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November 2023

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This & That

Mastering Video Content Marketing

By Patrick McGowan

Video content marketing is about a story. The videos you create — live or recorded — must be in service of this story. Your video content marketing (in support of your digital content strategy) includes how you show up on video meetings, the video shorts you post and even the production value of your video e-learning modules.

It addresses the question of whether you need to be on TikTok and why this genre of video may not be effective on LinkedIn.

Expert advice alone isn't enough.

Whether your video is a talking head (which most are) or a montage, one trap to avoid is shiny technology syndrome. The issue is not about what camera you use, but how human you are on camera.

Preparation

Today, video is how you do business. It's a video-first market, which means you need to command the screen. You want to show up on video with power, presence and credibility.

It's likely your video meetings with clients and prospects remain an untapped and under-resourced marketing opportunity. Both 2020 and 2021 proved to be the waiting years — everyone waiting for the pandemic and video meetings to go away.

The actor Phillip Seymour Hoffman used to prepare for the smallest roles with intensity and rigor. His friend, Ethan Hawke, recounted how Hoffman would dig into the minutest detail of the character: "Who was that guy? What does he have in his pocket? How did he get the job? Why does he do this dumb thing?"

The path to power, presence and credibility means knowing your story. Just as it was important for Phillip Seymour Hoffman to create a three-dimensional person out of a two-dimensional character, the same is true for you. How you show up on video speaks volumes about you and your business.

Positioning

The market is loud, crowded and noisy. To be seen and heard takes work. Because your job is to serve your existing clients and perhaps grow your practice, getting their attention is step one. This means you want to know your audience and what makes you unique.

It doesn't get any simpler. What's difficult is becoming comfortable with discomfort. You know you're doing things right when your positioning feels uncomfortably narrow.

This will make producing video content easier, though, because it leads to the genuine expression of your positioning. When you have in mind who you want to

reach and the story you want to tell them, the production process (from inception to final approval) becomes more doable, even enjoyable.

Attention is the result of creating a video that stands out. As a result, you rise above the masses. As film director Steve Stockman said about video, "If it's not good, it's off."

Positioning drives the creation of videos people want to watch. This gives you a competitive edge.

Punch

Your camera equipment is there to elevate and amplify your story. It punches up your preparation and positioning. There are no hacks.

Now, you may not need any new equipment. A smartphone might be the right choice. What camera you use should support the story you want to tell.

When you look better on camera, you feel better. And when you feel better, you do better. It's what scientists call enrobed cognition, or what the rest of us might call dressing for success. The right camera is the new power suit. Amplify your power, presence, and credibility with the right camera once you've prepared yourself and positioned your personal brand.

Conclusion

Many people define video content marketing by what gets recorded. In our video-first market, this is shortsighted All video — live and recorded — is video content marketing. It's also how we do business, which means it needs to be visually on brand and on message. You can be just as influential on camera as you are in person, but it takes preparation, positioning and punch.

It's hard to get people's attention. This is why integrating all video into your digital content marketing strategy makes sense. You have one opportunity to make a memorable impression — and on video, it's instantaneous.

Everything you do on video is in service of the story. Make it the right one. ▶

About the author

Patrick McGowan, MBA, consults, trains and coaches business executives and teams to have more power, presence and credibility on camera in a video-first market. He pulls together three decades in marketing, innovation and leadership. McGowan started Punchn to address the challenges and insecurities we all face when on camera. He is the author of "Across the Lens: How Your Zoom Presence Will Make or Break Your Success." Please visit www.punchn.io for more information.

NATP TAXPRO

Issue 11
Volume 45
November 2023

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The TAXPRO (001-839; ISSN 2994-7707) is published monthly by the National Association of Tax Professionals (NATP). Periodicals postage paid at Appleton, WI 54911 and additional mailing office. The TAXPRO is the official publication of the National Association of Tax Professionals. ©2023 National Association of Tax Professionals, Inc. Annual dues are based on membership level: $110 for Basic, $225 for Professional and $725 for Premium. Postmaster: Send address changes to NATP, TAXPRO, 3517 N. McCarthy Road, Appleton, WI 54913. Canada Agreement number: PM40063731. Return undeliverable Canadian addresses to Station A, PO Box 54, Windsor, ON N9A 6J5. Email: returnsil@imex.pb.com.

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Tom's Two Cents

Tips for Easing Into a New Filing Season

By Tom O'Saben, EA, Director of Tax Content

Another tax season is "in the books." Other than addressing some leftover correspondence, tackling a few amended returns or dealing with some fiscal-year filings, hopefully you find yourself with a bit of breathing room and a chance to reflect on the past year, and even plan for the future. But before you wander off to watch the changing seasons, here are a few planning tips for the graying days of November.

1. Encourage your clients to set up an online account with the IRS. The handwriting is on the wall; future interaction with the IRS will be digital. Soon, sending written responses to correspondence or waiting on hold with the IRS will be history. But there's work to be done in the meantime. Advise (or assist) your client by going to https://www.irs.gov/pub/irs-pdf/p5507.pdf. Once your client has their online account established, you need to use (or set up) your own Tax Pro Account [Tax Pro Account | Internal Revenue Service (irs.gov)]. Per the IRS, your Tax Pro Account lets you submit an authorization request to a taxpayer's IRS online account. This includes both power of attorney and tax information authorization requests. The taxpayers can then review, approve and sign the request electronically. After, you can check on what the IRS already has, what the IRS is still missing, or what the issue is, with the expectation that resolution can be handled electronically as well. However, this is still a goal and not necessarily a reality of the IRS's future service expectations. This access is only available for personal tax accounts, not businesses or other entities. Still, it's a start toward resolving issues more quickly.
2. November is an excellent time to reach out to clients who typically owe taxes and suggest they adjust their Form W-4 or estimated tax payments for the remainder of the year or soften the blow for the new year. Being proactive is typically better than being reactive.
3. November is also the time for your clients to make decisions on next year's health insurance and cafeteria plans, such as flex spending accounts. You can be a resource to your clients and help them evaluate the tax benefits and costs associated with these decisions. The last month of autumn is also the beginning of the open enrollment period for signing up for Marketplace health insurance, where premiums will be based on income projections for the following year. Again, you can add value to your services by assisting clients with this process.
4. Year-end planning is easier to deal with this month than in December since you have more time to help clients with their business buying decisions, pension funding or setup, and other year-end issues such as required minimum distributions (RMDs) and qualified charitable distributions (QCDs). In December, many firms want paperwork submitted by mid-month; otherwise, there's no guarantee the processing of RMDs or QCDs will be completed by year-end. Get those out of the way this month.

Entering into a new filing season with ease is the dream of all preparers. Tackling the above jobs can help you accomplish it. Plus, you'll have the bonus of being able to look up from your desk and observe the beauty of the changing seasons! ▸

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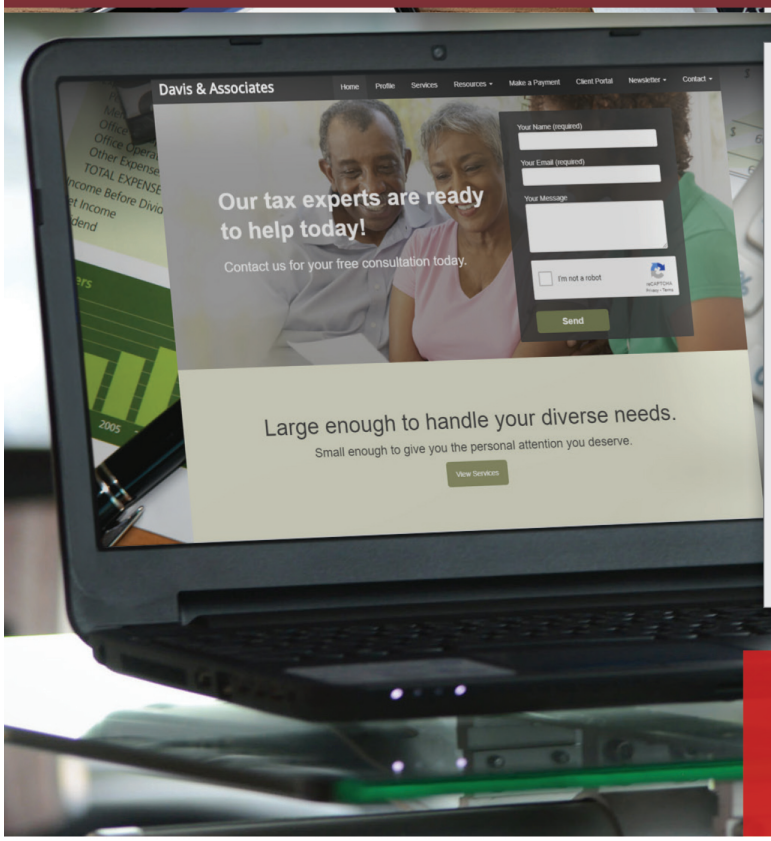

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TAX UPDATE

The Home Energy Audit Credit

By Chris Novak, CPA

With winter approaching, taxpayers might want to get a home energy audit before deciding which energy-efficient improvements they should make to their home. For tax years beginning after 2022, individuals may be eligible to claim a nonrefundable credit for their home energy audit [§25C(a)(3)]. This credit is part of the energy-efficient home improvement credit under §25C, so it's reported on Form 5695, *Residential Energy Credits*, Part II, Section B, Line 26, as shown in the draft form below. In general, the credit is 30% of the amount paid or incurred during the year. However, the credit for home energy audits cannot exceed $150 [§25C(b)(6)(A)]. In other words, individuals may claim the maximum credit for a home energy audit that costs at least $500 ($500 x 30% = $150). To the extent it costs more than $500, no credit is available for the additional amount paid. In addition, no credit is allowed unless the individual substantiates the credit by including certain information or documentation with their tax return as required by the IRS [§25C(b)(6)(B)].

The home energy audit credit is also part of the $1,200 per year limit. In general, the $1,200 limit applies to all qualified energy efficiency improvements (e.g., insulation, exterior doors and windows), certain residential energy property expenditures (e.g., air conditioners, furnaces, water heaters and boilers) and home energy audits. On the other hand, a separate $2,000 per year limit applies, in the aggregate, to all residential energy property expenditures for heat pumps, heat pump water heaters, biomass stoves and biomass boilers.

In other words, if an individual already paid or incurred costs for certain home improvements and will receive the maximum $1,200 energy-efficient home improvement credit, they should consider getting a home energy audit in a future year. That way, they can spread the cost of the audit and the resulting energy-efficient home improvements over different tax years to maximize the credit each year.

Form 5695 (2023) Page **3**

Section B—Residential Energy Property Expenditures *(continued)*

25a	Enter the cost of improvements or replacement of panelboards, subpanelboards, branch circuits, or feeders	**25a**			
b	Multiply line 25a by 30% (0.30). Enter the results. Do **not** enter more than $600			**25b**	
26	Home energy audits.				
a	Did you incur costs for a home energy audit that included an inspection of your main home located in the United States and a written report prepared by a certified home energy auditor? (See instructions.)			**26a**	☐ **Yes** ☐ **No**
	If you checked the "No" box, you cannot claim the home energy audit credit. Stop. Go to line 27.				
b	Enter the cost of the home energy audits	**26b**			
c	Multiply line 26b by 30% (0.30). Enter the results. Do **not** enter more than $150			**26c**	

For this purpose, a home energy audit is an inspection and written report with respect to a dwelling unit located in the U.S. that is owned or used by the taxpayer as their principal residence [§25C(e)]. The dwelling, including condominiums and certain manufactured homes, must be the taxpayer's main home within the meaning of §121 (i.e., the exclusion of gain from the sale of a principal residence). It can even be a home the taxpayer is renting, as long as it's their principal residence (FS-2022-40).

The audit must include an inspection and a written report that identifies the most significant and cost-effective energy efficiency improvements with respect to the home, including an estimate of the energy and cost savings with respect to such improvement. In addition, the audit must be conducted and prepared by a home energy auditor who meets certain certification requirements, unless the transition rule in Notice 2023-59 applies.

For 2023, the audit must be conducted and prepared by a home energy auditor. However, the auditor does have to be certified or meet the definition of a "qualified home energy auditor" as provided in Notice 2023-59. This is a special transition rule for audits conducted during 2023.

Starting in 2024, taxpayers must meet additional requirements under Notice 2023-59 to claim the home energy audit credit. To begin with, the audit must be conducted by a qualified home energy auditor. Next, the written report must be prepared and signed by the qualified home energy auditor and be consistent with industry best practices (i.e., the most recent Department of Energy-led and industry-validated Jobs Task Analysis). Finally, the written report must provide the qualified home energy auditor's name and employer identification number (EIN) or other taxpayer identification number (TIN), an attestation that the auditor is certified by a qualified certification program and the name of such program.

According to Notice 2023-59, a qualified home energy auditor must be certified by a qualified certification program listed at the following web address: www.energy.gov/eere/buildings/us-department-energy-recognized-home-energy-auditor-qualified-certification-programs. The Department of Energy (DOE) maintains this list, which will be updated on a rolling basis as the DOE identifies more qualified certification programs. Currently, the only certification programs through which an auditor can be a qualified home energy auditor for purposes of claiming the home energy audit credit include the following:

- ASHRAE Building Energy Assessment Professional (BEAP)
- AEE Certified Energy Auditor (CEA)
- BPI Home Energy Professional (HEP) Energy Auditor
- BPI Building Analyst Professional (BA-P)
- RESNET Home Energy Rater

In conclusion, the requirements for claiming the home energy audit credit in 2023 aren't as strict as they will be in subsequent years. For audits conducted after 2023, taxpayers need to make sure they use a qualified home energy auditor and meet all the other requirements to claim a home energy audit credit. Notice 2023-59 also states the forthcoming proposed regulations will provide that taxpayers claiming the home energy audit credit will meet the substantiation requirement under §25C(b)(6)(B) if they keep the written report signed by the qualified home energy auditor with their records and comply with the instructions for Form 5695. ▶

Notice 2023-59

ERC Accounting

How to properly report a claim

By Sheri Fronsee, CPA, and Tom O'Saben, EA

Unless you've been stationed in Antarctica for the last couple years, you have more than likely become familiar with the employee retention credit (ERC). Once the IRS started reviewing these claims, they quickly became an item of increased scrutiny. The agency continues to update guidance as it focuses more attention on ineligible and fraudulent claims. Of particular interest is the revised FAQ #3, which the IRS released on July 28, 2023.

Q3. Who is not eligible to claim the ERC?
A3. You don't qualify for the ERC if you did not operate a business or tax-exempt organization with employees.

Some examples of taxpayers who are not eligible to claim the ERC and are often targeted by ERC scam promoters include:

- Individual taxpayers who are not business owners
- Employees
- Retirees
- People who do not have employees
- Household employers
- Employers that didn't pay wages to employees during the qualifying time periods
- Employers who experienced supply chain disruptions but did not experience a full or partial suspension of operations by a qualifying order
- Government agencies

The big push now is to make sure everyone who was eligible to receive the ERC has received it. This is causing many businesses that didn't apply for the credit to apply for it now, for 2020 and 2021. Consequently, the trick is figuring out how to properly report this transaction in the company's books and records for the applicable years and the year for which it is filed.

Notice 2021-20, Section III. L. Special Issues for Employers: Income and Deduction, Q&A 60 states the ERC reduces the expenses that an eligible employer could otherwise deduct on its federal income tax return for the taxable year. This means the ERC requires businesses to reduce their payroll expense for the tax year in which the ERC is being claimed, not the tax year in which the ERC is applied for or received [N-2021-20 (irs.gov)].

Let's look at the proper reporting procedures for claiming the ERC when applying for it in subsequent years. This discussion does not address the qualifications for the credit.

