2021 ANNUAL INDIANA LAW SURVEY: FEDERAL TAX

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INTRODUCTION

The following is a survey and summary of noteworthy federal tax developments, including IRS hot button issues, the Employee Retention Credit, the CARES Act and other 2021 updates, and Tax Cuts and Jobs Act of 2017 guidance.

I. IRS HOT BUTTON ISSUES

A. Cryptocurrency Update

The Office of Chief Counsel Internal Revenue Service Memorandum No. 202114020, released on April 9, 2021, addresses the issue of whether a taxpayer who receives Bitcoin Cash as a result of a Bitcoin "hard fork" has gross income under section 61 of the Code.[1] The Office of Chief Counsel determined that such a taxpayer has gross income, because they had an accession to wealth under section 61 of the Code, which is also consistent with the principles of Revenue Ruling 2019-24 concerning the receipt of new cryptocurrency following a hard fork. Furthermore, the date of receipt and fair market value that is included in income will be dependent on when the taxpayer obtained dominion and control over the Bitcoin Cash.[2]

On August 1, 2017, at 9:16 a.m. EDT, the last common block shared by both Bitcoin and Bitcoin Cash was mined.[3] Immediately following this last common block, Bitcoin miners began mining a block that followed "Bitcoin's protocols but [that] was incompatible with Bitcoin Cash's protocols." Simultaneously, Bitcoin Cash miners began mining a block that followed Bitcoin Cash's protocols but that was incompatible with Bitcoin's protocols.[4] Consequently, at this date and time, a "hard fork" occurred, as holders of Bitcoin Cash generally were able to engage in Bitcoin Cash transactions that would no longer be reflected in

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1. Office of Chief Counsel Internal Revenue Service Mem. 202114020 (April 9, 2021) [hereinafter "Chief Counsel Memorandum 202114020"]. The simplest way to conceptualize a "fork" in a cryptocurrency's blockchain is to imagine that the fork introduces a new set of rules for bitcoin to follow. After a fork, bitcoin's blockchain diverges into two potential paths forward. After a new rule is introduced, the users mining that particular bitcoin blockchain can elect to follow one set of rules or another, which resembles a fork in the road. *See* Jane Frankenfield, *Hard Fork (Blockchain)*, (June 24, 2021, https://www.investopedia.com/terms/h/hard-fork.asp[https://perma.cc/C3LG-HYXJ].

2. Chief Counsel Memorandum 202114020 at 1.

3. *Id*. at 2.

4. *Id*.

Bitcoin's distribution ledger, and thus would have no effect on their Bitcoin holdings.[5]

In reaching their conclusion, the Office of Chief Counsel starts by noting that except as otherwise provided by law, "[s]ection 61(a)(3) provides that . . . gross income means all income from whatever source derived, including gains from dealings in property."[6] Moreover, under section 61 of the Code, "all gains or undeniable accessions to wealth, clearly realized, over which a taxpayer has complete dominion, are included in gross income."[7] Revenue Ruling 2019-24 applies these general principles of section 61 of the Code to determine that the receipt of a new cryptocurrency following a hard fork results in income.[8] Significantly, the specific manner in which the new cryptocurrency is distributed to a taxpayer following a hard fork does not change the Revenue Ruling's holding.[9]

B. IRS "Dirty Dozen" and Select Examples

The "Dirty Dozen" is an annual list compiled by the IRS of the "worst of the worst" scams that taxpayers may encounter, especially during filing season. In a notice dated July 1, 2021,[10] the IRS warned people to watch for certain schemes operated by tax promoters, including abusive micro-captive insurance arrangements, and syndicated conservation easements, among others.[11]

Abusive micro-captive insurance arrangements. In *CIC Services, LLC v. IRS*,[12] the U.S. Supreme Court unanimously held that the Anti-Injunction Act[13] did not prohibit a pre-enforcement challenge to an IRS information reporting requirement, where the failure to comply could result in civil and criminal penalties.

The Internal Revenue Code permits insurance companies whose premiums do not exceed a threshold to elect to be taxed only on their net investment income and not on their net insurance income.[14] The IRS was concerned that this could

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5. *Id*.
6. *Id*. at 3.
7. *Id*. at 3. *See* Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).
8. I.R.C. § 61; Treas. Reg. § 1.451-2; Rev. Rul. 2019-24.
9. Office of Chief Counsel Mem.202114020 at 3.
10. I.R.S. News Release IR-2021-144 (July 1, 2021) [hereinafter "IR-2021-144"].
11. In addition to syndicated conservation easements and abusive micro-captive arrangements, the IRS's annual "Dirty Dozen" list included the potentially abusive use of the US-Malta tax treaty, improper claims of business credits, and improperly monetized installment sales. *See* IR-2021-144.
12. 141 S. Ct. 1582, 1586 (2021).
13. *See* I.R.C. § 7421(a). The Anti-Injunction Act bars any "suit for the purpose of restraining the assessment or collection of any tax."
14. CIC Services, LLC v. IRS, 141 S. Ct. 1582, 1587 (2021). The Court explained that "a micro-captive transaction is typically an insurance agreement between a parent company and a 'captive' insurer under its control. The Code provides the parties to such an agreement with tax advantages. The insured party can deduct its premium payments as business expenses. And the

be used abusively and issued Notice 2016-66 naming the use of this election (under certain circumstances) a "Transaction of Interest."[15] The Notice required participants in the transaction and "material advisors" who provided tax advice to the participants to supply substantial information in Forms 8886 and 8918, respectively.[16] Failure to supply the information could subject the non-filer to a civil penalty and could also result in a criminal penalty.[17]

The Court concluded that the penalty for noncompliance did not trigger the Anti-Injunction Act for a combination of three reasons. First, the reporting obligation "inflict[s] costs separate and apart from the . . . tax penalty."[18] Second, the penalty is several steps away from the reporting requirement.[19] The plaintiff first would have to fail to disclose the information, then the IRS would have to identify that the disclosure had not occurred, and then the IRS would have to impose the entirely discretionary penalty. Lastly, a violation of the Notice could be subject to a criminal penalty, as much as one year in prison, for willful failure to comply with the Notice's requirement.[20] This precludes the plaintiff from taking the normal route of paying the tax and then suing for a refund. If the plaintiff does not disclose, it subjects itself to criminal penalties, which necessitates providing the ability to have a "pre-enforcement" challenge.

