

# **Business Tax Issues**

Chapter 9 pp. 307 - 347

## **2023 National Income Tax Workbook™**



# Business Tax Issues

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- 1. Recent Developments in Tax Credits and Deductions**
- 2. Deducting Attorney's Fees**
- 3. Correcting Depreciation**
- 4. Form 1099 Information Returns**
- 5. Business Interest Deduction Limitation**

# Business Tax Issues – Issue 1

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- **2022 Inflation Reduction Act (IRA) – Sec. 13403 - IRC Sec. 45W made changes to some business tax credits -**
  - **Commercial Clean Vehicle Credit**
  - **Work Opportunity Credit**
  - **Research Credit**
  - **Energy Efficient Commercial Buildings deduction.**

# Business Tax Issues – Issue 1

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## Commercial Clean Vehicle Credit

- **Maximum credit = lesser of:**
  - **15% gasoline/diesel combustion powered (30% non gasoline/diesel combustion powered engines), OR**
  - **Incremental cost (excess of purchase price over price of a comparable vehicle)**
- **Credit limited to:**
  - **\$7,500 (gross vehicle weight rating < 14,000 pounds)**
  - **\$40,000 all other vehicles**

# Business Tax Issues – Issue 1

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Figure 9.1 – Figure 9.2

	CONV	BEV	BEV Incremental	PHEV	PHEV Incremental	FCEV	FCEV Incremental
Compact	\$24,500	\$32,000	\$7,500	\$31,500	\$7,000	\$35,500	\$11,000
Midsize car	\$28,500	\$37,000	\$8,500	\$36,500	\$8,000	\$43,500	\$15,000
Midsize SUV	\$33,500	\$47,500	\$14,000	\$43,000	\$9,500	\$52,500	\$19,000
Pickup truck	\$36,000	\$55,500	\$19,500	\$50,000	\$14,000	\$71,500	\$35,500
Class 4-6 box	\$72,500	\$107,000	\$34,500	\$100,500	\$28,000	\$113,500	\$41,000
Class 7 Daycab	\$117,500	\$211,000	\$93,500	\$183,500	\$66,000	\$198,000	\$80,500
Class 8 Longhaul	\$160,000	\$457,500	\$297,500	\$324,000	\$164,000	\$265,500	\$105,500

## Qualified Commercial Clean Vehicle Credit

- **Defined as vehicle acquired for use or lease by taxpayer on or before 12/31/2032**
  - 1. Used in a trade or business**
  - 2. Made by qualified manufacturer**
  - 3. Made primarily for use on public streets and roadways**
  - 4. Significantly propelled by an electric motor drawn from a battery with capacity of not less than 15 kilowatt hours**

## Practitioner Note-New Clean Vehicle Credit

- **No commercial clean vehicle credit allowed for a vehicle for which a credit was allowed under IRC §30D new clean vehicle credit.**
- **Prop. Treas. Reg. §1.30D-1(b)(1) new clean vehicle portion to one or more depreciable vehicles- treated as current year gen. bus. credit.**
- **(b)(2) of that section requires apportionment of new clean vehicle credit where business use is <50%, and business use % is general business credit and personal use of vehicle is new clean vehicle credit.**

## Work Opportunity Tax Credit

- Available when employing individuals from one of 10 targeted groups
  - Credit extended to 12/31/25
- Credit equal to 40% of first \$6,000 qualified wages paid to individuals:
  - In 1st year of employment, AND
  - Are certified member of targeted group, AND
  - Works at least 400 hours



# Business Tax Issues – Issue 1

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## Work Opportunity Tax Credit

- **Maximum credit @ 40% = \$2,400**
- **25% rate for <400 hours work, but at least 120 hours**
- **Employers count up to \$25,000 wages for qualified veterans**
- **Unused credit can be carried back 1 year and forward 20 years**

# Business Tax Issues – Issue 1

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## Work Opportunity Tax Credit – Targeted Groups

1. Recipient of Temporary Assistance for Needy Families
2. Qualified Veteran
3. Qualified ex-felon
4. Resident within empowerment zone, enterprise community, renewal community, rural renewal county
5. Vocational rehab referral