Observation: Before amending any entity returns impacted by ERC claims, consider whether an Office of Professional Responsibility (OPR) position could force you to fire your client.

In February 2023, NATP, in conjunction with the National Society of Accountants (NSA), sent a joint letter to the acting Commissioner of the IRS and the OPR Director asking for swift guidance regarding the responsibilities of practitioners whose clients filed an ERC claim through a third party. Our letter asked for a possible safe harbor from potential preparer penalties in cases where the preparer did not create or submit an ERC claim, but only prepared entity and individual income tax returns impacted by an ERC claim.

OPR, in their release, Issue Number: 2023-02 , took the position that a return preparer is responsible for and must have accurate knowledge of all information impacting the return being submitted.

Further, OPR stated it does not believe a practitioner can rely on third-party advice provisions as provided under Circular 230, §10.37, since the firms submitting ERC claims do not meet the definition of a tax preparer.

This narrow interpretation leaves tax preparers with two choices in the event a client has filed an ERC claim that we disagree with:

1. Inform the client that you do not agree with their eligibility for the credit and take corrective action to amend the claim for credit or
2. Disengage from the client

Ignoring the ERC claim, failing to take responsibility for it, or not providing knowledge to the client as to why the ERC claim is erroneous may subject practitioners to potential preparer penalties and sanctions for filing frivolous returns, understating a client's tax obligation, failing to be sufficiently educated, etc.

NATP has also sought further clarification on whether the OPR position also represents responsibility on the part of a tax professional for an ERC claim if the practitioner merely allows deductions for the taxpayer's fees to the ERC processing firm on their entity filings.

Hitting the pause button

As of Sept. 14, 2023, to protect taxpayers from scams, the IRS has ordered an immediate stop to new ERC processing amid a surge of questionable claims and concerns from tax professionals. Aggressive marketing to ineligible applicants highlights unacceptable risk to businesses and the tax system. Also, the IRS has stated that claimants with pending ERC claims may request that the IRS withdraw the pending claim. The IRS plans to unveil a settlement process to give those businesses who have already received ERC claims an opportunity to potentially return these dollars to the Service if they were received in question.

This moratorium on processing new claims through year's end will allow the IRS to add more safeguards to prevent future abuse and protect businesses from predatory tactics. The IRS is working with the Justice Department to pursue fraud fueled by aggressive marketing promotions [IR-2023-169].

Accounting for the ERC claim

Entities eligible for the ERC include C corporations, S corporations, partnerships, sole proprietors, farmers and nonprofit organizations. In essence, any business that pays employees and deducts payroll expenses is considered an eligible entity.

Let's review the following facts:

1. ERC is a payroll credit, not an income tax credit. Therefore, it does not fall under Accounting Standard Codification (ASC) 740, Income Taxes. There is no specific guidance for for-profit business entities to account for these credits. Companies may account for the ERC by referring to International Accounting Standards (IAS) 20, Accounting for Government Grants and Disclosure of Government Assistance, under International Financial Reporting Standards (IFRS). Additional guidelines that can be applied include ASC 958-605 for contributions received by nonprofits or ASC 450, Contingencies. A nonprofit entity that receives a government grant should use ASC 958-605, Not-for-Profit Entities – Revenue Recognition.
2. Before selecting a policy, it's important to consider what accounting policy your client may have used for the Paycheck Protection Program (PPP) loan forgiveness, where they had the option to book the loan as debt or as a government grant (by using IAS 20). Those companies that elected the accounting treatment under IAS 20 were provided a further option to report it on an income statement as "other income" or to reduce an impacted expense. If your client decided to treat their PPP loan forgiveness under the government grant alternative, you need to continue with this accounting policy and report the ERC as either "other income" or reduce payroll expenses on the taxpayer's income statement and tax returns based on this prior election.
3. Most entities elected to treat their PPP loans as debt under ASC 470. To follow this election, companies should account for their ERC under IAS 20, which will have the ERC reported as either a reduction of payroll expenses or as "other income" on the income statement and tax returns.

Note: The ERC should only be recorded once it is deemed probable, meaning the ERC claim will likely be approved by the IRS, and the entity has complied with all requirements to receive ERC funds.

Once probability is likely, the entity should record a receivable and reduce the payroll expense or report other income for the anticipated amount of the credit.

For example, consider the following journal entry:

Debit: ERC receivable

Credit: Payroll expense or other income

However, for income tax purposes, record the ERC as a reduction of payroll expense, thus reducing payroll expense and increasing taxable income.

Now let's put words to action! Following is a case study showing how to properly report a business's claim for the ERC, made in the current tax year, for the past tax years of 2020 and 2021.

Case study

JMJ, a multi-member LLC, has elected to be taxed as an S corporation. It has 35 shareholders and more than 70 employees. Due to the impact of the pandemic, JMJ was forced to cease operations but continued to pay its employees. JMJ utilizes AAA Professional Accountants (AAA) for its tax and bookkeeping services but employs a third-party payroll provider, which determined JMJ was eligible for the ERC for tax years 2020 and 2021. The payroll provider submitted Forms 941-X, *Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund*, for the quarters in question. The expected refunds due to JMJ are more than $1 million. AAA does not provide payroll services and has rendered no opinion as to the validity of the ERC claims. Due to the interruption in business during the pandemic, JMJ corporate income tax returns, as well as its shareholders' tax returns, have not been filed for tax years 2020, 2021 and 2022.

In September 2023, the IRS informed JMJ that its ERC claim had been approved and the payment would be mailed out by Oct. 10, 2023. On Oct. 22, 2023, JMJ received a check for $1,030,000, which comprised the $1 million ERC claim plus $30,000 interest. How does AAA proceed to prepare the tax returns for JMJ?

Before beginning to prepare the returns for 2020, 2021 and 2022, AAA reviewed the substantial backup information provided by the third-party payroll provider and feels comfortable that it has completed reasonable due diligence on the ERC claim. With the understanding that its preparation of the entity and personal returns meets the guidelines outlined by OPR, AAA proceeds with the preparation of the returns. It is willing to be considered a participant in the ERC claim.

As noted in Notice 2021-20, Question 60, the ERC will need to be allocated to the appropriate years. In this case, JMJ allocates the $1 million ERC as follows: $250,000 in 2020 and $750,000 in 2021.

Tax year 2020. When preparing JMJ's financial statements, AAA made the following journal entry to JMJ's books to account for the 2020 ERC due to it:

Debit: ERC receivable $250,000
Credit: Payroll expense $250,000

In 2021, AAA had prepared preliminary financial statements to help the shareholders calculate their potential individual tax liability. AAA has now revised those preliminary statements to reflect the reduction of the payroll expense and increased income, and is sending revised letters to the shareholders explaining their tax liability will be increased by their pro-rata share of the additional $250,000 in net income.

Tax year 2021. When preparing JMJ's financial statements, AAA made the following journal entry to JMJ's books to account for the ERC due to it:

Debit: ERC receivable $750,000
Credit: Payroll expense $750,000

In 2022, as in 2021, AAA had prepared preliminary financial statements to help the shareholders calculate their potential individual tax liability. AAA has now revised those preliminary statements to reflect the reduction of the payroll expense and increased income, and is sending revised letters to the shareholders explaining that its tax liability will be increased by its pro-rata share of the additional $750,000 in net income.

Observation: Had the returns already been prepared by 2020 and 2021, the same results would need to be reflected on amended entity returns and amended Schedules K-1, *Shareholder's Share of Income, Deductions, Credits, etc.*, and provided to each shareholder.

Tax year 2022. The pending ERC claims have no impact on financial statements or tax returns, aside from carrying forward the $1 million ERC receivable on JMJ's balance sheet.

Tax year 2023. To properly report the $1,030,000 check JMJ received, AAA made the following journal entry:

Debit: Cash $1,030,000
Credit: ERC receivable $1,000,000
(reducing it to $0)
Credit: Interest income $30,000

Shareholders who faced increased taxes and were assessed penalties and interest for the late-filed returns for 2020 and 2021 have requested pro-rata distributions from JMJ to cover these expenses. Providing the distributions are not in excess of their basis, the distributions will be tax free. However, any distributions in excess of basis will be taxable to the shareholder.

Reminder: When making distributions to S corporation shareholders, all distributions must be equal to the shareholder's pro-rata ownership interest to avoid causing more than one class of stock and invalidating the S election.

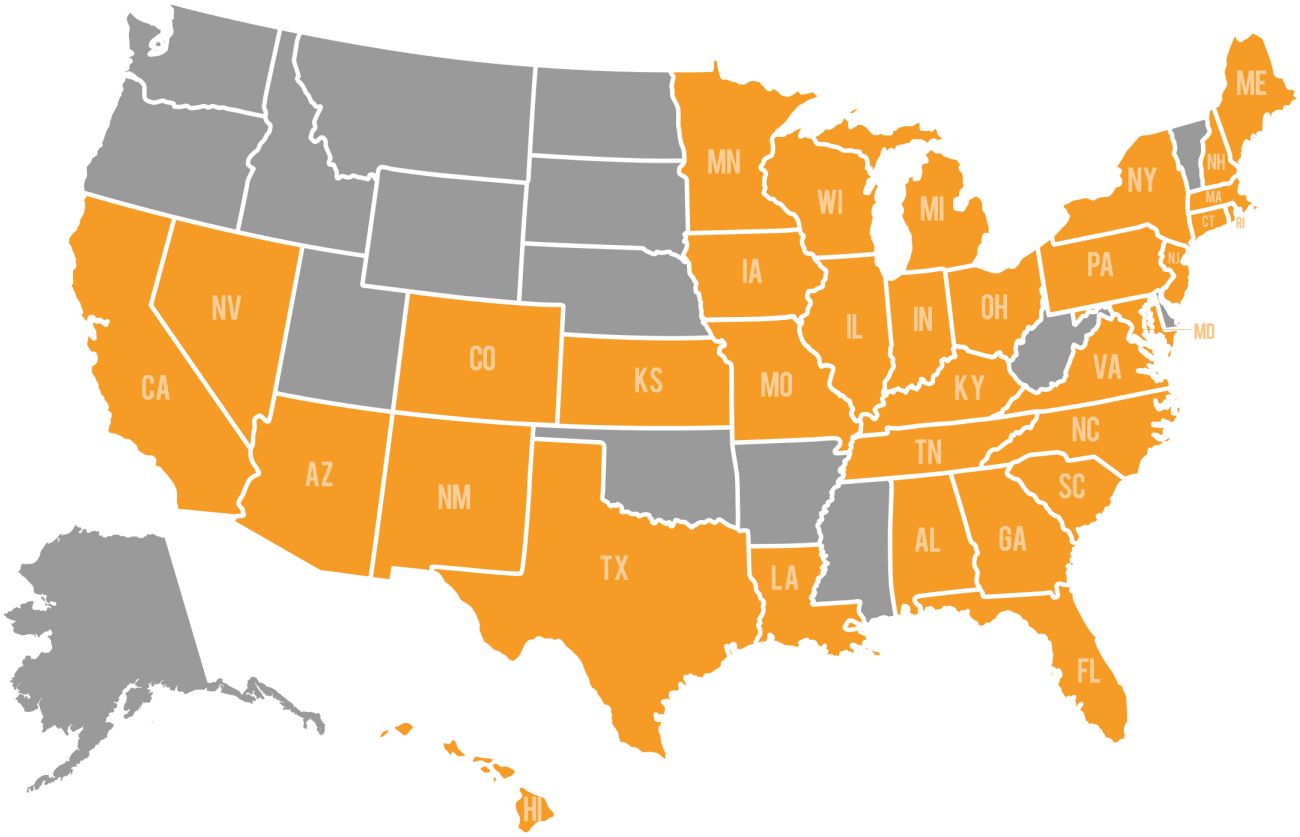
Observation: Due to the influx of cash in 2023 JMJ might consider making pass-through entity (PTE) elections for the open tax years if their resident state approved this tax treatment. This is assuming the company qualifies.

For more information on ERC claims, visit https://www.irs.gov/coronavirus/employee-retention-credit.

About the authors

Sheri Fronsee, CPA, currently works for NATP in the association's tax content department. Prior to that, she worked in corporate accounting and at several small tax offices.

Tom O'Saben, EA, is the director of NATP's Tax Content and Government Relations team. He has been a tax professional and enrolled agent for more than 30 years.



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Rental Activities

The real estate professional tax loophole

By Joseph LiPari, CPA, MBA, and Jo Ann M. Pinto, Ph.D., CPA (inactive)

For mid- to high-income taxpayers who own rental real estate that generates losses, real estate professional status can mean huge tax savings depending on the amount of the specific taxpayer's income and rental losses. This qualification can help reduce the taxpayer's marginal tax rate from 37% down to 12% or lower because rental activities for a real estate professional can be considered nonpassive and, therefore, not suspended and fully deductible in the year incurred, with no limitation against all active and portfolio income of the taxpayer. That's quite a loophole.

So, how exactly does one qualify for this real estate professional tax status? To be clear, it has absolutely nothing to do with being in the business of selling real estate, being a real estate agent or showing houses for sale. In the eyes of the Internal Revenue Service, the real estate professional is most likely to be an investor in real property who materially participates in the activity.

Following is a brief summary of the passive activity rules for rental real estate under §469, which, believe it or not, has been in existence since 1986 without any changes or cost of living adjustments.

A review of the rental real estate passive activity rules

Taxpayers must first apply rental real estate losses from rental activities in which they own and actively participate against other non-real estate passive income for the year. If there is still an excess passive loss generated by the real estate rental activity or activities, the taxpayer may then offset up to $25,000 of these rental real estate passive activity losses against active income. This exception is available only to individual taxpayers or their estates for tax years ending less than two years subsequent to the date of death.

This $25,000 offset is reduced or phased out as the taxpayer's modified adjusted gross income (MAGI) exceeds $100,000. Section 469 requires that the $25,000 offset be reduced by 50% of the taxpayer's MAGI in excess of $100,000. Therefore, a taxpayer with MAGI of $150,000 or more will not be allowed to deduct any passive rental real estate losses currently, as the entire $25,000 will be phased out and reduced to zero. These unused losses will become suspended and will carry over to future years or until a passive activity is sold or disposed of (see discussion below). For purposes of this exception, MAGI is computed by disregarding:

- Taxable Social Security and railroad retirement benefits
- The exclusion for qualified U.S. savings bond interest used to pay higher education expenses
- The exclusion of employer adoption assistance payments
- Passive activity income or loss on Form 8582, *Passive Activity Loss Limitations*
- Any overall loss from publicly traded partnerships
- Rental real estate losses allowed to real estate professionals
- Deductions for contributions to IRAs and pension plans
- The deduction for one-half of self-employment taxes and interest on student loans
- Deductions attributable to domestic production activities (DPAD)

Treatment of suspended losses

When a taxpayer disposes of an entire interest in a passive activity in a taxable transaction, the actual economic gain or loss from the activity, including suspended losses, can finally be determined. In accordance with the passive loss rules, any cumulative loss realized by an activity is recognized and can be used to offset any income. As mentioned, to qualify for this treatment, there must be a fully taxable transaction (i.e., a sale to a third party in an arm's-length transaction for a price at or near the property's fair market value).

When a taxpayer disposes of an interest to a related party, the suspended losses will not be recognized. In this situation, the taxpayer with these unused suspended losses will be able to claim the loss when the related party sells the activity in a taxable transaction with an unrelated party or abandons the activity.

Where there is a taxable transaction involving the sale of an activity in an arm's-length agreement, the gain recognized, if any, is treated as passive and is first offset by the suspended losses from the activity. If current and suspended losses of the passive activity exceed the gain realized or if the sale results in a realized loss, any loss for the activity for the current year (including suspended losses in the disposed of activity) that exceeds net income or gain from all passive activities for the year is treated as a non-passive loss.