Syndicated conservation easements. Section 170(f)(3)(B)(iii) of the Code allows a deduction for a qualified conservation contribution, which is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.[21] In Notice 2017-10, the IRS and the Treasury Department warned that "some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to claim charitable contribution deductions in amounts that significantly exceed the amount invested."[22] In such a transaction, a promoter will offer potential investors in a partnership or other pass-through entity the possibility of a deduction for a charitable contribution in exchange for the donation of a conservation easement.[23]

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insurer can exclude up to $2.2 million of those premiums from its own taxable income, under a tax break for small insurance companies." *Id*. (internal citations omitted).

15. *Id*.
16. *Id*. at 1587.
17. *Id*.
18. *Id*. at 1591.
19. *Id*.
20. *Id*. at 1592.
21. *See* I.R.C. § 170(h)(1)-(5); Treas. Reg. § 1.170A-14.
22. I.R.S. Notice 2017-10 at 2.
23. *Id*. "The promoters (i) identify a pass-through entity that owns real property, or (ii) form a pass-through entity to acquire real property. The promoters then syndicate ownership interests in the pass-through entity that owns the real property, or in one or more of the tiers of pass-through entities, using promotional materials suggesting to prospective investors that an investor may be entitled to a share of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment. The promoters obtain an appraisal that purports to be a qualified appraisal as defined in § 170(f)(11)(E)(i) but that greatly inflates the value

One of the notable recent cases concerning charitable contribution deductions for conservation easements is *Belair Woods, LLC v. Commissioner*,[24] in which the Tax Court examined whether the IRS properly disallowed the charitable contribution deduction claimed by Belair Woods, LLC, as the "conservation purpose underlying the easement was not 'protected in perpetuity'" as required by section 170(h)(5)(A) of the Code.[25] The IRS challenged the easement deed on the grounds that it disregards the requirement that the grantee receive, "in the event the easement is extinguished, a proportionate share of the proceeds upon any subsequent sale of the property."[26] According to the Treasury regulations, "a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation . . . can make impossible or impractical the continued use of the property for conservation purposes."[27] Regardless of this possibility the conservation purpose can continue to be treated as one "in perpetuity" if the restrictions are removed by judicial proceeding and the easement deed provides that following the sale, the charitable donee will receive a proportionate share of the proceeds, which are used in accordance with general conservation purposes.[28]

The court ultimately held that Belair's deed failed to satisfy the "protected in perpetuity" requirement for two main reasons. First, the grantee is not absolutely entitled to a proportionate share of the proceeds upon a post-extinguishment sale of the property.[29] Moreover, under the deed's judicial extinguishment provisions, "the grantee's share of the proceeds is improperly reduced by carve-outs both for donor improvements and for claims against the donor."[30] Consequently, Belair is ineligible for a charitable contribution deduction.

C. IRS Most Litigated Issues in U.S. Tax Court

As part of the requirements under section 7803(c)(2)(B)(ii)(XI) of the Code, the National Taxpayer Advocate must identify in his or her Annual Report to Congress the ten tax issues most litigated in federal courts.[31] Listed in order from most to least cases, based on data collected from June 1, 2019 through May 31, 2020, the most recent year's ten most litigated issues in federal courts include:

1. Appeals from Collection Due Process Hearings (Code Secs. 6320 and 6330);

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of the conservation easement based on unreasonable conclusions about the development potential of the real property." *Id*. at 2-3.

24. 120 T.C.M. (CCH) 73, 2 (July 22, 2020).

25. *Id*. at 1.

26. *Id*.

27. *Id*. at 8. (quoting Treas. Reg. § 1.170A-14(g)(6)).

28. *Id*. at 8.

29. *Id*. at 9.

30. *Id*. at 10.

31. 2020 Annual Report to Congress, *Most Litigated Issues*, TAXPAYER ADVOCATE SERVICE, 162 (2020), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_Most LitigatedIssues.pdf.

2. Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax (Code Sec. 7403);
3. Accuracy-Related Penalty (Code Secs. 6662(b)(1) and (2));
4. Trade or Business Expenses (Code Sec. 162(a) and related Code sections);
5. Gross Income (Code Sec. 61 and related Code sections);
6. Summons Enforcement (Code Secs. 7602(a), 7604(a), and 7609(a));
7. Failure to File Penalty (Code Sec. 6651(a)(1)), Failure to Pay Penalty (Code Sec. 6651(a)(2)), and Failure to Pay Estimated Tax Penalty (Code Sec. 6654);
8. Schedule A Deductions (Code Secs. 211-224);
9. Charitable Contribution Deductions (Code Sec. 170); and
10. Frivolous Issues Penalty (Code Sec. 6673 and related appellate-level sanctions).[32]

When compared against the previous year's top ten list of tax issues most litigated in federal courts, three significant movements are notable.[33] First, "Collection Due Process" hearings have ascended from third highest on the list in 2019 to now the most litigated tax issue in federal courts for 2020. Second, "Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax" has accelerated from the sixth most litigated issue to now the second most litigated. Lastly, "Trade or Business Expenses," which previously held the title as the most litigated tax issue in federal courts, has fallen in the rankings for 2020 to the fourth most litigated tax issue.

