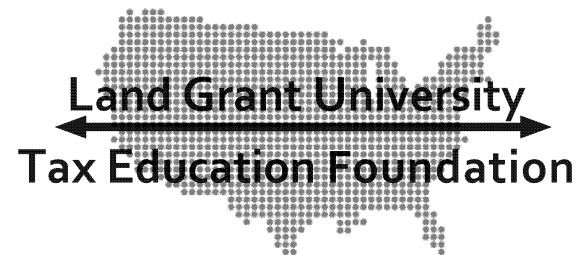


# 2022 NATIONAL INCOME TAX WORKBOOK

CHAPTER 4: BUSINESS TAX ISSUES



## CHAPTER 4 – LEARNING OBJECTIVES

PP. 127

- Multilevel Marketing
- Short-Term Vacation Rentals
- Business travel – remote workers
- Sale of a Business
- Employee Retention Credit

Direct sales companies

- Communication services
- Nutritional
- Weight loss
- Healthy environmental products
- Flower creations
- Jewelry
- Cookware
- Essential oils
- Wellness products
- .....

42 billion  
In direct  
selling  
sales!



# Retail Audit Technique Guide

This document is not an official pronouncement of the law or the position of the Service and cannot be used, cited, or relied upon as such. This guide is current through the revision date. Since changes may have occurred after the revision date that would affect the accuracy of this document, no guarantees are made concerning the technical accuracy after the revision date.  
The taxpayer names and addresses shown in this publication are hypothetical.

Audit Technique Guide Revision Date: 3/5/2021

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The Direct Selling Association and Federal Trade Commission have definitions of the industry  
IRS has a definition – called **direct sellers**

- **Single level marketing**
  - Cannot take on other distributors
  - Reward sellers for their own sales activity through commissions or bonuses
- **Multilevel marketing**
  - Can sponsor other distributors
  - Receive commissions based on downliners

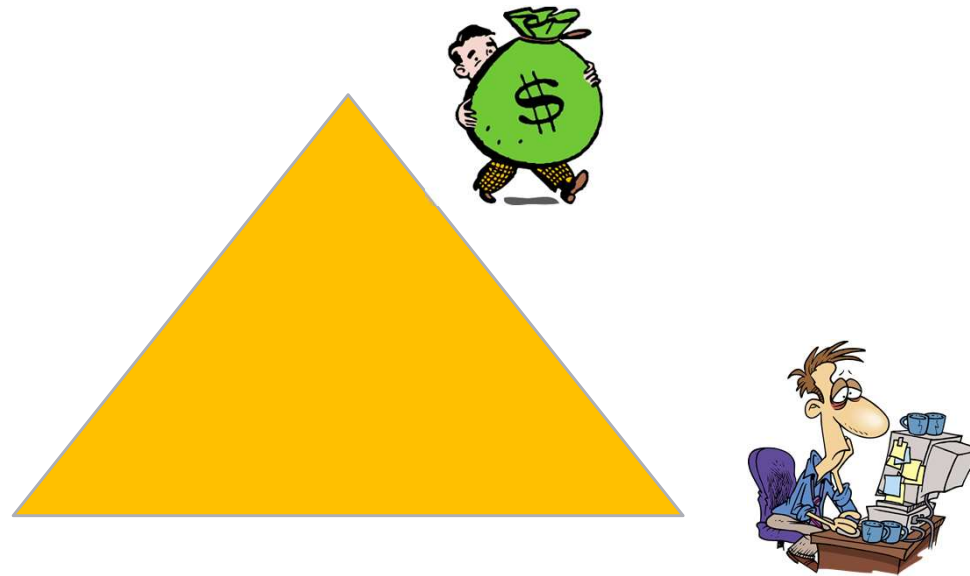
# PYRAMID SCHEMES

## Start-up Fee

Promoters make extravagant promises

Promoters emphasize recruiting new distributors

Promoters play on your emotions



# STATUTORY NONEMPLOYEE

p. 130

Employee

Independent contractor



~~Common law tests~~

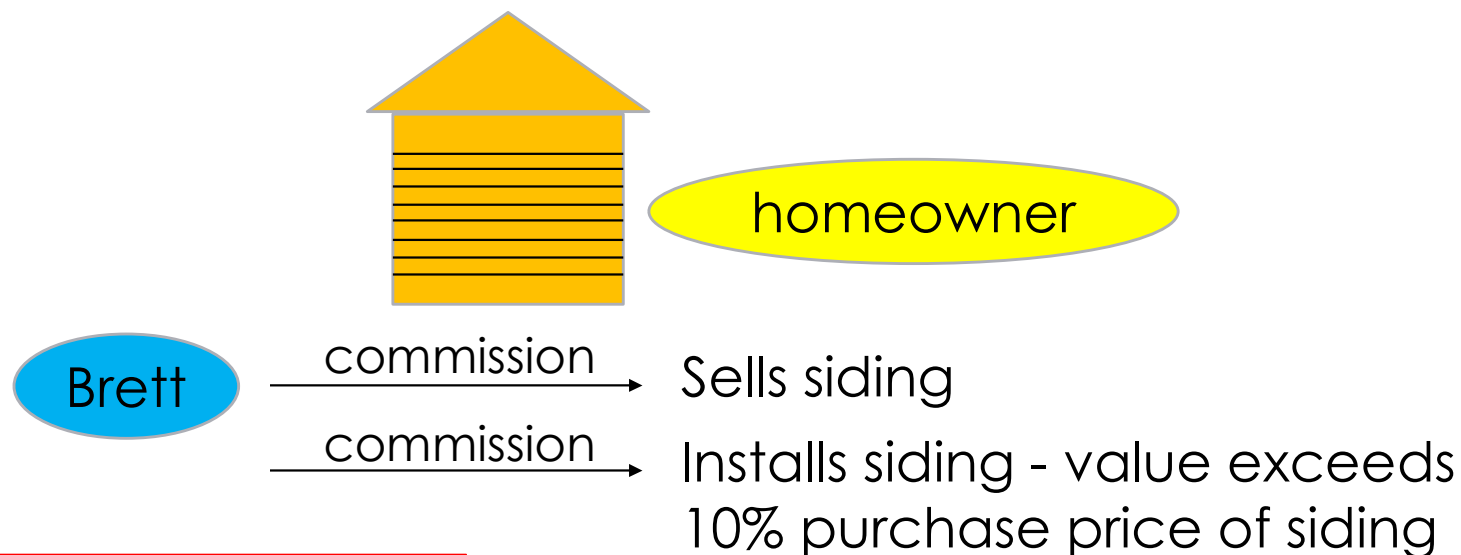
IRC 3508 – Direct Sellers

Pay SE tax

1. Sell consumer products – nonpermanent retail establishment
2. All remuneration related to sales
3. Written contract

## EXAMPLE 4.2 - DUAL SERVICES

p. 131



Nonemployee for services as direct seller

Common law principles for installation



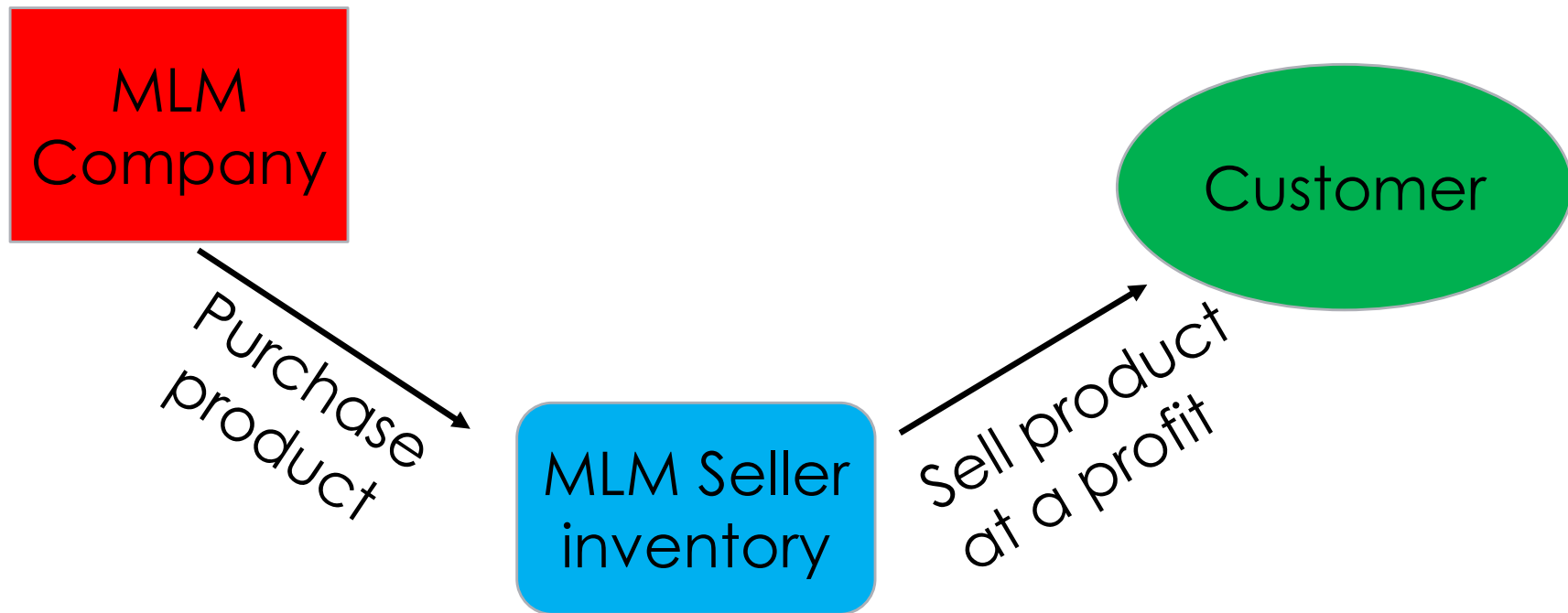
## MULTI LEVEL MARKETING INCOME

1. Income from direct sales of products
  - If taxpayer must purchase inventory
2. MLM company ships products to consumer
  - Commissions, bonuses

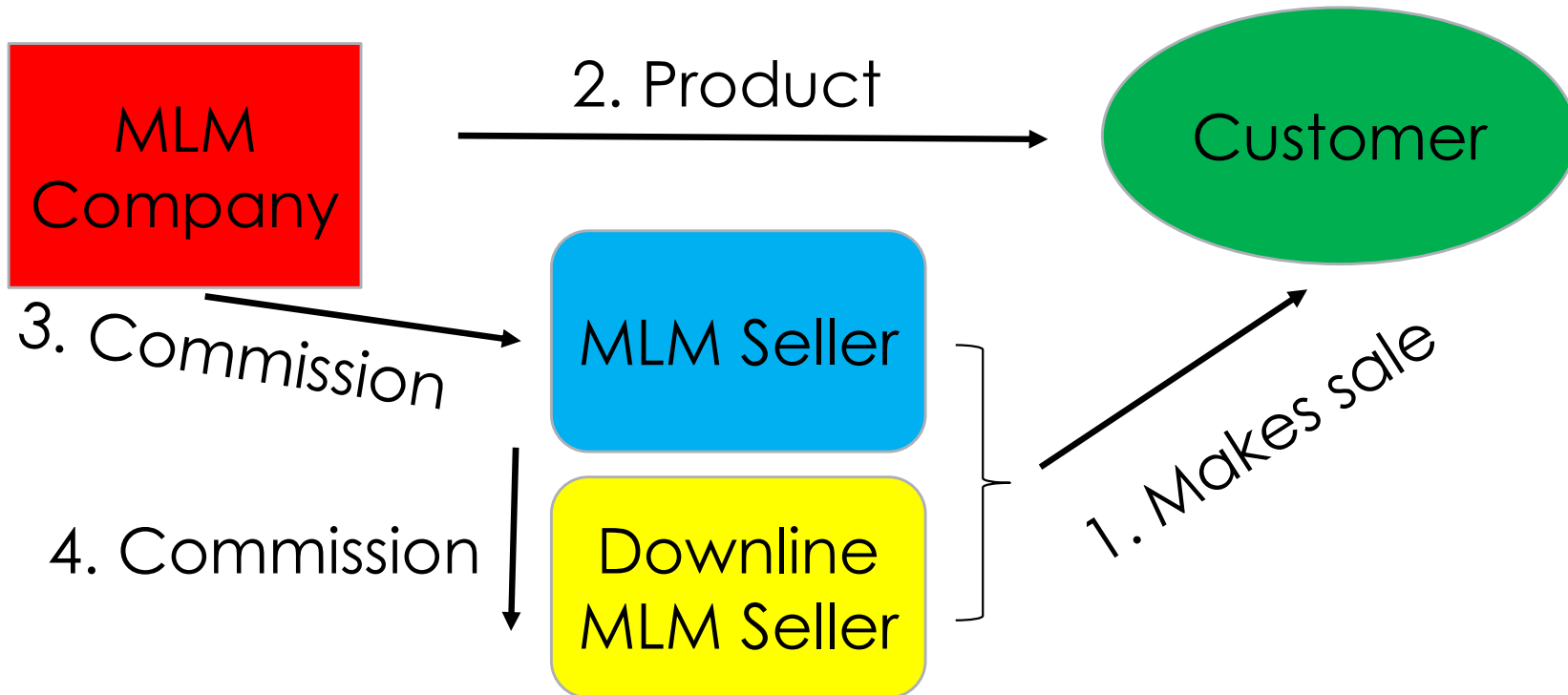
Both:

