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Senate Approves Budget Resolution; House Action Follows on Path to Reconciliation Bill

Early on August 11, 2021, the Senate approved a budget resolution entirely along party lines with a 50-49 vote. The resolution is a necessary first step to Senate Democrats using the budget reconciliation process to pass an expected enormous bill later in the year by a simple majority, avoiding the need to attract ten GOP votes in the evenly divided chamber.

The budget resolution leaves the specifics to committees in the House and Senate, but includes a prohibition on raising taxes on people making less than $400,000 per year. The budget resolution includes an instruction to the Senate Finance Committee requiring at least $1 billion in deficit reduction over 10 years. Senate Finance Committee Chair Ron Wyden (D-Ore) said in a statement that the changes would include overhauling the energy tax code; tax incentives and grants to encourage green energy and manufacturing; extending tax cuts for families with children, working adults, and caregivers; and revenue-raising proposals relating to multi-national corporations, the wealthiest individuals, and enforcement, as well as health care cost savings.

Budget Resolution Follows Senate Passage of Infrastructure Bill

The passage of the budget resolution follows a week-long effort to pass a heavily negotiated bipartisan infrastructure bill. The Infrastructure Investment and Jobs Act passed the Senate by a 69-30 vote. The most widely discussed tax change in the infrastructure bill is an expansion of the reporting requirements applicable to cryptocurrency. The provision is included as a revenue raiser, as it is believed that a significant amount of cryptocurrency gains escape taxation due to underreporting. Otherwise, the Infrastructure bill includes a few other tax changes, meant to spur private infrastructure investment, raise revenue, and expand the scope and applicability of disaster declarations, in addition to typical extensions of highway funding provisions. These other changes include:

- an extension of highway taxes to 2028 and highway trust fund expenditure authority to 2026;
- inclusion of qualified broadband projects and carbon dioxide capture facilities among the other types of projects for which private activity bonds can be issued;
- a return of the exception for water and sewage disposal utilities from the rule requiring a corporation to recognize contributions in aid of construction (removed by the Tax Cuts and Jobs Act of 2017);
- a return of Superfund excise taxes on certain chemicals, last effective in the mid 1990s;
- termination of the employee retention credit for employers closed due to COVID-19 after September 30, 2021; and

- changes to the extension of tax deadlines due to declared disasters and service in a combat area, as well as expansion of extension authority to taxpayers impacted by wildfires.

House Action Up Next

Speaker of the House Nancy Pelosi (D-Calif.) has been steadfastly insisting that the House would not consider the infrastructure bill unless the Senate also passes a budget resolution to kick off the reconciliation process. House Democrats were concerned that so many Democratic priorities were set aside in the negotiation of the bipartisan bill, they wanted to ensure that those items would still be on the table.

These priorities, from a tax standpoint, include extensions of popular credits passed as part of the American Rescue Plan Act of 2021, as well as many other non-tax provisions relating to the environment and immigration, but largely paid for with increases in individual and corporate tax rates.

The House was scheduled to be on recess until mid-September, but House Majority Leader Steny Hoyer (D-Md.) issued a letter to House Democrats that they would come back August 23 to vote on the budget resolution. The letter did not indicate whether the House would also act on the infrastructure bill during this brief return, however, Pelosi announced on August 11 that the House would not vote on the bill in August.

Reconciliation Content

Assuming the budget resolution is adopted, Democrats in Congress would begin working on the contents of a reconciliation package. The process has been frequently used in recent years to pass legislation in the Senate without the 60 votes needed to overcome a filibuster. Recent examples are the American Rescue Plan Act of 2021 and the Tax Cuts and Jobs Act of 2017.

With slim majorities in both chambers, Democrats could find it difficult to include everything that they want in the massive bill without losing any significant votes. With an evenly divided Senate, even one defector means a defeat for the bill. Hanging over all of this is the need to raise the debt ceiling. Senate GOP leadership has insisted they will not provide the votes needed to pass an increase in the Senate, and the budget resolution approved August 11 does not include an increase. While there is no firm date set for when the ceiling will be reached, the belief is that it will be sometime in the early fall.