Trade or Business Expense. Despite its drop as the once most litigated tax issue in federal courts, issues relating to trade or business expenses continued to be examined in 2020. Notably, in *Richmond Patients Group v. Commissioner*,[34] the Tax Court examined, among other items, whether Richmond was entitled to additional costs of goods sold (COGS) or deductions for business expenses other than those that the IRS already allowed.[35]

"Generally, section 162(a) [of the Code] allows a taxpayer to deduct from gross income ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business." "Section 261, however, provides that '[i]n computing taxable income no deduction shall in any case be allowed in respect of the items specified in this part,' which includes section 280E."[36] "Section 280E precludes taxpayers from deducting any expense related to a business that consists of trafficking in a controlled substance."[37] Section 280E disallows deductions only for business expenses and does not preclude taking

32. *Id.*

33. *Compare* 2019 Annual Report to Congress, TAXPAYER ADVOCATE SERVICE, (2019), https://www.taxpayeradvocate.irs.gov/reports/2019-annual-report-to-congress/full-report/.

34. Richmond Patients Grp. v. Comm'r, 119 T.C.M. (CCH) 1342 (2020).

35. *Id*. at 2.

36. *Id*. at 12-13 (citing Californians Helping to Alleviate Med. Problems, Inc. v. Comm'r, 128 T.C. 173, 180 (2007)).

37. *Id*. at 13.

COGS into account.[38]

"The dispensing of medical marijuana," which is the line of business Richmond operated, "while legal in California, is illegal under federal law."[39] In section 280E, Congress provides that an illegality under federal law is one trigger that precludes "a taxpayer from deducting expenses incurred in a medical marijuana dispensary business. This is true even if the business is legal under State law."[40]

Because Richmond was primarily engaged in purchasing and selling marijuana products, the Tax Court determined that it could not claim any of the typical business deductions, including rent, compensation and benefit programs, repairs and maintenance, taxes, contributions, depreciation, etc.[41] The IRS conceded, however, that Richmond's costs for testing and packaging were permitted to be included in COGS, and therefore deductible by Richmond.[42]

II. EMPLOYEE RETENTION CREDIT

The employee retention credit (ERC) under the Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136 (as amended, the "CARES Act"), is a refundable payroll tax credit against applicable employment taxes[43] that is available to eligible employers affected by the COVID-19 pandemic.

The ERC is claimed on IRS Form 941, *Employer's Quarterly Federal Tax Return*. An advance payment of the ERC may be claimed on IRS Form 7200, *Advance Payment of Employer Credits Due to COVID-19*.[44]

The ERC is discussed more fully below.

A. ERC: Employer Eligibility

An employer was eligible for the ERC if it operated a trade or business during a calendar quarter and experienced either (i) full or partial suspension of operations due to COVID-19-related governmental orders limiting commerce, travel or group meetings, or (ii) a significant decline in gross receipts due to

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38. *Id*. at 13; *see also* Californians Helping to Alleviate Med. Problems, Inc. v. Comm'r, 128 T.C. 173 (2007).

39. *Richmond*, 119 T.C.M. (CCH) at 13.

40. *Id*.

41. *Id*. at 14-15.

42. *Id*. at 16.

43. "Applicable employment taxes" means the taxes imposed under I.R.C. § 3111(a) (*i.e.*, Old Age, Survivors, and Disability Insurance (or OASDI) taxes), and the taxes imposed under I.R.C. § 3221(a) (*i.e.*, Railroad Retirement Tax Act (or RRTA) to the extent attributable to OASDI taxes. CARES Act, § 2301(c), Pub. L. No. 116-136, 134 Stat. 281 (2020).

44. *See Instructions for Form 7200, Advance Payment of Employer Credits Due to COVID-19*, INTERNAL REVENUE SERV. (last updated Apr. 2021), https://www.irs.gov/pub/irs-prior/i7200--2021.pdf [https://perma.cc/QG2C-TFNJ]; *see also How to Claim the Credits*, INTERNAL REVENUE SERV. (last updated Dec. 20, 2021), https://www.irs.gov/newsroom/how-to-claim-the-credits [https://perma.cc/W3H4-R3RR].

COVID-19.[45] For these purposes, a significant decline means a decrease in gross receipts (as defined in section 448(c) of the Internal Revenue Code of 1986, as amended ("Code") (section 6033 of the Code for tax-exempt organizations)) by more than 20% as compared to the same calendar quarter in 2019 (or in 2020 if the employer did not exist at the beginning of such 2019 calendar quarter).[46]

Significant Decline in Gross Receipts Example: Employer A's gross receipts were $100,000, $190,000, and $230,000 in the first, second, and third calendar quarters of 2021, respectively. Its gross receipts were $210,000, $230,000, and $250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, Employer A's 2021 first, second, and third quarter gross receipts were approximately 48%, 83%, and 92% of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, Employer A experienced a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2021 (the calendar quarter in which gross receipts were less than 80% of those in the same quarter of 2019) and ending on the first day of the third calendar quarter of 2021 (the quarter following the first quarter in which the gross receipts were more than 80% of those in the same quarter of 2019). Thus, Employer A is an eligible employer during the first and second calendar quarters of 2021.

