Quickfinder®

Small Business Quickfinder® Handbook (2022 Tax Year)

Post-publication Updates

Replacement Pages for Two-Sided (Duplex) Printing

Instructions: This packet contains “marked up” changes to the pages in the *Small Business Quickfinder® Handbook* that were affected by developments after the Handbook was published.

This is a specially designed update packet for owners of the 3-ring binder version of the *Handbook* who have access to a printer that prints two-sided (duplex). Simply print the entire PDF file (make sure to select two-sided or duplex printing), three-hole punch the pages, and then replace the pages in your *Handbook*. It’s that easy.

Reference Materials and Worksheets

Tab A Topics

Where to File: Business Returns Filing Addresses—2022 Returns

Note: At the time of publication, the IRS had not released the 2022 filing addresses for business returns. This information will be posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder** when available.

Principal Business Activity Codes—Forms 1065, 1120, and 1120-S

Note: At the time of publication, the IRS had not released the 2022 principal business activity codes for business returns. This information will be posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder** when available.

Business Quick Facts Data Sheet[1]

	2023	2022	2021	2020	2019
FICA/SE Taxes					
Maximum earnings subject to tax:					
Social Security tax	$ 160,200	$ 147,000	$ 142,800	$ 137,700	$ 132,900
Medicare tax	No Limit	No Limit	No Limit	No Limit	No Limit
Maximum tax paid by:					
Employee—Social Security	$ 9,932.40	$ 9,114.00	$ 8,853.60	$ 8,537.40	$ 8,239.80
SE—Social Security	19,864.80	18,228.00	17,707.20	17,074.80	16,479.60
Employee or SE—Medicare	No Limit	No Limit	No Limit	No Limit	No Limit
Business Deductions					
Section 179 deduction—limit	$ 1,160,000	$ 1,080,000	$ 1,050,000	$ 1,040,000	$ 1,020,000
Section 179 deduction—SUV limit (per vehicle)	28,900	27,000	26,200	25,900	25,500
Section 179 deduction—qualifying property phase-out threshold	2,890,000	2,700,000	2,620,000	2,590,000	2,550,000
Depreciation limit—autos, trucks, and vans (1st year with special depreciation)	20,200[3]	19,200	18,200	18,100	18,100
Depreciation limit—autos, trucks, and vans (1st year with no special depreciation)	12,200[3]	11,200	10,200	10,100	10,100
Retirement Plans					
SIMPLE IRA plan elective deferral limits:					
Under age 50 at year end	$ 15,500	$ 14,000	$ 13,500	$ 13,500	$ 13,000
Age 50 or older at year end	19,000	17,000	16,500	16,500	16,000
401(k), 403(b), 457, and SARSEP elective deferral limits:					
Under age 50 at year end	$ 22,500	$ 20,500	$ 19,500	$ 19,500	$ 19,000
Age 50 or older at year end	30,000	27,000	26,000	26,000	25,000
Profit-sharing plan/SEP contribution limits	66,000	61,000	58,000	57,000	56,000
Compensation limit (for employer contributions to profit-sharing plans)	330,000	305,000	290,000	285,000	280,000
Defined benefit plans—annual benefit limit	265,000	245,000	230,000	230,000	225,000
***Key employee* compensation threshold**	215,000	200,000	185,000	185,000	180,000
***Highly compensated* threshold**	150,000	135,000	130,000	130,000	125,000
Estate and Gift Taxes					
Estate tax exclusion	$12,920,000[2]	$12,060,000[2]	$11,700,000[2]	$11,580,000[2]	$11,400,000[2]
Gift tax exclusion	12,920,000[2]	12,060,000[2]	11,700,000[2]	11,580,000[2]	11,400,000[2]
GST tax exemption	12,920,000	12,060,000	11,700,000	11,580,000	11,400,000
Gift tax annual exclusion	17,000	16,000	15,000	15,000	15,000

[1] See Tab 3 in the *1040 Quickfinder® Handbook* for an expanded *Quick Facts Data Sheet*.

[2] Plus the amount of any deceased spousal unused exclusion and/or any restored exclusion related to lifetime gifts to a same-sex spouse—see Tab H.

~~[3] Amount not released by IRS at publication time; will be posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder** when available.~~

Types of Payments—Where to Report

Source: 2022 *General Instructions for Certain Information Returns (Forms 1096, 1097, 1098, 1099, 3921, 3922, 5498, and W-2G).*

Below is an alphabetic list of some payments and the forms to file and report them on. However, it is not a complete list of all payments, and the absence of a payment from the list does not indicate that the payment is not reportable. For instructions on a specific type of payment, see the separate instructions in the form(s) listed.

Type of Payment	Report on Form
ABLE accounts:	
—Contributions	5498-QA
—Distributions	1099-QA
Abandonment	1099-A
Accelerated death benefits	1099-LTC
Acquisition of control	1099-CAP
Agriculture payments.	1099-G
Allocated tips	W-2
Alternate TAA payments	1099-G
Annuities	1099-R
Archer MSAs:	
—Contributions	5498-SA
—Distributions	1099-SA
Attorney, fees and gross proceeds	1099-MISC
Auto reimbursements—employee	W-2
Auto reimbursements—nonemployee	1099-NEC
Awards—employee	W-2
Awards—nonemployee.	1099-NEC
Barter exchange income	1099-B
Bond tax credit	1097-BTC
Bonuses—employee	W-2
Bonuses—nonemployee	1099-NEC
Broker transactions	1099-B
Cancellation of debt	1099-C
Capital gain distributions.	1099-DIV
Car expense—employee	W-2
Car expense—nonemployee	1099-NEC
Changes in capital structure	1099-CAP
Charitable gift annuities	1099-R
Commissions—employee	W-2
Commissions—nonemployee	1099-NEC
Commodities transactions	1099-B
Compensation—employee	W-2
Compensation—nonemployee	1099-NEC
Contributions of motor vehicles, boats, and airplanes	1098-C
Cost of current life insurance protection	1099-R
Coverdell ESA contributions	5498-ESA
Coverdell ESA distributions	1099-Q
Crop insurance proceeds	1099-MISC
Damages	1099-MISC
Death benefits	1099-R
Debt cancellation	1099-C
Dependent care payments	W-2
Direct rollovers	1099-Q,1099-R, 5498
Direct sales of consumer products for resale	1099-MISC, 1099-NEC
Directors' fees	1099-MISC
Discharge of indebtedness	1099-C
Dividends	1099-DIV
Donation of motor vehicle	1098-C
Education loan interest	1098-E
Employee business expense reimbursement	W-2
Employee compensation	W-2
Excess deferrals, excess contributions-distributions	1099-R
Exercise of incentive stock option under section 422(b)	3921
Fees—employee	W-2
Fees—nonemployee	1099-NEC
Fishing boat crew members proceeds	1099-MISC
Fish purchases for cash	1099-MISC
Foreclosures	1099-A
Foreign persons' income	1042-S
401(k) contributions	W-2
404(k) dividend	1099-DIV
Gambling winnings	W-2G
Golden parachute—employee	W-2
Golden parachute—nonemployee	1099-NEC
Grants—taxable	1099-G
Health care services	1099-MISC
Health coverage tax credit (HCTC) advance payments	1099-H
Health savings accounts:	
—Contributions	5498-SA
—Distributions	1099-SA
Income attributable to domestic production activities, deduction for	1099-PATR
Income tax refunds—state and local	1099-G
Indian gaming profits paid to tribal members	1099-MISC
Interest income	1099-INT
Tax-exempt	1099-INT
Interest, mortgage	1098
IRA contributions	5498
IRA distributions	1099-R
Life insurance contract distributions	1099-R, 1099-LTC
Liquidation—distributions	1099-DIV
Loans, distribution from pension plan	1099-R
Long-term care benefits	1099-LTC
Medicare Advantage MSAs:	
—Contributions	5498-SA
—Distributions	1099-SA
Medical services	1099-MISC
Mileage—employee	W-2
Mileage—nonemployee	1099-NEC
Military retirement	1099-R
Mortgage assistance payments	1098-MA
Mortgage interest	1098
Moving expense	W-2
Nonemployee compensation	1099-NEC
Nonqualified deferred compensation:	
—Beneficiary	1099-R
—Employee	W-2
Nonemployee	1099-NEC
Original issue discount (OID)	1099-OID
Tax-exempt OID	1099-OID
Patronage dividends	1099-PATR
Payment card transactions	1099-K
Pensions	1099-R
Points	1098
Prizes—employee	W-2
Prizes—nonemployee	1099-NEC
Profit-sharing plan	1099-R
Punitive damages	1099-MISC
Qualified longevity annuity contract	1098-Q
Qualified plan distributions	1099-R
Qualified tuition program payments	1099-Q
Real estate transactions	1099-S
Recharacterized IRA contributions	1099-R, 5498
Refund—state and local tax	1099-G
Rents	1099-MISC
Reportable policy sale	1099-LS
Retirement	1099-R
Roth conversion IRA contributions	5498
Roth conversion IRA distributions	1099-R
Roth IRA contributions	5498
Roth IRA distributions	1099-R
Royalties	1099-MISC, 1099-S
Timber—pay-as-cut contract	1099-S
Sales:	
—Real estate	1099-S
—Securities	1099-B
Section 1035 exchange	1099-R
Seller's investment in life insurance contract	1099-SB
SEP contributions	W-2, 5498
SEP distributions	1099-R
Severance pay	W-2
Sick pay	W-2
SIMPLE contributions	W-2, 5498
SIMPLE distributions	1099-R
Student loan interest	1098-E
Substitute payments in lieu of dividends or tax-exempt interest	1099-MISC
Supplemental unemployment	W-2
Tax refunds—state and local	1099-G
Third party network transactions	1099-K
Tips	W-2
Traditional IRA contributions	5498
Traditional IRA distributions	1099-R
Transfer of stock acquired through an employee stock purchase plan under section 423(c)	3922
Tuition	1098-T
Unemployment benefits	1099-G
Vacation allowance—employee	W-2
Vacation allowance—nonemployee	1099-NEC
Wages	W-2

Partnerships

Tab B Topics

Basics of Partnerships

Form 1065; See also IRS Pub. 541 and Partnership Example on Page B-16

Filing requirements. Every domestic (non-foreign) partnership that has income, deductions, and/or tax credits for the year must file a return, unless it has elected not to be treated as a partnership (see *Exclusion From Partnership Treatment* on Page B-4) [Reg. 1.6031(a)-1].