How to obtain real estate professional status

An individual must pass two tests to be considered a real estate professional:

- More than one-half of personal services performed by the taxpayer during the year are in real property trades or businesses in which the taxpayer materially participates.
- More than 750 hours are spent in real property trades or businesses in which the taxpayer materially participates.

The major difference between the real estate professional and the passive non-real estate professional is the required material participation for the professional

versus only the active participation requirement for the nonprofessional.

Suffice it to say that if the taxpayer or the taxpayer's spouse, if married filing jointly, devotes more than half their time to real estate investments and more than 750 hours in the activity, the material participation requirement will be met.

Keep in mind that in the situation of a married couple, only one spouse must meet the material participation requirement. If so, the materially participating spouse would be considered nonpassive and any rental property losses for the tax year would be fully deductible. Also, if one spouse is considered nonpassive, the other spouse's activity is considered nonpassive as well.

As a practical example, I have seen situations in my practice where mid- to high-income married couples own several rental properties that have consistently generated passive losses primarily due to the non-cash depreciation deductions taken. Since their income (MAGI) far exceeds the $150,000 threshold for deducting passive losses, they are carrying forward massive amounts of suspended losses.

The most common scenario is when only one spouse works full-time and the other is a stay-at-home parent, or simply a non-working spouse. In this situation, it's incumbent on us as tax professionals to ask the proper questions to determine whether a real estate professional classification is appropriate.

Documenting real estate professional activities

The IRS requires that the taxpayer keep a log or diary of their hours and services performed during the year. No specific method is required. Keep copies of emails, phone calls, text messages, receipts, contractor communications, car mileage, tenant matters, etc. It's imperative that adequate documentation be kept in the event of an audit. ▸

About the authors

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Material Participation

A real estate professional also needs to meet one of the following seven tests to prove material participation.

1. **More than 500 hours.** Did the taxpayer participate in the activity for more than 500 hours during the tax year?
2. **Primary participant.** Was the taxpayer's participation during the tax year substantially all of the participation (including others, even nonowners) in the activity?
3. **Maximum participant (100 hours test).** Did the taxpayer participate in the activity for more than 100 hours during the tax year, and is that participation not less than the participation of any other individual (including non-owners)?
4. **Significant participation with activity aggregation.** Did the taxpayer participate in the activity for more than 100 hours during the tax year, and: (1) do the taxpayer's total participation hours in all activities exceed 500 hours, and (2) does the taxpayer fail to meet all other material participation tests for the activity? If the IRS finds that any significant activity meets any material participation test, the hours for that activity would be "taken away" from the aggregate significant hours. If this brings total hours to 500 or less, another activity may no longer qualify for significant participation.
5. **Historical participation.** Did the taxpayer materially participate in the activity in at least five out of the immediately preceding 10 years? (Participation years do not have to be consecutive.)
6. **Personal service activity with material participation.** Did the taxpayer materially participate in personal service activity for any three prior tax years? Personal service activities include health and veterinary services, law, engineering, architecture, accounting, actuarial science, the performing arts, consulting or any other trade or business in which capital is not a material income-producing factor.
7. **Facts and circumstances.** Did the taxpayer participate in activity regularly, continually and in a significant way?

Passports and Tax Debt

What to do if the IRS grounds your client

By Randall Brody, EA

As a tax professional, you're no stranger to navigating turbulence. You're the captain of a financial aircraft, directing clients through foggy regulations, over towering tax codes and around stormy IRS encounters. One tempest that might not be on your radar, however, is the grounding of your client's passport due to unpaid tax liabilities. Imagine the shock of your clients when they're told they can't jet off to that dream vacation because they're on the IRS's naughty list.

This article provides a basic introduction to the complex interplay between taxes and travel rights.

Expanded power

The IRS, traditionally associated with calculating taxes and enforcing compliance, has seen its powers significantly expand in recent years. With passage of the *Fixing America's Surface Transportation (FAST) Act* in 2015, the IRS gained the authority to influence an individual's passport privileges.

If your client owes a significant tax debt, termed "seriously delinquent," they might have unexpected consequences. If your client neglects any tax debts, their international travel plans could be upended.

The CP508C

In layman's terms, the CP508C notice is the IRS's version of a reality check. This notice means the IRS has identified your client's tax debt as meeting the definition of seriously delinquent in IRC §7345, and provided that information to the U.S. Department of State. The U.S. Department of State generally will not renew the passport or issue a new passport after receiving this certification from the IRS, and they may revoke or place limitations on your client's current passport.

For a taxpayer, every envelope that arrives in the mail can feel like an unwelcome gust of wind, ready to throw them off course. A CP508C notice is a significant red flag, but it doesn't mean the end of your client's journey. Your clients have rights, and they can exercise them to tackle their tax debts. As their tax professional, you can help them understand these rights and how to use them in their favor.

The client's role

The IRS advises those who receive a CP508C notice to:

- Read it carefully, as it explains the amount due, due date, what you need to know, and what you need to do to prevent the U.S. Department of State from denying, revoking or limiting your passport.
- If you have any questions or disagree with the notice, contact the IRS within 30 days from the date of the notice at the toll-free number at the top right corner.
- Keep the notice in your permanent records.

The tax professional's role

As a tax professional, your role is multi-faceted. You aren't just a compliance officer; you're also a trusted advisor who guides your clients through their financial journey. This involves addressing their immediate concerns, such as resolving tax debts and helping them plan for the future.

> "In layman's terms, the CP508C notice is the IRS's version of a reality check. This notice means the IRS has identified your client's tax debt as meeting the definition of seriously delinquent."

When dealing with tax-related passport issues, your knowledge and experience can make all the difference. You can provide valuable insights into navigating the tax debt resolution process, formulating an effective response to IRS notices and managing communication with the IRS.

Start by helping your client craft a response that effectively communicates their circumstances and intentions to resolve the debt. Remember, communication is key. The IRS is more likely to work with taxpayers who are proactive in settling their debts.

The path to resolution

Tax resolution can be a long and complex process, especially when it comes to seriously delinquent tax debts. Working with you, your clients can establish a feasible payment plan that suits their financial circumstances, ensuring their rights are protected and their tax debts do not unduly burden them. Let's look at a few strategies.

Before anything else, understand the implications of a CP508C Notice. Recognize that it's a signal from the IRS that your client's tax debt has been declared as "seriously delinquent." It means the IRS has reported this to the State Department, which could affect your client's passport privileges.

Review your client's financial records to confirm the validity of the tax debt in question. The "seriously delinquent" tax debt threshold is adjusted annually for inflation; currently, the threshold is $59,000. The IRS includes penalties and interest in this calculation.

Certainly, understanding the nuances of the exceptions to the definition of "seriously delinquent tax debt" is essential for any taxpayer concerned about potential passport denial or revocation. The term "seriously delinquent tax debt" might sound intimidating, but there are specific exceptions to this classification, as outlined in §7345(b)(2). These exceptions ensure that certain taxpayers do not unjustly lose their passport privileges.

To start, a seriously delinquent tax debt does not encompass a debt being actively addressed through an installment or compromise agreement. Nor does it include a debt where collections have been suspended because the individual has requested a collection due process hearing or has sought innocent spouse relief.

Furthermore, the IRS has outlined additional scenarios where it will refrain from certifying a debt as seriously delinquent. These scenarios include taxpayers in bankruptcy, victims of tax-related identity theft, individuals whose accounts are deemed currently non-collectible due to hardship, those residing in federally declared disaster areas, and those who have specific requests pending with the IRS (like an installment agreement or an offer in compromise). Importantly, for our brave individuals serving in combat zones, the IRS will delay notifying the State Department about their seriously delinquent tax debt. Thus, their passport remains untouched during their period of service. This comprehensive approach ensures that taxpayers dealing with specific hardships or actively addressing their debts are not unduly punished.

Communicate with the IRS on behalf of your client to clarify the nature and amount of the outstanding debt and the best ways to address the situation. Be proactive and cooperative, since the IRS tends to be more amenable to taxpayers who try to resolve their debts.

There are several ways to resolve a seriously delinquent tax debt, including:

- **Pay the debt in full.** The most straightforward way out of this quagmire is to pay the debt in full. Now, we understand not everyone has a pot of gold at the end of a rainbow. But if they do, this might be a good time to cash it in.
- **Enter into a payment plan with the IRS.** If full payment is out of reach, setting up an installment agreement with the IRS is a great way to chip away at the debt. It's like buying a car on installment but with less joy and no new car smell. An installment agreement will allow the taxpayer to pay their debt over time. It's important to ensure that the terms of this agreement are manageable for your client and that they can make these payments consistently.
- **Make an offer in compromise with the IRS.** In some cases, the IRS may accept a reduced sum to settle the debt. This isn't a garage sale, though; professional guidance is crucial to navigate this negotiation. This is the IRS's version of "Let's Make a Deal." You offer a lump sum or short-term payment plan that's less than the full debt; if the IRS accepts it, your client's debt is settled. However, it's important to note that not everyone qualifies for an offer in compromise. The IRS will examine your client's income, expenses, asset equity and ability to pay when determining whether they qualify.
- **Request innocent spouse relief**. Clients whose tax debt is primarily due to the actions of a current or former spouse may be eligible for innocent spouse relief. It's a tricky road, but a worthwhile avenue to explore.

Once the tax debt is resolved (either fully paid or arranged into a payment plan), the IRS will reverse the certification within 30 days and inform the State Department of the resolution. However, it's good practice to follow up with the IRS to ensure this has been done.

When to enlist additional help

Now that we've discussed possible options, let's address the elephant in the room. These options aren't exactly easy. They involve rigorous negotiation, an understanding of complex tax laws and the patience of a saint. If you are an unenrolled preparer, it's an uphill battle to wrestle with these issues alone.

This is where you need to enlist the aid of a third party. Calling on the help of a credentialed tax professional (i.e., EA, CPA) is key to successfully resolving your client's issue. These professionals have specialized knowledge, IRS representation rights and an uncanny ability to decode tax jargon into everyday language.

If you're starting to feel like you're out of your depth, it might be time to consider partnering with one of these experts. After all, it's not just about solving the problem at hand, it's about providing the best service possible to your clients. If you're working with a client facing a passport revocation, partnering with an EA or CPA could be just the ticket.

Preventing future turbulence

As a tax professional, your role goes beyond helping your clients become compliant with tax laws. It's also to guide them toward proactive tax and financial planning. After all, preventing a problem is always easier than trying to fix it.

Guide your clients toward better financial habits. Help them understand the importance of timely tax payments and the implications of ignoring their tax obligations. Teach them about the IRS's power to affect their passport status and how to avoid falling into the "seriously delinquent" category.

Understanding the factors that can trigger passport issues due to tax debts is crucial. This includes:

- **Knowing the threshold.** The FAST Act sets a threshold of $59,000 for seriously delinquent tax debts, adjusted annually for inflation. Inform your clients about this limit and help them understand its implications.
- **Understanding the legal processes.** Guide your clients through the legal processes of handling seriously delinquent tax debts. This includes understanding IRS notices, formulating responses and navigating the resolution process.
- **Planning for the future.** Encourage your clients to proactively manage their tax obligations. This includes making timely payments, seeking professional advice for complex tax situations and planning for the future to avoid tax delinquency.

Conclusion

Tax debt doesn't have to ground your clients. With a deep understanding of the laws, an active approach and a solid partnership with credentialed professionals, if needed, you can help your clients keep their passports—and their dreams of world travel—alive. Remember, taxes might be inevitable, but passport revocation due to tax debt? That's a destination we can avoid. ▸

About the author

Income tax expert Randall Brody, founder of Tax Samaritan and Peace of Mind Tax Help, specializes in solving tax problems for expats. Brody has removed over $800 million in tax debt for more than 9,500 taxpayers. Visit https://www.TaxSamaritan.com/TaxTips to subscribe to his free tax tips and advice.

Additional tips

- Even if a client has received a CP508C notice, their passport won't be revoked immediately. There's a window of opportunity to resolve the issue.
- Innocent spouse relief, installment agreements, offers in compromise are terms that might sound like legal mumbo-jumbo to your clients. Breaking it down into simple, relatable terms can ease their anxiety.
- Encourage your clients to keep you informed about any IRS notices they receive. Prompt action can prevent small tax issues from escalating into massive headaches.
- If not already a credentialed preparer, consider enrolling in a credentialing program yourself. Representing your clients before the IRS can elevate your services to a new level.

Form 1099-B

Broker transactions

By Amy M. Wall, EA, MBA

We're all familiar with the thick stack of papers we get from clients' brokers in February and March (and, yes, sometimes April). The task of sorting through 50+ pages of information can be a bit daunting. In a series of articles, we'll break that consolidated (aka, composite) 1099 into pieces and dissect each one.

The brokers' 1099s are referred to as "consolidated" or "composite" simply because there are many 1099s rolled into one monster reporting document. A consolidated 1099 may contain a 1099-B, a 1099-DIV, a 1099-INT, a 1099-OID and a 1099-MISC. No wonder it feels overwhelming!

This article takes a closer look at Form 1099-B, *Proceeds from Broker and Barter Exchange Transactions*. The IRS requires brokers to file a 1099-B for each person for whom they sold, stocks, commodities, regulated futures contracts, foreign currency contracts, forward contracts, debt instruments, options, securities futures contracts, bonds, commercial paper and basically any other type of investment that the broker handled for the taxpayer.

The 1099-B is filed for each account. If an account is owned jointly, only one 1099-B will be sent to the IRS and to the client. This article will cover the process of "nominee-ing" income in the "adjustments" section.

For simplicity, we'll cover the purchase and sale of stocks, but understand that the same principles hold true for other types of investments.

The forms

The 1099-B form provided by the IRS and the form we're accustomed to seeing in the consolidated 1099 look rather different. The IRS's version is shown in Figure 1 on the next page, as is the broker's version in Figure 2.

If you look closely, you'll see that all the various boxes shown on the IRS version (descriptions, date acquired, date sold or disposed, proceeds, cost or other basis, etc.) are faithfully reproduced on the broker's version, simply in a different format. If, at any point, you're uncertain as to what is being reported by the broker, refer back to the IRS form.

Tax lots

Stocks are sold by tax lots, which consist of shares of stock that are identical for tax purposes, meaning that all the shares have the same basis and holding period.

Example: On Jan. 1, 2022, John bought 100 shares of ABC stock for $10 per share. On the same day, he purchased another 50 shares of ABC stock for $10.10 per share. On Jan. 2, 2022, he purchased another 50 shares of ABC stock for $10.10 per share. John now has three different tax lots, which have the potential to result in three completely different tax consequences upon sale.

On Jan. 3, 2023, John decides to sell 25 shares of ABC stock. The question now is this: Which of the three tax lots will these 25 shares come from? The IRS allows taxpayers to select the tax lot from which shares are sold. This selection is typically made by the broker's software, which is programmed to select the tax lot that will result in the lowest tax. Typically, the broker will choose to sell shares that create a short-term loss, if possible, followed by a long-term loss, followed by long-term gain, and then, finally, short-term gain.

However, in the absence of any other election, the default is first-in, first-out (FIFO).