# Business Tax Issues – Issue 1

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## Work Opportunity Tax Credit – Targeted Groups cont'd:

6. Summer youth employee
7. Supplemental Nutrition Assist. Program (SNAP) benefits
8. Supplemental security income (SSI) recipient
9. Long-term family assistance recipient
10. Qualified long-term unemployment recipient (not less than 27 consecutive weeks)

# Business Tax Issues – Issue 1

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## Work Opportunity Tax Credit – Qualified Wages

- **IRC §51(b) Wages paid to employee - member of targeted group**
- **Special rules apply to agriculture and railroad employees – see IRC §51(h)**
- **Non-qualifying wages paid employee:**
  - **Dependent of employer**
  - **Relative of employer**
  - **Previously worked for the employee**
  - **Works less than 120 hours work for employer**

# Business Tax Issues – Issue 1

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## Work Opportunity Tax Credit – Claiming the credit

- On or before day of job offer- employer and applicant must complete F8850 (Pre-Screening Notice & Certification Request)
- Employer submits form within 28 days to local designated agency to obtain certification
- After certification – Taxable employer submits F5884 to claim WOTC
- Tax exempt organizations – submit F5884-C

# Business Tax Issues – Issue 1

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## Research Credit

- **IRC § 41 allows credit for increasing qualified research expenses**
- **Developing new or improved product formulations, design, new or improved product recipes, new packing processes**
- **Eligible small businesses ( < \$50,000,000 gross receipts)**
  - **Can claim credit against AMT liability**
- **Startups – low or no income**
  - **Claim credit against payroll tax**

# Business Tax Issues – Issue 1

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## Research Credit – Qualified Research

- Treated as §174 research expense –
  - Undertaken for discovering technological information intended for use in developing new or improved business components
  - Relating to a new or improved function, performance, reliability or quality
  - Tests applied separately to each business component under IRC §41(d)

## Research Credit – Qualified Research

- Credit does not apply to research activities:
  1. After beginning of commercial production
  2. Adapting existing product for a customer
  3. Duplicating an existing product
  4. Surveys/studies related to management functions
  5. Internal use software
  6. Outside the U.S.
  7. Social Science, arts or humanities
  8. Funded by another person (government or entity)



# Business Tax Issues – Issue 1

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## Research Credit – Eligible Small Business - AMT offset

- Corporation-not publicly held
- Partnership
- Sole proprietorship
  - With avg. annual gross receipts for the preceding 3-yr tax period not exceeding \$50,000,000
  - Not in business 3 years, use avg. annual gross receipts period business existed.

# Business Tax Issues – Issue 1

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## Research Credit – Qualified Small Business – Payroll Tax Credit Election

- Qualified small business can elect to claim against their employment tax liability
  - Before 1/1/2023 up to \$250,000 credit
  - IRA increase after 12/31/22 to \$500,000
- First reduce employer's share of social security up to \$250,000 per quarter, any remaining amount reduces employer Medicare tax for quarter
- Any remainder is carried over to next quarter

# Business Tax Issues – Issue 1

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## Research Credit – Qualified Small Business defined

- Corporation-including s-corporation or partnership with gross receipts <\$5,000,000 for the tax year, and \$0 gross receipts for any year in the 5- year tax period ending with the current tax year
- Any other person meeting the requirements above, taking into account aggregate gross receipts in all trades or businesses
- **Does not include** an IRC §501 tax-exempt organizations

# Business Tax Issues – Issue 1

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## Research Credit – Claiming Payroll Credit

- Claim on Form 6765 for first quarter after election made-against employer's portion of social security
- Amount from Form 6765, line 44 is reported on Form 8974 that is attached to the employment tax return

# Business Tax Issues – Issue 1

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## Energy efficient commercial buildings deduction

- U.S. located buildings, leased or owned may claim 179D deduction for portion of cost of energy efficient building property placed in service during tax year
- Applies to depreciable/amortizable property certified to be installed on or in one of 3 building systems:
  1. Interior lighting systems
  2. Heating, cooling, ventilation and hot water systems
  3. Building's envelope