Schedules K-2 and K-3. New for 2021, Schedule K-2 (Partners' Distributive Share Items-International) and Schedule K-3 (Partner's Share of Income, Deductions, Credits, etc.-International) replaced the boxes on Schedule K-1 related to reporting items of international tax relevance. Initially, it was thought that only a partnership with items of international relevance was required to file Schedules K-2 and K-3. However, in January 2022, the IRS released additional instructions that stated that even a partnership with no foreign owners, no foreign source income, no assets generating foreign source income, and no foreign taxes paid or accrued may still be required to file Schedules K-2 and K-3 if a partner claims a foreign tax credit or otherwise needs information from the partnership in order to complete Form 1116 [Foreign Tax Credit (Individual, Estate, or Trust)] or Form 1118 (Foreign Tax Credit-Corporations). The updated guidance effectively requires all partnerships to complete the applicable parts of Schedules K-2 and K-3 unless the partnership is certain that none of the partners will need to file Form 1116 or Form 1118. The FAQ section of the IRS website is a good source for new developments. The frequently asked questions (FAQs) for Schedules K-2 and K-3 can be found at **www.irs.gov/businesses/schedules-k2-and-k3-frequently-asked-questions-forms-1065-1120s-and-8865**. 2022 Partnership Instructions for Schedules K-2 and K-3 (Form 1065), dated December 23, 2022, provide a *domestic filing exception* and a *Form 1116 exemption exception* for filing and furnishing Schedules K-2 and K-3 for tax years beginning in 2022. Tax professionals should review the 2022 Instructions for these exceptions.

~~**Caution:** Unless a tax professional prepares the return of every partner, they have no way of knowing if a partner will require the information reported on Schedules K-2 and K-3. Consider asking partnership clients to verify the foreign tax status of their partners to eliminate any extra tax preparation work.~~

Filing deadline. Returns are due by the 15th day of the third month following the close of the tax year.

Extension deadline and form number. The extended deadline is six months (Reg. 1.6081-2). For calendar year 2022 returns, the extended due date is September 15, 2023. File Form 7004 to extend the filing deadline.

Electronic filing requirements. Partnerships with more than 100 partners are required to file returns electronically. Other partnerships generally have the option to file electronically. For tax years beginning on or after July 2, 2019, a religious or apostolic organization exempt from income tax under IRC Sec. 501(d) must file electronically. Certain returns may not be filed electronically (for example, those involving bankruptcy or pre-computed penalty and interest). If a partnership can demonstrate that hardship would result from the requirement to file electronically, a waiver may be requested by following procedures in the Form 1065 instructions.

Penalties. The statutory penalty amount for failure to file a partnership return is indexed by a cost-of-living adjustment (COLA). The COLA adjusted penalty amount for failure to file a return in 2023 is $220 per month or part of a month per partner up to twelve months, respectively (IRC Sec. 6698; Rev. Proc. 2021-45). The penalty is assessed against the partnership. Rev. Proc. 84-35 provides relief to certain small partnerships (generally partnerships with 10 or fewer partners at all times during the year) from the penalty under IRC Sec. 6698(a) for failure to file a partnership return. The revenue procedure references the small partnership exception in IRC Sec. 6231(a)(1)(B), which was repealed by the Bipartisan Budget Act of 2015. In a Program Manager Technical Advice (PMTA 2020-01), the IRS concluded that despite the repeal of IRC Sec. 6231(a)(1)(B), Rev. Proc. 84-35 continues to apply.

Amended return. Partnerships that become aware of incorrect items of income, deductions, etc. may amend the return. Small partnerships (non BBA—see *Partnership Audit Rules* on Page B-2) and partnerships that elect out of the centralized partnership audit regime—see *Electing out of the rules* on Page B-2) filing electronically to amend Form 1065 and Schedules K-1 check box G(5) on page 1 of Form 1065 to indicate that it is an amended return and follow the Form 1065 instructions for statements and explanations that are required. An amended Schedule K-1 should be provided to each partner. Partnerships subject to the centralized partnership audit regime must use Form 8082 [Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)] to file electronically. If paper returns are used to correct a previously filed partnership return, use Form 1065X [Amended Return or Administrative Adjustment Request (AAR)].

Schedule K-1 deadline. Partnerships are required to furnish a Schedule K-1 to each partner by the due date, including extensions, of the partnership tax return (Form 1065). For statements required to be furnished in 2023, a $290 penalty, imposed with respect to each Schedule K-1 for which a failure occurs, applies for failure to furnish Schedule K-1 when due or failure to include all required information or for including incorrect information. The maximum penalty is $3,532,500 for all such failures during a calendar year for taxpayers with average annual gross receipts for the most recent three tax years of more than $5,000,000. For taxpayers with average annual gross receipts of $5,000,000 or less, the maximum penalty is $1,177,500. If the requirement to report correct information is intentionally disregarded, each $290 penalty is increased to $580 or, if greater, 10% of the aggregate amount of items required to be reported, and the $1,177,500 (or $3,532,500) maximum doesn't apply. The $290 penalty may be reduced to $50 or $110 per failure, and the $1,177,500 (or $3,532,500) maximum penalty to $206,000 or $588,500 (or $588,500 or $1,766,000), respectively, depending on when the failure is corrected (IRC Sec. 6722; Rev. Proc. 2021-45).

Electronic Schedule K-1. Partnerships required to furnish a K-1 to a partner may provide it in an electronic format instead of on paper. The partner's affirmative consent to receive the K-1 in electronic format is one of the requirements of Rev. Proc. 2012-17 that must be met for the partnership to be treated as furnishing the K-1 timely.

Income/tax rates. Profits and losses are passed through to partners on Schedule K-1 and taxed on their individual returns.

Limited liability companies (LLCs) are created and regulated under state law. Those with more than one member are treated as partnerships for federal income tax purposes, unless an election is made to be taxed as a corporation. LLCs generally have the same options as partnerships for electing tax treatment under check-the-box regulations. See *Limited Liability Company (LLC)* on Page F-1 for more information.

Partnership representative. A partnership's primary representative in dealings with the IRS is its *partnership representative* (PR). The partnership must designate its PR by completing information on page 3 of Form 1065 for the tax year for which the designation applies. Designation of a PR is made separately for each tax year, and is only effective for the tax year for which it is made [Reg. 301.6223-1(a) and (c)].

The PR is not required to be a partner, and can be any person (including an individual or an entity) with a substantial presence in the U.S. A wholly-owned disregarded entity is eligible to serve as a PR, and the partnership can designate itself as its own PR. A person who is not an individual can be a PR only if an individual who meets the substantial presence test is appointed by the partnership as the sole individual through whom the PR will act. A PR meeting these requirements is an *entity partnership representative* and the individual through whom such an entity partnership representative acts is the *designated individual*. The designated individual must be appointed at the same time as the PR [Reg. 301.6223-1(b)].

The PR has the sole authority to bind the partnership and all partners. If a partnership does not designate a PR, the IRS may select any person as the PR, with certain limitations. Partnerships will need to ensure their agreements establish procedures for choosing, removing, and replacing the PR. In addition, the partnership agreement should carefully outline the duties of the representative. Consider addressing in the partnership agreement whether the:

- PR must provide partners with copies of IRS notices and inform them of the status of an audit or tax proceeding.
- Consent of a majority of the partners is needed before the PR can agree to extend the statute of limitations or settle with the IRS. (While such a provision will not limit the PR's authority in the eyes of the IRS, it may give partners recourse under state law if the PR fails to comply.)
- Partnership agreement should limit the PR's fiduciary risk through indemnity protection.

Partnership Audit Rules

For tax years beginning after 2017, the TEFRA audit procedures and the electing large partnership rules are repealed and replaced by the Bipartisan Budget Act of 2015 (BBA) *centralized partnership audit regime*. Under the current regime, any adjustment to a *partnership-related item* (any item or amount with respect to the partnership that is relevant in determining the federal income tax liability of any person, and any partner's distributive share of any such item or amount) is made at the partnership level. Any additional tax, penalty, or amount related to the tax is determined and collected at the partnership level unless the partnership elects an alternative payment process (also known as a push-out election) [IRC Secs. 6221(a), 6226, and 6241; Regs. 301.6221(a)-1, 301.6226-1, and 301.6241-6]. The IRS has launched a BBA centralized partnership audit regime website. It is intended to be a one-stop location for anything BBA-related and can be found at **www.irs.gov/businesses/partnerships/bba-centralized-partnership-audit-regime**.

If adjustments to partnership items are made, the partnership will be required to pay the *imputed underpayment amount*, which is generally the net of all adjustments for the reviewed year multiplied by the highest individual or corporate tax rate in effect for that year. However, the partnership can pay a lower amount if it can show that the underpayment would be lower if it were based on certain partner-level information. This could include the partners' amended returns, the tax rates applicable to specific types of partners (individuals, corporations, or tax-exempt organizations), and the type of income subject to the adjustments (IRC Sec. 6225).

Electing out of the rules. Partnerships with 100 or fewer partners can elect out of the audit rules for any tax year, in which case the partnership and its partners will be audited under the general rules for individual taxpayers [IRC Sec. 6221(b); Reg. 301.6221(b)-1]. Generally, a partnership is treated as having 100 or fewer partners for a tax year if it is required to furnish 100 or fewer Schedules K-1. The election is available only if each of the partners is an individual, a C or S corporation, a foreign entity that would be treated as a C corporation were it domestic, the estate of a deceased partner or another person identified in future IRS guidance. The election is made annually and may be revoked only with IRS consent. Partnerships must file Form 1065, Schedule B-2 (Election Out of the Centralized Partnership Audit Regime) with their Form 1065 to make the election.

Caution: Partnerships may assume they will be able to elect out of the audit procedures because they have 100 or fewer partners. However, the election is not available if any partner is a partnership, disregarded entity, trust, or foreign entity that would not be treated as a C corporation were it a domestic entity. (This could change if the IRS becomes convinced that expansion of the election out rules to tiered partnerships would not be overly burdensome.) Additionally, if any partner is an S corporation, the number of K-1s it must furnish to its shareholders must also be taken into account.

The IRS has issued final regulations that ~~will~~ allow the IRS to determine that the centralized partnership audit regime will not apply to adjustments of partnership-related items in certain limited circumstances (Reg. 301.6241-7). Specifically, the final regulations ~~will~~ allow the IRS to focus on a single partner or small group of partners with respect to a limited set of partnership-related items without unduly burdening the partnership and avoiding procedural concerns about the appropriate level at which such items must be examined. The ~~proposed~~ regulations also provide that IRC Sec. 6221(b) generally doesn't apply to a partnership with a QSub as a partner ~~(Prop.~~ [Reg. 301.6221(b)-1].

The partnership agreements of eligible partnerships should address whether an election out will be mandatory. In most situations, an election out will be preferable. However, partnerships looking to maintain flexibility in their partnership agreements should include provisions indicating how the decision to elect out will be made. Partnerships choosing to elect out may want to amend their agreements to prohibit the transfer of partnership interests to ineligible partners and to limit the number of partners to 100 or less.