Revenue Procedure 2021-33 provides a gross receipts safe harbor, which provides that the ERC "does not apply to so much of the qualified wages paid by an eligible employer as are taken into account as payroll costs in connection with forgiveness of a [Paycheck Protection Program ("PPP")] Loan or, in the case of § 3134(h) [of the Code], an ERC-Coordinated Grant (relief programs)."[47] For these purposes, the term "ERC-Coordinated Grant" means grants made by the U.S. Small Business Administration to (i) eligible live venues, performing arts, and museum operators and promoters (*i.e.*, shuttered venue operator grants), and (ii) to qualifying restaurants and food vendors (*i.e.*, restaurant revitalization grants).[48] In other words, an otherwise eligible employer is permitted to exclude amounts from forgiven PPP loans and "ERC-Coordinated Grants" from the definition of gross receipts solely for the purpose of determining its eligibility to claim the ERC.[49] The safe harbor is not mandatory, but an employer must elect

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45. I.R.C. § 3134(c)(2)(A); *see also* I.R.S. Notice 2021-20 III.A, 2021-11 I.R.B. 922, *amplified* by I.R.S. Notice 2021-23, 2021-16 I.R.B. 1113; *IRS FAQs: Employee Retention Credit under the CARES Act*, INTERNAL REVENUE SERV. (last updated Dec. 27, 2021), https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act [https://perma.cc/3WVQ-64SR].

46. I.R.C. §§ 3134(c)(2)(A), (c)(3)(B); *see also* Notice 2021-20, 2021-11 I.R.B. 922, *amplified by* Notice 2021-23, 2021-16 I.R.B. 1113, *amplified by* Rev. Proc. 2021-33, 2021-34 I.R.B. 327 (Employers may elect to determine gross receipts for the immediately preceding calendar quarter instead of the current one (the corresponding 2019 calendar quarter will need to be used for comparison purposes in such a case)); I.R.C. § 3134(c)(2)(B), CARES Act, § 2301(c)(2), Pub. L. No. 116-136, 134 Stat. 281 (2020).

47. Rev. Proc. 2021-33, Section 3.02, 2021-34 I.R.B. 327; *see also* CARES Act, § 2301(g), Pub. L. No. 116-136, 134 Stat. 281 (2020); I.R.C. § 3134(h).

48. *See* Rev. Proc. 2021-33, Section 2.04, 2021-34 I.R.B. 327.

49. *Id.* at Section 3.02. (However, "[the] safe harbor does not permit the exclusion of the

to use it[50] and it must be applied consistently.[51] Additionally, a safe harbor election can be revoked.[52] Due to the rule of consistency, upon the revocation of a safe harbor election, "the employer must adjust all employment tax returns that are affected by [such] revocation."[53]

Tax-exempt organizations under 501(c)(1) of the Code, as well as governmental entities that are a college or a university or the principal purpose or function of which is providing medical or hospital care, are also eligible for the ERC.[54] Recovery startup businesses, *i.e.*, employers that began business after February 15, 2020, have average annual gross receipts of up to $1 million, and are otherwise ineligible under the rules described above, are also eligible for the ERC with respect to wages paid from July 1, 2021 through December 31, 2021.[55] Federal, state, and local governments and their agencies or instrumentalities are generally ineligible.[56] The ERC is also not available to self-employed individuals for their self-employment services or earnings.[57] Employers who took out a PPP loan are not prohibited from claiming the ERC, though wages paid with the proceeds of a forgiven PPP loan cannot be taken into account for purposes of the ERC.[58]

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amount of forgiveness of a PPP Loan or the amount of ERC-Coordinated Grants from the definition of gross receipts under § 448(c) or § 6033 of the Code for any other Federal tax purpose.").

50. *See id.* at Section 3.02 and Section 3.04 ("An employer elects to use the safe harbor by excluding the amount of the forgiveness of a PPP Loan and the amount of ERC-Coordinated Grants from its gross receipts when determining eligibility to claim the [ERC] on its employment tax return or adjusted employment tax return for that calendar quarter or, for employers that file employment tax returns on an annual basis, for the year including the calendar quarter.").

51. *See id.* at Section 3.03 ("An employer consistently applies this safe harbor by (i) excluding the amount of the forgiveness of any PPP Loan and the amount of any ERC-Coordinated Grant from its gross receipts for each calendar quarter in which gross receipts for that calendar quarter are relevant to determining eligibility to claim the employee retention credit, and (ii) applying the safe harbor to all employers treated as a single employer under the employee retention credit aggregation rules.").

52. *See id.* at Section 3.05 ("[A]n employer may revoke its safe harbor election by including the amount of the forgiveness of the PPP Loan or the amount of ERC-Coordinated Grants in its gross receipts when determining eligibility to claim the employee retention credit for a calendar quarter on its adjusted employment tax return for that calendar quarter or, for employers that file employment tax returns on an annual basis, for the year including the calendar quarter.").

53. *Id.*

54. I.R.C. §§ 3134(f)(1), (f)(2).

55. *See* I.R.C. §§ 3134(a), 3134(b)(1)(B), and 3134(c)(5) (definition of recovery startup business).

56. I.R.C. § 3134(f)(1).

57. *See IRS FAQs: Employee Retention Credit under the CARES Act*, INTERNAL REVENUE SERV. (last updated Dec. 27, 2021), https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act [https://perma.cc/3WVQ-64SR].