- Prizes / awards
- Gifts of products to the direct seller

# MULTI LEVEL MARKETING INCOME



# MULTI LEVEL MARKETING INCOME



# EXAMPLE 4.2 – PERSONAL USE

Angie



Juice powered  
gummy vitamins

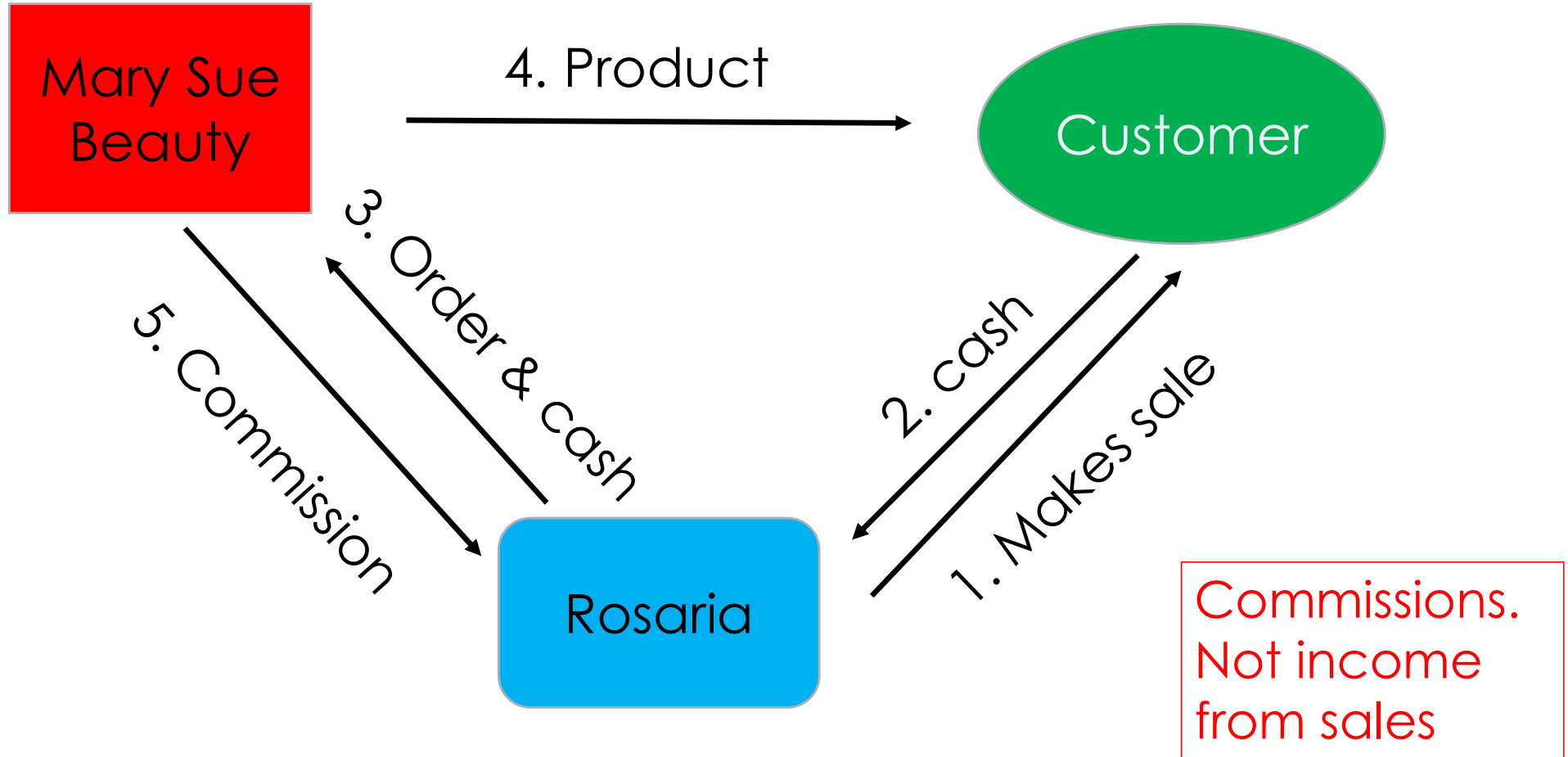


Takes  
vitamins to  
show how  
they make  
her hair shiny

sells

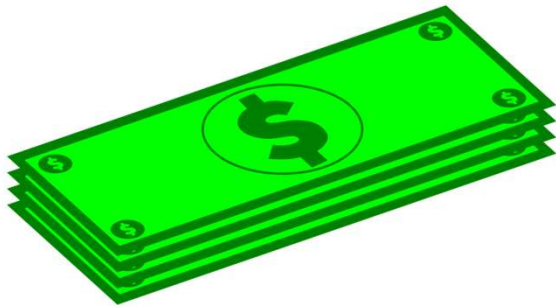


# EXAMPLE 4.3 COMMISSION SALES



# PRIZES AND AWARDS - TAXABLE

p. 132



IRC 61!



# DEDUCTIONS – SCHEDULE C

Gross income. Add lines 3 and 6

**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		21	Repairs and maintenance . . . . .	21	
14	Employee benefit programs (other than on line 19) . . . . .	14		22	Supplies (not included in Part III) . . . . .	22	
15	Insurance (other than health) . . . . .	15		23	Taxes and licenses . . . . .	23	
16	Interest (see instructions):			24	Travel and meals:		
a	Mortgage (paid to banks, etc.) . . . . .	16a		a	Travel . . . . .	24a	
b	Other . . . . .	16b		b	Deductible meals (see instructions) . . . . .	24b	
17	Legal and professional services . . . . .	17		25	Utilities . . . . .	25	
				26	Wages (less employment credits) . . . . .	26	
				27a	Other expenses (from line 48) . . . . .	27a	
				b	<b>Reserved for future use</b> . . . . .	27b	
28	<b>Total expenses</b> before expenses for business use of home. Add lines 8 through 27a . . . . .	28					

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

Start up	
Gifts	
Business use of home	

## START-UP COSTS – IRC 195

p. 133

Active trade or  
business begins

---

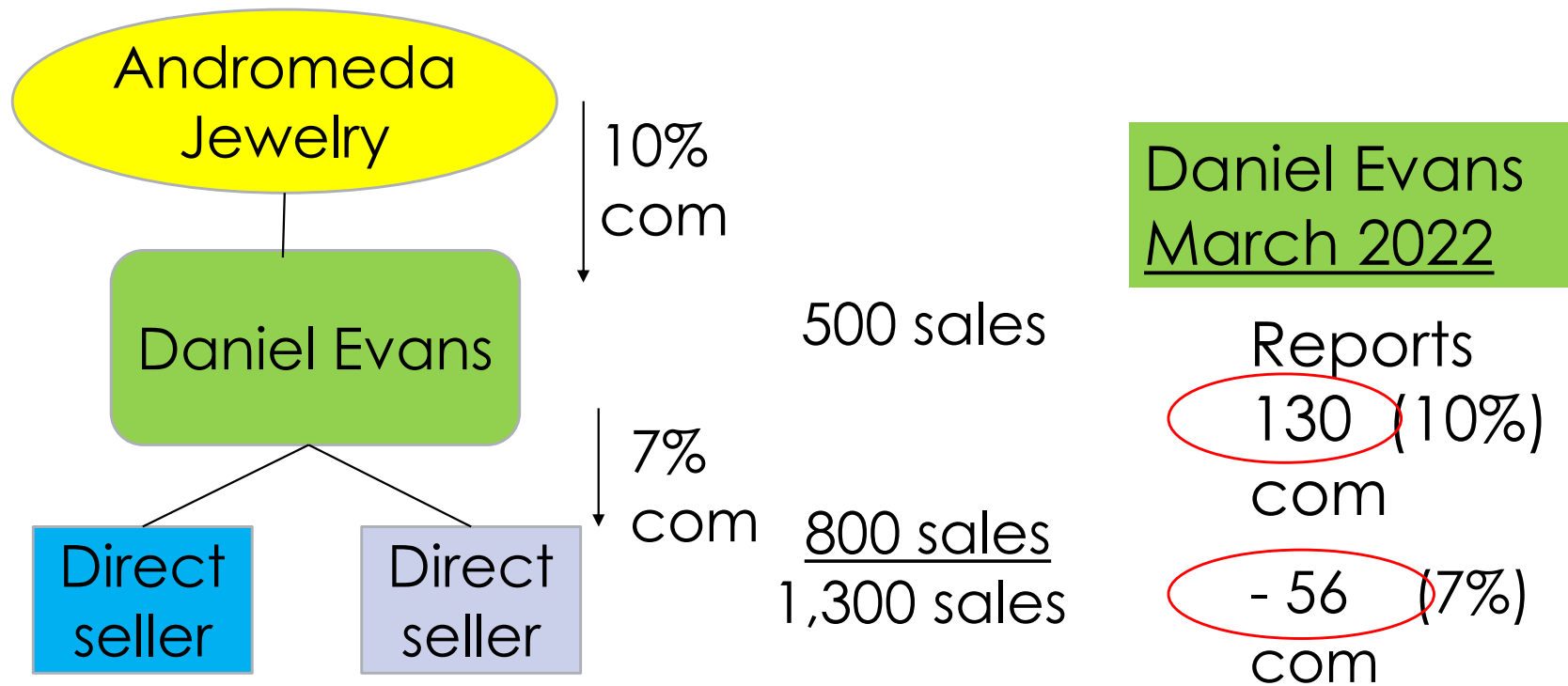
Before direct selling begins

- Investigate creation or acquisition of a trade or business
- Exploring different businesses cost of training
- Fee to become direct seller

Deduct up to 5,000  
(if over 50,000, reduce  
dollar for dollar and  
amortize remaining  
over 180 months)

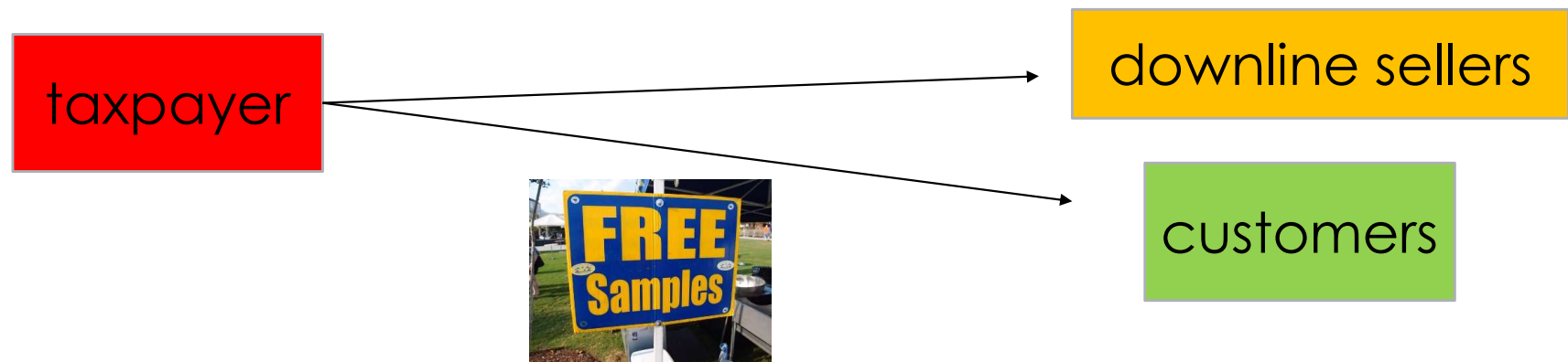


# EXAMPLE 4.4 COMMISSIONS PAID



# SAMPLES AND PROMOTIONAL ITEMS

p. 133



Give product samples

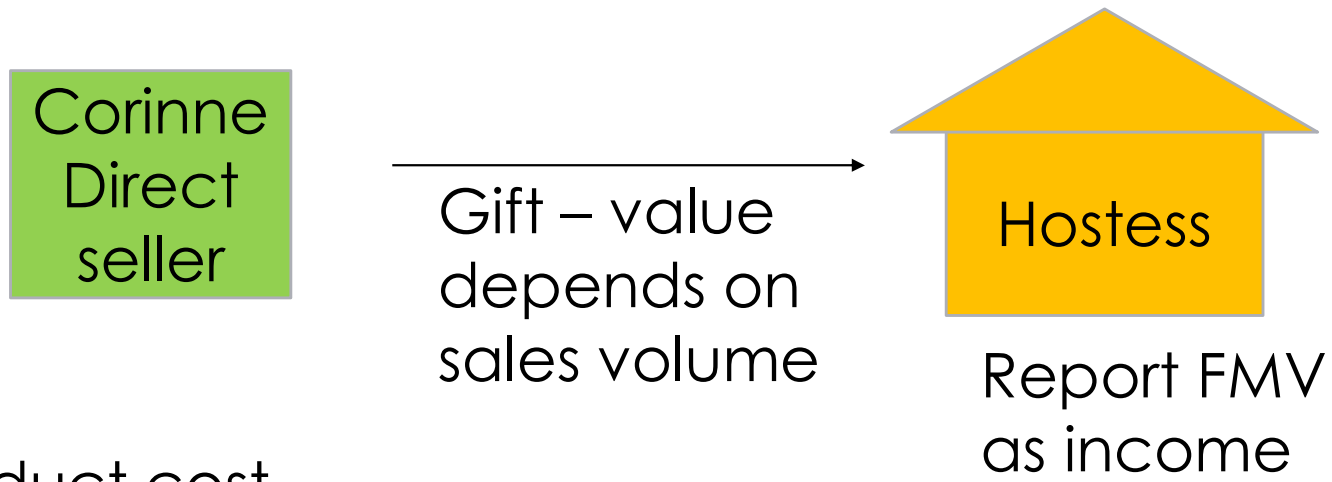
Follow gift rules:

25 / individual / year!