Transition Relief Guidance for Employers Claiming the WOTC

Notice 2021-43; IR-2021-168

The IRS issued transition relief for certain employers claiming the Work Opportunity Tax Credit (WOTC) under Code Sec. 51. This would apply for certain employees beginning work after December 31, 2020, in response to legislation permitting the designation of an Empowerment Zone under Code Sec. 1393(b) to be extended from December 31, 2020, through December 31, 2025. Specifically, section IV of this notice provides transition relief by extending the 28-day deadline for employers to request certification from a designated local agency that an individual who begins work on or after January 1, 2021, and before October 9, 2021, is a member of the Designated Community Resident targeted group or the Qualified Summer Youth Employee targeted group.

Additional Time to Submit Form 8850

The IRS stated that employers may need additional time to comply with the certification requirements of Code Sec. 51(d)(13)(A)(ii). Because the termination dates designated in Empowerment Zone nominations are not automatically extended until after the deadline in Rev. Proc. 2021-18, I.R.B. 2021-15 for submitting a written declination has passed, employers that hired an individual who is a Designated Community Resident or a Qualified Summer Youth Employee and who began work for that employer on or after January 1, 2021, may not have submitted Form 8850 to the designated local agency within 28 days of the individual beginning work. To be eligible for the relief provided by this notice, an employer that did not submit Form 8850 to the DLA within 28 days of an individual beginning work must submit the completed Form 8850 to the DLA.

An employer that hires an individual who is a Designated Community Resident or a Qualified Summer Youth Employee and who begins work for the employer on or after October 9, 2021, is not eligible for the transition relief described in this notice with respect to that new employee.

Effective Date

The effective date of this notice is August 10, 2021

REFERENCE KEY

USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***

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Gross Receipts Safe Harbor for Employers Claiming Employee Retention Credit

Rev. Proc. 2021-33; IR-2021-167

The Treasury and IRS have provided an optional safe harbor allowing employers to exclude the following amounts from their gross receipts solely for determining eligibility for the employee retention credit:

- the amount of the forgiveness of a Paycheck Protection Program (PPP) Loan;
- the amount of any Shuttered Venue Operators Grants under the Economic Aid to Hard-Hit Small Businesses, Non-Profits, and Venues Act; and
- the amount of any Restaurant Revitalization Grants under the American Rescue Plan Act of 2021 (ARP) (P.L. 117-2).

Certain employers may be eligible for an employee retention credit against applicable federal employment taxes if their gross receipts for a calendar quarter decline by a certain percentage as compared to a prior calendar quarter. For most employers, gross receipts are defined by Code Sec. 448(c). For tax-exempt employers, gross receipts are defined by Code Sec. 6033.

IRS Warns About Pandemic Related Email Schemes

The IRS has warned tax professionals to beware of evolving phishing scams that use various pandemic-related themes to steal client data. The IRS's Security Summit highlighted critical steps that could be taken to protect client data and urged tax professionals to work to strengthen their systems and protect client data during this pandemic and its aftermath.

Tax professionals engaged in remote transactions amid the pandemic have been highly vulnerable to identity thieves posing as potential clients. Scammers attempted to trick individuals and tax professionals into disclosing personal information such as passwords and bank account numbers by using phishing emails or SMS/texts (known as smishing). Such scams appeared to come from a known or trusted source, such as a colleague, bank, credit card company, or the IRS. Scammers tricked the receiver into opening a link or attachment by telling a story, often with an urgent tone.

Further, scammers took time to identify their victims and craft an enticing spear phishing email. They often targeted tax professionals through spear phishing by taking time to identify their victims and crafting a more enticing phishing email known as a lure. There have been recurring scams where criminals posed as potential clients, exchanging several emails with tax professionals before following up with an attachment that they claimed was their tax information. Through this, malware secretly get downloaded onto their computers, disclosing passwords to client accounts or remote access to the computers themselves once the tax professional clicked on the URL and opened the attachment. This malware, known as a remote access trojan, helped scammers take over the tax professional's office computer systems, identify pending tax returns, complete them and e-file them, and change only the bank account information to steal the refund. Moreover, international criminals have used ransomware attacks to shut down several companies in recent pandemic months.

These scams highlight the importance of the basic security steps to protect data. The IRS recently updated Publication 4557, Safeguarding Taxpayer Data, to help tax professionals guard against phishing scams and better protect taxpayer information. Finally, the IRS's Publication 5293, Data Security Resource Guide for Tax Professionals, also provides a compilation of data theft information.

IR-2021-166

Applying Safe Harbor Consistently

Employers must apply the safe harbor consistently in order to exclude these amounts from gross receipts for determining employee retention credit eligibility. An employer consistently applies the safe harbor by:

- excluding these amounts from its gross receipts for each calendar quarter in which gross receipts are relevant to determining eligibility to claim the employee retention credit; and
- applying the safe harbor to all employers treated as a single employer under the aggregation rules.