58. *See* Taxpayer Certainty and Disaster Tax Relief Act of 2020, Pub. L. No. 116-260, Div. EE, Title II, § 206(c), 134 Stat. 1182 (2020). (This prohibition ((as well as its application to entities under

B. ERC: Credit Amount and Wages

The ERC is equal to 70% of the qualified wages an eligible employer pays to an affected full-time employee from January 1, 2021 through September 30, 2021 (however, a "recovery startup business" may continue to claim the ERC for the fourth quarter).[59] To be considered "full-time," an employee, with respect to any calendar month, must have been employed for an average of at least 30 hours of service per week (or 130 hours of service in such month, since 130 hours of service in a month is treated as the monthly equivalent of at least 30 hours of service per week).[60] Note that employees of corporations or other trades or businesses that are part of the same controlled group are treated as employed by a single employer, and the ERC must be apportioned among the group based on their respective shares of the qualified wages paid.[61] A "single employer" for purposes of sections 52(a), 52(b), 414(m), or 414(o) of the Code are treated as a single employer for purposes of the ERC.[62] These rules apply in determining whether the employer has its trade or business fully or partially suspended, experiences a decline in gross receipts, is a recovery startup business, and in determining the employer's average quarterly wages and the number of full-time employees.[63]

The total amount of qualified wages that can be counted in determining the amount of the ERC is capped at $10,000 per employee per calendar quarter in 2021 (through September 30, 2021),[64] which equates to a maximum ERC of $7,000 per employee per such quarter.[65] This cap applies regardless of the size of

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common ownership of the employer)) was introduced under the CARES Act and eliminated by the Taxpayer Certainty and Disaster Tax Relief Act with retroactive effect).

59. *See* I.R.C. § 3134(a); *see also* Notice 2021-20, 2021-11 I.R.B. 922, *amplified by* Notice 2021-23, 2021-16 I.R.B., *amplified by* Notice 2021-49, 2021-32 I.R.B. 316, *amplified by* Rev. Proc. 2021-33, 2021-34 I.R.B. 327. ((The end date was previously December 31, 2021, but President Biden's signing of the Infrastructure Investment and Jobs Act on November 15, 2021 (the "IIJA"), retroactively eliminates an employer's ability to claim the ERC for eligible wages paid after September 30, 2021. Under the CARES Act, the ERC was equal to 50% of qualified wages paid from March 13, 2020, through December 31, 2020, and was capped at $5,000 per employee per calendar quarter in 2020)); CARES Act, § 2301(a), Pub. L. No. 116-136, 134 Stat. 281 (2020).

60. *See* I.R.C. § 4980H(c)(4)(A).

61. I.R.C. §§ 52(a), (b) (determined by a more-than-50% test); *see also* I.R.C. § 3134(e) (referencing 280C(a), which references I.R.C. §§ 52(a) and (b)).

62. CARES Act, § 2301(d), Pub. L. No. 116-136, 134 Stat. 281 (2020); I.R.C. § 3134(d).

63. *See* Notice 2021-20, III.B, 2021-11 I.R.B. 922, *amplified by* Rev. Proc. 2021-23, III.E, III.F, 2021-34 I.R.B. 327. (These aggregation rules also apply to determine the maximum credit amount per employee).

64. *See* I.R.C. §§ 3134(b)(1)(A), 3134(b)(1)(B); CARES Act, § 2301(b)(1), Pub. L. No. 116-136, 134 Stat. 281 (2020). (The cap amount is $50,000 per calendar quarter with respect to recovery startup businesses, as defined in *supra* Section I.A. of this Article.); *see* I.R.C. § 3134(c)(5).

65. This means the maximum ERC per employee available to an eligible employer in 2021 is

the employer. For these purposes, the term "qualified wages" means, in general:

> --For employers that had more than 500 full-time employees in 2019, the wages paid to employees who were not providing services due to the COVID-19-related governmental order or significant decline in gross revenue; or
> --For employers that had 500 or fewer full-time employees for 2019, the wages paid to all employees (providing services or not).[66]

2021 Example: Employer C is an eligible employer and pays $8,000 in qualified wages to Employee D in the second quarter 2021 and $8,000 in qualified wages in the third quarter 2021. The credit available to Employer C for the qualified wages paid to Employee D is equal to $5,600 in the second quarter and $1,400 in the third quarter due to the overall limit of 70% of $10,000 of qualified wages per employee for all calendar quarters.

Wages for purposes of the ERC mean wages and compensation,[67] and include certain qualified health plan expenses to the extent they are allocated to the applicable employee and period, but do not include amounts taken into account for purposes of (i) the payroll tax credits for required paid sick leave or required paid family leave under the Families First Coronavirus Act, (ii) wages taken into account for the employer income tax credit for paid family and medical leave under the Tax Cuts and Jobs Act of 2017, or (iii) wages paid to an employee for which the employer is allowed a Work Opportunity Credit.[68] Common aggregation rules apply in determining the size of the employer for purposes of this small/large employer distinction.

C. ERC: Related Individuals Are Disqualified

The ERC is not available to employers for wages paid to an employee who is a "related individual."[69] For these purposes, the following persons are considered related individuals with respect to an employer who is an individual: children, stepchildren, eligible foster children and grandchildren; siblings and

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$21,000 (not $28,000 as was previously the case prior to the signing of the IIJA). The maximum ERC for qualified wages paid to an employee in a calendar quarter that began prior to January 1, 2021, was $5,000.

66. I.R.C. § 3134(c)(3); CARES Act, § 2301(c)(3), Pub. L. No. 116-136, 134 Stat. 281 (2020). ((However, in the case of a "severely financially distressed employer" (*i.e.*, a company with gross receipt reductions of more than 90% as compared to the same quarter in 2019), "qualified wages" means wages paid by such employer with respect to an employee during any calendar quarter.); I.R.C. § 3134(c)(3)(C).

67. *See* I.R.C. §§ 3121(a) and 3231(e).

68. *See* 26 U.S.C. § 3134(c)(4)(B); *see also* CARES Act § 2301(c)(3)(C), Pub. L. No. 116-136, 134 Stat. 281 (2020).

