after employment is terminated.

All documents presented to the employer must be originals. The employer should make a copy of these documents to be retained in its files with the completed Form I-9.

Affordable Care Act

Employers with at least 50 full-time equivalent employees are subject to employer shared responsibility provisions, under which employers who do not offer affordable health coverage that provides a minimum level of coverage to their full-time employees (and their dependents) may be subject to an employer shared responsibility payment. This could occur if at least one of their full-time employees receives a premium tax credit for purchasing individual coverage on one of the Affordable Insurance Exchanges (also called a Health Insurance Marketplace) (IRC Sec. 4980H).

Note: Employers with fewer than 50 full-time equivalent employees and who provide health insurance to their employees may qualify for a tax credit. See *Small Employer Health Insurance Credit* on Page 9-24.

Form 1099-K Reporting

Payment settlement entities must report debit and credit card sales to the IRS and merchants receiving payments. These payments are reported on Form 1099-K.

A payment settlement entity is a bank or other organization that has the contractual obligation to make payment to participating payees in settlement of payment card transactions or third party network transactions. A participating payee is anyone who accepts a payment card (or account number associated with a card) as payment or accepts payments from a Third Party Settlement Organization (TPSO) in settlement of a third party network transaction.

Until recently, a TPSO was only required to issue a Form 1099-K to a payee when the total number of transactions during the calendar year exceeded 200 and the dollar amount of those transactions exceeded $20,000. This *de minimis* exception only applied to third party network transactions (not payment card transactions). However, the American Rescue Plan Act (ARPA) brought about changes to these rules.

Law Change Alert: The *de minimis* exception for TPSOs is significantly reduced to $600 per year with no minimum transaction requirement. This means a single transaction for $600 or more settled through a TPSO is now reportable. ~~These new requirements apply to payments made beginning in 2023 (tax year 2023 is a transitional year—see Notice 2023-10), which will be reported on 2023 Form 1099-K issued in January 2024.~~

Observation: The reduced 1099-K filing threshold was originally intended to take effect beginning in 2022. However, the IRS provided relief for TPSOs by declaring 2022 and 2023 transition periods for implementation of the lowered minimum reporting requirements and allowed them to use the threshold in place prior to the changes brought about by American Rescue Plan Act (ARPA) (Notices 2023-10 and 2023-74).

Practice Tip: Because many restaurants accept debit and credit cards, it is likely that they will receive one or more Form 1099-K. The amount reported to the payee and the IRS is the total reportable payment card/third-party network transactions for the year, without any adjustments for credits, discounts, refunded amounts or any other amounts. It could also include tips added to the total by customers. The amount reported on Form 1099-K is not reported on a specific line on the restaurant's tax return. However, any taxable amount should be included in the proper line on the return. The IRS does not match amounts reported on the Form 1099-K to the taxpayer's return. However, it could use the information reported on the Form 1099-K to identify potential under-reported income. So, taxpayers who receive Form 1099-K reporting information they believe is incorrect should contact the issuer to obtain a corrected Form 1099-K.

Tax Credits

Work Opportunity Tax Credit (WOTC)

The WOTC is available through December 31, 2025.

To be eligible for the WOTC, a new employee must be certified as a member of a targeted group by a state workforce agency (SWA). An employee is a member of a targeted group if he began working for the employer before 2026 and is a (IRC Sec. 51):

- Long-term family assistance recipient,
- Qualified recipient of Temporary Assistance for Needy Families (TANF),
- Qualified veteran,
- Qualified ex-felon,
- Designated community resident,
- Vocational rehabilitation referral,
- Summer youth employee,
- Supplemental Nutrition Assistance Program (SNAP) benefits (food stamps) recipient,
- SSI recipient, or

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