An employer must also retain in its records substantiating support for the credit claimed, including the use of the safe harbor.

If an employer revokes its safe harbor election, it must adjust all employment tax returns affected by the revocation.

Claiming the Employee Retention Credit

Employers claim the employee retention credit on their employment tax return, generally Form 941, Employers Quarterly Federal Tax Return, or on an adjusted employment tax return, generally Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund. An employer is not required to apply the safe harbor.

The safe harbor does not permit the exclusion of these amounts from gross receipts for any other federal tax purpose.

Effect on Other Documents

This guidance updates and amplifies Notice 2021-20, I.R.B. 2021-11, 922, Notice 2021-23, I.R.B. 2021-16, 1113, and Notice 2021-49, I.R.B. 2021-34.

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Accounting Method Change Consent Procedures for Code Sec. 451 Amendments

Rev. Proc. 2021-34

The IRS updated automatic consent procedures for taxpayers to change their method of accounting to comply with final regulations under Reg. §§1.451-3, 1.451-8, and 1.1275-2(l); and for certain inventory costs to comply with Code Sec. 263A, 461, and 471, if the changes are made in connection with a change to comply with Reg. §§1.451-3 and/or 1.451-8. The changes reflect amendments to Code Sec. 451 made by the Tax Cuts and Jobs Act (P.L. 115–97).

IRS Updates Accounting Methods for Credit Card Fees

Rev. Proc. 2021-35

The IRS updated Rev. Proc. 2013-26, 2013-22 I.R.B. 1160, to reflect amendments to Code Sec. 451(b) made by the Tax Cuts and Jobs Act (TCJA) (P.L. 115-97) and related Reg. §§1.451-3 and 1.1275-2(l). Rev. Proc. 2013-26 allows a taxpayer to use a safe harbor method of accounting, the proportional method, for original issue discount (OID) on a pool of credit card receivables.

However, the TCJA amended Code Sec. 451(b) to provide that the all events test for an accrual method taxpayer is met no later than when an income item is included as revenue in an applicable financial statement (AFS) (AFS Income Inclusion Rule). Thus, credit card late fees, credit card cash advance fees, and interchange fees are now subject to the AFS Income Inclusion Rule instead of the timing rules for OID.

Unknown Gift Tax Return Could Be Reasonable Cause for Late Filing

F.T. Leighton, FedCl, 2021-2 USTC ¶60,728

A missing or unknown federal gift tax return could constitute reasonable cause for the late filing of an estate tax return.

To understand the appropriate steps to take after the decedent's death, the executor was in contact with the decedent's tax preparer, a family office service, and an attorney. Several months after the decedent's death, the attorney advised that no estate tax return needed to be filed because the gross estate was below the basic exclusion amount for the year of death. Nearly two years after the decedent's death, the decedent's son, who had not been involved in the estate preparation and administration, indicated that various trusts might have been created. The attorney asked the tax preparer about the trusts and the tax preparer provided a gift tax return reporting gifts to the trusts. The amount of the gifts put the estate over the threshold amount for an estate tax return.

Complaint Established Reasonable Cause

Calling the government's argument circular, the court concluded that it would not dismiss the complaint based on the position that the attorney's advice on whether to file an estate tax return was objectively unreasonable. If the court sided with the government on this point, missing information could never constitute reasonable cause because the advice would never be based on all pertinent facts and circumstances. Relying on the complaint alone, the court could not decide whether the attorney's investigation constituted reasonable due diligence.

The executor is ultimately responsible for providing all of the information available to prepare a tax return. In this case, the question of whether the executor acted reasonably was dependent on the availability of the missing gift tax return. Absent more information from the tax preparer about the gift tax return, the complaint could not be dismissed.

TAX BRIEFS

Business Deductions

An individual was disallowed various business expense deductions that were claimed on his tax returns for two tax years at issue. Further, the taxpayer was subject to addition to tax for failure to timely file his tax returns and accuracy-related penalties for understatement of tax.

Wathen, TC, Dec. 61,915(M)

Controlled Corporations

The IRS issued rulings in two cases on a series of proposed transactions. In the first case, the rulings included that a controlling entity's (CI) contribution followed by its split-off would qualify as a reorganization under Code Sec. 368(a)(1)(D). A distributing entity (D1) and C1 would each be a party to the reorganization. Moreover, D1 would recognize no gain or loss on the C1's contribution. C1's shareholders would recognize no gain or loss on the receipt of the stock of C1 in C1's split-off.