69. 26 U.S.C. § 3134(e); 26 U.S.C. § 51(i)(1); *see also* Rev. Proc. 2021-49, 2021-49 I.R.B. 838.

stepsiblings; parents, stepparents and grandparents; nieces and nephews; aunts and uncles; child-, parent-, and sibling-in-laws; and dependent household members.[70] Additionally, if the employer is a corporation or other entity, then any person with a familial relationship as described above with respect to a majority owner (more than 50%, whether directly or indirectly) of the entity's outstanding stock or capital and profits interests, as the case may be, is also a related individual.[71] If the employer is an estate or trust, any grantor, beneficiary or fiduciary (as well as any person with a familial relationship as described above with respect to any such grantor, beneficiary or fiduciary) is likewise a related individual.[72]

Example 1: Corporation A is owned 80% by Individual E and 20 percent by Individual F. Individual F is the child of Individual E. Corporation A is an eligible employer. Both Individual E and Individual F are employees of Corporation A. Both Individual E and Individual F are treated as 100% owners of Corporation A. Accordingly, Corporation A may not treat as qualified wages any wages paid to either Individual E or Individual F because both Individual E and Individual F are each related individuals for ERC purposes.

Example 2: Corporation B is owned 100% by Individual G. Individual H is the child of Individual G. Corporation B is an eligible employer. Individual G is an employee of Corporation B, but Individual H is not. Individual H is attributed 100% ownership of Corporation B, and both Individual G and Individual H are treated as 100% owners. Accordingly, Corporation B may not treat as qualified wages any wages paid to Individual G because Individual G is a related individual for purposes of the ERC.

Example 3: Corporation C is owned 100% by Individual J. Corporation C is an eligible employer. Individual J is married to Individual K, and they have no other family members. Individual J and Individual K are both employees of Corporation C. Individual K is attributed 100% ownership of Corporation A, and both Individual J and Individual K are treated as 100% owners. However, Individuals J and K do not have any of the described relationships to each other. Accordingly, wages paid by Corporation C to Individual J and Individual K may be treated as qualified wages.

D. ERC: Refund Recapture

With respect to any calendar quarter, the ERC may not exceed applicable employment taxes (reduced by any allowed employment tax credits) on wages paid with respect to the employment of all of the eligible employer's employees for such calendar quarter.[73] If the ERC exceeds this limitation for any calendar

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70. 26 U.S.C. § 51(i)(1)(A).

71. *Id.* (for an entity other than a corporation, ownership is determined in accordance with the related person rules applicable to disallowance of losses on sales between related persons); *see also* 26 U.S.C. § 267(c).

72. 26 U.S.C. §§ 51(i)(1)(B)-(C).

73. CARES Act § 2301(b), Pub. L. No. 116-136, 134 Stat. 281 (2020); 26 U.S.C. § 3134(b)(2);

quarter, the excess will be considered as having been erroneously refunded or credited to the employer and will be treated as a refundable overpayment.[74] Such excess will also be treated as an underpayment of OASDI or RRTA taxes.[75] The regulations authorize the assessment and collection of any erroneous refund of the ERC in the normal course of processing the applicable employment tax returns or Forms 7200.[76]

E. ERC: Penalty Waiver

The Secretary of the Department of the Treasury will waive any penalty under section 6656 of the Code for any failure to make a deposit of any applicable employment taxes if the Secretary determines that such failure was due to the reasonable anticipation of the ERC.[77]

F. ERC: Conclusion – IRS Guidance Needed

Due to the IIJA retroactively eliminating the ERC for wages paid after September 30, 2021, the IRS may (and hopefully will) issue guidance providing for transition relief for employers affected by such retroactive change, since many employers likely reduced their employment tax deposits in anticipation of the availability of the ERC throughout the 2021 tax year or requested an advance of the ERC in the fourth quarter by filing Form 7200. Affected employers and tax practitioners should be on the lookout for such guidance.

III. ADDITIONAL CARES ACT AND 2021 LAW UPDATES

A. PPP Loan Forgiveness Tax Issues

Section 1106(b) of the CARES Act provides for the forgiveness of "covered loans," *i.e.*, Paycheck Protection Program (PPP) loans, and section 1106(i) of the CARES Act provides, for purposes of the Code, that any amount that otherwise would be includible in an eligible recipient's gross income by reason of such

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see also I.R.S. Notice 2021-20, 2021-11 I.R.B. 922 (amended by I.R.S. Notice 2021-23, 2021-16 IR.B. 1113); *see also IRS FAQs: Employee Retention Credit under the CARES Act*, INTERNAL REVENUE SERV. (last updated Dec. 27, 2021), https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act [https://perma.cc/3WVQ-64SR].

74. CARES Act § 2301(b), Pub. L. No. 116-136, 134 Stat. 281 (2020); 26 U.S.C. § 3134(b)(3); *see also How to Claim the Credits*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/how-to-claim-the-credits (Dec. 20, 2021) [https://perma.cc/W3H4-R3RR].

75. *See* Treas. Reg. § 31.3111-6T (2020); Treas. Reg. § 31.3221-5T (2020).

76. *See* I.R.S. News Release IR-2020-169 (July 27, 2020).