Since  
1962!!

NOTE: 25 limit does  
not apply to gifts to  
host / hostess

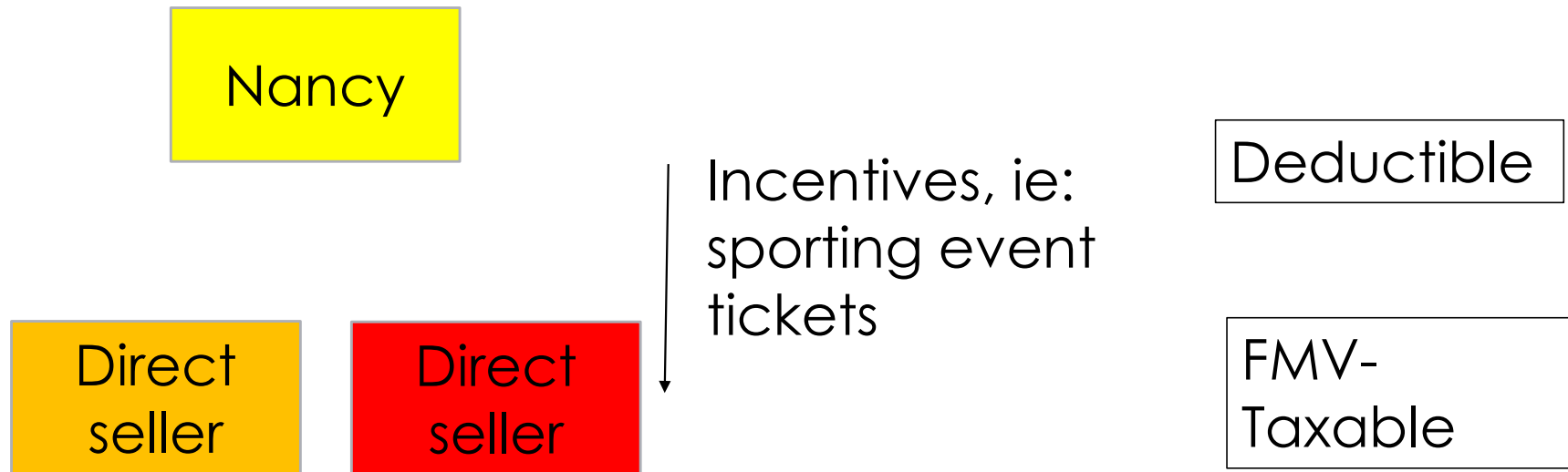
## EXAMPLE 4.5 HOSTESS GIFTS



Deduct cost –  
separate purchase  
or part of COGS

Not subject  
to gift rules

# EXAMPLE 4.6 – PRIZE – BUSINESS EXPENSE



Not gifts

# GOODS USED FOR DEMONSTRATION

p. 134

Products used for demonstration

available for sale

include in COGS

used for demonstrations

< year

deduct

> year

capitalize

# AUTOMOBILE EXPENSES – MILEAGE METHOD



## 2022

Standard mileage rate

1<sup>st</sup> 6 mo: 58.5 cents / mile

Last 6 mo: 62.5 cents / mile

But, no commuting  
(example 4.9)

January							February							March						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
						1			1	2	3	4	5			1	2	3	4	5
2	3	4	5	6	7	8	6	7	8	9	10	11	12	6	7	8	9	10	11	12
9	10	11	12	13	14	15	13	14	15	16	17	18	19	13	14	15	16	17	18	19
16	17	18	19	20	21	22	20	21	22	23	24	25	26	20	21	22	23	24	25	26
23	24	25	26	27	28	29	27	28	27	28	29	30	31							
30	31																			

April							May							June						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
						1	1	2	3	4	5	6	7			1	2	3	4	
3	4	5	6	7	8	9	8	9	10	11	12	13	14	5	6	7	8	9	10	11
10	11	12	13	14	15	16	15	16	17	18	19	20	21	12	13	14	15	16	17	18
17	18	19	20	21	22	23	22	23	24	25	26	27	28	19	20	21	22	23	24	25
24	25	26	27	28	29	30	29	30	31	26	27	28	29	30						

July							August							September						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
						1	1	2	3	4	5	6			1	2	3			
3	4	5	6	7	8	9	7	8	9	10	11	12	13	4	5	6	7	8	9	10
10	11	12	13	14	15	16	14	15	16	17	18	19	20	11	12	13	14	15	16	17
17	18	19	20	21	22	23	21	22	23	24	25	26	27	18	19	20	21	22	23	24
24	25	26	27	28	29	30	28	29	30	31	25	26	27	28	29	30				
31																				

October							November							December						
S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S
						1	1	2	3	4	5			1	2	3				
2	3	4	5	6	7	8	6	7	8	9	10	11	12	4	5	6	7	8	9	10
9	10	11	12	13	14	15	13	14	15	16	17	18	19	11	12	13	14	15	16	17
16	17	18	19	20	21	22	20	21	22	23	24	25	26	18	19	20	21	22	23	24
23	24	25	26	27	28	29	27	28	29	30	25	26	27	28	29	30	31			
30	31																			

## BUZZ WORDS

Code: "Ordinary and necessary"

Regs: "Reasonable and necessary"

"Away from home"

"Solely for business"

Not "lavish or extravagant"

NOTE: Meals limited

Example 4.10 – Convention strictly for business

## BUSINESS USE OF HOME

p. 136

(reminder – no office in home for employees)

Tests of section 280A:

Regular - more than incidental / occasional

Exclusive – identifiable specific area  
(Product storage except)



## BUSINESS USE OF HOME - FUNCTION TESTS

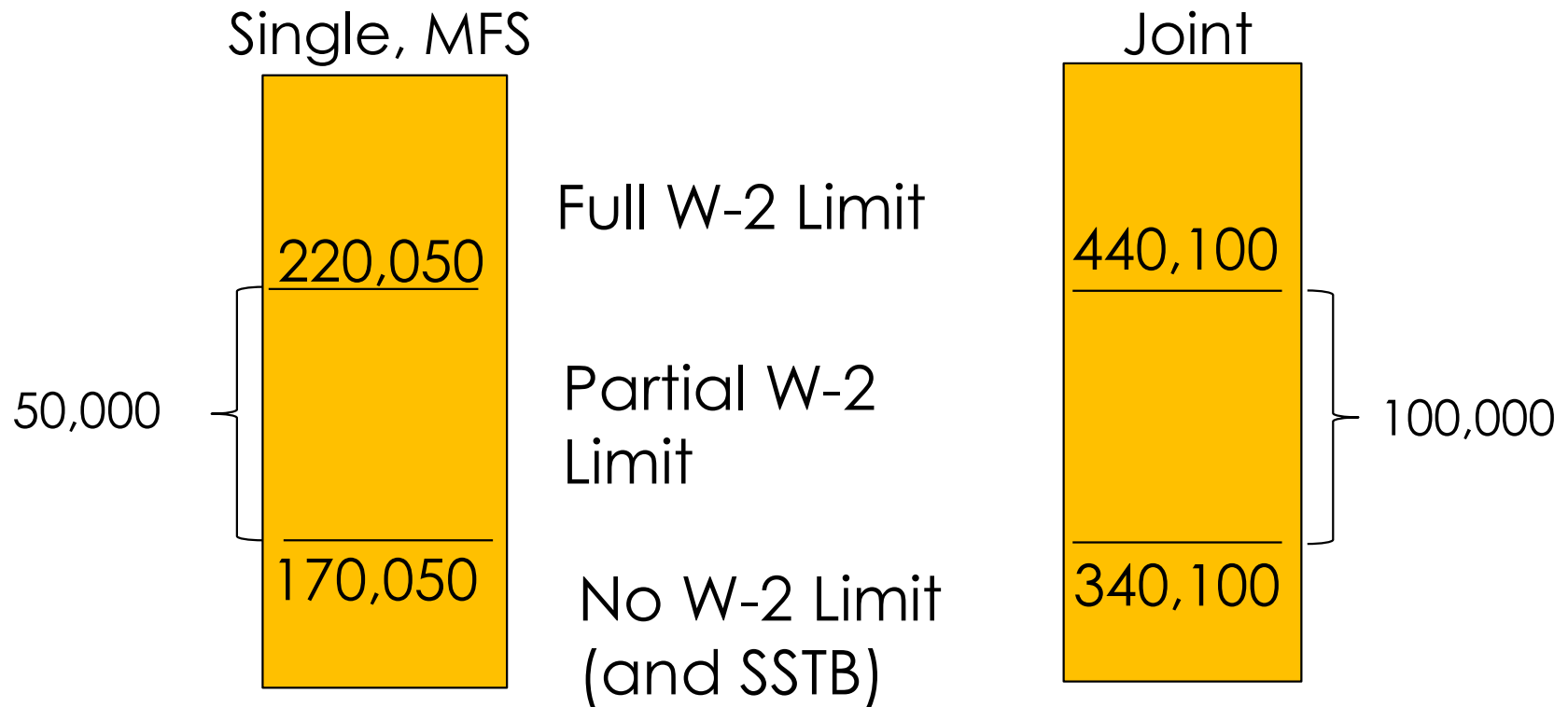
p. 136

Must meet one of the following:

- Principal place of business
- Meet with patients, clients or customers in the normal course of business
- Separate structure

See 2019 workbook pages 214 – 2018 for a detailed discussion of calculating the deduction

# QBI - 2022 PHASEIN RANGES



## HOBBY OR BUSINESS

### IRC 183 applies

#### Prior to 2018

Income taxable.  
Expenses, up to  
income, deductible  
as misc itemized  
deduction, if over 2%

#### New Law

Income taxable.  
Expenses not  
deductible, even if  
profitable.  
But, COGS deductible

NOTE: Gross income taxable,  
not gross receipts

## HOBBY LOSSES

9 factors to determine if activity engaged in for a profit

1, 3 and 6 most relevant to Direct Sellers?

- Manner carried on
- Time & effort
- History of income/loss

Presumption that engaged in for a profit if profitable 3 out of 5 years

## EXAMPLE 4.13 – NOT ENGAGED IN FOR PROFIT

p. 138

R/E agent  
425,000



Sells essential oils  
(10,000)

Elizabeth

Gives oil samples to  
R/E clients

Bought Laptop to  
track inventory &  
sales

Hosted one  
champagne party

Factor 3 – minimal time  
and effort

Factor 9 – elements of  
personal pleasure

How would you advise  
Elizabeth to change her  
essential oil business to be  
engaged in for profit?

X

## ISSUE #2 SHORT-TERM VACATION RENTALS

p. 139

 → 4,000,000 hosts → 1 billion guests!

Income Tax? - De minimis Rule?

SE Tax? - Services rendered?

Allocation of expenses?

Loss limited – Vacation home rules?