# Business Tax Issues – Issue 1

p. 315

## Energy efficient commercial buildings deduction

- Property Installed must be certified as part of plan to reduce energy by 25% (50% for tax years beginning before 1/1/2023) or more
- For 2023 applicable dollar value=\$0.54 per sq. foot increased by \$0.02 per certified reduction in energy costs by >25% up to maximum of \$1.07 per sq. foot.
- If property meets prevailing wage & apprenticeship requirement, applicable dollar value is \$2.68 increase by \$0.11 for each % point of annual energy reduction by >25%, up to a max of \$5.36 per sq. foot. (indexed for inflation)

# Business Tax Issues – Issue 1

p. 315

## Energy efficient commercial buildings deduction

- Prevailing wage requirement
  - Laborers, mechanics employed by taxpayer or contractor/subcontractor installing property must be paid not less than prevailing rates in locality where property is located as determined by DOL
- Apprenticeship Requirements
  - Requirement met if not less than % of total labor hours of construction, alternation, repair work (including work by contractor or subcontractor) is performed by qualified apprentices. (4 to 1 ratio, 4 employees to 1 apprentice)

# Business Tax Issues – Issue 2

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## Deducting Attorney's fees – General rules

- Attorney Fees awarded in a settlement or judgment, are in most cases included in income.
- The underlying legal issue determines the deductibility of the fees under IRC § 162, or §212 (itemized deductions 2% AGI when allowed)
- Discrimination and Whistleblower claims are above the line deductible legal fees.
- Settlement proceeds exempt from income, the prevent deduction of legal fees.



# Business Tax Issues – Issue 2

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## Ex. 9.3 – Attorney Fees- Business Expense

- George independent contractor, life insurance salesman – terminated by Life Ins. Co. who did not pay commissions on policies he previously sold as agreed - he sued the life insurance company
- Court awarded unpaid commissions and punitive damages
- Lawsuit was deemed business related, award was ordinary and necessary business expense to recover commissions owed him.
- *Guill v. Commissioner*, 112 T.C. 325 (1999)

# Business Tax Issues – Issue 2

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## Business of Being an Employee

- Employment related lawsuits for wrongful discharge or breach of contract where damages received are for compensation for economic loss are includable in income.
- Employee not deemed to be a trade or business, so attorney fees to obtain this compensation, are an employee business expense.
- Legal fees are itemized deductions subject to 2%-of-AGI floor (when allowable)

# Business Tax Issues – Issue 2

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## Personal Expenses

- IRC § 162 prohibits deduction for personal expenses
- Deductibility of legal fees depends on connection to TP's profit-seeking activities or personal activities.
- Generally legal expenses paid to defeat claims arising from a marital relationship are personal and nondeductible. Exceptions exist!!!

# Business Tax Issues – Issue 2

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## Ex. 9.6 Legal Fees Deduction for Securing Income

- Martin & Genevieve, each own 50% interest in a store. Divorce settlement gave Martin possession of store and ordered him to pay periodic payments to Genevieve (represents her share of income from 1/2 interest in the store).
- Court held that her legal fees relating to that part of the settlement was for production of taxable income and not personal or capital.
- Hahn v Commissioner, T.C. Memo 1976-113.

# Business Tax Issues – Issue 2

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## Capital Expenditures

- Legal fees incurred to perfect, defend, recover, develop or improve property (other than investment property and income if/when recovered is included in gross income) are capital under IRC § 263(a) and characterized as acquisition costs.
- Attorney fees to quiet title are capital, but fees to collect rent on the property are allocable to deductible expense.

# Business Tax Issues – Issue 2

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## Discrimination and Whistleblower Suits

- Discrimination - IRC §62(a)(20) for unlawful discrimination, claims against federal govt, Medicare secondary provider
- Whistleblower - IRC §62(a)(21) award for providing information for:
  - Tax underpayment and fraud as per IRC §7623(b)
  - Violations of federal securities law
  - Fraud against state or local government
  - Violations against the Commodity Exchange Act

# Business Tax Issues – Issue 2

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## Personal Injury Suits

- IRC §104(a)(2) provides-exclusion from gross income for damages (other than punitive) for personal physical injuries/sickness.
- If settlement agreement is silent as to basis of payment, courts will look to payer's intent.
- Legal fees allocable to the nontaxable awards or settlements are NOT deductible