FIGURE 1

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		Applicable checkbox on Form 8949	OMB No. 1545-0715 **2023** Form **1099-B**	**Proceeds From Broker and Barter Exchange Transactions**
		1a Description of property (Example: 100 sh. XYZ Co.)		
		1b Date acquired	**1c** Date sold or disposed	
PAYER'S TIN	RECIPIENT'S TIN	**1d** Proceeds $	**1e** Cost or other basis $	**Copy 1 For State Tax Department**
		1f Accrued market discount $	**1g** Wash sale loss disallowed $	
RECIPIENT'S name		**2** Short-term gain or loss ☐ Long-term gain or loss ☐ Ordinary ☐	**3** If checked, proceeds from: Collectibles ☐ QOF ☐	
Street address (including apt. no.)		**4** Federal income tax withheld $	**5** If checked, noncovered security ☐	
City or town, state or province, country, and ZIP or foreign postal code		**6** Reported to IRS: Gross proceeds ☐ Net proceeds ☐	**7** If checked, loss is not allowed based on amount in 1d ☐	
Account number (see instructions)		**8** Profit or (loss) realized in 2023 on closed contracts $	**9** Unrealized profit or (loss) on open contracts—12/31/2022 $	
CUSIP number	FATCA filing requirement ☐	**10** Unrealized profit or (loss) on open contracts—12/31/2023 $	**11** Aggregate profit or (loss) on contracts $	
14 State name / **15** State identification no. / **16** State tax withheld $ / $		**12** If checked, basis reported to IRS ☐	**13** Bartering $	

Form **1099-B** www.irs.gov/Form1099B Department of the Treasury - Internal Revenue Service

FIGURE 2

Recipient's Name and Address

DANA JONES
JOHN JONES
C/O SAMPLE GLOBAL ENTERPRISE
3RD FLOOR, SUITE 1800
1234 MAIN STREET
ANYTOWN, US 12345
Taxpayer ID Number: ***-**-0000 **Account Number:** 1111-9999

Payer's Name and Address **Date Prepared: January 11, 2022**

CHARLES SCHWAB & CO., INC.
211 MAIN STREET
SAN FRANCISCO, CA 94105

Telephone Number: (800) 435-4000
Federal ID Number: 94-1737782

Proceeds From Broker Transactions—2021 **Form 1099-B**

Department of the Treasury–Internal Revenue Service — Copy B for Recipient (OMB No. 1545-0715)

SHORT-TERM TRANSACTIONS FOR WHICH BASIS IS REPORTED TO THE IRS–Report on Form 8949, Part I, with **Box A** checked.

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds / 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	*Realized Gain or (Loss)*	**4–Federal income tax withheld**
5 CALL SAMPLE CORPORATION	**SC**	01/15/21	$ 602.75	$ 525.00	--	$ 77.75	**$ 0.00**
XXYY 03/21/2021 20.00 C		02/11/21			--		
10 CALL SAMPLE CORPORATION	**X**	01/15/21	$ 0.00	$ 1,050.00	--	$ (1,050.00)	**$ 0.00**
XXYY 03/21/2021 20.00C		03/21/21			--		
Security Subtotal			**$ 602.75**	**$ 1,575.00**	**-- --**	**$ (972.75)**	**$ 0.00**
10,000 PRETEND CORPORATE BOND **DUE 04/15/24**	**S**	01/09/21	$ 9,750.00	$ 9,550.00	$ 200.00	0.00	**$ 0.00**
54321XXXX		10/13/21			--		
Security Subtotal			**$ 9,750.00**	**$ 9,550.00**	**$ 200.00 --**	**$ 0.00**	**$ 0.00**

Example: Alice bought 50 shares of ABC stock four years ago at $40 per share. Two years ago, Alice bought another 50 shares of ABC stock for $70 per share. Today, the shares are trading for $100 per share, and she'd like to sell 25 of her shares. Unless another election is made, the IRS says that she must sell the shares she purchased four years ago, which would result in a gain of $60 per share prior to selling the shares she purchased two years ago, which would result in a gain of only $30 per share. Happily, however, her broker can make the election to sell the shares purchased two years ago.

Of course, Alice might have a reason for wanting to sell the shares that would result in a higher gain. Perhaps she has low taxable income this year and it makes sense to take that long-term capital gain now, rather than later.

The 1099-B reports sales of tax lots rather than individual shares. The broker's version of the form is divided into sections to help us report these transactions correctly, specifically:

- Short-term gains and losses for which basis is reported to the IRS
- Short-term gains and losses for which basis is not reported to the IRS
- Long-term gains and losses for which basis is reported to the IRS
- Long-term gains and losses for which basis is not reported to the IRS

These transactions are reported on Form 8949, *Sales and other Dispositions of Capital Assets*, with Box A, B, D and E, respectively, checked. Our software automatically sums up these transactions and reports the totals on Schedule D, Part I for short-term transactions and Part II for long-term transactions.

A common area of concern for tax preparers is the burning question of whether we're required to report every individual transaction on Form 8949. Given that clients often engage in hundreds, even thousands, of transactions every year, it really is cause for concern. The short answer is yes — unless the situation qualifies for an exception.

The IRS gives us two possible exceptions to the onerous task of reporting every transaction individually on Form 8949.

The first exception is this: If the client received a 1099-B or similar report showing basis was reported to the IRS and no adjustments were shown or required, if there is no ordinary income component (which would be indicated by Box 2 being checked), and there is no income being deferred, or deferral being terminated, from a Qualified Opportunity Fund (QOF) investment, then not only do you *not* have to report every transaction on Form 8949, but you can actually report the total proceeds, basis, gain or loss directly on Schedule D without using Form 8949 at all.

Example: Jack's 1099-B shows a series of long-term transactions for which basis is reported to the IRS. There are no adjustments shown on the 1099-B, and you don't need to make any adjustments on your end. (We'll cover the topic of adjustments more in a bit.) There are no QOF investments involved, and Box 2, indicating ordinary income, isn't checked. Gross proceeds are $6,000 and basis is $2,000. Instead of reporting these transactions on Form 8949, we can proceed directly to Schedule D (see Figure 3 below).

If these were short-term transactions rather than long-term transactions, we'd use Line 1a on Part I of Schedule D, rather than Line 8a on Part II.

However, often there are adjustments, usually a wash sale or the basis of the transactions were not reported to the IRS (categories B and E), in which case, we don't qualify for this exception.

FIGURE 3

Part II **Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year** (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b .	$6,000	$2,000		$4,000

In that case, we look to the second exception: Instead of reporting each transaction on a separate row of Part I or II, we can report them on an attached statement containing all the same information as Parts I and II and in a similar format [i.e., description of property, dates of acquisition and disposition, proceeds, basis, adjustment and code(s), and gain (or loss)]. Then we enter the combined totals from all the attached statements on Parts I and II with the appropriate box checked. Code "M" for multiple is put in column (f) to alert the IRS to look for the attached statements. It may look as shown in Figure 4 below.

You may need to fill in column (b) with the word "various" and column (c) with the last date of the tax year to make your software happy. But note the code "M" in column (f); in this situation, there is no need to fill in column (g).

The easiest way to comply with the requirement to send statements is to simply attach the broker's 1099-B to the tax return. Many brokers will supply an Excel spreadsheet with that same information in an easier format, and that can be attached to the tax return instead. If the return is paper filed, simply attach the statements and mail it off. If you are e-filing the return, you can either upload a pdf, assuming your software permits it, or you can mail the attachment using Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*. Check the very last box on the form, which reads "Form 8949, Sales and Other Dispositions of Capital Assets (or a statement with the same information), if you elect not to report your transactions electronically on Form 8949."

Adjustments

We've mentioned adjustments several times. Adjustments are reported in columns (f) and (g) on Form 8949. Column (f) is used to report the type of adjustment and column (g) reports the amount of the adjustment. The most commonly used adjustments for sales of securities are:

- B, indicating that the basis shown on the 1099-B is incorrect
- M, indicating that multiple transactions are reported on a single row
- N, indicating that some amount of gain or loss belongs to another taxpayer
- W, indicating that a wash sale loss is being disallowed

FIGURE 4

Form 8949 (2022) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side | **Social security number or taxpayer identification number**

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☑ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☐ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). See the separate instructions. (f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
SCHWAB (see attached statement)			$55,000	$30,000	M		$25,000

We've already seen that code M is used to alert the IRS to the fact that multiple transactions are reported on a single row.

Code B, basis adjustment, is used when the basis shown by the broker is incorrect. How this is reported on the tax return depends on whether the basis was reported to the IRS (categories A and D) or not reported to the IRS (B and E).

If basis is not reported to the IRS, the IRS doesn't know what the broker thought the basis was. This is a simple fix. We just put in the correct basis in column (e), the code "B" in column (f) and zero in column (g). It's that easy. On the other hand, if basis was reported to the IRS, our job becomes a little more difficult.

The IRS provides a handy worksheet in the instructions to Form 8949 to help us understand how to correct basis that was reported to the IRS, which we'll use in the next example.

Example: Barb purchased stock for $100. Three months later, she sold it for $1,000, resulting in a short-term gain of $900. Her 1099-B, however, reported her basis as $900, showing a short-term gain of $100. This basis and gain were reported to the IRS. We use the worksheet to determine how to report this adjustment (see Figure 5 below).

The basis that was reported on the 1099-B is entered on Line 1. The correct basis is entered in Line 2. If the correct basis is more than the reported basis, we enter the difference on Line 3 and report that amount as a negative adjustment on Form 8949, column (g). If the correct basis is less than the reported basis, as is Barb's case, we enter the difference on Line 4 and report the difference as a positive adjustment on Form 8949, column (g). A negative adjustment has the effect of reducing gain, while a positive adjustment increases gain; so, what you are actually adjusting here is not the basis, but the gain or loss position. Barb's Form 8949, then, would appear as shown in Figure 6 below.

FIGURE 5

Worksheet for Basis Adjustments in Column (g) *Keep for Your Records*

If the basis shown on Form 1099-B (or substitute statement) isn't correct, do the following.
- If the basis wasn't reported to the IRS, enter the correct basis in column (e) and enter -0- in column (g) (unless you must make an adjustment for some other reason). You don't need to complete this worksheet.
- If the basis was reported to the IRS, enter the reported basis shown on Form 1099-B (or substitute statement) in column (e) and use this worksheet to figure the adjustment to include in column (g).

1.	Enter the cost or other basis shown on Form 1099-B (or substitute statement)	1.	$900
2.	Enter the correct cost or other basis	2.	$100
3.	If line 1 is larger than line 2, leave this line blank and go to line 4. If line 2 is larger than line 1, subtract line 1 from line 2. Enter the result here and in column (g) as a negative number (in parentheses)	3.	
4.	If line 1 is larger than line 2, subtract line 2 from line 1. Enter the result here and in column (g) as a positive number	4.	$800

FIGURE 6

Part I **Short-Term.** Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.
Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box A, B, *or* C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☑ **(A)** Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(B)** Short-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☐ **(C)** Short-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	Adjustment, if any, to gain or loss If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g).
			$1,000	$900	B	$800	$900

Code N is used if a taxpayer received a Form 1099-B reporting a transaction, but the taxpayer who received the form is not the owner of the account. To satisfy the IRS matching software in this situation the transaction is entered on Form 8949 as if the taxpayer were the actual owner, but any gain is reported as a negative amount in column (g) of Form 8949 and any loss is reported as a positive amount in column (g) of Form 8949, accompanied by the code "N" in column (f).

Sometimes the taxpayer who receives the Form 1099-B is a partial owner, in which case the gain or loss amount is adjusted to reflect the actual amount of gain or loss that represents that taxpayer's ownership interest in that transaction.

Consider adding a disclosure statement to the tax return explaining the circumstances that have led to a nominee situation, including the name and, if possible, the tax ID number of the person to whom you are nominee-ing the gain or loss. The Form 8949 instructions do not require this, but it can prevent your client from receiving an inquisitive letter from the IRS.

Wash sale

The most common adjustment for sales of investments is Code W, wash sale losses. A wash sale loss is the sale of a security at a loss, followed by a repurchase of the same or substantially same security within 30 days before or after that sale. In this case, the loss is disallowed, but is added to the basis of the newly purchased shares. The holding period of the newly purchased shares dates back to the holding period of the original shares. It is, in effect, as if that wash sale never took place. The idea, clearly, is to prevent investors from harvesting losses for tax purposes without a true change in economic substance.

Timing is everything. For example, if Georgina sold stock at a loss on Nov. 29 and repurchased that same stock on Dec. 28, her loss would be disallowed. If she waited just a few more days and repurchased that stock on Dec. 30, the loss would be allowed in full.

Brokers report wash sale losses on the 1099-B, but be careful. The wash sale loss is reported beneath the horizontal line as shown in Figure 7 on the next page, and the accrued market discount is reported above the horizontal line as shown in Figure 8. In the first image, we see an accrued market discount of $200; in the second image, we see a wash sale loss of $142.38. It's easy to confuse the two.

This wash sale loss would be reported on Form 8949 as shown in Figure 9 at the bottom of the next page.

Be aware that wash sale losses transcend accounts. If a taxpayer sells stock in one account and repurchases that stock through another account — perhaps an IRA — this is still considered a wash sale. The same holds true if a taxpayer sells stock and their spouse purchases that same stock in a different account. The broker is unlikely to spot that, as the IRS makes the broker responsible for reporting wash sales only in each account, but the IRS makes the rule clear in Pub 550, *Investment Income and Expenses*, which states, "If you sell stock and your spouse or a corporation you control buys substantially identical stock, you also have a wash sale."

FIGURE 7

SHORT-TERM TRANSACTIONS FOR WHICH BASIS IS REPORTED TO THE IRS–Report on Form 8949, Part I, with **Box A** checked.

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	Realized Gain or (Loss)	4–Federal income tax withheld
5 CALL SAMPLE CORPORATION	SC	01/15/21	$ 602.75	$ 525.00	--	$ 77.75	$ 0.00
XXYY 03/21/2021 20.00 C		02/11/21			--		
10 CALL SAMPLE CORPORATION	X	01/15/21	$ 0.00	$ 1,050.00	--	$ (1,050.00)	$ 0.00
XXYY 03/21/2021 20.00C		03/21/21			--		
Security Subtotal			**$ 602.75**	**$ 1,575.00**	**-- $**	**(972.75)**	**$ 0.00**
10,000 PRETEND CORPORATE BOND **DUE 04/15/24**	S	01/09/21	$ 9,750.00	$ 9,550.00	$ 200.00	0.00	$ 0.00
54321XXXX		10/13/21			--		
Security Subtotal			**$ 9,750.00**	**$ 9,550.00**	**$ 200.00**	**$ 0.00**	**$ 0.00**

FIGURE 8

LONG-TERM TRANSACTIONS FOR WHICH BASIS IS REPORTED TO THE IRS–Report on Form 8949, Part II, with **Box D** checked.

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	Realized Gain or (Loss)	4–Federal income tax withheld
0.50 EXAMPLE COMMON STOCK	C	04/07/20	$ 22.03	$ 19.16	--	$ 2.87	$ 0.00
17296XXXX/ABC		05/10/21			--		
7 X (Please note that you cannot claim a loss based on the amount in box 1d.)							
Security Subtotal			**$ 22.03**	**$ 19.16**	**-- $**	**2.87**	**$ 0.00**
1,000 QUALIFIED OPPORTUNITY FUND	S	02/12/20	$ 2,000.00	$ 2,000.00	--	$ 0.00	$ 0.00
88888XXXX		07/11/21			--		
3–If checked, proceeds from: QOF ☒							
Security Subtotal			**$ 2,000.00**	**$ 2,000.00**	**-- $**	**0.00**	**$ 0.00**
1,000 SAMPLE CORP BOND **CALLED**	S	01/21/20	$ 1,183.69	$ 1,326.07	--	$ (1.75)	$ 0.00
03759XXXX		02/08/21			$ 142.38		
Security Subtotal			**$ 1,183.69**	**$ 1,326.07**	**-- $**	**(1.75)**	**$ 0.00**
					$ 142.38		

FIGURE 9

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☑ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☐ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis See the **Note** below and see *Column (e)* in the separate instructions.	**Adjustment, if any, to gain or loss** If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g).
SAMPLE CORP BOND	1/21/2020	2/8/2021	$1,184	$1,326	w	$142	$0

Missing basis

We often see a 1099-B that shows basis missing, as shown by the green arrows in Figure 10 on the next page.