## DE MINIMIS RULE

2 part test:

- ✓ Dwelling unit used “as a residence / personal purposes” greater than 14 days or 10% of rental days
- ✓ Rented to others for fewer than 15 days during the year

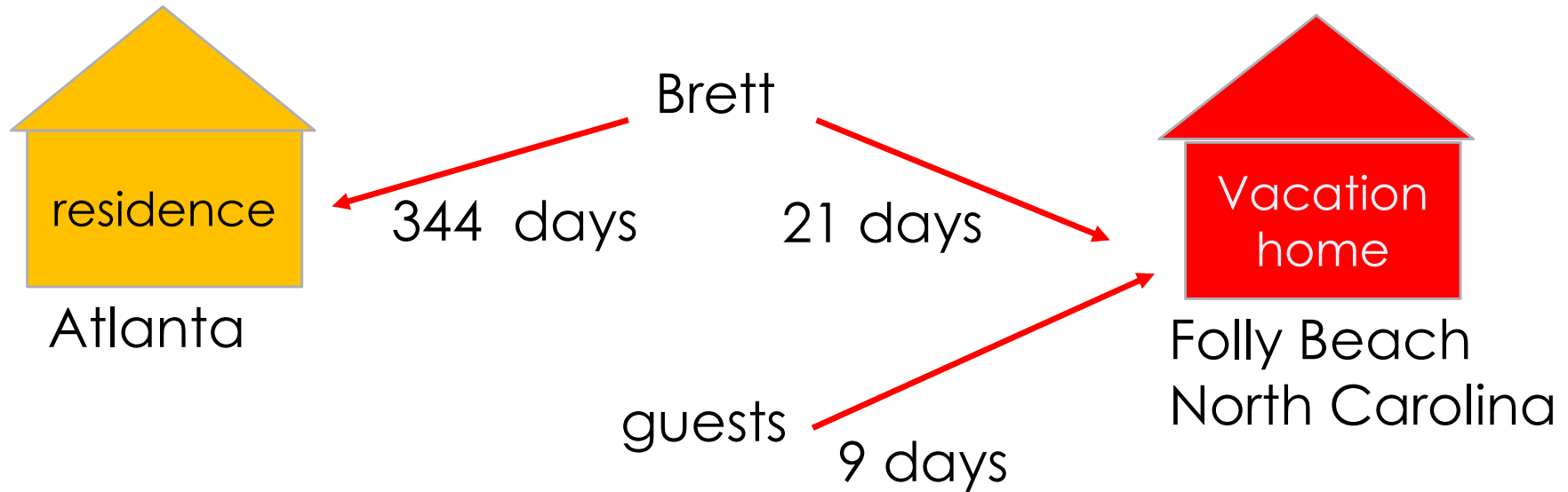
Treat property as though it had not been rented:



- Income not taxable
- Deductions limited to allowable itemized deductions

NOTE: if get a 1099, disclose on return!

### EXAMPLE 4.14 – SHORT TERM RENTALS

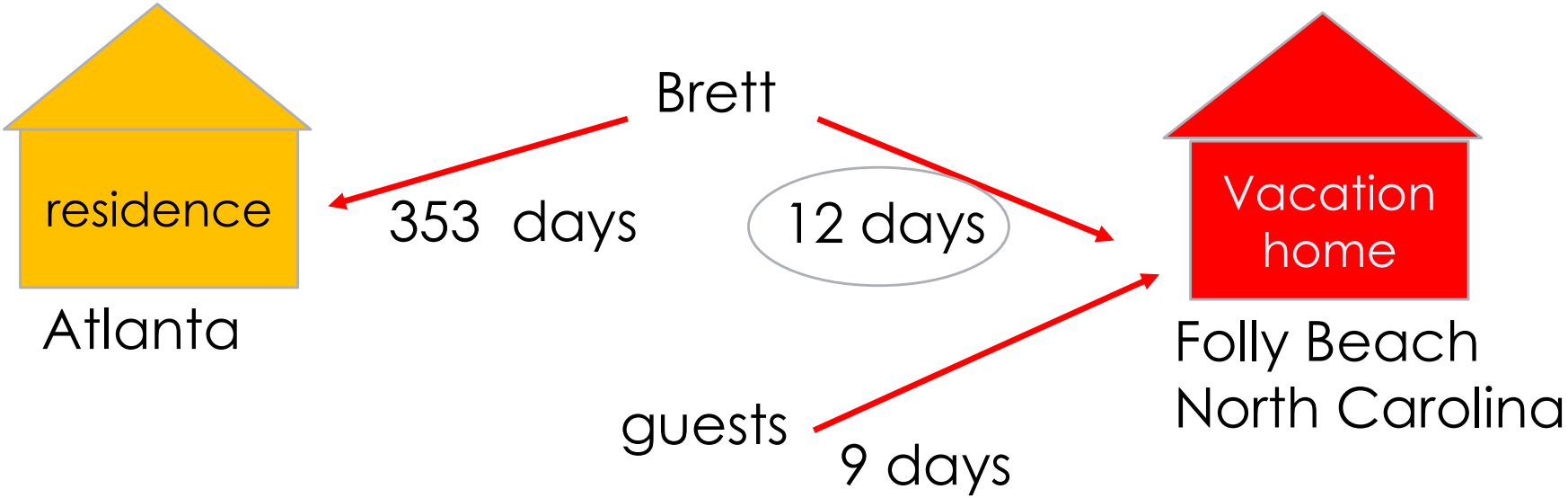


Test #1 Brett lived in home > 14 days or 10% rental days

Test #2 Rented house for fewer than 15 days.



# EXAMPLE 4.15 – SHORT-TERM RENTALS



Test #1 Brett did **not** lived in home > 14 days

Rental income is taxable 😞

## PERSONAL USE DAYS

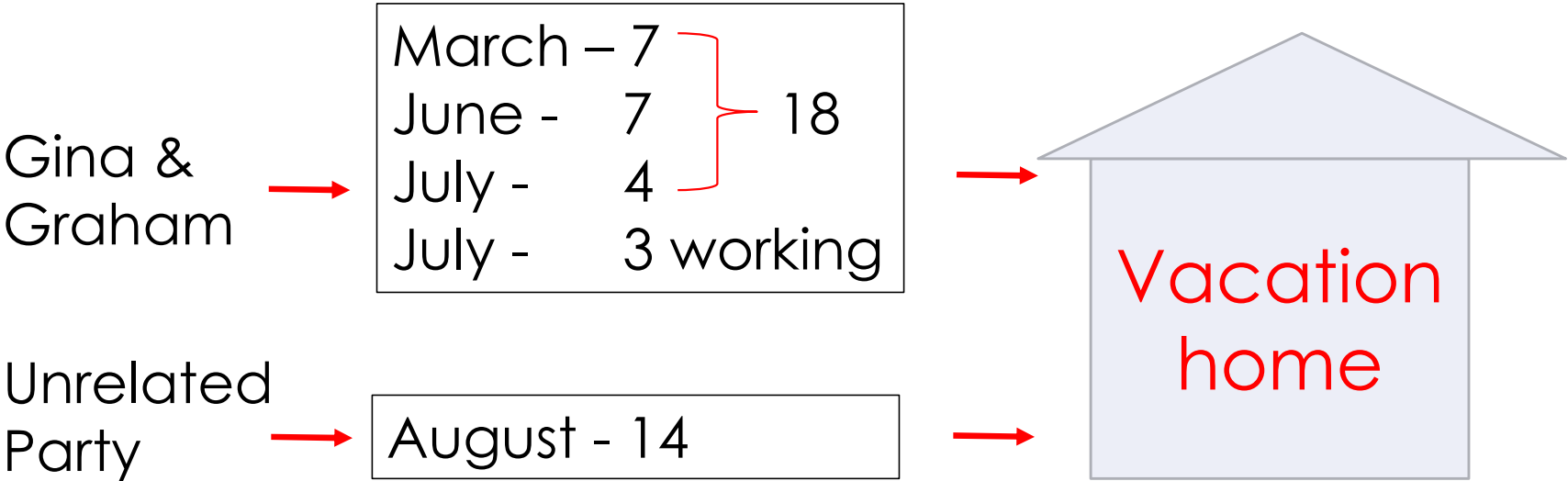
Property used by:

- Taxpayer, family member
- Person participating in a home exchange arrangement
- Anyone who does not pay fair rental value

Days a taxpayer spends working substantially full-time to repair and maintain the dwelling unit are not counted as personal use days



# EXAMPLE 4.16 – PERSONAL USE DAYS

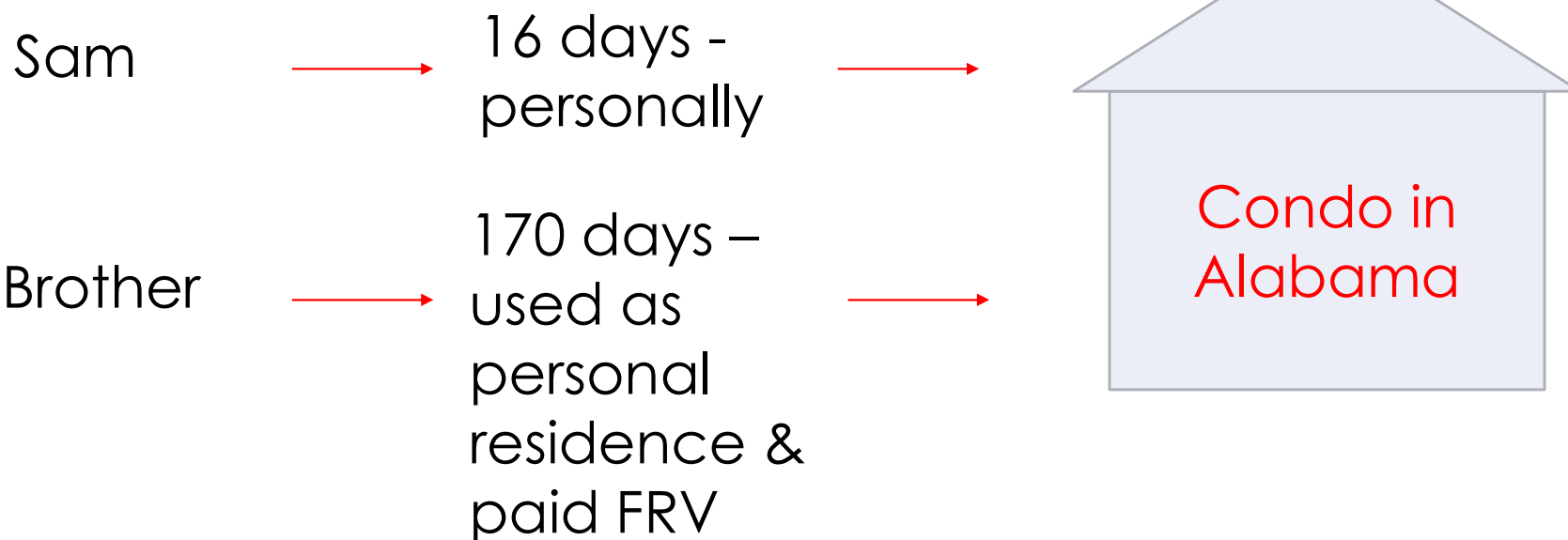


18 personal use days > 14

Rented < 15

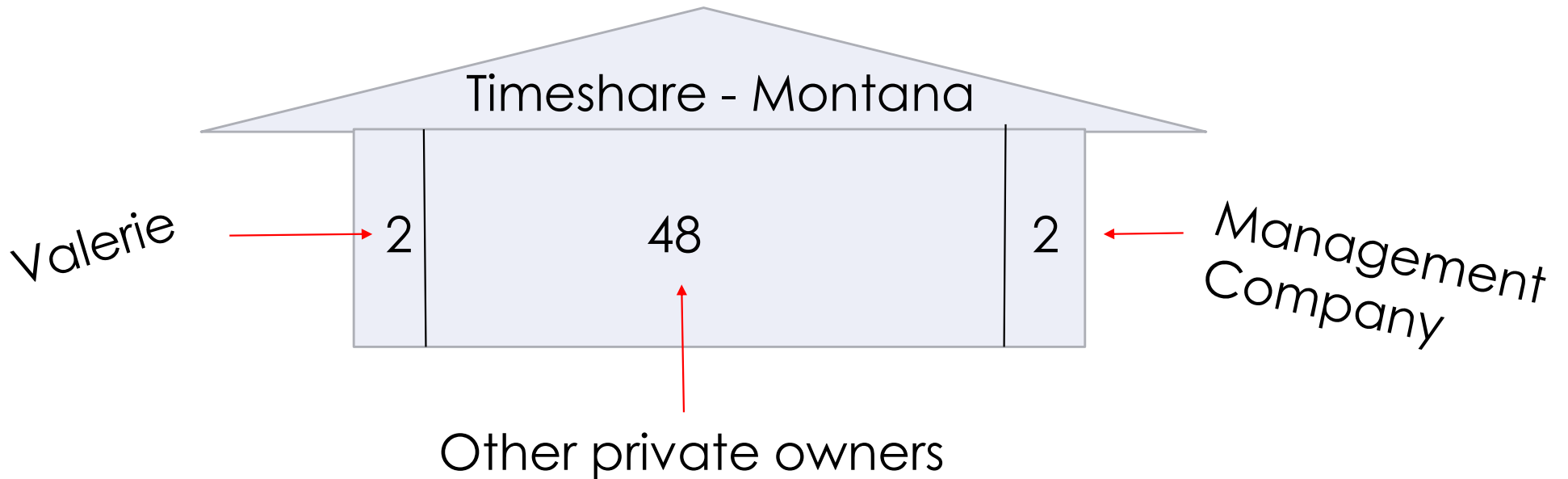
Nontaxable only itemized deductions

## EXAMPLE 4.17 – FAMILY MEMBER



Special rule: Since Brother used as personal residence and paid FRV, not considered personal use days

# EXAMPLE 4.18 - TIMESHARE



Use of the condo by all the timeshare owners is aggregated to apply the personal use test.