# Business Tax Issues – Issue 2

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## Allocating Attorney Fees

- Legal fees relating to a settlement that is partially taxable are allocated based on the ratio between the taxable settlement and the total settlement
- $\text{Deductible fees/costs} = (\text{Ratio of taxable proceeds to total proceeds}) \times (\text{total fees and costs})$

### Ex. 9.9 Allocating Attorney Fees:

- Wrongful termination suit award to petitioner \$100,000 (\$20,000 for medical costs & \$80,000 lost wages)
- Legal fees \$52,000
- Taxable proceeds = 80% ( $\$80,000 / \$100,000$ )
- Deductible fees = \$41,600 ( $\$52,000 \times 80\%$ ) – Misc. Itemized ded.



# Business Tax Issues – Issue 3

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## Correcting Depreciation

- IRC § 481(a) - adjustments requiring a change in method of accounting is computed on F-3115-adjusted prospectively (not an amended return)
- Amended Return - Correcting a depreciation error-not requiring a § 481(a) adjustment

# Business Tax Issues – Issue 3

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## Not Accounting Method Changes

1. IRC § 167 Changing useful life of depreciable assets
2. Same taxpayer changing use of asset
3. Late depreciation or amortization election or revoking an election made (Ltr. Ruling generally required)
4. Changing placed-in-service date of asset

# Business Tax Issues – Issue 3

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## Changing Use

- Change in use of MACRS property (personal to business or income-producing)
- If change in use=shorter recovery period/accelerated method:
  1. Compute depreciation in the year of change
  2. Elect to continue depreciation before change
- Longer recovery period or less accelerated depreciation, use longer or less accelerated method in year change occurred.

# Business Tax Issues – Issue 3

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## Long & Short Term Rentals

- Residential rental property-recovery period is 27.5 years
- Short-term rental may be 39-year non-residential real property
- Residential Real Property = Building or structure if 80% or more of gross rental income is income from dwelling units (house or apartment-providing living accommodations in a building or structure)
  - Does not apply if  $> \frac{1}{2}$  units used on transient basis, i.e. hotel, motel.

# Business Tax Issues – Issue 3

p. 324

## Correcting Change in Use:

- Correcting change in use, complete F4562 in year of change, compute depreciation as though change in use had not occurred.

# Business Tax Issues – Issue 3

p. 324

## Changing the Placed-in-Service Date:

- Change in Placed- in- Service Date (Corrected only by amending the return)
  - Asset acquired, available and in a state of readiness for business use (not actual use of asset)
- Corrections may be made in earlier open tax years (not earlier than the placed in- service date)
- Taxpayer initiated change in placed in service date can make corrections by correcting the current and subsequent tax years (and not file amended returns)

# Business Tax Issues – Issue 3

p. 325

## Adopting a Method of Accounting for Depreciation:

- Changing methods of accounting require IRS approval
- Adopting a Method of Accounting for Depreciation
  1. Taxpayer uses a permissible method on the first filed tax return
  2. Taxpayer uses same impermissible method on 2 or more consecutive tax returns
- Correction requires change in accounting request
  - Limited exception for impermissible method used only 1 year (amending return)

# Business Tax Issues – Issue 3

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## Changes that Require Consent:

1. From impermissible method used on 2 or more tax returns
2. Asset from non-depreciable to depreciable or vice versa
3. Asset depreciable rather than deductible expense or vice versa
4. Method, recovery period or convention used
5. 1st Yr. depreciation claim where TP did not elect out
6. Claiming to not claiming 1st year depreciation for non-qualifying Asset



# Business Tax Issues – Issue 3

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## Obtaining Consent:

### Automatic Consent Request

- See F-3115 Instructions for approved changes for Automatic Consent
  - Original F-3115 attached to timely filed return for year of change
  - Copy submitted to IRS National Office

### Advance Consent Request (doesn't qualify as automatic)

- Request for letter ruling submitted with F-3115
  - Basic user fee is \$11,500
  - User Fee = \$8,500 - Gross Income =>\$250,000 not more than \$1,000,000
  - User Fee = \$3,000 – Gross Income < \$250,000

# Business Tax Issues – Issue 3

pp. 326 - 327

## IRC Sec. 481(a) Adjustment :

- Generally required for unclaimed or excess depreciation
- Adjustment = difference actual deduction and allowable amount prior to year of change (if no depreciation claimed, adjustment = total allowable depreciation)
- Negative adj. = decrease taxable income in year of change (Other expense)
- Positive Adj. = Increase Taxable income (over 4 years)- unless elected to report all in year of change, if <\$50,000 – check Line 28, yes box of F-3115. See Fig. 9.3, P 327.