77. CARES Act § 2301(k), Pub. L. No. 116-136, 134 Stat. 281 (2020); 26 U.S.C. § 3134(k); *see also* I.R.S. Notice 2020-22, 2020-17 I.R.B. 664 (amended by I.R.S. Notice 2021-24, 2020-18 I.R.B. 1122); I.R.S. Notice 2021-20, 2021-11 I.R.B. 922 (amended by I.R.S. Notice 2021-23, 2021-16 I.R.B. 1113); *see also How to Claim the Credits*, INTERNAL REVENUE SERV. (last updated Dec. 20, 2021), https://www.irs.gov/newsroom/how-to-claim-the-credits [https://perma.cc/W3H4-R3RR].

forgiveness is excluded from gross income.[78] Although expenses paid from the proceeds of a forgiven PPP loan would ordinarily be disallowed under section 265(a)(1) of the Code (regarding expenses and interest relating to tax-exempt income) and appropriate Treasury Regulations, section 276(a) of the Consolidated Appropriations Act, 2021, Pub. L. No. 116-260, provides that "no deduction shall be denied, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income," and also that, (ii) in the case of a partnership or S corporation, "any amount excluded . . . shall be treated as tax-exempt income for purposes of sections 705 and 1366 of the [Code]."[79]

B. Business Interest Expense Deduction Increase

The business interest expense deduction under section 163(j) of the Code, as amended by the Tax Cuts and Jobs Act, Pub. L. No. 115-97, is limited to 30% of a taxpayer's adjusted taxable income for the taxable year. The CARES Act temporarily increased the deductible amount of the business interest expense for taxable years 2019 and 2020 by increasing the current 30% limitation to 50%.[80]

For partnerships, the increased limitation only applied for taxable year 2020. Instead, unless a partner elects otherwise, 50% of a partnership's 2019 excess business interest expense allocated to a partner under section 163(j)(4)(B)(ii)(I) of the Code is "treated as business interest [which is] paid or accrued by the partner" in the partner's first taxable year beginning in 2020 and which is not subject to the section 163(j) limitation in that year.[81] The other 50% is subject to the normal limitations for the excess business interest deduction.[82]

C. Net Operating Loss Carrybacks

The CARES Act retroactively allowed taxpayers to carryback net operating losses (NOLs) arising in 2018, 2019 and 2020 for five years, and suspended the taxable income limitation imposed on NOL carry forwards arising in tax years commencing prior to January 1, 2021 (allowing those carryforwards to fully offset taxable income rather than 80% of taxable income), and suspended the excess business loss provisions applicable to noncorporate taxpayers.[83] The CARES Act precluded a carryback from offsetting income includible under the

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78. CARES Act § 1106, Pub. L. No. 116-136, 134 Stat. 281 (2020) (codified as amended at Small Business Act § 7A, 15 U.S.C. 632).

79. Consolidated Appropriations Act of 2021, Pub. L. No. 116-260, 134 Stat. 1979 (2021); *see also* Rev. Rul. 2020-27, 2020-50 I.R.B. 1552 (invalidated by Rev. Rul. 2021-2, 2021-04 I.R.B. 495); I.R.S. Notice 2020-32, 2020-21 I.R.B. 837 (invalidated by Rev. Rul. 2021-2, 2021-04 I.R.B. 495).

80. *See* CARES Act § 2301(k); 26 U.S.C. § 163(j).

81. 26 U.S.C. § 163(j)(10)(A)(ii)(I).

82. *Id.*

83. 26 U.S.C. § 172(b)(1)(D) (as amended by CARES Act § 2303(b), Pub. L. 116-136, Stat. 352, 353, 355 (2020)); *see also* 26 U.S.C. § 461(l)(1) (as amended by CARES Act, § 2304(a), Pub. L. 116-136, 134 Stat. 356 (2020)).

so-called "transition tax" imposed by section 965 of the Code.[84]

D. Qualified Improvement Property (QIP) "Retail Glitch"

The CARES Act corrected a technical error in prior law (commonly referred to as the "retail glitch").[85] The correction allows businesses to immediately expense certain costs associated with improving facilities instead of having those improvements depreciated over the 39-year life of the building.[86] This change was effective for property placed in service in 2018 and following years.[87]

IV. TAX CUTS AND JOBS ACT OF 2017 UPDATES

In 2021 the IRS continued to provide guidance regarding certain provisions of the Tax Cuts and Jobs Act of 2017 ("TCJA"). Of particular note are the final regulations issued regarding tax on excess tax-exempt organization executive compensation, as well as regarding the denial of deductions for certain fines, penalties, and other amounts.

A. Tax on Excess Tax-Exempt Organization Executive Compensation

The TCJA added a provision to the Code that applies a 21% tax on payments made to an exempt organization executive (i.e., a "covered employee") in excess of $1,000,000.[88] The final regulations implement section 4960 of the Code by providing that an "applicable tax-exempt organization"[89] that pays any excess parachute payment or remuneration to a "covered employee"[90] in excess of

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84. *See* 26 U.S.C. § 172(b)(1)(D)(iv)-(v).

85. CARES Act § 2307, Pub. L. No. 116-136, 134 Stat. 281 (2020) (codified as 26 U.S.C. § 163 NOTE).

86. 26 U.S.C. § 168(e)(3)(E)(vii).

87. *Id.*

88. 26 U.S.C. § 4960 (codified by Tax Cuts and Jobs Act § 13602, Pub. L. No. 115-97, 131 Stat. 2054, 2157 (2018)) (On December 31, 2018, the Treasury Department and the I.R.S. issued I.R.S. Notice 2019-09, 2019-04 I.R.B. 403, which set forth initial guidance on the application of 26 U.S.C. § 4960. The Treasury Department and I.R.S. subsequently published proposed regulations regarding 26 U.S.C. § 4960 in the Federal Register (85 Fed. Reg. 35746 (June 11, 2020)). Following notice and comment, these proposed regulations were adopted as final regulations, with certain revisions.); *see also* 86 Fed. Reg. 6196-01 (Jan. 19, 2021).

89. *See* 26 U.S.C. § 4960(c)(1) (term "applicable tax-exempt organization" means any organization which for the taxable year (i) is exempt from taxation under section 501(a); (ii) is a farmers' cooperative organization described in § 521(b)(1); (iii) has income excluded from taxation under section 115(1); or (iv) is a political organization described in § 527(e)(1)).