## SE TAX?

Rent personal residence > 14 days



Only amenities



Schedule E

OR

Ongoing rental business?



Substantial services – daily housekeeping/breakfast




Schedule C and SE tax

## VACATION HOME EXPENSE LIMITS

p. 141

Personal use > 14 days, or 10% rental days, cannot deduct a loss:

Rental Income	XX,XXX	
Expense to obtain tenants	<u>(Y,YYY)</u>	
Gross income from property	ZZ,ZZZ	
Expenses allocated to rental use	<u>(ZZ,ZZZ)</u>	 How?
Net reflected on tax return	-0-	

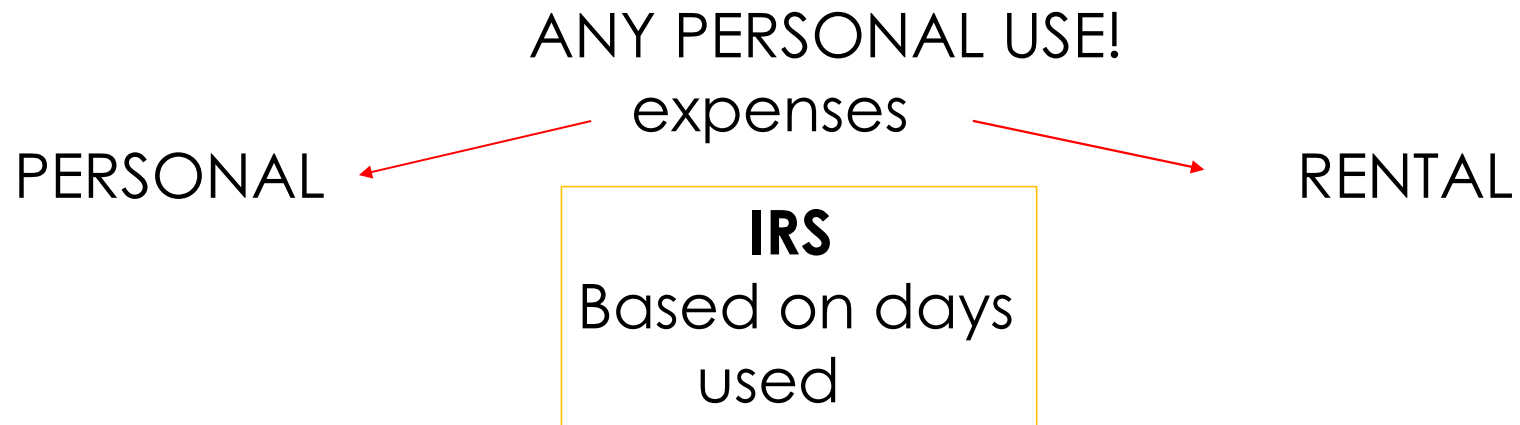
## ORDERING OF EXPENSE

Gross Income	xx,xxx	
Less Tier 1 - property taxes, interest	(x,xxx)	
Less Tier 2 – Operating costs – insurance, repairs, utilities	(x,xxx)	} Excess carried over
Less Tier 3 – Depreciation	<u>(x,xxx)</u>	
	-0-	



# ALLOCATION OF EXPENSE

p. 142



## ***Bolton case***

Interest / taxes:  
Days rented/365

all other expenses:  
based on days used

EXAMPLE 4.19 + 4.20

	<b>IRS</b>	<b>Bolton</b>	
Rental Income	10,000	10,000	
Tier 1 -Interest / taxes	<u>(6,160)</u>	<u>(1,688)</u>	More to Sch A
After tier 1	3,840	8,312	
Tier 2 – other expenses	<u>(1,680)</u>	<u>(1,680)</u>	
After tier 2	2,160	6,632	
Tier 3 – depreciation	<u>(2,160)</u>	<u>(4,480)</u>	More Depr
Total rental property income	-0-	2,152	

If itemized, able to claim 2,320 more depreciation

If don't itemized, report 2,152 more taxable income

## PASSIVE ACTIVITY LOSS RULES

If the taxpayer did not use the property “for personal purposes” for more than 14 days or 10% of rental days, you could have a deductible loss.

What about passive loss rules?

1. If average period of customer use is 7 days or less, activity treated as **non-rental activity**
2. Exceeds 7 days, but less than 30, and owner provides significant services, the activity treated as **non-rental activity**
3. Over 30 days, **rental activity**

# ISSUE #3 BUSINESS TRAVEL FOR REMOTE WORKERS



More than 1 place of business?

Traveling away from home?

General area of tax home?

No Regular place of business?

Principal place of business?

Itinerant worker?

Away from home longer than an ordinary day's work?

## **Employee**

No employee business expenses anymore (no Form 2106)

If employer has accountable plan, reimbursements not taxable and employer deducts expenses

## **Self employed**

Deduct on schedule C

- Ordinary and necessary
- Away from home
- Solely for business
- Not lavish or extravagant

# ACCOUNTABLE PLAN

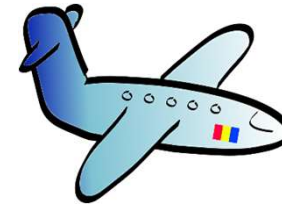
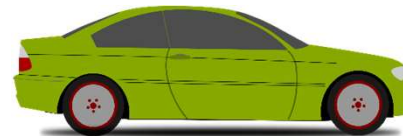
Go to page 330 to see a  
sample Accountable Plan

**FIGURE 9.1**  
**Sample Accountable Plan**

*XYZ Company Accountable Reimbursement Policy*

Treas. Reg. §§ 1.162-17 and 1.274-5(e) provide that employees do not have to report on their tax returns expenses paid or incurred by them solely for the benefit of their employer for which they are required to account and do account to their employer and that are charged directly or indirectly to the employer or paid by advancement or reimbursement.

# TRAVELING AWAY FROM HOME



Regular or principal place of work.  
If none, place of abode (personal or business connections) or itinerant

Outside general area of tax home, substantially longer than an ordinary day's work.

Need to sleep or rest



# MAIN PLACE OF BUSINESS OR WORK

p. 146



## **Main place of business?**

1. Time spent in each place
2. Level of business in each place
3. Income in each place



# EXAMPLE 4.21 – REMOTE WORKER

p. 147



deductible



CPAs



90%  
of  
time

Levi – IT work

Occasional  
trips



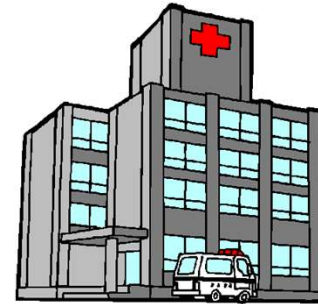
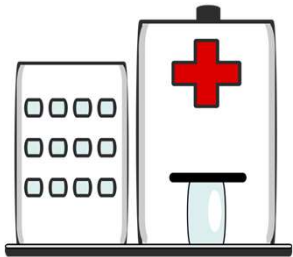
Law firm



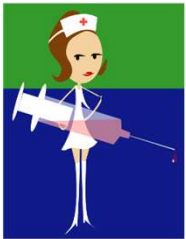
Online  
retail  
based in  
Delaware

## EXAMPLE 4.22 ITINERANT WORKER

p. 147



2 to 3 months →



Stays in housing provide by hospital

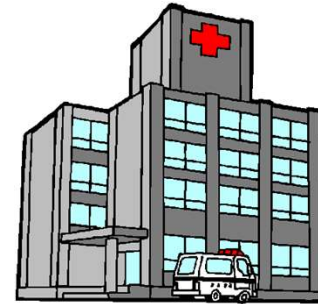
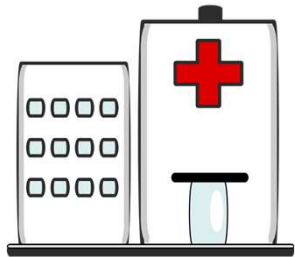
Room in sister's house that she stays in 1 to 2 weekends per year.

Single travel  
nurse - Bethany

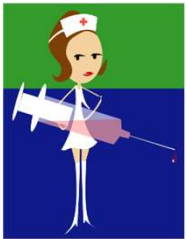


## EXAMPLE 4.22 ITINERANT WORKER?

p. 147



2 to 3 months →



Stays in housing provide by hospital

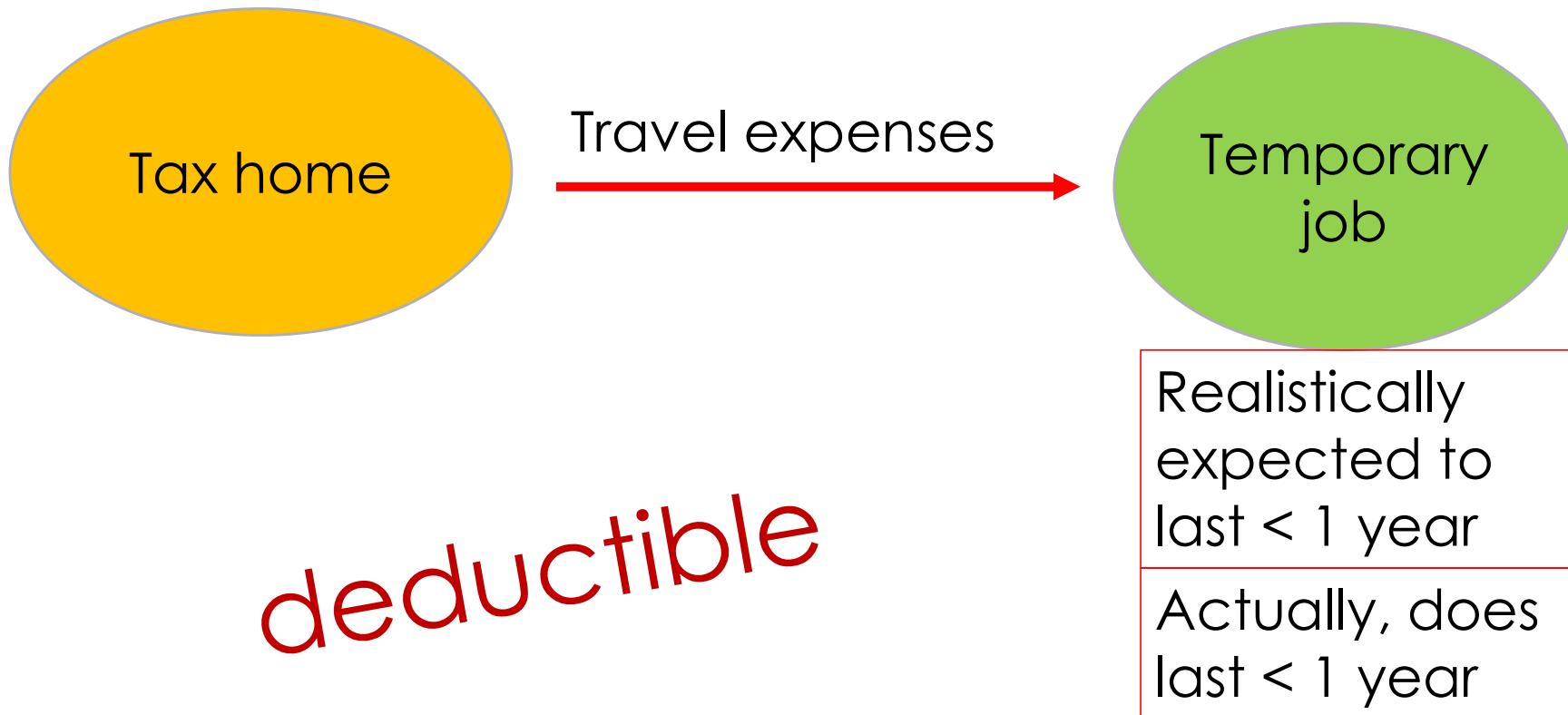
Room in sister's house that she stays in 1 to 2 weekends per year.