Push-out election. Under the audit regime, a partnership must pay the imputed underpayment amount (along with penalties and interest) resulting from an IRS audit unless it makes a push-out election, which lets a partnership push an adjustment out to the reviewed year partners (IRC Sec. 6226). This shifts the liability away from the current partners to those who were partners in the year the adjusted item arose. The election must be made within 45 days of the date on which the final partnership adjustment (FPA) is mailed by the IRS. This 45-day period cannot be extended, and once made, the election may only be revoked with the consent of the IRS [IRC Sec. 6226(a)].

The IRS has issued two forms to facilitate making or revoking the push out election: Form 8988 (Election for Alternative to Payment of the Imputed Underpayment—IRC Section 6226) and Form 8989 (Request to Revoke the Election for Alternative to Payment of the Imputed Underpayment). Form 8978 (Partner's Audit Liability Under Section 6226) has also been issued for partners of partnerships that have made the push out election and are subject to audit adjustments.

Consider addressing in the partnership agreement whether the partnership representative:

- Must make a push-out election or the circumstances in which one will be made.
- Must analyze factors such as higher underpayment interest rates, self-employment tax, net investment income tax, and state and local tax implications in determining whether to make a push-out election.

If a push-out election is provided for, the partnership agreement should ensure that partners who sell their interests in the business will continue to comply with their tax obligations.

S Corporations

Tab D Topics

Basics of S Corporations

Form 1120-S

Filing Requirements

Every S corporation must file a return, regardless of the amount of income or loss (IRC Sec. 6037). It must file even if it stops conducting business. Filing ends when totally dissolved.

Filing deadline. By the 15th day of the third month following the close of its tax year or date of dissolution (March 15 for calendar year S corporations).

Electronic filing of Form 1120-S is normally required for S corporations that have $10 million or more in assets and annually file 250 or more returns of any type (including information returns such as Forms W-2 and 1099) (Reg. 301.6037-2). See Notice 2010-13 for the requirements to request a waiver.

Caution: Proposed regulations would require that any S corporation required to file Form 1120-S, regardless of the corporation's reported total assets at the end of its tax year, file that return electronically if the corporation is required to file at least 10 returns (1099s, W-2s, 1120-S, etc.) of any type during calendar years after 2021 (Prop. Reg. 301.6037-2). Tax professionals should monitor this area for future developments.

Extension deadline and form number. A six-month extension of time to file may be obtained by filing Form 7004 (Application for Automatic Extension of Time To File Certain Business Income Tax, Information, and Other Returns).

Penalties. The statutory penalty amount for failure to file an S corporation return is indexed by a cost-of-living adjustment (COLA). The COLA adjusted penalty amount for failure to file a return in 2023 is $220 per month or part of a month per shareholder up to 12 months (IRC Sec. 6699; Rev. Proc. 2021-45). The penalty is assessed against the corporation.

If S corporation taxes are due, a late filing penalty may be imposed equal to 5% of tax owed per month, up to 25%. If the return is more than 60 days late (including extensions) a minimum penalty of the lesser of $450 for returns required to be filed in 2023 (Rev. Proc. 2021-45) or the amount of unpaid tax applies. A late payment of tax penalty may also be imposed equal to one-half of one percent per month, up to 25% (IRC Sec. 6651).

In an IRS Program Manager Technical Advice (PMTA 2013-15) the IRS concluded that an untimely S corporation return should not be subject to both the general failure to file penalty under IRC Sec. 6651(a)(1) (which does not apply unless the S corporation owes tax) and the failure to file an S corporation return penalty under IRC Sec. 6699(a)(1) at the same time.

Additional information regarding penalties is found at *Penalties:* on Page C-1.

Schedule K-1 deadline. S corporations must furnish a Schedule K-1 and Schedule K-3, as applicable, to each shareholder by the due date, including extensions, of the corporation tax return (Form 1120-S). This penalty is annually adjusted for inflation. A $290 penalty for Schedules K-1 required to be furnished in 2023 (2022 tax year filings) is imposed with respect to each Schedule K-1 for which a failure occurs. This penalty applies for failure to furnish Schedule K-1 when due, failure to include all required information, or for including incorrect information (Rev. Proc. 2021-45). The $290 penalty may be reduced to $50 or $110 per failure, depending on when the failure is corrected (IRC Sec. 6722). Higher penalties apply if the failure is due to intentional disregard of the law. See IRC Sec. 6722 for details.

Reasonable cause exception. The penalties discussed here will not be imposed if the failure was due to reasonable cause (IRC Secs. 6651, 6699, and 6724).

Schedules K-2 and K-3. Schedules K-2 and K-3 were new for the 2021 tax year. These schedules replace, supplement, and clarify the reporting of certain amounts formerly reported on Schedule K, lines 14 and 17d and Schedule K-1, Part III, lines 14 and 17. The schedules assist S corporations in providing shareholders with the information necessary to complete their returns with respect to the international tax provisions of the Internal Revenue Code. For example, Schedule K-3 provides information necessary for shareholders who make an election under IRC Sec. 962 to figure their foreign tax credit on Form 1118 (Foreign Tax Credit—Corporations) and other shareholders to figure their foreign tax credit on Form 1116 [Foreign Tax Credit (Individual, Estate, or Trust)], respectively. Schedule K-2 is an extension of Form 1120-S, Schedule K, and is used to report items of international tax relevance from the operation of an S corporation. Schedule K-3 is an extension of Schedule K-1 (Form 1120-S) and is generally used to report to shareholders their share of the items reported on Schedule K-2. Shareholders must include the information reported on Schedule K-3 on their tax or information returns.

~~All S corporations must provide information even if they have no items of international tax relevance.~~ In January 2022, the IRS released additional instructions to provide clarification and guidance for 2021 Schedules K-2 and K-3 (Form 1120-S). The changes relate to the section entitled "Who Must File" and address the requirement for Schedule K-2 and K-3 completion for shareholders who may need certain information from the S corporation to complete Form 1116. The additional instructions address each part of the schedules with new or amended instructions. These changes~~, which are anticipated to be incorporated into the 2022 instructions,~~ can be found at **www.irs.gov/forms-pubs/changes-to-the-2021-s-corporation-instructions-for-schedules-k-2-and-k-3-form-1120-s**. 2022 S Corporation Instructions for Schedules K-2 and K-3 (Form 1120-S), dated December 5, 2022, provide a *domestic filing exception* and a *Form 1116 exemption exception* for filing and furnishing Schedules K-2 and K-3 for tax years beginning in 2022. Tax professionals should review the 2022 Instructions for these exceptions. Penalties may apply for filing Form 1120-S without all required information or for furnishing Schedule K-3 to shareholders without all required information. See *Penalties* on Page D-1 for more information.

Estimated tax requirements. Shareholders pay estimated tax for their individual returns. The S corporation pays estimated tax only if corporate-level taxes apply [IRC Sec. 6655(g)(4)].

C Corporation vs. S Corporation

An eligible domestic corporation can elect to be taxed as an S corporation. An S corporation generally does not pay federal income tax—its profits and losses pass through directly to shareholders. This avoids the C corporation double tax, and allows shareholders to deduct corporate losses on their individual returns.

For tax purposes, S corporations are treated similar to partnerships. Many rules governing S corporations are intended to subject S corporation shareholders to the same tax treatment as partners.

An S election can be useful in a corporation's early years, since losses pass through to shareholders.

	C Corporation	S Corporation
Taxation	Double taxation of profits. Income is taxed at the corporate level; profits distributed as dividends are taxed at the individual level.	Profits are passed through directly to shareholders, escaping corporate-level tax. Qualified business income (QBI) from a taxpayer's qualified businesses is eligible for a QBI deduction. See *Qualified Business Income (QBI) Deduction* on Page D-2.
Dividends	Dividends paid by a C corporation are generally taxed to the individual at the same rate as long-term capital gains (0%, 15% or 20%).	S corporation earnings passed through to a shareholder are taxed as ordinary income.
Ordinary Losses	C corporation losses are not passed through to shareholders. Losses can be deducted only at the corporate level as NOL carrybacks (for certain entities) and carryforwards.	Losses are passed through directly to shareholders. Current-year losses are deductible up to the shareholder's basis in S corporation stock and loans to the S corporation. **Note:** For tax years 2021–2028, the excess business losses of a taxpayer other than a C corporation are not allowed for the year [IRC Sec. 461(l)].
Capital Gains	Taxed at the same rate as ordinary income.	Pass through to shareholders and are eligible for favorable capital gain tax rates for individuals.
Capital Losses	Allowed only to the extent of capital gains. Net capital losses are carried back three years and forward five years.	Pass through to shareholders. Capital losses are deductible subject to limitations on the shareholder's return.

Qualified Business Income (QBI) Deduction

The TCJA added IRC Sec. 199A, which applies to tax years 2018–2025. Under this provision, individuals, estates, and trusts may deduct up to 20% of their QBI from sole proprietorships (including farms) and pass-through entities.

Observation: IRC Sec. 199A is intended to provide tax relief to businesses not benefitting from the reduction in the top corporate rate from 35% to 21%. Thus, pass-through businesses (S corporations, partnerships, and LLCs) as well as sole proprietorships (including single-member LLCs) are eligible for the deduction. The rules are complex and subject to phase-outs and limits. Understanding the mechanics of the QBI deduction is essential to effective planning to maximize its tax benefit. [See *Qualified Business Income (QBI) Deduction* on Page F-4 for additional information.]