# Business Tax Issues – Issue 3

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## Practitioner Note – Other Adjustment Periods:

- Rev Proc 2015-13 provides (limited exceptions) adjustment period is 2 years (year of change and next)
- Taxpayer under IRS exam, positive adjustment-full inclusion in yr. of change (if eligible acquisition transaction occurs in the yr. of change)
- Adj. required for:
  - Impermissible method to permissible method
  - Asset change from nondepreciable to depreciable
  - Expensing to depreciating

# Business Tax Issues – Issue 3

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## Practitioner Note-Bonus Depreciation:

- Bonus Depreciation must be claimed the first year return or election out
- Election – class by class basis
- Failure to claim, without election out is a depreciation error requiring correction
- If only one return filed incorrectly, return can be amended
- Otherwise, taxpayer must file F-3115 to make correction – automatic consent procedure

# Business Tax Issues – Issue 4

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## Form 1099-MISC:

- Required for payments of \$600 or more paid for -
  1. Rents (box 1)
  2. Prizes and awards for services performed (box 3)
  3. Other income payments (box 3)
  4. Payment from notational principal contract to indiv., partnership, estate (box 3)
  5. Medical/healthcare payments (box 6)
  6. Crop insurance proceeds (box 9)
  7. Gross proceeds paid to an attorney (box 10)
  8. IRC Sec. 409A deferrals (box 12)
  9. Nonqualified deferred compensation (box 15)
  10. \$5,000 or more sales of consumer products sold on commission basis (box 7) or can be reported on 1099-NEC (box 2)

# Business Tax Issues – Issue 4

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## Form 1099-MISC – Box 3, Other Income payments:

### Includes:

- Deceased employee wages
- Tribal members Indian gaming profits
- Payments to individuals participating in medical research
- Termination payments to self-employed insurance salespersons
- Punitive damage payments
- Foreign agriculture payments to individuals without a valid TIN (subject to backup withholding)

# Business Tax Issues – Issue 4

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## Form 1099-MISC – Deceased Employee Payments:

### Payment in year of death:

- Report on W-2, box 3 and withhold social security and Medicare tax.

### Payment after year of death:

- No W-2 reporting or withholding
- Payment either time requires reporting on F-1099 MISC box 3 (withholding applies) to the estate or beneficiary.

# Business Tax Issues – Issue 4

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## Form 1099-MISC – Royalty Payments:

- Gross royalties, broker payments, or tax-exempt interest (if \$10 or more) - report in box 2
- Oil, Gas or other mineral royalties (surface royalties) (box 1)
- Oil & Gas - Working Interest Royalties get report on F1099- NEC (box 1) – NOT 1099-MISC
- Timber royalties (pay-as-cut contract) – report on F1099-S



# Business Tax Issues – Issue 4

p. 337

## Form 1099-MISC – Payments to Corporations:

Generally F-1099 reporting not required – except for:

- Cash payments for fish resale – (box 11)
- Medical & Healthcare payments – (box 6)
- Substitute payments in lieu of dividends or exempt interest (box 8)
- Gross proceeds paid to attorney = 1099-MISC (box 10), 1099-NEC (box 9)
- Payments to LLC, electing S or C corporation, reporting not required.
- Payments to LLC electing single member or partnership – must report if paying \$600 or more

# Business Tax Issues – Issue 4

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## Payments to Attorneys:

- Trade or business payments of \$600 or more for services – payer reports on Form 1099-NEC
- Trade or business payments of \$600 as part of settlement – payer reports on F-1099-MISC
- Wages reported on W-2
- Profits distributed by partnership on K-1

# Business Tax Issues – Issue 4

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## Form 1099-NEC:

- For trade or business payments of \$600 or more for services
- Payments to non-profit organizations and some other organizations are subject to the same requirements
- 1099-NEC generally not required for corporations
- Payments to Nonemployees includes:
  - Auto expense reimbursements, fees, mileage, vacation allowance, prizes & awards, bonuses & commissions

# Business Tax Issues – Issue 4

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## Form 1099-NEC - Payments Made on Behalf of Another:

- Treas. Reg. § 1.6041-1(e)
- Payer must file an information return if information return otherwise required and payer:
  1. Performs management or oversight functions regarding the payment, OR
  2. Has a significant economic interest in the payment.