This usually comes about because the investment was purchased prior to the Jan. 1, 2011, date when brokers were required to track stock basis. The requirement date was phased in for other investments. The IRS's position is that if basis is not known, it's zero.

The first step, honestly, is to calculate what tax your client would pay if you did use a zero basis. If the tax is a whopping $10, it might not be worth a whole lot of effort to avoid paying it. Of course, your client might have taken a big loss on the sale, in which case, some effort would be warranted.

The first step is to have the client call the broker to see if any information is available. If this doesn't help, ask the client if they have any records that might shed some light on the situation. If the client was involved in a dividend reinvestment program, just adding up the dividends that were reinvested will give you at least some basis. Sometimes the client will recall when it was purchased, and you can get an average cost basis from historical price information.

Of course, document how you arrived at the basis in case there are questions later!

Holding period

The holding period is a crucial factor in the taxation of sales of investments. There's a common misperception that the holding period begins on the day the taxpayer buys the stock. The holding period actually begins the day *after* the trade date.

The trade date is the date the taxpayer entered into the transaction. It might be the day they told their broker to buy the investment, but it might be a day or two later, depending on when the phone call took place. The confirmation statement the taxpayer receives will provide the trade date. The settlement date, on the other hand, is the date that the shares and the money actually change hands. It's the *trade* date that is relevant for our holding period, not the settlement date.

If our taxpayer's trade date is Jan. 1, 2022, their holding period begins on Jan. 2, 2022. If they sell it on or before Jan. 1, 2023, the transaction is short-term. A sale on or after Jan. 2, 2023, is long term.

Example: Fred's trade date for the purchase of ABC stock was Feb. 28, 2019. He sold the stock on Feb. 29, 2020 (a leap year), believing that he had met the requirements for a long-term transaction. Sadly, though, because his trade date was Feb. 28, his holding period began on March 1. Selling the stock on Feb. 29 resulted in a short-term transaction.

Tax withholding

The 1099-B may include information on federal and state tax withholding. Federal withholding is shown in the column labeled "4–Federal income tax withheld." It's generally in bold to get you to notice it. State information is shown in boxes 14, 15 and 16, and is not in bold. This can look confusing on the 1099-B. See Figure 11 on the next page.

If you look closely, you can see that this client has a total of $512.08 of federal tax withheld, and $128.02 of tax withheld for the state of California.

Activity codes

Forms 1099-B will generally contain codes to help you understand what's happening. They provide a helpful key to these codes, as shown in Figure 12 on the next page.

You'll see the codes used on the 1099-B right next to the description of the investment sold. What we see in Figure 13 on the next page is that this bond was held until maturity, as is indicated by the code "MT."

Conclusion

Hopefully, this article took some of the mystery out of Form 1099-B. We'll continue our consolidated 1099 series in future issues by covering the 1099-DIV, a 1099-INT, a 1099-OID and a 1099-MISC. Stay tuned! ▸

About the author

Amy M. Wall, EA, MBA, is recently retired from her private tax practice in Tucson, Arizona, where she worked with individuals, small businesses and S corporations. Amy now spends her time teaching and writing on taxation. She teaches for several continuing education providers and has been published in a number of tax journals, including NATP's TAXPRO Journal and Wolters Kluwer Journal of Tax Practice & Procedure. She is the author of *Virtual Tax: The taxation of Cryptocurrency*; *Income Taxes for Real Estate Agents*; *Divorce and Taxes*; and *The Parish*, a work of fiction about a tax preparer whose nighttime clients aren't quite what they seem.

FIGURE 10

LONG-TERM TRANSACTIONS FOR WHICH BASIS IS MISSING AND NOT REPORTED TO THE IRS–Report on Form 8949, Part II, with **Box E** checked.

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	*Realized Gain or (Loss)*	**4–Federal income tax withheld**
1,000 SAMPLE REMIC	**R**	10/12/15	$ 1,000.00	Missing	--	-- $	**0.00**
31392XXXX		01/18/21			--		
Security Subtotal			**$ 1,000.00**	--	-- --	-- $	**0.00**
-- SAMPLE UNIT INVESTMT TRUST	**P**	--	$ 171.18	Not Provided	--	-- $	**0.00**
45808XXXX		10/25/21			--		
Security Subtotal			**$ 171.18**	--	-- --	-- $	**0.00**
Total Long-Term (Cost basis is missing and not reported to the IRS)			**$ 1,171.18**	--	-- --		

FIGURE 11

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	*Realized Gain or (Loss)*	**4–Federal income tax withheld**
10,000 SAMPLE CORP BOND **DUE 04/15/25**	**R**	04/10/21	$ 9,800.00	$ 9,730.65	--	$ 69.35	**$ 0.00**
04939XXXX		06/15/21			--		
Security Subtotal			**$ 9,800.00**	**$ 9,730.65**	-- --	**$ 69.35**	**$ 0.00**
50 SAMPLE LTD PARTNERSHIP	**S**	04/27/21	$ 1,828.85	$ 1,854.98	--	$ (26.13)	**$ 512.08**
28370XXXX/XXX		09/08/21			--		
14–State name CA		**15–State identification no.** 00-0000000			**16–State tax withheld**	$	128.02
Security Subtotal			**$ 1,828.85**	**$ 1,854.98**	-- --	**$ (26.13)**	**$ 512.08**

FIGURE 12

**Activity Codes (Not reported to the IRS):

C = Cash in Lieu	**E** = Exchange	**P** = Principal	**S** = Sale	**T** = Tender	**BC** = Buy to Close	**X** = Expiration
CV = Conversion	**M** = Cash Merger	**MT** = Maturity	**R** = Redemption	**SS** = Short Sale	**SC** = Sell to Close	

FIGURE 13

1a–Description of property (Example–100sh. XYZ Co.) / CUSIP Number/Symbol	**	1b–Date acquired / 1c–Date sold or disposed	1d–Proceeds 6–Reported to IRS: Gross proceeds (except where indicated)	1e–Cost or other basis	1f–Accrued Market Discount / 1g–Wash Sale Loss Disallowed	*Realized Gain or (Loss)*	**4–Federal income tax withheld**
10,000 EXAMPLE CORP BOND **MATURED	**MT**	07/02/19	$ 10,000.00	$ 10,605.97	--	$ (605.97)	**$ 0.00**
12589XXXX		04/15/21					
Security Subtotal			**$ 10,000.00**	**$ 10,605.97**	--	**$ (605.97)**	**$ 0.00**

How To

Stock Trader vs. Investor

By Kris Siolka, EA and Sheri Fronsee, CPA

Individuals who participate in active trading consider themselves traders as opposed to investors with the desire to deduct their investment expenses on Schedule C (Form 1040), *Profit or Loss From Business*, instead of Schedule A (Form 1040), *Itemized Deductions*, as investment interest or investment expenses.

Note: The *Tax Cuts and Jobs Act* (TCJA) eliminated deductions subject to 2%-of-AGI limits such as investment expenses. However, investment interest is not subject to 2%-of-AGI limits and is still deductible.

Generally, most taxpayers are investors. However, with the increased popularity of online trading and discount brokers, taxpayers spending considerable time trading securities regularly may qualify as traders.

The IRS has no specific guidelines for distinguishing between traders or investors for tax purposes. The general presumption is that a taxpayer is an investor unless their actions show they are in the business of trading securities.

The Federal Circuit Court of Appeals and the Tax Court use the following factors to determine whether an individual is a trader or investor:

- The taxpayer's investment intent
- The nature of the income to be derived from the activity
- The frequency, extent and regularity of the taxpayer's securities transactions

A taxpayer is considered a trader when both of the following are true:

- Trading activity is substantial
- Profit is sought from short-term swings in the daily market movement, rather than from holding investments for the long-term

Therefore, when making the determination between trader and investor, it's important to look at the following:

- Number of trades
- Average holding period of the security
- Sources of income
- Taxpayer's ongoing involvement in the activity
- Percentage of available trading on the day in which the trading activity occurred

The Tax Court looks to both the number of trades in a year and the amount of money involved in the trades. However, there are instances when the amount of money earned weighs heavier than the number of trades.

The chart below shows the basic characteristics of traders versus investors.

Tax reporting considerations for traders

Because of the unusual reporting rules for traders, tax preparers should consider the following facts.

Schedule C losses

Traders who do not make the mark-to-market election (discussed later) report expenses only on Schedule C, thus creating a loss year after year. Due to the hobby loss rules, the IRS could question the continued losses. To mitigate this possibility, add a footnote or a statement to the Schedule C explaining that the taxpayer is a securities trader.

Currently there is no guidance on how the Schedule C loss impacts self-employment (SE) earnings when a taxpayer has more than one trade or business subject to SE taxes. The presumption is that the Schedule C loss from the trading activity can be offset against SE earnings from other sources.

Form 1099-B reconciliation

Traders who do not make the mark-to-market election report the trades on Form 8949, *Sales and Other Dispositions of Capital Assets*, and Schedule D, (Form 1040), *Capital Gains and Losses.* Consequently, there should be no matching issues with the IRS.

Traders who make the mark-to-market election report trading gains and losses by entering the total gross proceeds from Forms 1099-B, *Proceeds from Broker and Barter Exchange Transactions*, on Form 4797, *Sales of Business Property*, Part II, Line 1. This could ultimately cause a matching issue with the IRS. To mitigate this, in addition to reporting the information on Form 4797, also report the gross proceeds on Form 8949 and enter the appropriate code (Code O) from the instructions in Column (f) along with the appropriate amount in Column (g). This should reconcile differences between Forms 1099-B and 8949.

Detailing trading activity

When reporting the detailed trading activity, taxpayers list everything on Form 8949 or attach a statement containing all the same information as Form 8949 and in a similar format, such as the detail from the consolidated Form 1099.

Similarly, when making the mark-to-market election, the Form 4797 instructions state the taxpayer should attach a detailed statement to the trading activity. The statement totals are reported on Form 4797, Part II, Line 10.

The above properly accounts for the trading activity; however, to properly report the activity, tax preparers may need to override the tax software.

The chart at the top of the next page summaries the tax reporting of investors versus traders.

Characteristics	Trader	Investor
Buying and selling	Short-term market swings and stock selection based on technical factors	Long-term market swings, consider income-producing dividends and appreciation, and selection based on fundamental factors
Involvement	Substantial, frequent, regular and continuous involvement, devoting considerable time, primary source of income	Active trading on weekends and after-work hours, relies on a broker or agent, has other primary sources of income, relatively short periods of high-volume trading may occur
Hold periods	Generally, 30 days or less, minimum stocks held longer than one year	Both long- and short-term holding periods
Trade frequency	Daily or almost daily with one or more trades each day, few periods of inactivity	Sporadic trading, no particular pattern to activity, long periods without any activity
Source of income	Short-term gains	Interest, dividends, long-term gains

Description	Investor	Trader	Mark-to-Market Election
Gains and losses	Capital Form 8949 and Schedule D	Capital Form 8949 and Schedule D	Ordinary Form 4797
Interest expense	Investment interest Schedule A (Form 1040)	Business expense Schedule C	Business expense Schedule C
Trading expenses	Miscellaneous itemized deductions subject to 2% AGI, no longer deductible	Trade or business expenses on Schedule C No effect on net investment income	Trade or business expenses on Schedule C No effect on net investment income
SE taxes	None	None	None

Taxation of investors

The sale of the stocks are capital assets reported on Form 8949 and Schedule D. Any expenses incurred in the connection with their trading activity are expenses incurred for the production of income under §212 and, prior to 2018, were deductible on Schedule A as miscellaneous itemized deductions subject to the 2%-of-AGI limitations [§67]. Miscellaneous itemized deductions on Schedule A are no longer allowed (2018–2025).

Investment expenses are not allowed when computing alternative minimum tax (AMT). Commissions paid when purchasing the securities are capitalized as part of the cost of the security, but are a reduction of the sales proceeds when sold.

Example 1: Investor

Josie Jacobs dabbles in the stock market. Currently she works full time and doesn't have enough time to follow and properly assess stock activity herself. Consequently, she lets her broker make stock investment suggestions along with her purchases and sales. Her investment strategies are for long-term growth to save for retirement in 20 years. She does not invest for short-term profit from daily swings in the stock market. On average, her broker makes less than 20 trades in a year for her.

Based on the factors used by the Federal Circuit Court of Appeals and the Tax Court (intent, nature of income derived from the activity, and frequency, extent and regularity of security transactions), along with the fact that Josie's trading activity is not substantial nor does she seek profit from short-term swings in the daily market, Josie does not meet the definition of a trader and is considered an investor for tax-reporting purposes.

Josie's broker issued her a Form 1099-B consolidated listing her investment activity. As an investor, she reports her investment activities on Form 8949, if no exceptions apply, and Schedule D. She is not able to deduct any of her related investment expenses. Her Form 1099-B lists the following stock sales with Boxes A and D checked, indicating cost basis is reported to the IRS.

Stock	Shares	Date Purchased	Date Sold	$/share	Proceeds	Cost	Gain (Loss)	S/L Term
Stock A	100	01/15/22	02/16/22	$25	$2,500	$500	$2,000	S
Stock B	200	04/16/20	05/17/22	$75	$15,000	$12,500	$2,500	L
Stock C	300	06/16/21	07/16/22	$100	$30,000	$16,000	$14,000	L
Stock D	250	07/17/20	08/18/22	$20	$5,000	$4,000	$1,000	L
Stock E	100	09/17/18	10/18/22	$650	$65,000	$6,000	$59,000	L
Stock F	300	10/17/22	11/19/22	$25	$7,500	$1,000	$6,500	S
Stock G	500	11/15/17	12/10/22	$75	$37,500	$8,000	$29,500	L
Stock H	500	04/15/16	12/15/22	$75	$37,500	$2,000	$35,500	L
Total	2,250				$200,000	$50,000	$150,000	

Because Boxes A and D are checked on Form 1099-B, indicating all basis is reported to the IRS, Josie meets Exception 1 to the requirement for filing Form 8949. However, for demonstration purposes and because she has minimal stock sales, she chose to report the stock sales separately on Form 8949 and Schedule D.

Exception 1 to reporting Form 8949 states that Form 8949 isn't required for transactions (other than the sale of collectibles) for which the taxpayer receives a Form 1099-B showing all basis was reported to the IRS, and (1) doesn't show any adjustment in Form 8949, Box 1f or 1g; (2) ordinary box in Form 8949, Box 2, isn't checked; (3) there are no adjustments to the basis or type of gain reported on Form 1099-B or to the gain; and (4) there is no election to defer income due to an investment in a qualified opportunity fund (QOF) and the taxpayer isn't terminating deferral from an investment in a QOF.

Josie's Form 8949 is shown below. Her Schedule D for investor purposes is shown to the right.