S corporation/shareholder considerations. When applying the QBI rules to S corporations and shareholders, keep the following in mind:

- *The deduction applies at shareholder level,* but the shareholder's tax basis in the S corporation is not reduced by the QBI deduction [Reg. 1.199A-1(e)(1)]. Each shareholder takes into account his allocable share of the S corporation's QBI from each of its businesses. Also, for computing the wage/investment limit on QBI, shareholders take into account their allocable shares of the S corporation's W-2 wages and Unadjusted Basis Immediately after Acquisition (UBIA) of qualified property.
- *S corporations must provide information on Schedule K-1*, including information regarding shareholders' shares of QBI, W-2 wages, and investment in qualified property for each of their qualifying businesses (as defined for the QBI rules) and whether any of those businesses are specified service trades or businesses (SSTBs). S corporations must also report any amounts reported to them by pass-through entities, as well as any qualified REIT dividends or qualified PTP income (or loss) they received [Reg. 1.199A-6(b)(3)]. This may require capturing new data in the accounting system. If the S corporation fails to report this information, the shareholder's share (and the share of any upper-tier indirect owner) of each unreported item of positive QBI, W-2 wages, or UBIA in qualified property attributable to the entity's businesses will be presumed to be zero [Reg. 1.199A-6(b)(3)(iii)].
- *Items excluded from QBI include* reasonable compensation paid to a taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business [IRC Sec. 199A(c)(4)]. Thus, reasonable compensation received by an S corporation shareholder is excluded from the shareholder's QBI, but the compensation reduces the S corporation's QBI if it is deductible and allocable to the business [Reg. 1.199A-3(b)(2)(ii)(H)].
- *Previously disallowed losses or deductions* (for example, under the at-risk or passive activity loss rules, or due to the limits on S corporation losses due to lack of basis) are taken into account for computing QBI, except for losses or deductions that were disallowed, suspended, limited or carried over from years ending before 2018.
- *Determining whether a taxpayer is engaged in a SSTB* is a critical step since income from such a business is not QBI unless the taxpayer's taxable income is at or below an annually adjusted threshold. Whether the business is a SSTB is determined at S corporation level [Reg. 1.199A-6(b)(3)(i)(B)].
- *Shareholder's share of S corporation's W-2 wages* is determined in same manner as shareholder's share of S corporation's wage expense. Each shareholder's share of qualified property is a share of the unadjusted basis proportionate to the ratio of shares in the S corporation held by the shareholder on the last day of the tax year over the total issued and outstanding shares of the S corporation [Reg. 1.199A-2(a)(3)(iii)].

Strategy: S corporations may be able to increase the wage/investment limit by paying their shareholder-employees a salary. However, the amount paid out as salary reduces the S corporation's QBI. So, there is a point at which the increase in the wage/investment limit due to paying salary is more than offset by the reduction in the QBI deduction. This point depends on the amount of wages paid to nonowners and any qualified property (since these also potentially affect the wage/investment limit). Also, S corporations must pay their shareholders reasonable compensation, so merely computing the wage amount that maximizes the QBI deduction may not meet the reasonable compensation requirement. The preamble to the proposed regulations clarified that even if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are still prevented from including an amount equal to reasonable compensation in their QBI.

Note: The final regulations did not provide additional guidance with respect to what constitutes reasonable compensation for a shareholder-employee of an S corporation.

Observation: S corporations may have an advantage over partnerships with respect to the wage/investment limit as they may be able to increase the limit by paying their shareholder-employees a salary that qualifies as reasonable compensation. Partners in a partnership are not considered employees and therefore cannot be paid W-2 wages, and guaranteed payments are not considered wages for QBI purposes.

<table>
<tr><th colspan="4">2022 Employer and Self-Employed Retirement Plan Chart</th></tr>
<tr><th>Defined-Benefit</th><th>Defined-Contribution (Profit-Sharing)</th><th>401(k)</th><th>403(b)</th></tr>
<tr><td colspan="3">Any employer.</td><td>Tax-exempt religious, charitable, or educational organizations.</td></tr>
<tr><td colspan="3">Employees at least age 21 with one year of service (1,000 hours).</td><td>Employees[7] who work 20 or more hours per week, do not participate in another 401(k), 457 or 403(b) plan, and will contribute more than $200 per year.</td></tr>
<tr><td>Actuarially determined contribution. Maximum benefit payout limited to 100% of average compensation for the three consecutive years of highest compensation (limited to $305,000), but not to exceed $245,000.[8]</td><td>Contributions per participant up to lesser of 100% of compensation or $61,000. Employer deduction limited to 25% of aggregate compensation (limited to $305,000 per employee) for all participants (20% of net SE income after SE tax deduction for self-employed).[8]</td><td>Employee elective deferrals limited to $20,500 (additional $6,500 if age 50 or older at end of the year). Employer deduction limited to 25% of combined wages of all employees (elective deferrals do not reduce wages for the 25% limit). Combined employer contributions and employee elective deferrals per employee limited to lesser of 100% of wages or $61,000 (additional $6,500 for employees age 50 or older by year-end).[8]</td><td>Employee elective deferrals limited to $20,500 (additional $6,500 if age 50 or older at end of the year). Special formula applies to additional employer contributions based on years of service. Combined employer contributions and employee elective deferrals per employee limited to lesser of 100% of wages or $61,000 (additional $6,500 for employees age 50 or older by year-end).[8]</td></tr>
<tr><td colspan="4">10% of distribution. (See Exceptions to 10% Withdrawal Penalty Before Age 59½ on Page K-6.)</td></tr>
<tr><td colspan="4">For self-employed and >5% owners, by April 1 of the year following the year the account owner turns age 72. For all other employees, April 1 of the year following the year the account owner turns age 72 or retires, whichever is later.</td></tr>
<tr><td colspan="2">Return due date, including extensions for profit-sharing plan contributions. 8½ months after year-end for defined benefit plan contributions.
Note: Qualified retirement plans adopted after the close of a tax year but before the due date (including extensions) of the tax return may be electively treated as having been adopted on the last day of the tax year.</td><td colspan="2">For employer contributions, return due date including extensions.[9]
Note: Qualified retirement plans adopted after the close of a tax year but before the due date (including extensions) of the tax return may be electively treated as having been adopted on the last day of the tax year.</td></tr>
<tr><td>Yes</td><td>No</td><td colspan="2">Generally no.</td></tr>
<tr><td colspan="4">Yes, if plan permits. Must pay back in five years (unless used to buy a principal residence). Qualified plans are prohibited from making plan loans through credit cards or similar arrangements.</td></tr>
<tr><td>Yes</td><td>Yes</td><td>Yes</td><td>Yes</td></tr>
<tr><td colspan="2">Employers are subject to a 10% excise tax on nondeductible (excess) contributions, unless an exception applies.</td><td colspan="2">Employee's elective deferral: No penalty or tax if 2022 excess is withdrawn by April 18, 2023 (but allocable earnings are taxable in year withdrawn). If not withdrawn by April 18, 2023, excess is taxed twice—once in the year of excess contribution and again when distributed because no cost basis is allowed for excess contribution.
Employer's contribution: 10% penalty on excess contributions (resulting from plan failing average deferral percentage test) unless distributed (with earnings) to highly compensated employee(s) within 2½ months after the close of the plan year (taxable to employee in year of deferral). Failure to distribute excess within 12 months after close of plan year results in plan failing to qualify for that plan year and all subsequent plan years for which the excess contributions remain uncorrected.</td></tr>
<tr><td colspan="4">[7] Includes self-employed ministers.
[8] Nondiscrimination rules may affect contributions/deferrals for certain employees. For plan years beginning after 2019, the maximum default rate for automatic safe harbor enrollment is increased from 10% to 15%. However, the rate remains at 10% for the initial year that the deemed election applies to a participant.
[9] The Tax Code does not specify when the employer is required to deposit employee elective deferrals into the employee's account. However, under ERISA regulations, employee elective deferrals must be contributed to the employee's 401(k) plan account as soon as reasonably can be segregated from the employer's general assets, but not later than the 15th business day of the month immediately after the month in which the contributions either were withheld or received by the employer.</td></tr>
</table>

Advantages to Employer and Self-Employed Plans

Qualified plans, SEPs, and SIMPLEs:

- Contributions are generally tax deductible by the contributor and tax deferred for the plan participant. Earnings on contributions are tax deferred until withdrawn.
- Maximum contributions (including SEPs and SIMPLEs) are generally greater than IRAs.

SEPs and SIMPLEs:

- Easy to set up and maintain.
- Allow plan participant to choose how funds are invested as opposed to a plan administrator through employer.
- Participant is always 100% vested in the plan.

SEPs:

- No annual reporting requirements; easy to administer.
- Do not require recurring contributions.

SIMPLEs: Similar to 401(k) employee elective deferral and employer matching, without complex nondiscrimination and "top-heavy" rules.

401(k) and 403(b) plans:

- Employers allowed to match employee contributions; employee is generally fully vested sooner than with other qualified plans.
- Plan is managed by professionals.
- Easy for employees—contributions through payroll reductions.
- Certain tax-free borrowing from plan is permitted.

Exceptions to 10% Withdrawal Penalty Before Age 59½

Note: Distributions treated as a return of nondeductible contributions, distributions of excess contributions or deferrals, and distributions of excess aggregate contributions to meet nondiscrimination requirements are not subject to the 10% additional tax.

Form 5329 Number	Applies to distributions from:	Exception
01	Qualified plan	Distribution made to an employee after separating from service in or after the year he reaches age 55 (age 50 for qualified public safety employees).
02	Qualified plan or IRA	Distribution is part of a series of substantially equal periodic payments made over the life expectancy of the participant or joint lives of participant and his beneficiary.
03	Qualified plan or IRA	Distribution made due to total and permanent disability.
04	Qualified plan or IRA	Distribution made due to death.
05	Qualified plan or IRA	Distribution to the extent the individual's unreimbursed medical expenses exceed 7.5% of his AGI.
06	Qualified plan	Distribution made to an alternate payee pursuant to a qualified domestic relations order (QDRO).
07	IRA	Distribution to pay for health insurance premiums for certain unemployed individuals.
08	IRA	Distribution to the extent of the qualified higher education expenses for the year of the taxpayer, spouse, child, or grandchild.
09	IRA	Distribution for first-time home purchases (no home ownership in prior two years). Exception limited to $10,000 (lifetime).
10	Qualified plan or IRA	Distribution due to an IRS levy on the qualified plan or IRA. The exception will not apply if funds are withdrawn to avoid a levy or to satisfy a levy on other property.
11	Qualified plan or IRA	Distribution to reservists while serving on active duty for at least 180 days.
12	Qualified plan or IRA	Distribution incorrectly indicated as early by code 1, J, or S in box 7 of Form 1099-R.
13	457 plan	Distribution from a Section 457 plan, which isn't a rollover from a qualified plan.
14	Qualified plan	Distribution from an employer plan to an employee (1) who separated from service on or before 3/1/86; (2) who as of 3/1/86, had his entire interest in pay status under a written election providing a specific schedule for the distribution of the entire interest; and (3) whose distribution is being made under the written election.
15	Qualified plan	Distribution that is dividend paid with respect to stock described in IRC Sec. 404(k).
16	Qualified plan or IRA	Distribution from annuity contract that is allocable to investment in the contract before 8/14/82. See Pub. 575 for additional exceptions that apply to annuities.
17	Qualified plan	Distribution of phased retirement annuity payments to federal employees. See Pub. 721.
18	Qualified plan	Permissible withdrawals under IRC Sec. 414(w).
19	Qualified plan or IRA	Distribution for the birth or adoption of a child (up to $5,000 per parent, per child).