Single travel  
nurse - Bethany



No tax  
home -  
itinerant

# TEMPORARY ASSIGNMENT OR JOB



EXAMPLE 4.23 - SAME FACTS AS 4.21

p. 148



CPAs



Levi – IT work

Occasional trips



Law firm

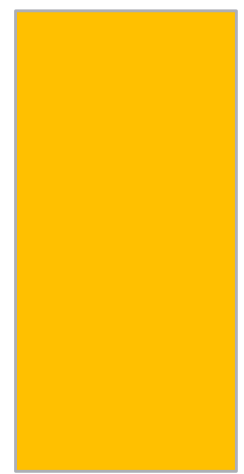
7 month trip.  
Temporary.  
Travel deductible



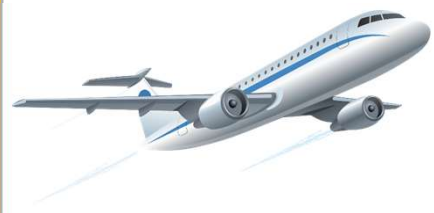
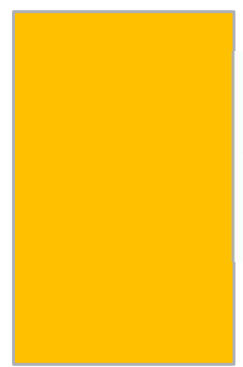
Online retail based in Delaware

# BUSINESS PURPOSE

Business

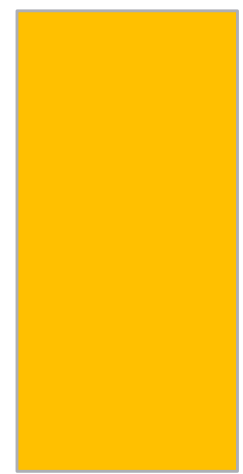


Personal

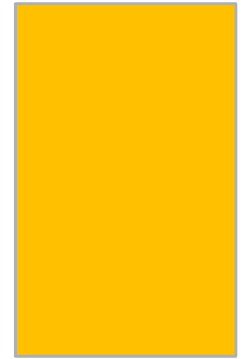


Travel to and from deductible

Personal



Business



Travel to and from not deductible, but allocable business expenses are

Based on facts and circumstance

## TRAVEL EXPENSES FOR ANOTHER PERSON

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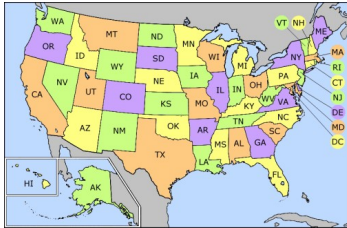
Spouse (or other family member) travel expenses not deductible

### UNLESS

It can be adequately shown that the spouses presence has a **bona fide business purpose**

Example 4.24 Spouse typing notes, attends meal does not establish her presence was necessary.

## INTERNATIONAL TRAVEL



Outside



- Foreign per diem rates different
- If entirely business, all travel costs deductible
- If not 100% business, considered for business if meet one of these exceptions:
  - *Taxpayer did not have control over arranging trip*
  - *Outside US one week or less*
  - *> week and < 25% of time nonbusiness*
  - *Personal vacation not a major consideration*



# SUBSTANTIATION

p. 149

## IRC 274(d)

### Travel documentation

- Dates of departure and return
- Place of travel
- Business purpose
- Receipts, paid bills or similar evidence



## Employee travel reimbursement

Reimbursement for travel expense may be taxable. Not taxable if reimbursed under an accountable plan:

- Business connection. Incurred while performing services as an employee
- Expenses timely substantiated (amount, time, place and business purpose)
- Employee timely returns any excess
- Per Diem allowances OK. Rates have gone up 10/1/22!
- See Notice 2022-44

## ISSUE #4 SALE OF A BUSINESS

NOTE: This issue assumes the business is owned by a **corporation or partnership** (sale of sole proprietorship would be an asset sale)

Why sell? financial distress, retirement, or simply want to do something different.

If a corporation, could be a stock sale or an asset sale.

## ISSUE #4 STOCK VS ASSET SALE?

Seller wants



Tax – one level of taxation

Non-Tax – no continuing obligation for most liabilities

Buyer wants



Tax – higher basis in assets and higher depreciation

Non-Tax – avoids assumption of potential unknown liabilities

## C CORPORATION – SALE OF STOCK

SELLER



BUYER

- Capital gain or loss
- Possible net investment income
- No impact on corporation

- Basis in stock equal to purchase price
- No immediate deduction based on purchase price

# EXAMPLE 4.25 - STOCK SALE

Green Mountain Enterprises C Corp

No gain

60%

40%

100%

Wilma

Ryan

Dillan

390,000

260,000

650,000

Basis  
Gain

(60,000)

(40,000)

330,000

220,000

Long term capital gain  
May have NIIT

## C CORPORATE ASSET SALE

**STEP #1**

Sale of assets	xxx,xxx
Basis	<u>(xx,xxx)</u>
Corporate taxable gain	xxx,xxx

**STEP #2**

Corporation liquidates	
Cash distributed to shareholders	
Shareholder – cash received	xxx,xxx
Shareholder basis	<u>(xx,xxx)</u>
Long term capital gain	xxx,xxx

**Buyer**

Assets have basis equal to purchase price

Can be expensed, depreciated, include in COGS

Purchaser demands asset sale? What can you do?

1. Negotiate increase in price to offset tax
  2. Try to allocate a portion of purchase price to reputation, expertise, skill, knowledge (personal goodwill).
- IMPACT: Personal goodwill only taxed at shareholder level, which reduces gain taxed at corporate level



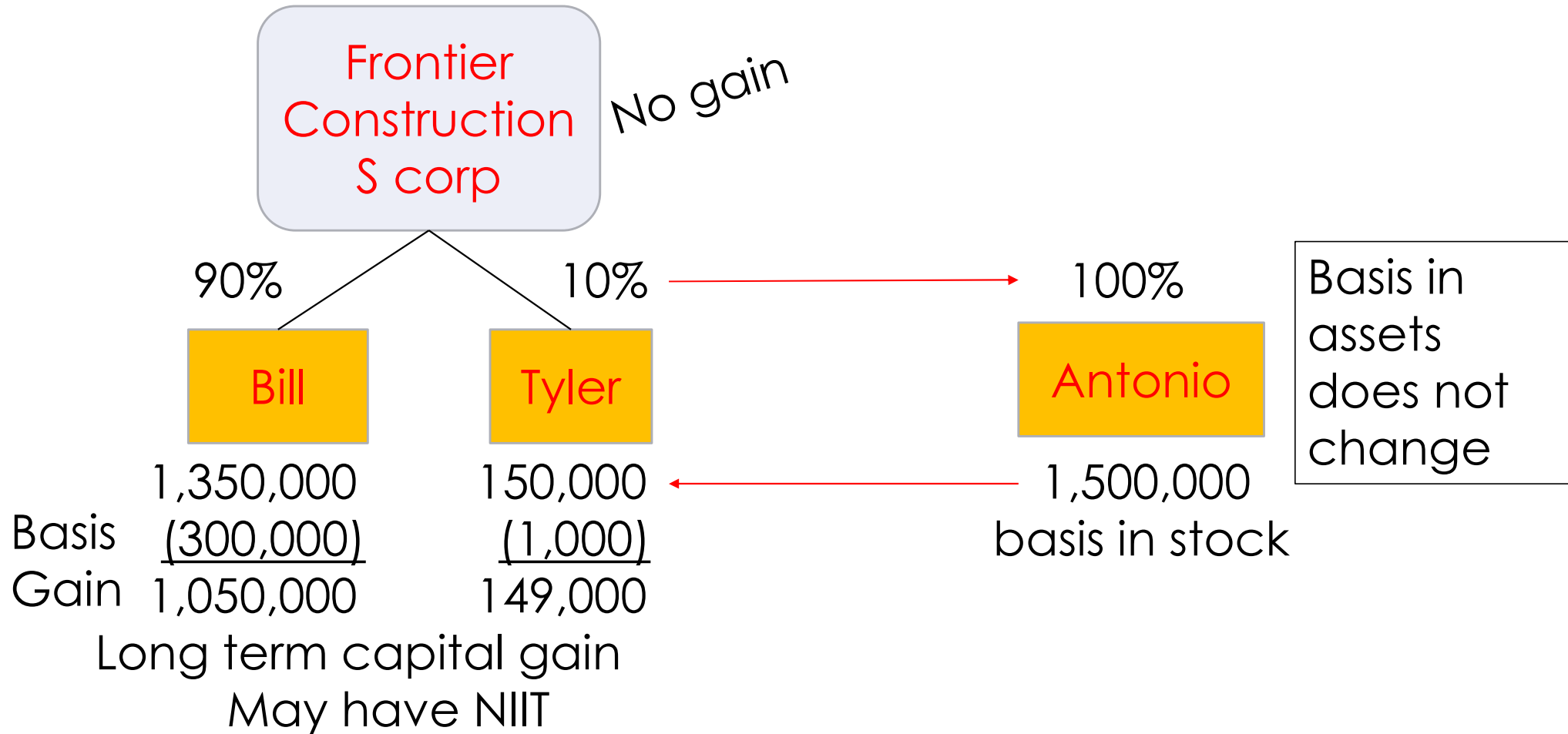
# S CORPORATION - STOCK SALE

Form <b>1120-S</b>		<b>U.S. Income Tax Return for an S Corporation</b>		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. ▶ Go to <a href="http://www.irs.gov/Form1120S">www.irs.gov/Form1120S</a> for instructions and the latest information.		<b>2021</b>
For calendar year 2021 or tax year beginning _____, 2021, ending _____, 20				
<b>A</b> S election effective date	<b>TYPE OR PRINT</b>	Name	<b>D</b> Employer identification number	
<b>B</b> Business activity code number (see instructions)		Number, street, and room or suite no. If a P.O. box, see instructions.	<b>E</b> Date incorporated	
		City or town, state or province, country, and ZIP or foreign postal code	<b>F</b> Total assets (see instructions)	\$ _____
<b>C</b> Check if Sch. M-3 attached <input type="checkbox"/>				
<b>G</b> Is the corporation electing to be an S corporation beginning with this tax year? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No				

SELLER: S/H has capital gain on sale of stock

BUYER: basis equal to purchase price. Might allow for larger nontaxable distributions or allow larger losses flow through.

### EXAMPLE 4.27 – STOCK SALE



# S CORPORATE - ASSET SALE

## **STEP #1**

Sale of assets	xxx,xxx
Basis	<u>(xx,xxx)</u>
Gain flows through to S/H on K-1 (gain increase S/Hs basis – prevents double taxation)	xxx,xxx

## **STEP #2**

Corporation liquidates Cash distributed to shareholders	
Shareholder – cash received	xxx,xxx
Shareholder basis in S corp stock	<u>(xx,xxx)</u>
Long term capital gain	xxx,xxx