– text continued on next page

SCHEDULE D (Form 1040) — Department of the Treasury, Internal Revenue Service

Capital Gains and Losses

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/ScheduleD* for instructions and the latest information.
Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

OMB No. 1545-0074 — **2022** — Attachment Sequence No. **12**

Name(s) shown on return: JOSIE JACOBS — Your social security number: 311-11-1111

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? ☐ Yes ☒ No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I Short-Term Capital Gains and Losses — Generally Assets Held One Year or Less (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b				
1b Totals for all transactions reported on Form(s) 8949 with Box A checked	10,000	1,500	0	8,500
2 Totals for all transactions reported on Form(s) 8949 with Box B checked				
3 Totals for all transactions reported on Form(s) 8949 with Box C checked				

4	Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4
5	Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5
6	Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions	6 ( )
7	**Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7 8,500

Part II Long-Term Capital Gains and Losses — Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b				
8b Totals for all transactions reported on Form(s) 8949 with Box D checked	190,000	48,500	0	141,500
9 Totals for all transactions reported on Form(s) 8949 with Box E checked				
10 Totals for all transactions reported on Form(s) 8949 with Box F checked				

11	Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11
12	Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12
13	Capital gain distributions. See the instructions	13
14	Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions	14 ( )
15	**Net long-term capital gain or (loss).** Combine lines 8a through 14 in column (h). Then go to Part III on the back	15 141,500

For Paperwork Reduction Act Notice, see your tax return instructions. — Schedule D (Form 1040) 2022

Form 8949 — Department of the Treasury, Internal Revenue Service

Sales and Other Dispositions of Capital Assets

Go to *www.irs.gov/Form8949* for instructions and the latest information.
File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

OMB No. 1545-0074 — **2022** — Attachment Sequence No. **12A**

Name(s) shown on return: JOSIE JACOBS — Social security number or taxpayer identification number: 311-11-1111

Before you check Box A, B, or C below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part I Short-Term. Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.
Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box A, B, or C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☒ **(A)** Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(B)** Short-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☐ **(C)** Short-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions. (f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
100.000 sh STOCK A	01/15/22	02/16/22	2,500	500			2,000
300.000 sh STOCK F	10/17/22	11/19/22	7,500	1,000			6,500
2 **Totals.** Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 1b** (if **Box A** above is checked), **line 2** (if **Box B** above is checked), or **line 3** (if **Box C** above is checked)			10,000	1,500		0	8,500

Note: If you checked Box A above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.
For Paperwork Reduction Act Notice, see your tax return instructions. — Form **8949** (2022)

Form 8949 (2022) — Attachment Sequence No. **12A** — Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side: JOSIE JACOBS — Social security number or taxpayer identification number: 311-11-1111

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II Long-Term. Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.
Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☒ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☐ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). See the separate instructions. (f) Code(s) from instructions	(g) Amount of adjustment	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g).
200.000 sh STOCK B	04/16/20	05/17/22	15,000	12,500			2,500
300.000 sh STOCK C	06/16/21	07/16/22	30,000	16,000			14,000
250.000 sh STOCK D	07/17/20	10/18/22	5,000	4,000			1,000
100.000 sh STOCK E	09/17/18	10/18/22	65,000	6,000			59,000
500.000 sh STOCK G	11/15/17	12/10/22	37,500	8,000			29,500
500.000 sh STOCK H	04/15/16	12/15/22	37,500	2,000			35,500
2 **Totals.** Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked)			190,000	48,500		0	141,500

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.
Form **8949** (2022)

Taxation of traders

Traders are considered to be in a trade or business. Thus, their expenses are reported on Schedule C. Traders will incur normal business expenses such as supplies, depreciation, travel and office expenses. In addition, traders may have interest paid on margin accounts used with the trading activity as well as a home office deduction.

When traders sell securities, the sales are reported on Form 8949 and Schedule D as either short-term or long-term capital gains or losses. The securities in the hands of traders are considered capital assets because they do not have customers to whom they sell the securities. If they had customers, the securities sales would be treated as sales of inventory reported as ordinary income on Schedule C.

Any losses a trader incurs on the disposition of the securities is subject to the $3,000 annual capital loss limitations. Additionally, wash sale rules apply to traders.

Trader example

Josie Jacobs loves investing in the stock market. She currently works part-time and spends much of her free time following and assessing stock activity. She has a self-directed investment account and makes her own purchases and sales based on her research. Her investment strategies are for short-term profit from daily swings in the stock market to help enhance her part-time salary. On average, she could make up to 20 trades in a week.

Josie has a home office she uses for investment research and making stock trades. Her total expenses for the year are mortgage interest of $5,000, utilities of $2,000 and insurance of $1,000. Her entire home is 1,500 square feet and the room she has dedicated to her home office use is 150 square feet, or 10% of the total square footage of the home. The cost of her home was $150,000 and the amount allocated to land is $30,000.

She uses her cell phone 10% for stock activity. Her total cell phone expenses for the year are $1,500, and she has $1,000 of interest on margin accounts. Additionally, she just purchased a new computer for $2,000, which she uses 60% of the time for stock activities. She would like to take the §179 deduction for it and has investment fees for her trades of $5,000.

Based on the factors used by the Federal Circuit Court of Appeals and the Tax Court (intent, nature of income derived from the activity and frequency, extent and regularity of security transactions), along with the fact that Josie's trading activity is substantial and she seeks profit from short-term swings in the daily market, Josie meets the definition of a trader and is considered a trader for tax purposes. As a trader, she still reports her investment sales on Form 8949 and Schedule D; however, she can also deduct related expenses on Schedule C.

Josie received a Form 1099-B consolidated showing over 300 stock sales indicating both short- and long-term transactions. Boxes A and D are checked indicating all basis is reported to the IRS. Disregarding wash sale rules, Josie's short-term gains are $50,000 ($350,000 sales proceeds - $300,000 cost) and her long-term gains are $10,000 ($410,000 proceeds - $400,000 cost).

Form 8949. Josie meets Exception 1 to the requirement for filing Form 8949. In this case, she chooses to aggregate her short-term and long-term stock sales and report them directly onto Schedule D, Lines 1a (short-term) and 8a (long-term). She does not file Form 8949.

Schedule D. Because Josie did not file Form 8949, using Exception 1, she reports her short-term stock activity on Schedule D, Line 1a, and her long-term stock activity on Line 8a. If she had filed Form 8949, her stock activity would have been reported on Lines 1b and 8b. Josie's Schedule D is shown at the top of the next page.

Schedule C. Because Josie is a trader, she is eligible to report her trading expenses on Schedule C. Additionally, her trader business status makes her eligible for claiming a home office deduction, providing the requirements of §280A(c) are met. In this case, she meets the requirements of §280A(c). Because her net income from her trading activities (though reported on Schedule D instead of Schedule C) provides her with sufficient income, she is eligible to claim a home office deduction on Form 8829, *Expenses for Business Use of Your Home*. Her actual Form 8829 expenses are $1,095 and her simplified home office expenses are $750 (150 square feet x $5/square foot). She chooses to use actual expenses on Form 8829.

Her Schedule C is shown on the bottom of the next page.

Her income is blank because the stock activity was reported on Schedule D.

Line 30, home office deduction is reported even though there is no income on Schedule C. Remember, her related income is reported on Schedule D instead.

Jose's Form 8829 is shown on page 40.

SCHEDULE D (Form 1040)
Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

Attach to Form 1040, 1040-SR, or 1040-NR.
Go to *www.irs.gov/ScheduleD* for instructions and the latest information.
Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.

OMB No. 1545-0074
2022
Attachment Sequence No. **12**

Name(s) shown on return: JOSIE JACOBS
Your social security number: XXX-XX-XXXX

Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? ☐ **Yes** ☐ **No**
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I **Short-Term Capital Gains and Losses—Generally Assets Held One Year or Less** (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b	350,000	300,000		50,000
1b Totals for all transactions reported on Form(s) 8949 with **Box A** checked				
2 Totals for all transactions reported on Form(s) 8949 with **Box B** checked				
3 Totals for all transactions reported on Form(s) 8949 with **Box C** checked				

4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions	6	( )
7 **Net short-term capital gain or (loss).** Combine lines 1a through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7	50,000

Part II **Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year** (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b	410,000	400,000		10,000
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked				
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked				
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked				

11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13 Capital gain distributions. See the instructions	13	
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions	14	( )
15 **Net long-term capital gain or (loss).** Combine lines 8a through 14 in column (h). Then, go to Part III on the back	15	10,000

For Paperwork Reduction Act Notice, see your tax return instructions. **Schedule D (Form 1040) 2022**

Part III **Summary**

16 Combine lines 7 and 15 and enter the result • If line 16 is a **gain**, enter the amount from line 16 on Form 1040, 1040-SR, or 1040-NR, line 7. Then, go to line 17 below. • If line 16 is a **loss**, skip lines 17 through 20 below. Then, go to line 21. Also be sure to complete line 22. • If line 16 is **zero**, skip lines 17 through 21 below and enter -0- on Form 1040, 1040-SR, or 1040-NR, line 7. Then, go to line 22.	16	60,000
17 Are lines 15 and 16 **both** gains? ☒ **Yes.** Go to line 18. ☐ **No.** Skip lines 18 through 21, and go to line 22.		
18 If you are required to complete the **28% Rate Gain Worksheet** (see instructions), enter the amount, if any, from line 7 of that worksheet	18	
19 If you are required to complete the **Unrecaptured Section 1250 Gain Worksheet** (see instructions), enter the amount, if any, from line 18 of that worksheet	19	
20 Are lines 18 and 19 both zero or blank and you are not filing Form 4952? ☒ **Yes.** Complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 16. **Don't** complete lines 21 and 22 below. ☐ **No.** Complete the **Schedule D Tax Worksheet** in the instructions. **Don't** complete lines 21 and 22 below.		
21 If line 16 is a loss, enter here and on Form 1040, 1040-SR, or 1040-NR, line 7, the **smaller** of: • The loss on line 16; or • ($3,000), or if married filing separately, ($1,500) **Note:** When figuring which amount is smaller, treat both amounts as positive numbers.	21	( )
22 Do you have qualified dividends on Form 1040, 1040-SR, or 1040-NR, line 3a? ☐ **Yes.** Complete the **Qualified Dividends and Capital Gain Tax Worksheet** in the instructions for Form 1040, line 16. ☐ **No.** Complete the rest of Form 1040, 1040-SR, or 1040-NR.		

SCHEDULE C (Form 1040)
Department of the Treasury
Internal Revenue Service

Profit or Loss From Business

(Sole Proprietorship)
Go to *www.irs.gov/ScheduleC* for instructions and the latest information.
Attach to Form 1040, 1040-SR, 1040-NR, or 1041; partnerships must generally file Form 1065.

OMB No. 1545-0074
2022
Attachment Sequence No. **09**

Name of proprietor: JOSIE JACOBS
Social security number (SSN): XXX-XX-XXXX

A Principal business or profession, including product or service (see instructions): INVESTMENT TRADER
B **Enter code from instructions**
C Business name. If no separate business name, leave blank.
D **Employer ID number (EIN)** (see instr.)
E Business address (including suite or room no.)
City, town or post office, state, and ZIP code

F	Accounting method: **(1)** ☒ Cash **(2)** ☐ Accrual **(3)** ☐ Other (specify)	
G	Did you "materially participate" in the operation of this business during 2022? If "No," see instructions for limit on losses	☒ **Yes** ☐ **No**
H	If you started or acquired this business during 2022, check here	☐
I	Did you make any payments in 2022 that would require you to file Form(s) 1099? See instructions	☐ **Yes** ☐ **No**
J	If "Yes," did you or will you file required Form(s) 1099?	☐ **Yes** ☒ **No**

Part I **Income**

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked ☐	1	
2	Returns and allowances	2	
3	Subtract line 2 from line 1	3	
4	Cost of goods sold (from line 42)	4	
5	**Gross profit.** Subtract line 4 from line 3	5	
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)	6	
7	**Gross income.** Add lines 5 and 6	7	

Part II **Expenses.** Enter expenses for business use of your home **only** on line 30.

8	Advertising	8		**18**	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions)	9		**19**	Pension and profit-sharing plans	19	
10	Commissions and fees	10		**20**	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		**a**	Vehicles, machinery, and equipment	20a	
12	Depletion	12		**b**	Other business property	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	1,200	**21**	Repairs and maintenance	21	
				22	Supplies (not included in Part III)	22	
14	Employee benefit programs (other than on line 19)	14		**23**	Taxes and licenses	23	
15	Insurance (other than health)	15		**24**	Travel and meals:		
16	Interest (see instructions):			**a**	Travel	24a	
a	Mortgage (paid to banks, etc.)	16a		**b**	Deductible meals (see instructions)	24b	
b	Other	16b	1,000	**25**	Utilities	25	
17	Legal and professional services	17		**26**	Wages (less employment credits)	26	
				27a	Other expenses (from line 48)	27a	5,150
				b	**Reserved for future use**	27b	

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27a	28 7,350
29	Tentative profit or (loss). Subtract line 28 from line 7	29 (7,350)
30	Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method. See instructions. **Simplified method filers only:** Enter the total square footage of (a) your home: _____ and (b) the part of your home used for business: _____. Use the Simplified Method Worksheet in the instructions to figure the amount to enter on line 30	30 1,095
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If a loss, you **must** go to line 32.	31 (8,445)
32	If you have a loss, check the box that describes your investment in this activity. See instructions. • If you checked 32a, enter the loss on both **Schedule 1 (Form 1040), line 3,** and on **Schedule SE, line 2.** (If you checked the box on line 1, see the line 31 instructions.) Estates and trusts, enter on **Form 1041, line 3.** • If you checked 32b, you **must** attach **Form 6198.** Your loss may be limited.	**32a** ☒ All investment is at risk. **32b** ☐ Some investment is not at risk.

For Paperwork Reduction Act Notice, see the separate instructions. **Schedule C (Form 1040) 2022**

Part III **Cost of Goods Sold** (see instructions)

33	Method(s) used to value closing inventory: **a** ☐ Cost **b** ☐ Lower of cost or market **c** ☐ Other (attach explanation)		
34	Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation	☐ **Yes**	☐ **No**
35	Inventory at beginning of year. If different from last year's closing inventory, attach explanation	35	
36	Purchases less cost of items withdrawn for personal use	36	
37	Cost of labor. Do not include any amounts paid to yourself	37	
38	Materials and supplies	38	
39	Other costs	39	
40	Add lines 35 through 39	40	
41	Inventory at end of year	41	
42	**Cost of goods sold.** Subtract line 41 from line 40. Enter the result here and on line 4	42	

Part IV **Information on Your Vehicle.** Complete this part **only** if you are claiming car or truck expenses on line 9 and are not required to file Form 4562 for this business. See the instructions for line 13 to find out if you must file Form 4562.

43	When did you place your vehicle in service for business purposes? (month/day/year)		
44	Of the total number of miles you drove your vehicle during 2022, enter the number of miles you used your vehicle for: **a** Business _____ **b** Commuting (see instructions) _____ **c** Other _____		
45	Was your vehicle available for personal use during off-duty hours?	☐ **Yes**	☐ **No**
46	Do you (or your spouse) have another vehicle available for personal use?	☐ **Yes**	☐ **No**
47a	Do you have evidence to support your deduction?	☐ **Yes**	☐ **No**
b	If "Yes," is the evidence written?	☐ **Yes**	☐ **No**

Part V **Other Expenses.** List below business expenses not included on lines 8–26 or line 30.

CELL PHONE	150
INVESTMENT FEES	5,000

48	**Total other expenses.** Enter here and on line 27a	48 5,150

Schedule C (Form 1040) 2022

Form **8829**

Department of the Treasury
Internal Revenue Service

Expenses for Business Use of Your Home

File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.
Go to *www.irs.gov/Form8829* for instructions and the latest information.