Law Change Alert: The Consolidated Appropriations Act, 2023, exempts from the 10% additional tax on early distributions from qualified plans and IRAs up to $22,000 for *qualified disaster recovery distributions* made within 180 days of a federally declared disaster occurring on or after January 26, 2021 [IRC Sec. 72(t)(2)(M) and (t)(11)]. Distributions are included in income ratably over a three-year period, but can be repaid within three years and not included in income.

Annual Lease Value (ALV) Method

ALV amounts are based on the auto's FMV on the first day made available to the employee for personal use. The personal-use percentage (based on miles driven during the year) of the ALV amount is the employee's taxable income from personal use of the car. Once adopted, the ALV method must continue for that car, except that the commuting valuation rule may be used for any period that the auto qualifies.

The car's FMV is redetermined (1) on January 1 (or the beginning of special accounting period) of the fifth tax year and (2) if the vehicle is transferred to another employee.

Prorated annual lease value. When the auto is available for at least 30 days but less than a full year, the ALV amount from the table is pro-rated based on the number of days the car was available during the year. The personal-use percentage is then applied to the pro-rated amount to calculate the value of the employee's personal use.

Auto Lease Value Table
Reg. 1.61-21(d)(2)

Automobile FMV	*Annual Lease Value*
$ 0 to 999	$ 600
1,000 to 1,999	850
2,000 to 2,999	1,100
3,000 to 3,999	1,350
4,000 to 4,999	1,600
5,000 to 5,999	1,850
6,000 to 6,999	2,100
7,000 to 7,999	2,350
8,000 to 8,999	2,600
9,000 to 9,999	2,850
10,000 to 10,999	3,100
11,000 to 11,999	3,350
12,000 to 12,999	3,600
13,000 to 13,999	3,850
14,000 to 14,999	4,100
15,000 to 15,999	4,350
16,000 to 16,999	4,600
17,000 to 17,999	4,850
18,000 to 18,999	5,100
19,000 to 19,999	5,350
20,000 to 20,999	5,600
21,000 to 21,999	5,850
22,000 to 22,999	6,100
23,000 to 23,999	6,350
24,000 to 24,999	6,600
25,000 to 25,999	6,850
26,000 to 27,999	7,250
28,000 to 29,999	7,750
30,000 to 31,999	8,250
32,000 to 33,999	8,750
34,000 to 35,999	9,250
36,000 to 37,999	9,750
38,000 to 39,999	10,250
40,000 to 41,999	10,750
42,000 to 43,999	11,250
44,000 to 45,999	11,750
46,000 to 47,999	12,250
48,000 to 49,999	12,750
50,000 to 51,999	13,250
52,000 to 53,999	13,750
54,000 to 55,999	14,250
56,000 to 57,999	14,750
58,000 to 59,999	15,250
If FMV > $59,999, ALV equals (.25 × FMV) + $500.	
Employer-provided fuel must be added at FMV or at 5.5¢ per mile.	

Daily lease value. If the auto was available for personal use for less than 30 days, figure the daily lease value by multiplying the ALV by a fraction, using four times the number of days of availability as the numerator and 365 as the denominator [Reg. 1.61-21(d)(4)]. However, employers can elect to treat the auto as having been available for 30 days (even though the actual period of availability was less than 30 days), which results in a lower imputed income amount whenever the car is available for personal use for more than seven (but less than 30) days.

Determining the car's FMV. If the employer bought the car in an arm's-length transaction, its cost (including applicable sales tax, title fee, and other transaction costs) can be used as FMV.

If the employer leases the auto, the manufacturer's suggested retail price (including applicable sales tax, title fees, and other transaction costs) less 8% can be used as the safe-harbor FMV figure. Or, a leased auto's FMV can be determined by reference to the retail value of the auto as reported by a nationally recognized pricing source. Finally, for leased autos, the employer can use the manufacturer's invoice price (including applicable options) plus 4% as the auto's FMV (Notice 89-110).

Commuting Value Method

In rather limited circumstances, an employee's personal use of a company car can be valued at $3 per round-trip to and from work ($1.50 per one-way commute) [Reg. 1.61-21(f)]. If multiple employees commute in the same vehicle, the imputed personal use income for each is $3 per round trip/$1.50 per one-way commute.

Requirements for Commuting Value Method

Requirement	*Description*
Employee required to commute in the employer provided vehicle	For valid business reasons, the employee is required to commute to work in the vehicle (for example, a job requires 24-hour on-call availability).
Personal use prohibited	The employer has an enforced, written policy that prevents the employee (and/or anyone whose use would be taxable to the employee, such as a spouse) from using the car for personal reasons other than commuting to and from work.[1]
No personal use occurs	The employee does not actually use the car for personal use other than commuting.[1]
Employee is not a control employee	A control employee is: • Officer with compensation ≥ $120,000 (for 2022);[2] • Director; • Employee with compensation ≥ $245,000 (for 2022) or[2] • Owner of 1% or more of the employer's equity, capital or profits.

[1] *De minimis* personal use (such as a trip to the grocery store on the way home from work) is allowed.
[2] Notice 2021-61.

Safety Requirement for Commuting

An employer can deduct expenses for providing transportation between an employee's residence and principal place of employment only when it is necessary for ensuring the safety of the employee when unsafe conditions, as described in Reg. 1.61-21(k)(5), exist for the employee [IRC Sec. 274(l)(1); Reg. 1.274-14(b)]. Other expenses for such travel are specifically disallowed.

Clearly, unsafe conditions exist in situations when a bona fide business-oriented security concern exists regarding an employee's safety. If the employer provides security protection, such as armor plating or a chauffeur trained in evasive driving techniques, the value of the security protection may be excluded as a working condition fringe benefit, even during personal trips or commuting, if the employer has a bona fide business-related security concern

[Reg. 1.132-5(m)]. The regulation lists situations that demonstrate when a bona fide security concern exists.

Cents-per-Mile Method

Sometimes, the standard business mileage rate can be used to value an employee's personal use of a company car [Reg. 1.61-21(e); Rev. Proc. 2019-46]. If the employer does not provide or pay for fuel, the cents-per-mile rate can be reduced by up to 5.5¢ per mile. The standard business mileage rate for the period January 1–June 30, 2022, is 58.5¢ per mile (Notice 2022-3). For the period July 1–December 31, 2022, the rate is 62.5¢ per mile (Ann. 2022-13).

Requirements for Cents-per-Mile Method

Requirement	*Description*
Period of Use	The employer must expect that the car will be used regularly for business for the entire year (or, if less, the time the employer owns the car) OR
OR	
Required Mileage	The car must be driven (primarily by employees) at least 10,000 miles (pro-rated if not owned the entire year) during the calendar year.
Cap on FMV	The car's FMV may not exceed $51,100 (2022 amounts per Notice 2022-3).

In general, the employer must adopt the cents-per-mile method for an auto by the first day an employee uses it for personal purposes. Once the cents-per-mile method is used for an auto, it must be used as long as that auto is eligible for it. But, if an auto later qualifies for the commuting value method, that method can be used even though the cents-per-mile method was used earlier.

Note: See *Maximum FMV using the fleet-average or vehicle cents per-mile valuation methods* on Page K-20

Recordkeeping Requirements

An employee may not exclude from income any portion of the value of an employer-provided automobile unless the use is substantiated by records.

The records should contain (Temp. Reg. 1.274-5T):
- Date of each use.
- Mileage per trip.
- Business purpose of the trip.
- Description of destination, business purpose, benefit derived, etc. (for travel outside tax home area).
- Total mileage for the year.

Records must be kept at or near the time of the use. If there are no written records, the employee may provide a statement containing information related to the automobile's use or may provide other corroborative evidence sufficient to establish use. However, without written records, the IRS may disallow the exclusion from income.

Reporting Employee Personal Use on Business Tax Return

When the personal use of a company car is included in an employee's wages as taxable compensation, the employer recovers the cost of the car as if it were used entirely for business purposes. Section A in Part V of Form 4562 on the employer's tax return would then show business-use percentage as 100%.

Retirement Plan Law Changes

SECURE Act

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted December 20, 2019, contained provisions affecting individuals, employer plans, plan administration, and penalties. Here is a quick summary of the most relevant retirement plan provisions—
- Raises the required minimum distribution (RMD) age from 70½ to 72 effective for individuals who reach age 70½ after December 31, 2019.
- Modifies the post-death RMD rules for those who die after December 31, 2019 (with certain exceptions).
- Allows penalty-free plan withdrawals for expenses related to the birth or adoption of a child after December 31, 2019.
- Expanded the definition of *compensation* for IRA contribution limit purposes. Effective December 20, 2019, difficulty-of-care payments are treated as compensation for determining nondeductible IRA contributions limits even though these payments are excluded from gross income. For defined contribution plans, this applies to plan years beginning after December 31, 2015.
- Provides that compensation for IRA contribution limit purposes includes any amount included in an individual's gross income and paid to the individual in the pursuit of graduate or postdoctoral study for years beginning after December 31, 2019.
- Allows a small employer automatic enrollment credit for certain retirement plans for tax years beginning after December 31, 2019.
- Annual limit on the credit for small employer pension plan start-up costs increased to a maximum of $5,000 per year for plan years beginning after December 31, 2019.
- Increases the maximum default rate under the automatic enrollment safe harbor from 10% of pay to 15% for plan years beginning after December 31, 2019.
- Requires expanded coverage by 401(k) plans for long-term part-time employees who have worked more than 500 hours per year with the employer for at least three consecutive years for plan years beginning after December 31, 2020.
- Eases notice requirements and amendment timing rules to facilitate adoption of nonelective contribution 401(k) safe harbor plans for plan years beginning after December 31, 2019.
- Allows qualified plans adopted by the filing due date to be treated as in effect as of the close of the tax year effective for plans adopted for tax years beginning after December 31, 2019.
- Allows a group of qualified plans to file a consolidated Form 5500 effective for plan years beginning after December 31, 2021.
- Increases the penalties for failure to file retirement plans to $250 per day for returns due after December 31, 2019.

Law Change Alert: For coverage of the SECURE 2.0 Act of 2022, see the summary table posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder**.

Qualified Retirement Plans

A qualified retirement plan is one of the best tax-saving tools available, since the plan contributions are deductible by the employer and tax deferred to the employee. The rules governing retirement plans are lengthy and complex. Some of the general rules are covered below. For more coverage see the *IRA and Retirement Plan Quickfinder® Handbook*.

An employer may adopt a qualified retirement plan retroactively to the last day of a plan year if the plan is adopted by the due date (including extensions) of the employer's tax return for the tax year.

Qualified retirement plans fall into two basic categories:
- Defined-contribution plans.
- Defined-benefit plans.