# Business Tax Issues – Issue 4

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## Form 1099 Extension of Time to Furnish Statements:

- Fax letter to IRS (877-477-0572) which includes:
  - Name, TIN, Address, Return Type, Statement indicating extension is to provide statements, Reason for delay, and Signature of payer/authorized agent.
- IRS must receive by due date of form to be furnished to the recipient.
- If approved, grants 30 day extension

# Business Tax Issues – Issue 5

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## Business Interest Deduction Limitation:

- IRC § 163(j) generally limits the deduction for business interest to the sum of business interest income, 30% of adjusted taxable income (ATI), and floor plan financing interest
- Generally applies to tax shelters and small businesses categorized as a tax shelter

# Business Tax Issues – Issue 5

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## Taxpayers subject to limitation:

- TCJA (2017) expanded IRC §163(j), includes all U.S. TPs
- Small Business exception in 2023 if average gross receipts < \$29,000,000 for the prior 3 years
- Tax Shelters (gross receipt test does not apply)
  1. An enterprise other than a C corporation that must register an offering of the sale of securities with a state or federal regulatory authority
  2. Any syndicate within the meaning of IRC §1256 (e)(3)(B)
  3. Any tax shelter as defined in IRC § 6662(d)(2)(C)(ii)

# Business Tax Issues – Issue 5

pp. 343 - 344

## IRC §163(j) does NOT apply to:

1. The trade or business of performing services as an employee
2. Any electing real property trade or business
3. Any electing farming business
4. Certain utility companies if the rates have been established by a governmental agency or instrumentality or certain other public service entities or cooperatives



# Business Tax Issues – Issue 5

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## 2 types of electing business:

1. Real Estate-development, construction, acquisition, conversion, operation, management, leasing, or brokerage trade or business
2. Farming-includes operating a nursery, harvesting trees, fruit, nuts, or other crops, ornamental trees (not evergreen) >6 years old when cut.
  - Once made-election is irrevocable
  - Electing businesses must use ADS depreciation
  - To make election, attach statement to timely filed (includes extension) return

# Business Tax Issues – Issue 5

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## Calculating the Limit:

- Business Interest Deduction = sum of:
  1. 100% of business interest income
  2. 30% adjusted taxable income for tax year (not < zero)
  3. All floor plan financing interest of the taxpayer
- Amounts not allowed due to limitation, carried to next year
- Business Interest = Interest paid or accrued allocable to trade or business operation (NOT investment interest).

# Business Tax Issues – Issue 5

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## Business Interest Income & Limit rules:

- C Corp. interest is business interest (unless from excepted business)
- S Corp. – apply limitation at entity level (interest deduction not allowed is carried over at entity level)
- See Reg. Sec. 1.163(J)-6(f)(2) for rules regarding the allocating deductible business interest expense for partnerships and S Corporations.

# Business Tax Issues – Issue 5

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## Adjusted Taxable Income:

- For tax years beginning 1/1/22, Adjusted Taxable Income = Taxable Income less:
  1. Income, gain, deduction or loss not related to a trade or business
  2. Business interest paid or business interest income received
  3. NOL deduction under IRC Sec. 172
  4. IRC 199A QBI deduction

THANK YOU

The image features the words "THANK YOU" in a bold, bubbly, 3D font. The letters are primarily pink with yellow sides and black outlines. The word "THANK" is on the top line, and "YOU" is on the bottom line. The letters have a slight shadow, giving them a three-dimensional appearance. Surrounding the text are several yellow and pink stars of varying sizes, along with black motion lines (short lines radiating from a point) that suggest energy and excitement. The entire graphic is set against a plain white background.