OMB No. 1545-0074

2022

Attachment Sequence No. **176**

Name(s) of proprietor(s): JOSIE JACOBS

Your social security number: XXX-XX-XXXX

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)			1	150
2	Total area of home			2	1,500
3	Divide line 1 by line 2. Enter the result as a percentage			3	10 %
	For daycare facilities not used exclusively for business, go to line 4. All others, go to line 7.				
4	Multiply days used for daycare during year by hours used per day	4	hr.		
5	If you started or stopped using your home for daycare during the year, see instructions; otherwise, enter 8,760	5	hr.		
6	Divide line 4 by line 5. Enter the result as a decimal amount	6	.		
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3			7	10 %

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, **plus** any gain derived from the business use of your home, **minus** any loss from the trade or business not derived from the business use of your home. See instructions.			8	60,000
	See instructions for columns (a) and (b) before completing lines 9–22.	**(a)** Direct expenses	**(b)** Indirect expenses		
9	Casualty losses (see instructions)	9			
10	Deductible mortgage interest (see instructions)	10		5,000	
11	Real estate taxes (see instructions)	11			
12	Add lines 9, 10, and 11	12		5,000	
13	Multiply line 12, column (b), by line 7	13	500		
14	Add line 12, column (a), and line 13			14	500
15	Subtract line 14 from line 8. If zero or less, enter -0-			15	59,500
16	Excess mortgage interest (see instructions)	16			
17	Excess real estate taxes (see instructions)	17			
18	Insurance	18		1,000	
19	Rent	19			
20	Repairs and maintenance	20			
21	Utilities	21		2,000	
22	Other expenses (see instructions)	22			
23	Add lines 16 through 22	23		3,000	
24	Multiply line 23, column (b), by line 7	24	300		
25	Carryover of prior year operating expenses (see instructions)	25			
26	Add line 23, column (a), line 24, and line 25			26	300
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26			27	300
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15			28	59,200
29	Excess casualty losses (see instructions)	29			
30	Depreciation of your home from line 42 below	30	295		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)	31			
32	Add lines 29 through 31			32	295
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32			33	295
34	Add lines 14, 27, and 33			34	1,095
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684**. See instructions			35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions			36	1,095

Part III Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	37	150,000
38	Value of land included on line 37	38	30,000
39	Basis of building. Subtract line 38 from line 37	39	120,000
40	Business basis of building. Multiply line 39 by line 7	40	12,000
41	Depreciation percentage (see instructions)	41	2.461 %
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	295

Part IV Carryover of Unallowed Expenses to 2023

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter -0-	43	0
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	0

For Paperwork Reduction Act Notice, see your tax return instructions. Form **8829** (2022)

Mark-to-market election

Section 475(f) allows traders to treat their security holdings as ordinary income instead of capital assets if they make the mark-to-market election and mark their securities to market value at the end of the tax year.

When the election is made, all securities on hand at year-end are deemed to be sold at the year-end market value. This causes the trader to recognize unrealized gains and losses on their tax return. The major reason traders make the mark-to-market election is to avoid the $3,000 capital gain loss limitation rules and the wash sale rules.

The deemed sale of the securities is reported on Form 4797, Part II.

Unfortunately, by making the mark-to-market election, the trader's securities are no longer eligible for capital gain treatment. However, since the securities are probably traded on a short-term holding period basis, the loss of the desirable long-term capital gain treatment may not be an issue or will have minimal impact.

If a trader makes the mark-to-market election, the securities, though taxed as ordinary income on Schedule C, do not lose their character as capital assets. This is important because capital gains and losses are specifically excluded from net earnings from self-employment; thus, earnings from trading activities are not subject to SE taxes.

In other words, making the §475 mark-to-market election converting the gains and losses to ordinary income does not change their character for SE tax purposes [§475(f)(1)(D)].

Taxpayers must make the mark-to-market election no later than the due date of the return, excluding extension, for the tax return for the year prior to the year the election is to be effective by attaching the election statement to the prior year return or extension request.

Seminars

The Tax Court has held that investors cannot deduct the cost of attending seminars in securities day trading; however, traders can.

The idea is that, for investors, expenses relating to a convention, seminar or similar meeting for a non-business-related item are not deductible under §274(h)(7), whereas for traders, the cost of the seminar is an ordinary and necessary business expense under §162. ▸

Tax Talk

Big charitable deduction needs big backup

By Misty Erickson, MBA

The reasonable cause exception to the strict substantiation requirements for charitable donations exceeding $500,000 allowed members of the Murphy family to deduct conservation easements made through their S corporation. This was only a partial win for the family, as the amount of the deduction was reduced after additional valuations of the property were made as part of the court proceedings.

Background

The Murphy family owned an S corporation, Duplin Land Development Inc. It acquired several tracts of land with the purpose of developing the parcels into a residential community, "River Landing," which contained two golf courses, residential lots, a clubhouse, recreational facilities and hiking trails. The two main tracts of land were the "River Tract" and the "Landing Tract." The only area accessible to nonresidents of the community without stopping at a visitor's entrance was the hiking trails. One such tract of land was mainly wetlands and flood plains dense with trees and vegetation while the other ran along the northern border of the Northeast Cape Fear River. River Landing preserved numerous open spaces containing lakes, ponds, wooded areas and river frontage. One of the golf courses, River

Course, had significant water features, vegetation and wetland areas throughout central portions of the course, while Landing Course preserved modest natural features.

In 2010, the family made easement donations of the two main tracts of property to the North American Land Trust (NALT), a §501(c)(3) charitable organization that is a qualified organization for the purposes of §170(h)(1)(B). The donation itself was made through Duplin Land Development.

The easement deed placed perpetual restrictive covenants on the property, which prohibited Duplin Land Development from adding structures, land improvements, or anything that would disrupt waterways or the land itself. In addition, the company could not introduce any non-native invasive species. While restrictions on development were in place, the golf courses on the properties could remain in operation if they applied best environmental practices prevailing in the golf industry.

A before and after valuation was made on the tracts subject to the conservation easements. The appraiser, F. Bruce Sauter, determined that the value of the Landing Tract before the easement donation was $1,457,842 and its value after the easement donation was $377,028; therefore, the value attributable to the Landing Tract easement was $1,080,814. Duplin Land's return reported the donations of the River Tract easement and the Landing Tract easement and claimed corresponding charitable contribution deductions of $7,344,095 and $1,080,814. The return included Form 8283, *Noncash Charitable Contributions*, for each easement. It was signed by both Sauter and NALT President Andrew L. Johnson and included the cover letters of Sauter's appraisals. However, the following portions of Duplin Land's Forms 8283 were either incomplete or entirely blank. Page 1 included only Duplin Land's identifying information, but nothing about the contributions. Page 2 failed to include the date and manner in which the donor acquired the property, the donor's cost or adjusted basis for the property, or whether the contribution was made as part of a bargain sale.

The IRS reviewed Duplin Land's 2010 return and disallowed the charitable contribution deductions, which flowed through to the individual shareholders. In addition, the IRS issued notices of deficiency to the shareholders — the Murphy family — disallowing the deduction on their individual returns. The notices did not state the deductions were disallowed based on the failure to satisfy the substantiation or reporting requirements under §170(f)(11). In regard to donations above $500,000, a taxpayer must attach a qualified appraisal to the tax return. The appraisal must include the date the property was donated, the cost or other basis of the property, and the date the donee received the property [Reg. §1.170A-13(c)(4)(ii)].

The shareholders filed a petition challenging the disallowance of the charitable contribution as well as for penalties assessed during the audit process.

Conclusion

The court reviewed the Murphy's case and applied the strict substantiation requirements of Reg. §1.170A-13(c)(4)(ii) for donations greater than $500,000. There was also an analysis of whether they had reasonable cause for not adhering to those reporting requirements. The reasonable cause essentially trumps the fact that they did not provide all the documentation required. In this instance, the courts found that their reliance on a CPA to prepare their tax return and the required forms was enough reasonable cause to allow the charitable contribution.

In addition to the allowance of the deduction, there was also a question as to the valuation of the donation. The appraisals done prior to the donation assumed specific uses of the property would continue. Those valuations did not reflect the actual use of the property. As a result, the donations were reduced to $2,790,274 for the River Tract easement and $100,000 for the Landing Tract easement. ▸

Wendell H. Murphy, Jr., et al. v. Comm'r
T.C. Memo. 2023-72

> In regard to donations above $500,000, a taxpayer must attach a qualified appraisal to the tax return.

Court to IRS: No authority, no assessment

By Virginia B. Hilton, MST, CPA

In Alon Farhy v. Comm'r, the U.S. Tax Court held that the IRS lacks statutory authority to assess §6038(b)(1) and (2) monetary penalties on a taxpayer who failed to file Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, for multiple years. The §6038(b)(1) penalty for willful failure to file is assessed systemically on many foreign information reporting forms without review by the IRS. The court ruled that the penalties must instead be assessed through civil action rather than through an automatic process. As a result, the IRS cannot collect the penalties it assessed through a lien or levy notice.

Background

During the years 2003 through 2010, Alon Farhy owned 100% of two corporations located in Belize. He held Katumba Capital Inc. from 2003–2010 and Morningstar Adventures Inc. from 2005–2010. Under §6038(a), Farhy was required to file Form 5471 to provide ownership information about the foreign corporations. Although he knew of his responsibility, he chose not to file the form. Per IRS standard practice, the agency notified Farhy of his failure to file, assessed penalties and, when ignored, ultimately issued a notice of intent to levy. Farhy requested a collection due process hearing (§6330), which upheld the assessed penalties. Farhy then petitioned the Tax Court to challenge the IRS's authority to assess penalties, specifically under §6038(b).

In this case, assessable penalties for willful failure to file the reports are a minimum of $10,000 for each accounting period where a failure to file exists, as well as a continuation penalty of $10,000 for each 30-day period where the failure continues after a 90-day notice period, to a maximum of $50,000 or $60,000 total [§6038(b)(1) and (2)]. Although both types of penalties are subject to the reasonable cause exception under §6038(c)(4)(B), Farhy's failure to pay was admittedly willful, so reasonable cause could not apply. In these circumstances, collection efforts generally begin before an employee ever reviews the validity of the assessment.

Unlike a multitude of other penalties, no actual language links the penalty created by §6038(b) to the IRS's right to assess and collect it automatically. Standard operating procedure, however, has been to adhere to the §6201(a) statutory authority granted by the Treasury Secretary, who authorizes the IRS to assess all taxes imposed by the Internal Revenue Code (IRC). "Taxes," in this case, includes tax, additions to tax, penalties and interest [§6665(a)(2)].

Since §6201(a) is not strictly defined, nor is the right to collect penalties specifically granted to the IRS, Farhy's challenge to the tax as one systemically assessed and administratively collected via liens and levies had merit.

During the court case, the taxpayer argued that the specific penalty, §6038(b), unlike others in the IRC, does not authorize the assessment of the penalty it calls for. Therefore, as the argument goes, the §6038(b) penalty is not an "assessable penalty," and only a civil action may force collection. Essentially, the taxpayer argued, because this code section falls outside of the sections in Subchapter B of Chapter 68 of Subtitle F, entitled "Assessable Penalties," and because it has no language linking its penalty provision to any other authorization to assess and collect penalties, the IRS does not have authority to assess and collect this penalty. The IRS noted that the term "assessable penalties" includes any penalties found in the IRC that are not subject to the code's deficiency procedures. Because the penalties were not subject to deficiency procedures, then, by definition, they had to be assessable.

As such, taxpayers assessed a $10,000 penalty must pay the penalty, file a claim for refund and, if necessary, file a refund suit in the appropriate U.S. district court or the U.S. Court of Federal Claims.

Holding

The Tax Court found the IRS did not have authority to assess and collect penalties under §6038.

Because these penalties were not assessable, the IRS was prohibited from proceeding with collection. The only way the IRS can pursue collection of the taxpayer's penalties was by 28 U.S.C. Sec. 2461(a), which allows recovery of any penalty by civil court action.

The court noted that Congress explicitly authorized assessment with respect to many penalty provisions in the IRC, but not for §6038(b) penalties. The court stated it was "loath to disturb this well-established statutory framework by inferring the power to administratively assess and collect the §6038(b) penalties when Congress did not see fit to grant that power to the Secretary of the Treasury expressly as it did for other penalties in the Code."

This decision is expected to have a broad reach and will affect most IRS Form 5471 filers, namely Category 1, 4 and 5 filers. It will not affect Category 2 and 3 filers, who are subject to penalties under §6679, which remains assessable. ▶

Alon Farhy v. Comm'r
160 T.C. No. 6 (April 3, 2023)

Physician misclassified workers

By Jan Socha, CPA

Employers are subject to employment taxes, which include taxes required by the *Federal Insurance Contributions Act* (FICA) and the *Federal Unemployment Tax Act* (FUTA). These taxes only apply in the case of employees and are not applicable to payments made to independent contractors. Employers are also required to make periodic deposits of amounts withheld from employee wages for income tax withholding and FICA and amounts corresponding to the employer's share of FICA and FUTA tax. Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, and Form 941, *Employer's Quarterly Federal Tax Return*, are employment tax returns that employers are required to file. Lastly, Form 1099-MISC, *Miscellaneous Income*, (prior to the 2020 tax year) or Form W-2, *Wage and Tax Statement*, are used to report compensation to workers, the filing of which is determined by how the worker is classified. The following case illustrates what can

happen when an employer incorrectly treats workers as independent contractors and does not have a reasonable basis for not treating the workers as employees.

Dr. Frank Daniel Kresock is the sole member of an active Arizona limited liability company (LLC), which was treated as a disregarded entity for federal tax purposes. Therefore, income and deductions were reported on Kresock's personal tax returns.

For the tax periods at issue (2010–2015), Kresock's practice consisted of four medical assistants and an officer manager. Each medical assistant was paid with a cashier's check signed by Kresock after submission of a biweekly time sheet, which was approved by the office manager. The timesheets identified the medical assistants as employees and the office manager as manager. The medical assistants were paid a set hourly rate and an increased hourly rate for work performed in excess of eight hours per workday. The office manager and Kresock lived together. She was not paid directly; however, Kresock paid her personal bills (mortgage payments on homes titled in her name).

All the workers reported to Kresock and were subject to his supervision. He and the office manager created

and communicated office procedures the workers were expected to follow. None of the workers were able to realize a profit or loss because of their services. There were no formal employment contracts between Kresock and any of his workers. The medical assistants were able to determine their own schedules. They were allowed to arrive and leave at any time without adverse consequences from Kresock or the office manager.

The office manager was responsible for managing the office and the workers as well as performing coding tasks. She worked almost every day. The medical assistants, at the direction of the office manager, performed front- and back-office duties, including answering phones, taking care of patients, completing prior authorizations, faxing prescriptions and other tasks associated with a medical practice. They worked for Kresock for several years.

Kresock did not file or issue Forms 1099-MISC or Forms W-2 reporting the compensation paid to the workers. He also did not file any employment tax returns (Forms 940 and 941).

The IRS determined that the practice's medical assistants and office manager were employees, not independent contractors. The determination made by the IRS is presumed to be correct; therefore, Kresock bears the burden of proving that the workers were not employees during the tax periods at issue.

Various factors are considered in determining whether a worker is a common-law employee or an independent contractor. These factors include the degree of control the principal exercised over the worker; which party invests in the work facilities used by the worker; the worker's opportunity for profit or loss; whether the worker can be discharged by the principal; whether the worker is part of the principal's regular business; the permanency of the relationship; and the relationship the parties believed they were creating. The IRS has also issued guidance using some 20 factors in determining whether an employment relationship exists (Rev. Rul. 87-41, 1987-1 C.B. 296).

In looking at the relevant factors, the U.S. Tax Court concluded that the relationship between the office manager and Kresock, and Kresock and the medical assistants, is best characterized as an employment relationship. The principal's degree of control over workers is a crucial factor in determining whether an employment relationship exists, and this factor was met,

according to the court. Additional factors that found in favor of an employment relationship include investment in the work facilities used by the workers, the worker's opportunities for profit or loss, whether the work was part of Kresock's regular business and the permanency of the relationship.