## **Buyer**

Assets have  
basis equal to  
purchase price

Can be  
expensed,  
depreciated,  
include in  
COGS

# PARTNERSHIP INTEREST SALE

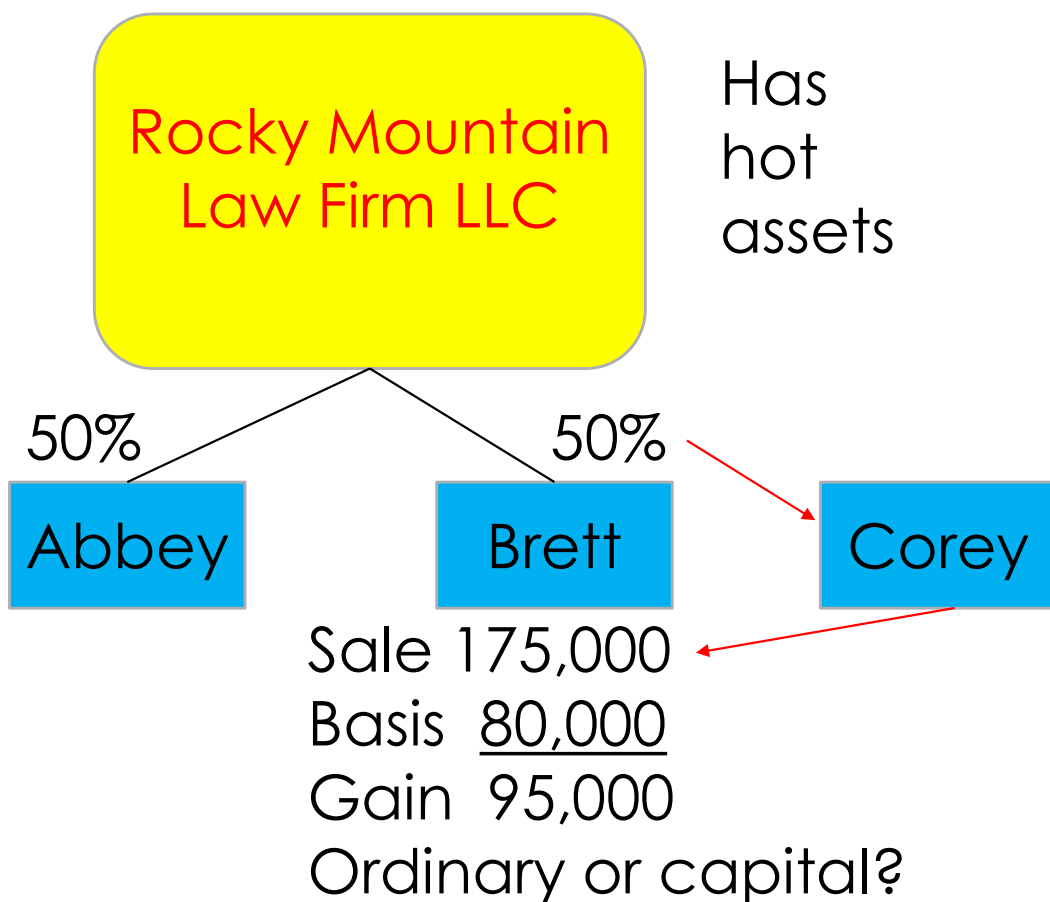
<b>Form 1065</b>		<b>U.S. Return of Partnership Income</b>		OMB No. 1545-0123
Department of the Treasury Internal Revenue Service		For calendar year 2021, or tax year beginning _____, 2021, ending _____, 20_____.		<b>2021</b>
		▶ Go to <a href="http://www.irs.gov/Form1065">www.irs.gov/Form1065</a> for instructions and the latest information.		
<b>A</b> Principal business activity	<b>Type or Print</b>	Name of partnership	<b>D</b> Employer identification number	
<b>B</b> Principal product or service		Number, street, and room or suite no. If a P.O. box, see instructions.	<b>E</b> Date business started	
<b>C</b> Business code number		City or town, state or province, country, and ZIP or foreign postal code	<b>F</b> Total assets (see instructions)	
			\$ _____	
<b>G</b> Check applicable boxes: (1) <input type="checkbox"/> Initial return (2) <input type="checkbox"/> Final return (3) <input type="checkbox"/> Name change (4) <input type="checkbox"/> Address change (5) <input type="checkbox"/> Amended return				

Sale of a partnership interest – total	XXX,XXX
Relieved of partnership liabilities	XX,XXX
Inventory, unrealized A/R, 1245 recap – ordinary	<u>(XX,XXX)</u>
Sale of a capital asset	XXX,XXX

☀ Quite different from sale of S Corp

# EXAMPLE 4.29 – SALE OF PARTNERSHIP INTEREST

p. 156



<u>Hot assets:</u>	<u>gain if sold</u>
Unrealized receivables	30,000
1245 recapture	<u>150,000</u>
Total gain	180,000
Brett's portion	<u>x.50</u>
ordinary income	90,000
Balance capital	5,000

## PARTNERSHIP ASSET SALE

No entry level tax on gain from sale of partnership assets

### **Step #1**

Gain flows through on the partner's K-1s. Sale hot assets is ordinary. Increases partner's basis in the partnership

### **Step #2**

Upon distribution of cash in liquidation of partnership, partner will have gain to the extent the distribution exceeds basis in the partnership.

## ALLOCATION OF PURCHASE PRICE IN ASSET

<u>Asset</u>	<u>Seller</u>	<u>Buyer</u>
Land	capital	non-depreciable
Buildings	capital, but recapture	depreciable – long life
A/R	face value no preference	face value no preference
Inventory	ordinary income	quick ordinary writeoff
Equipment	up to tax basis good	fast depreciation writeoff
Goodwill	capital	15 year amortization?

## ALLOCATION OF PURCHASE PRICE

*IRC 1060* – buyer and seller must use Form 8594 to report the sale if:

- Goodwill or going concern values attach, or could attach to the assets, and
- If the purchaser's basis in the assets is determined only by the amount paid for the assets.

**If the parties agree** on the asset allocation, the allocation is binding (unless IRS determines the allocation is not appropriate).

**If the parties don't agree**, the residual method will be used



# RESIDUAL METHOD

p. 158 + 159

- Financial {
  - CLASS 1 – Cash
  - CLASS 2 – actively traded personal property, certificates of deposit, foreign currency
  - CLASS 3 – mark to market assets
- Operating {
  - CLASS 4 – inventory
  - CLASS 5 – all assets not in any other class. Furniture, fixtures, buildings, land equipment, etc..
- intangible {
  - CLASS 6 – 197 assets, except goodwill and going concern
  - CLASS 7 - goodwill and going concern

## PARTNERSHIP EQUITY SALES

Normal reporting – 8949, Schedule D, 4797

Except: special reporting when a partnership interest has been transferred and it has 751 asset (hot assets – inventory / unrealized A/R)

Notify partnership in writing within 30 days or by January 15 of the following year. Information required:

1. Names and addresses
2. Identification numbers
3. Date of exchange

Partnership completes Form 8308

Form **8308**  
(Rev. September 2018)  
Department of the Treasury  
Internal Revenue Service

### Report of a Sale or Exchange of Certain Partnership Interests

OMB No. 1545-0123

▶ Go to [www.irs.gov/Form8308](http://www.irs.gov/Form8308) for the latest information.

Name of partnership	Phone number	Employer identification number
---------------------	--------------	--------------------------------

Number, street, and room or suite no. If a P.O. box, see instructions.

City or town, state or province, country, and ZIP or foreign postal code

**Part I** **Transferor Information** (Beneficial owner of the partnership interest immediately before the transfer of that interest)

Name	Identifying number
------	--------------------

Number and street (including apt. no.)

City or town, state or province, country, and ZIP or foreign postal code

**Notice to Transferors:** *The information on this form has been supplied to the Internal Revenue Service. The transferor in a section 751(a) exchange is required to treat a portion of the gain realized from the exchange as ordinary income. For more details, see Pub. 541, Partnerships.*

**Statement by Transferor:** *The transferor in a section 751(a) exchange is required under Regulations section 1.751-1(a)(3) to attach a statement relating to the sale or exchange to his or her return. See Instructions to Transferors for more details.*

**Part II** **Transferee Information** (Beneficial owner of the partnership interest immediately after the transfer of that interest)

Name	Identifying number
------	--------------------

Number and street (including apt. no.)

City or town, state or province, country, and ZIP or foreign postal code

**Part III** **Date of Sale or Exchange of Partnership Interest** ▶      /      /

**Sign here only if you  
are filing this form by  
itself and not with Form  
1065**

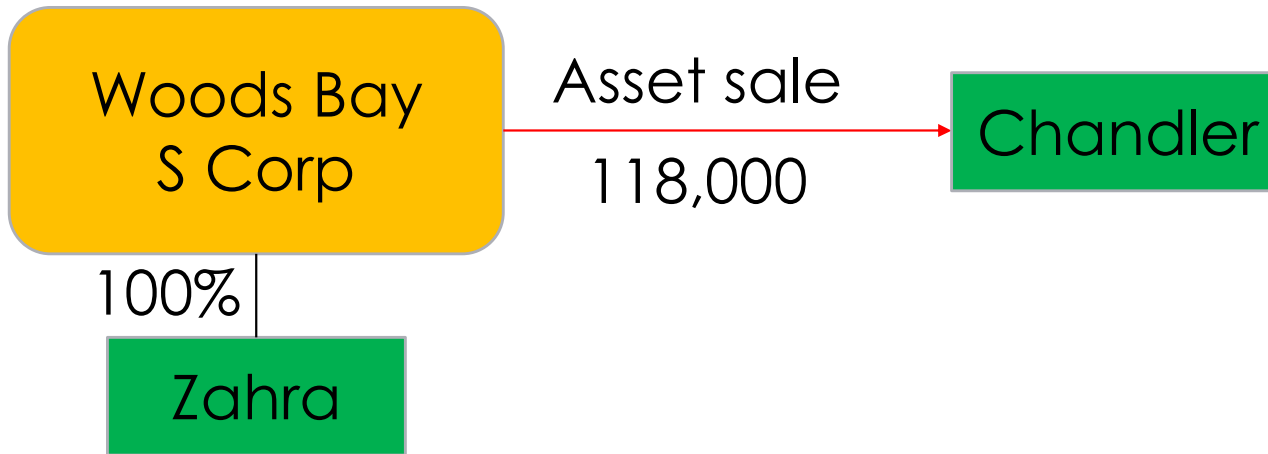
Under penalties of perjury, I declare that I have examined this return, including accompanying attachments, and to the best of my knowledge and belief, it is true, correct, and complete.

▶ \_\_\_\_\_  
Signature of partnership representative or partner or limited liability company member

▶      /      /  
Date

# CASE STUDY

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asset	Basis	sale	gain
A/R	0	20,000	20,000
Equipment	41,233	65,000	23,767
Goodwill	0	33,000	33,000
	41,233	118,000	76,767

## Forms

4797 part II, 1120-S

4797 part III & part II, 1120-S

8949, Schedule D, Sch K

8594

Final 1120-S, letter to IRS

X

# ISSUE #5 EMPLOYEE RETENTION CREDIT

3/13/20

12/27/20

3/11/21

11/15/21

ERC Enacted. Not eligible if received a PPP loan.

ERC modified so employers could claim ERC and PPP, if not using same wages. ERC extended to 7/1/21 and expanded it.

Extended ERC from 7/1/21 to 12/31/21. New category: Startup Businesses

Retroactively eliminated the ERC for the 4<sup>th</sup> quarter of 2021, except start up businesses

## ERC ELIGIBILITY

*Concept is to keep employees on the payroll!*

- Employers of any size
- 2020 -Government entities generally not eligible
- 2021 – Colleges, Universities, medical or hospital care
- Tribal governments or entities eligible
- Must meet suspended business test:
  1. Fully or partially shut down by government authority, **OR**
  2. Significant decline in gross receipts

## SUSPENDED BUSINESS TEST



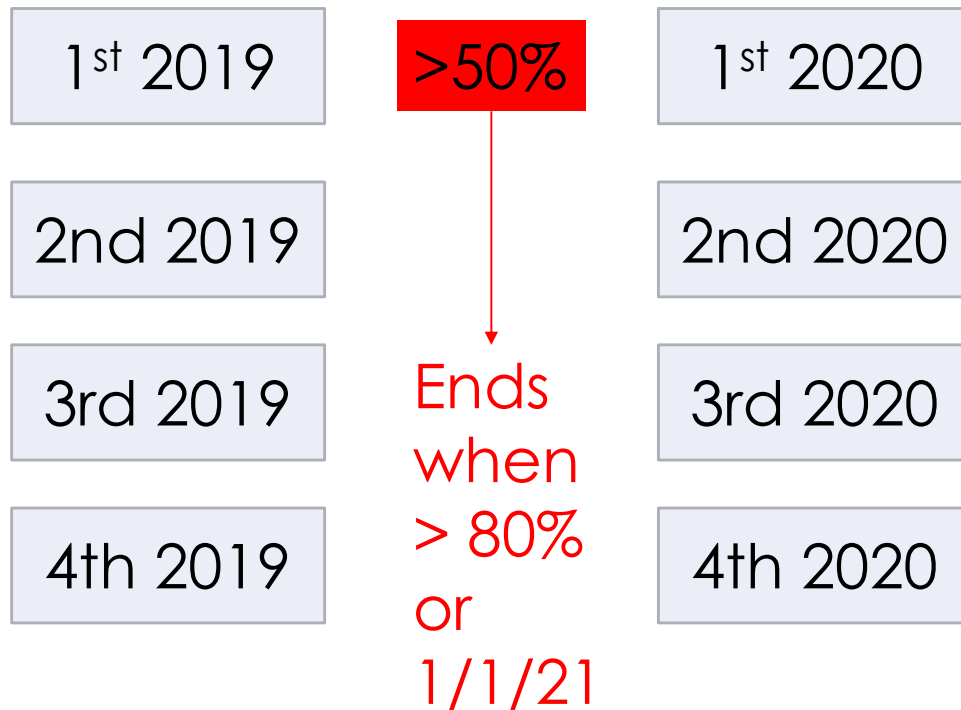
**Close!!**



Order, proclamation or decree  
Must have jurisdiction  
Mandatory, not advisory  
Without regard to level of enforcement  
Recommendations to close not enough  
Not just social distancing guidance  
Limiting commerce, travel, group meetings  
is a partial shutdown (over 10% test)