1) *Defined-contribution plans* provide benefits based on the amount contributed to an employee's individual account plus any income, expenses, gains, losses, and forfeitures of other employees that are allocated to the account [IRC Sec. 414(i)]. Plan contributions are determined by formula and not by actuarial requirements (except for target benefit plans).

The IRS gives automatic consent to taxpayers that want to change their accounting method to use the 12-month rule for prepaid expenses. See Rev. Procs. 2006-12 and 2006-37 for guidance. Taxpayers must follow the automatic change procedures of Rev. Proc. 2015-13 (see discussion that follows). Also see *Intangible Assets* on Page O-16 for more information.

Change in Accounting Method

To change an accounting method, a taxpayer generally must receive IRS consent. Under certain circumstances, automatic consent is available. Form 3115 (Application for Change in Accounting Method) is used to request a change in method.

User fees. If the change is not automatic, a user fee of $11,500 applies for all requests received by the IRS after February 2, 2022 (Rev. Proc. 2022-1). Reduced user fees of $8,500 and $3,000 are available for businesses with gross income of less than $1 million or $250,000 respectively. See Rev. Proc. 2022-1, Appendix A, for more information about user fees (the IRS updates and issues a new Rev. Proc. each year). There is no fee for filing Form 3115 if the change in accounting method is eligible for automatic consent.

Note: All user fee payments must be made through **www.pay.gov** (Rev. Proc. 2022-1).

Consent required to change accounting method. Rev. Proc. 2015-13 sets forth procedures for obtaining a nonautomatic change in accounting method.

Automatic consent to change accounting method. Rev. Proc. 2015-13 also sets forth procedures for obtaining automatic consent for a change in accounting method. Highlights of the procedure include:

- Provisions exist for limited relief for late filing of the application on an amended return within six months of the original due date.
- The application must clearly identify the method to be changed by including the designated automatic accounting method change number (from Rev. Proc. 2022-14, as modified through the date of this publication by Rev. Proc. 2022-23) on the appropriate line of the Form 3115.

Note: One copy of Form 3115 (signed and dated) may be faxed to (844) 249-8134, starting July 31, 2020 until further notice (versus mailing to the IRS Ogden, Utah office). This IRS temporary procedure change applies only to taxpayers requesting consent to make a change in accounting method under the automatic change procedures. Taxpayers will still need to submit two copies of the Form 3115 to the IRS. The original is attached to the income tax return for the year of change. The return must be filed by the due date (including extensions), and the copy filed with the IRS must be filed no later than the tax return. Neither copy may be filed before the first day of the tax year of change.

Many automatic accounting method changes are contained in Rev. Proc. 2022-14, as modified through the date of this publication by Rev. Procs. 2022-23 and 2023-11, including (but not limited to):

- Changing the timing of incurring liabilities for certain employee commissions.
- Depreciation method changes [late elections or revocation of elections, qualified improvement property, and tangible property under IRC Sec. 168(g)].
- Changes to treatment of research and experimental expenditures.
- Changes to costs of computer software.
- Changes to Uniform Capitalization (UNICAP) treatment.
- Interest capitalization.
- Deduction of amounts owed to a Controlled Foreign Corporation (CFC).
- Change from accrual to cash method for specified transportation industry taxpayers.
- Changes in basis of computing reserves under IRC Sec. 807(f).
- Changing to an overall cash method for farmers.
- Deducting accrued bonus and vacation pay in the year the all events test has been met to establish the liability and the pay is received by the employee by the 15th day of the third month following year end.
- Changing from cash to accrual method for specific items.
- Advance payments, including certain gift cards.
- California franchise tax deductions.
- Change in connection with whether the recurring-item exception to the economic performance rules of an accrual method taxpayer applies with respect to the prepayment of lease or service contract extending over two years (Rev. Rul. 2012-1).
- Changes in connection with the tangible property regulations related to accounting methods for amounts paid to acquire, produce or improve tangible property (Rev. Proc. 2014-16).
- Changes in connection with the tangible property regulations related to dispositions of tangible depreciable property (Rev. Procs. 2014-17 and 2014-54).
- Changes by a taxpayer using the retail inventory method to comply with regulations under Reg. 1.471-8 clarifying a taxpayer's treatment of certain sales-based vendor allowances, margin protection payments, permanent markups and markdowns, and temporary markups and markdowns when determining the cost complement (Rev. Proc. 2014-48).
- Change from applying the Section 263A UNICAP rules to certain citrus replanting costs to instead deducting such costs (Rev. Proc. 2018-35).
- Changes specified in Rev. Proc. 2018-40, as modified by Rev. Proc. 2022-9 as discussed at *Automatic accounting method change* on Page L-2.
- Change to an overall accrual method by an eligible terminated S corporation for which the resulting positive or negative Section 481(a) adjustment is taken into account over a six-tax year period beginning with the year of change [IRC Sec. 481(d); Rev. Proc. 2018-44].
- Changes for adopters or early adopters of the FASB "New Standards" for identifying performance obligations, allocating transaction price to performance obligations, and/or considering performance obligations satisfied (see discussion below) (Rev. Procs. 2018-29 and 2018-49).
- Changes to comply with Section 451(b) as discussed at *Accrual method income* on Page L-1 (Rev. Proc. 2018-60). Also see CCA 201852019.
- Changes to the recovery period for qualified improvement property (QIP) placed in service during 2018 or 2019 were made by a technical correction in the CARES Act. QIP is now correctly classified as 15-year property (20-year for the ADS). Taxpayers who used a 39-year life as originally required must change to the 15-year or 20-year recovery period. (Rev. Proc. 2020-25, as modified by Rev. Proc. 2020-50).
- Changes for specified Research and Experimental (R&E) expenditures to comply with IRC Sec. 174, as amended by the TCJA. The TCJA requires that specified R&E expenditures paid or incurred in tax years beginning after 12/31/21 must be capitalized and amortized over a five-year period (Rev. Proc. 2023-11).

Section 481 adjustment. When a business changes its accounting method, an income adjustment is required under IRC Sec. 481 to make sure income and expenses are not duplicated or omitted. A positive adjustment resulting from an automatic consent to change of accounting method is generally recognized over four years. Under a *de minimis* rule set forth in Rev. Proc. 2015-13, a positive adjustment of less than $50,000 may be recognized in the year of change. A negative adjustment (in favor of the taxpayer) is fully recognized in the year of change. Guidance for a Section 481(a) adjustment for a nonautomatic method change and for an automatic method change is provided by Rev. Proc. 2015-13, Section 7.03.

Example: Don owns Goodware Sales as a sole proprietor. Don has been using the hybrid method of accounting—accrual for purchases and sales of merchandise and cash for other income and expenses.

In 2022 Don decides to change to the cash method of accounting under Rev. Proc. 2022-14 Balance sheet items include the following:

Accounts receivable	$ 100,000
Accounts payable	(40,000)
Negative 481 adjustment	$ 60,000

By switching to the cash method of accounting, Don deducts a Section 481 adjustment of $60,000 for tax year 2022.

In computing the net Section 481(a) adjustment, consider all relevant accounts. For example, the Section 481(a) adjustment for a change in the proper time for deducting salary bonuses under IRC Sec. 461 should reflect any necessary adjustments for amounts of salary bonuses capitalized to inventory under IRC Sec. 263A (Rev. Proc. 2015-13, Sec. 3.15).

A small business taxpayer changing to the cash method for a trade or business must include open accounts receivable in income. An *open accounts receivable* is any receivable that is due in full in 120 days or less and not subject to the mark to market rules for dealers in securities under IRC Sec. 475 [Rev Proc. 2018-40, Sec. 3.02(1)].

A partnership or corporation reports a Section 481 adjustment on the "Other income" line of the tax return.

Guidance on financial revenue recognition standards. In Rev. Procs. 2018-29 and 2018-49, the IRS provides procedures for taxpayers to obtain automatic consent to change a method of accounting used to recognize income for federal tax purposes to a method in which the taxpayer uses the new financial accounting standards for income recognition [FASB's Revenue From Contracts With Customers (Topic 606)] to (1) identify performance obligations, (2) allocate transaction price to performance obligations and/or (3) consider performance obligations satisfied.

Tax Year

The tax year is the period for which taxable income will be computed and reported.

An entity adopts a tax year when it files its first tax return. The tax year can be a calendar or fiscal year. Once a tax year is adopted, IRS approval is generally required to change it, even if changing from an improper tax year. See *Changing a Tax Year* on Page L-6.

Calendar Tax Year

Generally, any entity can adopt a calendar tax year. A calendar year *must* be used if a taxpayer [IRC Sec. 441(g)]:

1) Does not keep adequate records,
2) Has no annual accounting period,
3) Has an accounting period that does not qualify as a fiscal tax year, or
4) Is required to use a calendar year by a provision of the Code or Regulations.

Fiscal Tax Year

A fiscal year is either [IRC Sec. 441(e)]:

1) A 12-month period ending on the last day of any month except December or
2) A 52–53 week tax year.

52–53 week tax year. A 52–53 week tax year always ends on the same day of the week, and must end either on the date that day last falls in a particular calendar month, or the date that day falls nearest to the last day of a particular calendar month.

Example #1: ZAP Corporation elects a 52–53 week tax year that will end on the last Friday in October. In 2022, ZAP's tax year ends on Friday, October 28.

Example #2: TAB Corporation elects a 52–53 week tax year that will end on the Friday closest to the last day of November. In 2022, TAB's tax year ends on Friday, November 25.

When computing depreciation or amortization, a 52-53 week tax year is generally considered a 12-month tax year.

To elect a 52–53 week tax year, attach a statement to the tax return showing [Reg. 1.441-2(b)(1)]:

1) The day of the week on which the tax year will always end,
2) Whether it will end on the last such day of the week in the calendar month or on the date such day of the week occurs nearest the end of the month, and
3) The month in which (or with reference to which) the tax year will end.

C corporations and estates generally can elect a fiscal tax year without any special restrictions. The fiscal year is chosen when the first tax return is filed.

Trusts must use a calendar tax year (but see *Tax year* on Page G-1 for a limited exception).

S corporations, PSCs and partnerships must use a "required tax year." See *Required Tax Year* on Page L-7.

Short Tax Year

A short tax year is a tax year of less than 12 months [IRC Sec. 443(a)].

The two situations that result in a short tax year are:

1) Entity is not in existence for an entire tax year such as the first or last tax return of a partnership or corporation.
2) Entity changes its accounting period.

Entity not in existence for an entire year. If the entity was not in existence for an entire year, the filing requirements and the tax computation generally are the same as if the return was for a full 12 months ending on the last day of the short tax year.

Example #1: AAA Corporation came into existence on September 9, 2021, and elected a fiscal year ending the last day of April. The C corporation has a short tax year for the period September 9, 2021 to April 30, 2022. The due date for the return is August 15, 2022.