Under §530, when applicable, a taxpayer can be afforded relief from federal employment taxes even if the relationship between the principal and worker would otherwise require the payment of those taxes. Generally, the term 'federal employment taxes' refers to taxes imposed under FICA, FUTA and federal income tax withholdings. To qualify for §530 relief, a taxpayer must not have treated the worker as an employee for any period for purposes of federal employment taxes; must have consistently filed all federal tax returns required to be filed by the taxpayer (including information returns); must have had a reasonable basis for not treating the worker as an employee; and must not have treated as an employee any individual holding a position substantially similar to that of the worker in question.

The court looked at the requirement of whether the taxpayer had a reasonable basis for not treating the workers as employees with respect to the disputed payments and found Kresock failed to establish its qualification for the reasonable basis requirement. Also, he failed to file Forms 1099-MISC for the tax periods at issue, which is also a requirement as stated above.

Under a literal reading of the §530 text, all requirements must be met to receive relief. The court found Kresock is not entitled to §530 relief and is liable for all federal employment taxes reflected in the notice of determination. ▸

Cardiovascular Center, LLC v. Comm'r
T.C. Memo. 2023-64

Deficiency notice not required following taxpayer lawsuit

By J.P. Finet, JD

Before filing suit in a federal court seeking to collect taxes, the IRS is not required to follow deficiency procedures, which include issuing a notice of deficiency. This court decision allows the IRS to rely on common-law court procedures for collecting an outstanding debt rather than the statutory notice of tax deficiency procedure in the Internal Revenue Code.

It's generally accepted that the government may use one of two methods for collecting a tax debt, said the U.S. District Court for the District of Colorado in its decision on U.S. v. Liberty Global, Inc. It may do so either through summary collection procedures, such as a tax lien or levy, or through its common-law right to sue for outstanding debt. While the tax code requires a notice of deficiency before the IRS issues an administrative assessment, the court noted there is nothing in the statute that suggested the provision applies to a civil lawsuit.

In 2022, the same court ruled in Liberty Global Inc.'s (LGI's) favor on another issue in the case when it found that temporary regulations to implement the §245A dividend received deduction enacted as part of the *Tax Cuts and Jobs Act* (TCJA) were invalid due to the failure to comply with the notice-and-comment requirements in the *Administrative Procedures Act* (APA).

An attempt to exploit a loophole

LGI is a multinational telecommunications company that was approached by its tax advisors at Deloitte LLC in 2018 about an opportunity to exploit a perceived loophole in the international tax provisions of the TCJA. Deloitte then assisted LGI in planning a four-step series of transactions referred to as "Project Soy" that would allow LGI to avoid global intangible low tax income and capital gain taxes on billions of dollars in unrealized gains from the company's interests in one of its sub-entities.

The Treasury Department issued temporary regulations addressing the international tax changes that were made by the TCJA in June 2019. In October of that year, LGI filed its 2018 consolidated federal income tax

return, which it then amended in December 2019. The initial return reported the fourth step of the transactions in a manner that was consistent with the temporary regulations, but the amended return took the position that the regulations were invalid and claimed a $95.8 million refund instead.

After LGI filed its amended returns, the IRS began investigating the transactions and requested information from LGI. When the company failed to produce all of it, the IRS issued LGI a delinquency notice and included a deadline of Nov. 27, 2020, for responding to the notice, after which the IRS would seek a formal summons for the information in a federal court proceeding.

On Nov. 27, 2020, LGI filed a complaint in federal district court seeking a $110 million refund for the 2018 tax year. Because the company had yet to provide all the information requested by the IRS, the U.S. contended that discovery was still necessary to determine the nature of the transaction and LGI's earnings and profits.

The court granted part of LGI's motion for summary judgment in April 2022. However, when the court found the 2019 temporary regulations did not comply with the APA and were therefore not retroactive to 2018, it also found factual questions remained as to LGI's compliance with the tax laws. LGI asked the court to dismiss the action a second time, claiming the IRS failed to comply with the statutory prerequisites for filing a lawsuit.

Administrative rules don't apply to civil court actions

LGI contended that the government was barred from maintaining its lawsuit for its 2018 tax deficiency because the agency never provided the company with a timely notice of the deficiency. LGI claimed that §6213(a) requires the IRS to issue a notice of deficiency before it can collect any tax from the taxpayer.

However, the court found the company's arguments to be "misleading and inaccurate" because the tax code requires a notice of deficiency before an administrative assessment of a taxpayer's obligation, which is not binding or relevant in the context of a common-law suit on the debt. It added that a notice of deficiency allowing LGI to contest the assessment in the U.S. Tax Court would duplicate the notice that provided the opportunity for the company to contest the deficiency in district court.

"Defendant's lamentations of inadequate process ring particularly hollow when its own machinations truncated the administrative process—which would have included issuance of a notice of deficiency and an opportunity for defendant to be heard in Tax Court—and forced the matter into district court.... Defendant cannot seek to profit by compelling litigation in one forum and then complain that it has been deprived some benefit provided by the other forum," the court concluded. ▸

U.S. v. Liberty Global, Inc.
No. 1:22-cv-02622-RBJ (D. Colo. 2023)

First-Time Abatement

By Virginia Hilton, CPA, MST

Q: Tim failed to file his 2021 Form 1040 until well past the extended due date of Oct. 17, 2022. He received a CP14 Notice after filing, stating that he owed a failure to file penalty [§6651(a)(1)] and interest on the late tax payment. Because Tim had been otherwise compliant with his previous tax filings and plans to file his 2022 Form 1040 on time, his accountant, Sherri, wondered whether he might qualify for a first-time abatement of the penalty. Is this option available to Tim for the failure to file penalty assessed to him?

A: Yes. The IRS has statutory authority to waive penalties under the first-time abate policy as a matter of "enforcement discretion" to enhance voluntary compliance. Tim will qualify for the first-time abatement (FTA) if he meets all the following requirements: (1) has filed all returns due in the prior three years (if due) or had no penalties in last three years, (2) has filed or will file all current year returns and (3) has paid or arranged to pay any tax currently due. The abatement can only apply to a single tax period. However, because the policy requires only a three-year history of no penalties (except estimated tax penalties), it is possible for someone to receive multiple first-time abatements.

The abatement process is now automated. It is currently applied by the Reasonable Cause Assistant (RCA) software program that performs a first-time abatement analysis prior to a reasonable cause analysis. Under this process, all applicants who meet the first-time abatement criteria will be granted a first-time abatement waiver. This is done by suppressing the penalty on the taxpayer's Master File, which causes the penalty to remain, but with a $0 balance.

IRC §7801(a) grants the Secretary of the Treasury the power to delegate penalty assessment and enforcement to the IRS. As part of that process, it is also granted the authority to refrain from taking enforcement action (i.e., to abate a penalty). The term "penalty" includes any addition to tax or any additional amount [§6751(c)].

However, not all tax return penalties qualify for FTA. For instance, the following forms do not qualify: Forms 706, 709, 990, 1099, 3520, 3520-A, 5471 and 5472. The ones that do qualify are Forms 1040, 1120, 1120-S, 1065, 940, 941, 2290 and 720. Not all penalties may be abated, either. Only three types may be abated:

- The failure to file (FTF) penalty under §§6651(a)(1), 6698(a)(1) and 6699(a)(1)
- The failure to pay (FTP) penalty under §§6651(a)(2) and 6651(a)(3)
- The failure to deposit (FTD-941s) penalty under §6656

Notice that the accuracy-related penalty under §6662 is not an abatable penalty. This is otherwise known as the "substantial underreporting penalty." Note, as well, that if the penalty year is from a substitute for a return (SFR) prepared for the taxpayer by the IRS, it is not abatable. To count in the three-year look-back period, an original return must be on file.

Going back to Tim, what if he had a penalty reversed for reasonable cause? Does this disqualify him from FTA? No, it does not. Unless the penalty was for estimated taxes, Tim still qualifies. This does not include penalties that were assessed and paid off; they must have been reversed or abated. This makes the years "clean years."

To get Tim the first-time abatement, Sherri has two options: call or write.

Sherri can call the Practitioner Priority Service at 866-860-4259 and request FTA in person. She must have Form 2848, *Power of Attorney and Declaration*

of Representative, for Tim on file for the penalty year and three years prior, or the call will be terminated. For instance, if Sherri calls for tax year 2021, she must have a POA on file for years 2017–2020 at a minimum. Form 8821, *Tax Information Authorization*, will not suffice. Service representatives can instantly enact the abatement on the phone. The representative will tell Sherri that Tim will receive a letter in 10 to 14 days (Letter 3503C) citing history of timely filing and payment as a reason to abate the penalty.

Sherri may also call a new penalty assistance line at 1-855-223-4017, ext. 225, which is available for tax preparers and taxpayers alike.

Alternatively, Sherri can make a written request with Form 843, *Claim for Refund and Request for Abatement*, or write a letter requesting the abatement. She would mail those to the address on the most recent notice or to the processing center where Tim would file a paper return.

On March 29, 2023, the IRS released an updated Internal Revenue Manual (IRM). Part 20, Penalty and Interest, includes Chapter 1, Penalty Handbook, which deals exclusively with civil penalties.

> “A new penalty assistance line is available at 1-855-223-4017, ext. 225, for tax preparers and taxpayers alike.”

Statement of Ownership, Management and Circulation
(required by 39 U.S.C. 3685)

Title of publication: TAXPRO Monthly

Publication number: 0897-4306

Date of filing: 9/26/2023

Issue frequency: Monthly

Number of issues published annually: 12

Annual subscription price: N/A

Complete mailing address of the headquarters of general business office of the publisher:
NATP
3517 N. McCarthy Road
Appleton, WI 54913

Editor:
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Owner:
National Association of Tax Professionals, Inc.
3517 N. McCarthy Road
Appleton, WI 54913

I certify that the statements made by me are correct and complete.

Cindy Van Beckum, Editor

13. Publication Title			14. Issue Date for Circulation Data Below	
TAXPRO Monthly			October 2023	
15. **Extent and Nature of Circulation**			**Average No. Copies Each Issue During Preceding 12 Months**	**No. Copies of Single Issue Published Nearest to Filing Date**
a. Total Number of Copies *(Net press run)*			18,041	18,200
b. Paid Circulation *(By Mail and Outside the Mail)*	(1)	Mailed Outside-County Paid Subscriptions Stated on PS Form 3541 (Include paid distribution above nominal rate, advertiser's proof copies, and exchange copies)	17,705	17,819
	(2)	Mailed In-County Paid Subscriptions Stated on PS Form 3541 *(Include paid distribution above nominal rate, advertiser's proof copies, and exchange copies)*	0	0
	(3)	Paid Distribution Outside the Mails Including Sales Through Dealers and Carriers, Street Vendors, Counter Sales, and Other Paid Distribution Outside USPS®	0	0
	(4)	Paid Distribution by Other Classes of Mail Through the USPS (e.g., First-Class Mail®)	120	25
c. Total Paid Distribution *[Sum of 15b (1), (2), (3), and (4)]* ▶			17,825	17,844
d. Free or Nominal Rate Distribution *(By Mail and Outside the Mail)*	(1)	Free or Nominal Rate Outside-County Copies included on PS Form 3541	0	0
	(2)	Free or Nominal Rate In-County Copies Included on PS Form 3541	0	0
	(3)	Free or Nominal Rate Copies Mailed at Other Classes Through the USPS (e.g., First-Class Mail)	0	0
	(4)	Free or Nominal Rate Distribution Outside the Mail *(Carriers or other means)*	189	256
e. Total Free or Nominal Rate Distribution *(Sum of 15d (1), (2), (3) and (4))*			189	256
f. Total Distribution *(Sum of 15c and 15e)* ▶			18,014	18,100
g. Copies not Distributed *(See Instructions to Publishers #4 (page #3))* ▶			27	100
h. Total *(Sum of 15f and g)*			18,041	18,200
i. Percent Paid *(15c divided by 15f times 100)* ▶			98.95	98.58

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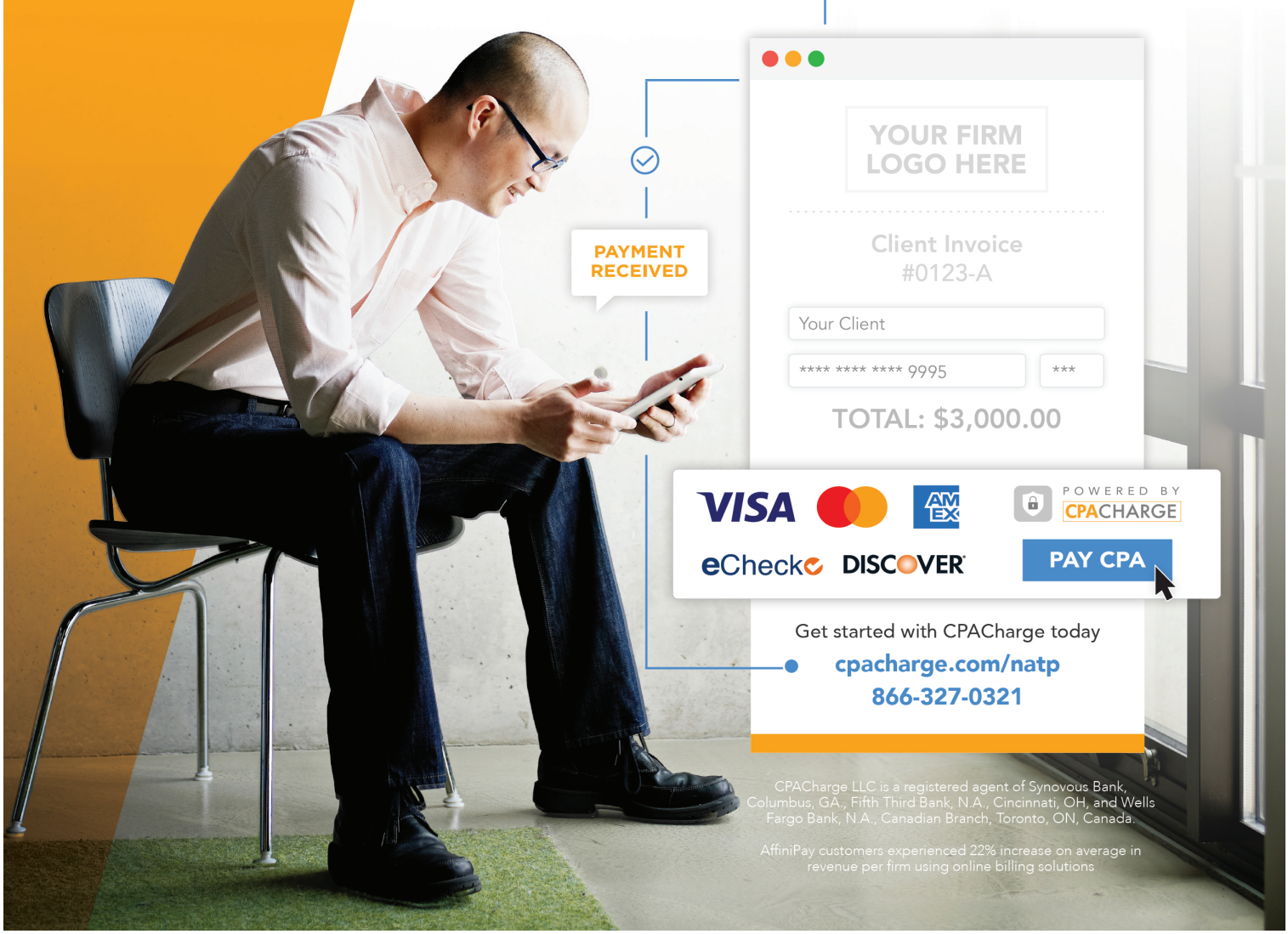

CPACharge LLC is a registered agent of Synovous Bank, Columbus, GA., Fifth Third Bank, N.A., Cincinnati, OH, and Wells Fargo Bank, N.A., Canadian Branch, Toronto, ON, Canada.

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