# GROSS RECEIPTS TEST - 2020

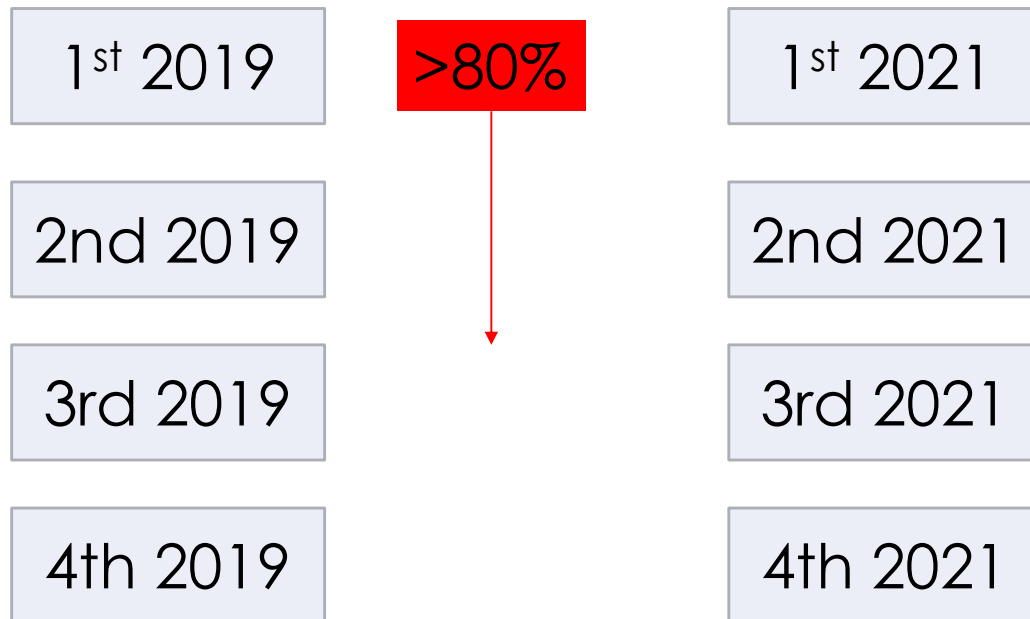
## 2020 ERC





# GROSS RECEIPTS TEST - 2021

## 2021 ERC



Alternate calculation:  
Use the quarter immediately preceding the current quarter

# CALCULATING THE ERC



Per employee

2020	Per quarter
Wages	xx,xxx
Health plan	<u>x,xxx</u>
Total	xx,xxx (max 10,000/ employee)
Rate	<u>50%</u>
ERC	xx,xxx (max 5,000/ employee)

---

3 quarters in 2021, except recovery startups

2021	Per quarter
Wages	xx,xxx
Health plan	<u>x,xxx</u>
Total	xx,xxx (max 10,000/ employee)
Rate	<u>70%</u>
ERC	xx,xxx (max 7,000/ employee)

## QUALIFIED WAGES

p. 171

### **2020**

Between 3/12/20 – 12/31/20

### **2021**

Between 1/1/21 – 9/30/21

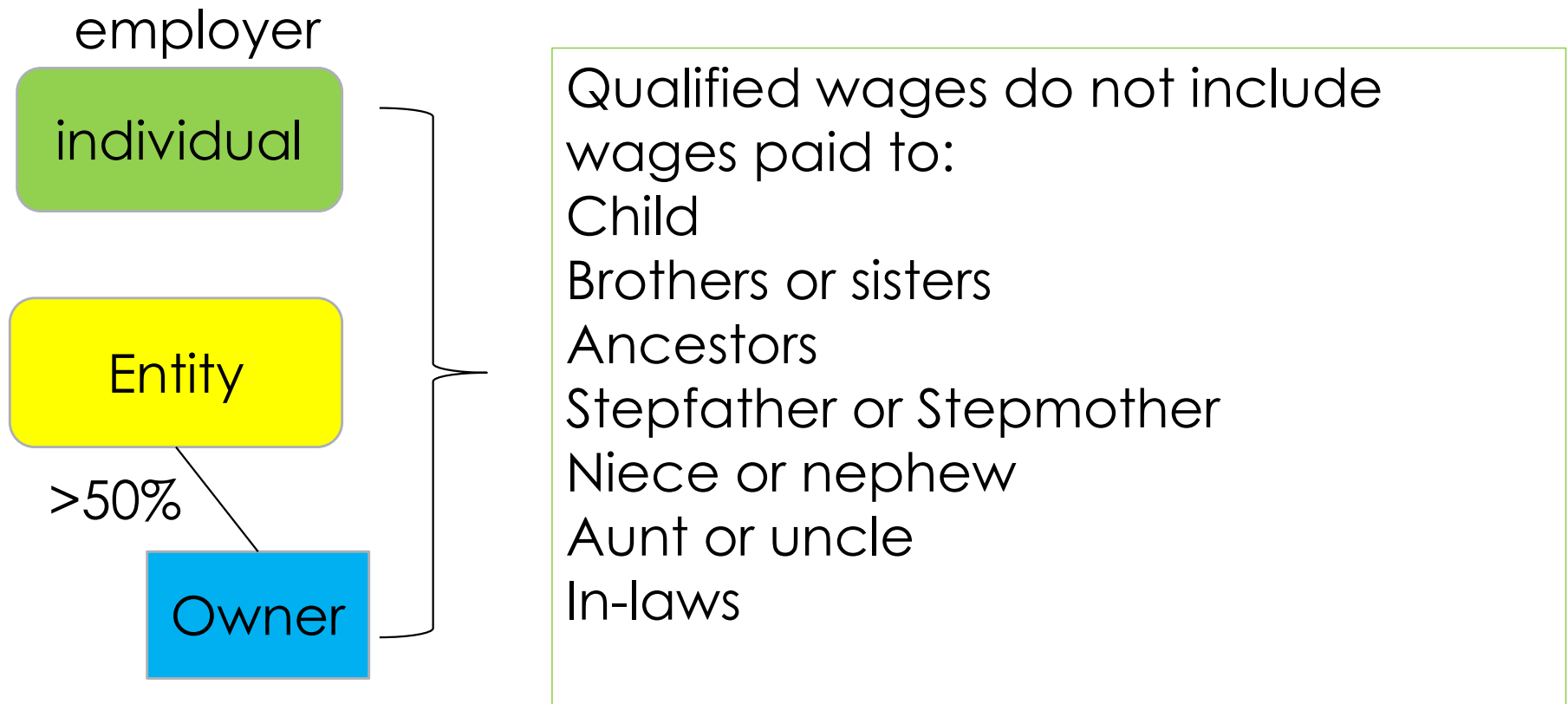
### **2021 – recovery startup businesses**

Between 7/1/21 – 12/31/21

- Only W-2 wages, subject to FICA
- Includes employer group health insurance, to extent excluded from income under IRC 106. Allocated to individual employees applying any reasonable method

## RELATED INDIVIDUALS EXCLUSION

p. 171



### **BASICS:**

- Began carrying on a trade or business after 2/15/20
- Average annual gross receipts < 1,000,000 for 3 tax years ending with the tax year before the calendar quarter in which the employer claimed the ERC.
- 3<sup>rd</sup> quarter 2021, must not be an otherwise eligible employer that meets the suspended business test or decline in gross receipts test. (but, after the 3<sup>rd</sup> quarter, this requirement was removed.)

# AMOUNT OF ERC FOR RECOVERY STARTUP BUSINESSES

p. 173



Wages	xx,xxx	
Health plan	<u>x,xxx</u>	
Total	xx,xxx	(max per quarter is 10,000)
Rate	<u>70%</u>	
ERC	xx,xxx	(max per quarter is 7,000)

But, there is also a maximum limit of 50,000 per quarter, so 100,000 maximum for the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2021

## AMENDING RETURNS TO CLAIM ERC

p. 174

Eligible employers that did not claim the ERC in 2020 or 2021 may amend their employment tax returns.

File forms 941-X, 943-X or 944-X.  
When? 3 years from when filed. 941s for a calendar year are deemed filed on 4/15 of succeeding year.

The income tax returns claiming the deduction for the wages need to be amended to reduce wages by the credit.

Form **941-X: Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund**

(Rev. July 2021)

Department of the Treasury — Internal Revenue Service

OMB No. 1545-0029

Employer identification number (EIN)   -

Name (not your trade name)

**Return You're Correcting...**

Check the type of return you're correcting.

941

11a; you must attach Form 8974)

- |             |  |                      |   |                      |   |                      |                  |                      |
|-------------|--|----------------------|---|----------------------|---|----------------------|------------------|----------------------|
| <b>17.</b>  | <b>Nonrefundable portion of credit for qualified sick and family leave wages for leave taken before April 1, 2021</b> (Form 941 or 941-SS, line 11b) | <input type="text"/> | - | <input type="text"/> | = | <input type="text"/> | See instructions | <input type="text"/> |
| <b>18a.</b> | <b>Nonrefundable portion of employee retention credit</b> (Form 941 or 941-SS, line 11c)   | <input type="text"/> | - | <input type="text"/> | = | <input type="text"/> | See instructions | <input type="text"/> |
| <b>18b.</b> | <b>Nonrefundable portion of credit for qualified sick and family leave wages for leave taken after March 31, 2021</b> (Form 941 or 941-SS, line 11d) | <input type="text"/> | - | <input type="text"/> | = | <input type="text"/> | See instructions | <input type="text"/> |
| <b>18c.</b> | <b>Nonrefundable portion of COBRA premium assistance credit</b> (Form 941 or 941-SS, line 11e)   | <input type="text"/> | - | <input type="text"/> | = | <input type="text"/> | See instructions | <input type="text"/> |



## STEPS TO FILE AMENDED RETURNS

p. 174

- |    | 2020  |                 |                 |                 | Eligible? | 2021            |                 |                 |                 | Eligible? |
|----|---|-----------------|-----------------|-----------------|-----------|-----------------|-----------------|-----------------|-----------------|-----------|
|    | 1 <sup>st</sup>   | 2 <sup>nd</sup> | 3 <sup>rd</sup> | 4 <sup>th</sup> |           | 1 <sup>st</sup> | 2 <sup>nd</sup> | 3 <sup>rd</sup> | 4 <sup>th</sup> |           |
| 1. |   |                 |                 |                 |           |                 |                 |                 |                 |           |
| 2. | Determine qualified wages   |                 |                 |                 |           |                 |                 |                 |                 |           |
| 3. | Eliminate wages used on a successful PPP forgiveness, used for other credits, If based on a shutdown, wages while employees working |                 |                 |                 |           |                 |                 |                 |                 |           |
| 4. | Eliminate wages paid to unqualified employees - related   |                 |                 |                 |           |                 |                 |                 |                 |           |
| 5. | Calculate ERC by quarter  |                 |                 |                 |           |                 |                 |                 |                 |           |
| 6. | File 941-X, 943-X, or 944-X   |                 |                 |                 |           |                 |                 |                 |                 |           |
| 7. | Amend income tax return   |                 |                 |                 |           |                 |                 |                 |                 |           |

## EXTENDED PERIOD TO ASSESS TAX

Normal statute to assess tax is 3 years

But, there is a 5 year statute on the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2021.

## AGGRESSIVE PROMOTORS

Charge up front fees 1,500 – 2,000

Plus receives a percentage of the refund

Aggressively applying rules- le:

- Wages to related parties don't qualify
- In Michigan Q3 2021 no standing orders to close in Michigan

Really an ethical question.

# IRS warning!

IR-2022-183, October 19, 2022

WASHINGTON — The Internal Revenue Service today warned employers to be wary of third parties who are advising them to claim the Employee Retention Credit (ERC) when they may not qualify. Some third parties are taking improper positions related to taxpayer eligibility for and computation of the credit.

These third parties often charge large upfront fees or a fee that is contingent on the amount of the refund and may not inform taxpayers that wage deductions claimed on the business' federal income tax return must be reduced by the amount of the credit.

If the business filed an income tax return deducting qualified wages before it filed an employment tax return claiming the credit, the business should file an amended income tax return to correct any overstated wage deduction.

Businesses are encouraged to be cautious of advertised schemes and direct solicitations promising tax savings that are too good to be true. Taxpayers are always responsible for the information reported on their tax returns. Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties and interest.

**X**

Any  
Questions