Example #2: NOM Corporation, a calendar-year taxpayer, dissolved on July 21, 2022. The C corporation's final year is a short tax year for the period January 1 to July 21. The due date for NOM's final return is November 15, 2022.

The tax computation for the preceding examples is calculated as if the tax year was a full 12 months. However, depreciation will need to be figured under the short tax year rules. See Tab J for a discussion of short-year depreciation.

Changing a Tax Year

Changing a tax year generally requires IRS consent. The request for change of tax year is made by filing Form 1128 (Application To Adopt, Change, or Retain a Tax Year). Changes that require IRS consent are subject to user fees.

Certain changes are given automatic consent if requirements are met. Provisions for automatic change of tax year generally involve establishing a business purpose for a fiscal year or changing to a 52–53 week year.

The IRS has issued the following guidance to provide comprehensive information about changes in tax years:

Rev. Procs. 2002-37, 2006-45, and 2007-64. Automatic approval provisions for C corporations.

qualifies as "similar or related in service or use." This relaxed definition for replacement property allows business owners to postpone gain when starting a new business, even if the new business is different from the one operated before the disaster.

Replacement period. To postpone the gain, the property must be replaced within a specified period of time [IRC Sec. 1033(a)].

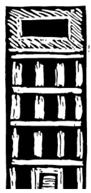
Replacement period begins on the earlier of:

1) Date on which the condemned property was disposed of or
2) Date on which the threat of condemnation began.

Replacement period ends two years after the close of the first tax year in which any part of the gain on the conversion is realized. *Exception:* Three-year replacement period for real property used in a trade or business or for investment.

Property acquired from related parties. Certain taxpayers must recognize gain on involuntary conversions if the replacement property is acquired from a related party, including [IRC Sec. 1033(i)]:

1) C corporations,
2) Partnerships in which C corporations own more than 50% of the capital or profits interest, and
3) Any other taxpayer, including individuals, if the realized gain is greater than $100,000.



Exception: Recognition of gain under these rules will not apply if the related party acquired the replacement property from an unrelated party during the replacement period. For definitions of related parties, see IRC Secs. 267(b) and 707(b)(1).

Electing to defer gain. A taxpayer is not required to defer recognition of gain on an involuntary conversion, but rather is allowed to elect to either defer recognizing the gain or recognize it in the current year. The election to defer the gain from income in the current year is made by excluding the deferred gain from income and attaching a statement to the return reporting all details of the conversion [Reg. 1.1033(a)-2]. Including the gain in income in the year of sale is an election to recognize the gain in that year.

See Tab 9 of the *Depreciation Quickfinder® Handbook* for more information on involuntary conversions.

Casualties

For 2018–2025, personal casualty losses in excess of personal casualty gains are deductible only if attributable to a federally declared disaster and are subject to AGI and dollar thresholds. Casualty losses on business property (other than employee property) and income-producing property are not subject to these limits. See Tab 5 in the *1040 Quickfinder® Handbook* for discussion of personal casualty losses and Tab 4 in the *Individuals—Special Tax Situations Quickfinder® Handbook* for an expanded discussion of disaster victims.

Disaster losses. A casualty loss occurring in, and attributable to, a federally declared disaster can be deducted in the year the disaster occurred or in the year preceding the loss [IRC Sec. 165(i)]. The election must be made on or before the date that is six months after the original due date for the taxpayer's federal tax return for the disaster year (without extensions). The taxpayer need not request a filing extension for the disaster year to benefit from this due date. The taxpayer makes the election to deduct the loss in the preceding tax year by deducting the loss on an original (if not yet filed) or amended return for the preceding year and attaching a specified election statement to the return. The election can be revoked within 90 days of its due date (Reg. 1.165-11; Rev. Proc. 2016-53).

See IRS Pubs. 547 (Casualties, Disasters, and Thefts) and 584-B (Business Casualty, Disaster, and Theft Loss Workbook) for additional discussion.

Condemnations

A condemnation is the process by which private property is legally taken for public use without the owner's consent. It is, in a sense, a forced sale with the owner as the seller and the condemning authority as the buyer.

To be a condemnation, one of the following must occur (Rev. Rul. 63-221):

1) *Threat of condemnation.* Official authorized to acquire property for public use informs the owner that there is a plan to acquire the property.
2) *Reports of condemnation.* Owner learns through the media that his property will be acquired for public use, and this report is confirmed by a representative of the government body or by the public official involved.

Example #1: Frank owns property along a public utility line. The utility company has the authority to condemn Frank's property. They notify Frank that they intend to acquire his property by negotiation or condemnation. Frank's property is under threat of condemnation when he receives their notice.

Example #2: Stan received a health department notice stating that his apartment building will be condemned unless repairs are made. His property is not under threat of condemnation because the notice does not relate to a condemnation of private property for public use.

Voluntary sales. If the taxpayer's property is under threat of condemnation, the taxpayer sells the property to someone other than the condemning authority, the buyer knows about the threat of condemnation and the buyer sells it to the condemning authority, such a *forced sale* also qualifies as a condemnation (Rev. Rul. 81-180).

A voluntary sale of property may be treated as a condemnation if the property had a substantial economic relationship to other property that is condemned. It must be shown that the two properties were one economic unit; suitable nearby property of a like kind to the condemned property is not available to continue doing business as before; and the sale proceeds must be used to acquire like-kind property (Rev. Rul. 59-361). The taxpayer must own both properties before the condemnation.

Easements

An easement is a legal right or privilege that one has in another's land, as the right of way. Granting or selling an easement is usually not a taxable sale of property, since legal title to the property has not changed hands. Instead, the amount received for the easement is subtracted from the basis of the property. If the amount received is more than the taxpayer's basis in the property, the excess is taxable as recognized gain. However, if a taxpayer transfers a perpetual easement for consideration and does not keep any beneficial interest in the property affected by the easement, the transaction is treated as a sale of property. If the easement affects only a specific portion of a tract of land, only the basis properly allocable to the affected portion is considered in determining gain or loss (Rev. Ruls. 59-121 and 68-291).

Example: Bruce purchases a 600-acre farm for $60,000. An easement of 20 acres is granted to an electric company for construction of a pole line. The basis of the easement for purposes of determining gain or loss is $2,000 [(20 acres ÷ 600 acres) × $60,000].

The character of a taxpayer's gain or loss from transferring a perpetual easement depends on how he used the land (trade or business, investment, etc.). The easement's holding period is measured by the land's holding period. If, for example, the property is used in a trade or business and held for more than one year, it is Section 1231 property and the easement gain is long-term.

If a taxpayer grants an easement under threat of condemnation, it is considered to be a forced sale, even though the taxpayer keeps the legal title to the property. The gain or loss is treated as a gain or loss from a condemnation.

If the taxpayer grants an easement for a finite term following which the easement would revert to the taxpayer, the transaction is a lease and not a sale [*Gilbertz*, 59 AFTR 2d 87-424 (10th Cir. 1987)].

Conservation easements. A landowner who grants a conservation easement is eligible for a charitable contribution deduction [IRC Sec. 170(h)]. The allowable deduction is generally the amount by which the FMV of the property drops as a result of the easement. To qualify, easement rights must be granted in perpetuity and must be granted to a qualified organization such as a governmental unit or local land trust.

The easement must also be granted for a qualified conservation purpose, such as:

1) Preservation of land areas,
2) Protection of natural habitat,
3) Preservation of historically important areas or structures, or
4) Preservation of open space.

Under Reg. 1.170A-14, *preservation of open space* includes easements granted "for the scenic enjoyment of the general public." Physical access to the property does not necessarily need to be granted, and the entire property does not need to be visible. For these reasons, a taxpayer with a view may realize tax benefits from granting a conservation easement without sacrificing enjoyment of owning the property.

Special rules for qualified conservation contributions. Qualified conservation contributions that are not deductible because of the applicable percentage-of-income limitation on total contribution deductions have a 15-year carryover period (rather than the usual five-year carryover period). For individual taxpayers, a conservation contribution is taken into account for purposes of the 50%-of-AGI-limitation (versus only 30% under the normal rules) base (100% in the case of qualified farmers and ranchers) only after taking into account all other contributions (which are subject to the five-year carryover period), saving this contribution for deduction in later years (Notice 2007-50). The special 100% limit also applies to corporate qualified farmers and ranchers for whom it is especially beneficial, as deductibility of donations by corporations is generally limited to 10% of taxable income [IRC Sec. 170(b)(1)(E) and (b)(2)(B)].

Caution: The IRS has announced that conservation easement transactions involving syndication of interests in pass-through entities and similar transactions are listed transactions (that is, presumed tax shelters) and therefore, they must be disclosed by the participants (investors) claiming a share of the charitable contribution deduction (Notices 2017-10, 2017-29, 2017-58; Ann. 2022-28; Prop. Reg. 1.6011-9). IRC Sec. 170(f)(19) and (h)(7) provide specific reporting requirements for, and deduction limitations on, qualified conservation contributions made by pass-through entities after December 29, 2022.

Abandonment or Worthlessness of Investment Property—Ordinary vs. Capital Loss

Sale of investment property at a loss is generally subject to capital loss limits. However, if nondepreciable investment property is abandoned or becomes worthless, the transaction may be eligible for deduction as an ordinary loss (Reg. 1.165-2).

Under the Regulations, ordinary loss treatment for worthless or abandoned property applies to transactions that do not constitute a sale or exchange, even if the property is a capital asset.

Establishing abandonment. A taxpayer must show intent to abandon an asset and must overtly act to abandon it. Under Reg. 1.165-1(b), the loss must be evidenced by closed and completed transactions, fixed by identifiable events and actually sustained during the tax year. For example, a taxpayer who deeded property to the taxing authorities was found to have abandoned the property [*Jamison*, 8 TC 173 (1947)].

Dispositions must be carefully structured to achieve the desired tax effects. For example, a loss on investment property that is properly abandoned is treated as an ordinary loss. However, if the same property is sold for $1, the loss is subject to capital loss limits.

Prior to enactment of the TCJA, an individual's deduction for abandonment or worthlessness of investment property was taken as a Section 165(a) miscellaneous itemized deduction on Schedule A of Form 1040, subject to the 2%-of-AGI floor. These deductions are suspended for tax years 2018–2025, so no tax benefit is available to individuals in these years.