90. 26 U.S.C. § 4960(c)(2) ("covered employee" means any employee (including any former employee) of an applicable tax-exempt organization if the employee: (i) is one of the 5 highest compensated employees of the organization for the taxable year, or (ii) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016).

$1,000,000 for a taxable year is subject to an excise tax on such amounts.[91]Importantly, the $1,000,000 threshold amount is not adjusted for inflation. Moreover, the amount subject to tax under section 4960(a)(2) of the Code as an excess parachute payment is not subject to tax under section 4960(a)(1) as excess remuneration.[92]

B. Deduction Denial for Certain Fines, Penalties, and Other Amounts

For amounts paid or incurred on or after December 22, 2017, section 162(f)(1) of the Code generally denies the deduction of amounts paid or incurred (e.g., by suit, agreement, or otherwise) to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by the government or entity into the potential violation of any law.[93] The IRS issued new guidance relating to the information reporting requirements under section 6050X of the Code with respect to such fines, penalties, and other amounts. Generally, section 6050X of the Code provides that the appropriate official[94] of any government or entity detailed in section 162(f)(5) which is involved in a certain suit or agreement[95] shall file an information return that sets forth (i) the amount required to be paid as a result of the suit or agreement to which paragraph section 162(f)(1) of the Code applies, (ii) any amount required to be paid as a result of the suit or agreement which constitutes restitution or remediation of property, and (iii) any amount required to be paid as a result of the suit or agreement for the purpose of coming into compliance with any law which was violated or involved in the investigation or inquiry.[96] Reporting is made by filing Form 1098-F, Fines, Penalties, and Other Amounts, or any successor form, as provided by the instructions, with Form 1096, Annual Summary and Transmittal of U.S. Information Returns.[97]

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91. 26 U.S.C. § 4960(a).

92. *See* 86 Fed. Reg. 6196-01 (Jan. 19. 2021).

93. 26 U.S.C. § 162(f)(1) (codified by TCJA § 13306(a)); 26 U.S.C. § 6050X (codified by TCJA § 13306(b)).

94. 26 U.S.C. § 6050X(c) (defines the term "appropriate official" as the officer or employee having control of the suit, investigation, or inquiry or the person appropriately designated for purposes of this section).

95. *See* 26 U.S.C. § 6050X(a)(2) (describes such suits or agreements as those in which the aggregate amount involved in all court orders and agreements with respect to the violation, investigation, or inquiry is $50,000 or more, and it is either (i) a suit with respect to a violation of any law over which the government or entity has authority and with respect to which there has been a court order, or (ii) an agreement which is entered into with respect to a violation of any law over which the government or entity has authority, or with respect to an investigation or inquiry by the government or entity into the potential violation of any law over which such government or entity has authority).

96. 26 U.S.C. § 6050X(a)(1).

97. Treas. Reg. § 1.6050X-1(b)(2) (2020).

C. Deducting Settlements, Restitution, Remediation, and Similar Amounts

Section 162(f)(2) of the Code provides an exception to the general disallowance rule in section 162(f)(1) of the Code for certain amounts paid or incurred for restitution, remediation, or to come into compliance with a law. Under section 162(f)(2)(A)(i) and (ii), section 162(f)(1) does not apply to amounts that (i) the taxpayer establishes were paid or incurred as restitution (including remediation of property) or to come into compliance with a law (i.e., establishment requirement),[98] and (ii) are identified in a court order or settlement agreement as restitution, remediation, or amounts paid or incurred to come into compliance with a law (i.e., identification requirement).[99] Moreover, section 162(f)(2)(B) provides that amounts paid for restitution, remediation, and to come into compliance with a law do not include any amount paid or incurred as reimbursement to a government or governmental entity for the costs of any investigation or litigation.[100]

V. 2021 TAX INCREASES?

At the time of writing this article, the U.S. House of Representatives narrowly passed the Build Back Better Act on November 19, 2021.[101] In its current form, the spending bill appropriates nearly $2 trillion for programs related to climate change, health care expansion, and increasing the country's social safety net. As part of the tax provisions presently included in this package is a 15% minimum tax on the corporate profits of corporations with over $1 billion in profits.[102] With regard to individual and corporate income tax rates, it is difficult to determine with any certainty at this point in time whether there will be increases in 2022, as these provisions continue to be hotly contested in the Senate.

CONCLUSION

This Survey Article summarizes certain key federal tax updates, including

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98. Treas. Reg. § 1.162-21(b)(3) (2020) (establishment requirement is met if the taxpayer, using documentary evidence, proves the taxpayer's legal obligation, pursuant to the order or agreement, to pay the amount identified as restitution, remediation, or to come into compliance with a law; the amount paid or incurred; the date the amount was paid or incurred; and that, based on the origin of the liability and the nature and purpose of the amount paid or incurred, the amount the taxpayer paid or incurred was for restitution or remediation or to come into compliance with any law).

99. *See* 26 U.S.C. § 162(f)(2)(A) (in accordance with Treas. Reg. § 1.162-21(b)(2) (2020), a court order or an agreement identifies a payment by stating the nature of, or purpose for, each payment that each taxpayer is obligated to pay, and the amount of each payment identified).

100. *See* 26 U.S.C. § 162(f)(2)(B).

101. H.R. 5376, 117th Congress (2021).

102. *President Biden Announces the Build Back Better Framework*, THE WHITE HOUSE (Oct. 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/28/president-biden-announces-the-build-back-better-framework/ [https://perma.cc/BES7-4QPJ].

IRS hot button issues, the Employee Retention Credit, the CARES Act and other 2021 updates, and the Tax Cuts and Jobs Act of 2017. With much uncertainty still lingering over the anticipated passage of the Build Back Better Act, the year 2022 will likely be teeming with yet another round of changes to the federal tax system.