Abandoned/worthless securities. While losses under IRC Sec. 165 generally are ordinary, IRC Sec. 165(g) provides that a capital loss results when a security that is a capital asset becomes worthless during the tax year. The worthless security is treated as if it was sold on the last day of the tax year. Some taxpayers have claimed ordinary losses under IRC Sec. 165(a) for abandoned securities, arguing that IRC Sec. 165(g) applies only when a security becomes worthless, not when it is abandoned. However, the IRS position is that, if the abandoned security is a capital asset, the loss is treated as a capital (not ordinary) loss on the last day of the tax year—the same as a worthless security. To abandon a security, a taxpayer must permanently surrender and relinquish all rights in the security and receive no consideration in exchange for the security [Reg. 1.165-5(i)].

Note: See Rev. Rul. 93-80 for information about worthlessness or abandonment of partnership interests.

Costs of abandoned business restructuring. Generally, costs incurred in investigating and pursuing mutually exclusive business restructurings (recapitalization, divestiture of business divisions, etc.) must be capitalized as part of the cost of the completed transaction. However, if such costs relate to a transaction that is not completed, they can be deducted under IRC Sec. 165 at the time the transaction is abandoned.

Asset Acquisitions

Form 8594; see also IRC Sec. 1060

Form 8594 (Asset Acquisition Statement Under Section 1060) is filed by both the seller and the buyer of a group of assets that constitutes an *applicable asset acquisition*. An applicable asset acquisition is any direct or indirect transfer of a group of assets that constitutes a trade or business in the hands of either the seller or the buyer, and the purchaser's basis in the assets is determined wholly by the amount paid for the assets. The purpose is to identify goodwill or going-concern value that could be attached to the sale price of the business.

Differences in the buyer and seller amounts on Form 8594 can give the IRS incentive to examine the transaction and make its own allocations. To avoid drawing attention to the transaction, the buyer and the seller can agree in writing to specific allocations and prepare the Forms 8594 according to those allocations.

The allocation is generally done under the rules of IRC Sec. 338 (b)(5) and Reg. 1.338-6 and is referred to as the *residual method* (discussed at *Allocation Using the Residual Method* on Page N-19). If a written agreement is entered into and that agreement differs from the residual method figures reported on Form 8594, the written purchase agreement will take precedence [*Peco Foods, Inc.*, 112 AFTR 2d 2013-5137 (11th Cir. 2013)]. As a practical matter, any taxpayer involved in an asset acquisition who has a cost segregation study done should do it before entering into a written agreement. The written agreement should match that cost segregation, and those figures should be used for Form 8594 reporting to avoid unwanted IRS scrutiny.

The taxpayer should be careful in assigning allocations, as the amounts agreed to become the tax bases of assets; changing allocations (for example, to assign more to a depreciable asset and less to land) could result in an accounting method change. Accounting method changes are discussed in Tab L.

Form 8594 is not required to be filed if:

1) The acquisition is not an applicable asset acquisition (as defined above),
2) The group of assets that constitutes a trade or business is exchanged for like-kind property in a transaction to which IRC Sec. 1031 applies (however, if IRC Sec. 1031 does not

What's New

Tab Q Topics

Inflation-Adjusted Amounts

For a summary of inflation-adjusted amounts for 2022 (plus 2023 and 2021 and prior years), see the *Business Quick Facts Data Sheet* on Page A-1.

Tax Legislation

CHIPS Act of 2022

On August 9, 2022, President Biden signed into law H.R. 4346, the Supreme Court Security Funding Act of 2022 (P.L. 117-167), which includes as its Division A the CHIPS Act of 2022. The CHIPS Act provides more than $52 billion for American semiconductor research, development, and production. The CHIPS Act includes new IRC Sec. 48D, which provides a 25% advanced Investment Tax Credit (ITC) for eligible investments in semiconductor manufacturing as well as for the manufacturing of specialized tooling equipment required for the semiconductor manufacturing process. Eligible taxpayers may elect to treat the credit as a payment against tax ("direct pay") and the credit is generally available for qualifying property placed in service after December 31, 2022 for which construction begins before January 1, 2027.

Inflation Reduction Act of 2022

On August 16, 2022, President Biden signed into law the Inflation Reduction Act of 2022 (H.R. 5376, P.L. 117-169). The Act includes a 15% corporate alternative minimum tax, a 1% excise tax on stock buybacks, and numerous environmental and green energy tax credits. The Act adds IRC Sec. 5000D, which imposes a new excise tax on sales by drug manufacturers, producers, and importers of "designated drugs" during the time that the manufacturer, etc., fails to enter into drug pricing agreements under the Social Security Act. The Act extends the current Premium Tax Credit (PTC) rules through 2025. The Act also increases the qualified small business payroll tax credit for research activities after 2022 [IRC Sec. 41(h)(4)(B) and (h)(5)(B) and IRC Sec. 3111(f)].

See the table *Inflation Reduction Act of 2022 (P. L. 117-169) Selected Tax Provisions* on Page Q-2 for a summary of selected tax provisions included in the Act.

Student Loan Relief

President Biden announced a three-part plan addressing student loan debt. The first part of the plan would allow $20,000 in debt forgiveness if a taxpayer went to college on a Pell Grant, or $10,000 for non-Pell Grant recipients. Private (non-federal) loans are not eligible for debt relief. Debt forgiveness applies only to those with adjusted gross income of less than $125,000 (single or MFS) or $250,000 (MFJ, HOH, or QW) in 2020 or 2021. Dependent students' eligibility for debt forgiveness is based on their parents' income. The plan's second part is an extension of the pause on student loan repayments one final time, until December 31, 2022. The third part is a modification to the income-based repayment plan rules. The Biden administration said those with undergraduate degrees and a Pell Grant would have their repayments capped at 5% of monthly income. For more information, go to **https://studentaid.gov/debt-relief-announcement/**. At the time of publication, this website indicated that application for debt forgiveness is open, but processing of debt discharges is paused. Tax professionals should monitor this website for developments. Expanded details on the debt forgiveness part of the plan are available at **https://studentaid.gov/debt-relief-announcement/one-time-cancellation**.

Consolidated Appropriations Act, 2023

On December 29, 2022, President Biden signed into law the Consolidated Appropriations Act, 2023 (P.L. 117-328). This omnibus spending bill includes the SECURE 2.0 Act of 2022, which contains many retirement provisions and a number of smaller non-retirement tax provisions. See the summary table posted to the *Handbook Updates* section of **tax.thomsonreuters.com/quickfinder**.

Notes

Inflation Reduction Act of 2022 (P. L. 117-169)
Selected Tax Provisions

Item	*IRC Sec.*	*Effective Date*	*New Law*	*Prior Law*
Energy Efficient Home Improvement Credit ***Formerly*** **Nonbusiness Energy Property Credit**	25C	Property placed in service after 2022.	A $1,200 annual credit is allowed for qualified energy-efficient improvements installed during the year and residential energy property expenditures paid or incurred. Credit equals 30% of the cost of the improvements and expenditures made during the year. An additional credit amount of $150 is available for a home energy audit. Credit amounts are limited to: • Any qualified energy property—$600 • Windows and skylights—$600 • Exterior doors—$250 and $500 in aggregate • Heat pump and heat pump water heaters, biomass stoves and boilers—$2,000 Identification numbers will be required with respect to specified property items placed in service after 2024.	A $500 lifetime credit was allowed for personal energy property (such as energy-efficient doors and windows) for the taxpayer's principal residence. The credit equaled 10% of the cost of qualified energy-efficient improvements plus 100% of the cost of residential energy property expenditures. This credit has been extended for property placed in service through 12/31/22.
Residential Clean Energy Credit ***Formerly*** **Residential Energy Efficient Property**	25D	Expenditures made after 2021 and before 2035.	The credit is increased to 30% for qualified expenditures. The rate is reduced in stages after 2032. Qualified battery storage technology is considered a qualified expenditure after 2022.	Individuals were allowed a Residential Energy Efficient Property (REEP) credit of 26% of their qualified expenditures for solar electric, solar hot water, fuel cell, small wind energy, geothermal heat pump, and biomass fuel property installed in homes.
Credit for Previously-owned Clean Vehicles	25E	Vehicles acquired after 2022 and before 2033.	Qualified buyers who acquire and place in service a previously owned clean vehicle are allowed a credit equal to the lesser of $4,000 or 30% of the vehicle's sale price. No credit is available if the buyer's modified AGI for the year of purchase or, if lower, the preceding year exceeds $150,000 for MFJ ($112,500 for HOH, and $75,000 for all others).	NA
Alternative Fuel Vehicle Refueling Property Credit	30C	Property placed in service after 2022 and before 2033.	A credit equal to 6% (increasing to 30% if certain conditions are met) of the cost of any qualified alternative fuel vehicle refueling property is available. The credit is limited to $100,000 per single item. Eligible property includes bidirectional charging equipment and electric charging stations for two- and three-wheeled vehicles for public road use. Charging or refueling property is only eligible if placed in service in a low-income or rural census tract.	A credit equal to 30% of the cost of any qualified alternative fuel vehicle refueling property placed in service by a trade or business or at a taxpayer's principal residence was available for property placed in service before 2022. The credit was limited to $30,000 for all business property annually and $1,000 for personal property. This credit has been extended for property placed in service during 2022.
Clean Vehicle Credit ***Formerly*** **New Qualified Plug-in Electric Drive Motor Vehicles**	30D	Final assembly requirement applies after 8/16/22. All other criteria apply after 2022 and before 2033.	Final assembly of qualifying electric vehicles must be in North America. The clean vehicle credit is capped at $3,750 for meeting the critical minerals requirement and $3,750 for meeting the battery component requirement (among other requirements). The manufacturer phase-out is eliminated. No credit is available for taxpayers whose modified AGI for year of purchase or, if lower, the preceding year exceeds $300,000 for MFJ ($225,000 for HOH and $150,000 for all others). No credit is allowed for cars with a manufacturer's suggested retail price over $55,000 ($80,000 for vans, sport utility vehicles and pickups).	Taxpayers could claim a credit of up to $7,500 for each New Qualified Plug-in Electric Drive Motor Vehicle (NQPEDMV) placed in service. The credit phased out when a manufacturer sold its 200,000th plug-in electric drive motor vehicle for use in the U.S.
Premium Tax Credit	36B	Tax years beginning in 2021 through 2025.	The favorable ARPA rules are extended for three additional tax years and indexing is suspended for that period. Taxpayers with household income over 400% of the Federal Poverty Line (FPL) remain eligible for the PTC.	The refundable Premium Tax Credit (PTC) was available on a sliding scale basis for individuals and families enrolled in an Exchange-purchased qualified health plan and who were not eligible for other qualifying coverage. The PTC was partially based on the taxpayer's household income multiplied by an applicable percentage, which was then indexed based on the rates of premium growth relate to income growth. The American Rescue Plan Act of 2021 (ARPA) suspended indexing for 2021 and 2022 and substituted a statutory table with favorable rates that resulted in a higher PTC. Indexing was to have resumed in 2023.