In the second case, a distributing entity (D2) and controlling entity (C2) would not recognize gain or loss on a contribution. C2's basis in each asset received in the contribution would be the same as the basis of such asset in the hands of D2 immediately before the contribution. D2's shareholders would not recognize gain or loss (and no amount will be includable in income) upon receipt of C2's stock in a distribution. Finally, any earnings and profits would be allocated between D2 and C2.

IRS Letter Ruling 202132005; IRS Letter Ruling 202132006

Collection Due Process

A childcare company was not in compliance with its employment tax return filing and federal tax deposit obligations. Moreover, the Office of Appeals was justified in upholding the proposed levy.

Kidz University, Inc., TC, Dec. 61,916(M)

CTC Payments

The IRS and Treasury announced that millions of American families were receiving their advance Child Tax Credit (CTC) payment for August as direct deposits and checks arrive. The majority of second batch of advance monthly payments, worth about $15 billion, would be issued by direct deposit. Payments would continue each month for the rest of 2021. Each payment is up to $300 per month for each child under age 6 and up to $250 per month for each child ages 6 through 17. Besides the July 15 and August 13 payments, payment dates are September 15, October 15, November 15, and December 15.

IR-2021-169

Grants and Scholarships

Two private foundations' procedures for awarding scholarships were approved. In both cases, the foundation's procedures met the requirements under Code Sec. 4945(g). The first foundation awarded scholarships to qualifying children of employees for study at a college, university or vocational school. The second foundation operated a scholarship program to encourage students to seek and achieve continuing post-secondary education at a university, college, vocational, or technical school. Both foundations' awards met the requirements under Code Sec. 4945(g)(1) and were not taxable expenditures if used for qualified tuition and other related expenses; therefore, the awards were subject to Code Sec. 117(b). Finally, all awards were made on a nondiscriminatory basis.

IRS Letter Ruling 202132010; IRS Letter Ruling 202132011

Gross Income

An individual's unreported income was taxable. The taxpayer worked for 12 businesses throughout the tax year at issue. Eleven of these businesses reported the taxpayer's wages on Forms W-2, Wage and Tax Statement, and one business reported a payment as "Other Income" on Form 1099-MISC, Miscellaneous Income. The taxpayer was not liable for a Code Sec. 6673 penalty.

Silver, TC, Dec. 61,913(M)

Per Diem Rates

The U.S. State Department has released a listing of maximum travel *per diem* allowances for travel in foreign areas. The rates apply to all government employees and contractors, and are effective as of August 1, 2021.

August Maximum Travel Per Diem Allowances for Foreign Areas

Real Estate Investment Trusts

The IRS ruled that amounts received by a limited liability company (LLC) (taxpayer) qualify as rents from real property under Code Secs. 856(c)(2) and (3). The amounts were from tenants for the use of the taxpayer's leased real property assets and personal property. The furnishing of the services listed and performed by either a taxable real estate investment trust subsidiary or an independent contractor as defined in Code Sec. 856(d)(3) from whom the taxpayer does not derive or receive any income, and the performance of the activities did not give rise to impermissible tenant service income. Moreover, it would not cause any portion of the rents received by taxpayer under each of six agreements to fail to qualify as rents from real property.

Next, the Service ruled that purposes of the limited rental exception under Code Sec. 856(d)(8)(A), the property with regard to the taxpayer's fiber optic cable was the continuously connected fiber optic cable within the geographic boundaries of the applicable area. The taxpayer leased systems composed of permanently affixed coaxial and fiber optic cable, and the associated conduit piping (real property assets), among other assets. Finally, no opinion was expressed concerning whether the taxpayer otherwise qualified as a real estate investment trust (REIT).

IRS Letter Ruling 202132002

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Refunds

The Tax Court ruled that it lacked jurisdiction to decide an individual's claim for refund for a year that was not before it. Even if it had jurisdiction, the taxpayer would not be entitled to a refund because he failed to meet the threshold requirements for claiming a refund.

Mohsen, TC, Dec. 61,914(M)

Reimbursements

The IRS's Chief Counsel ruled that joint and several liability among members of a controlled group did not result in a per se exclusion from a remitting a member's gross income, of reimbursement by other members of all or a portion of the Branded Prescription Drug (BPD) fee. The taxpayer was a member of an affiliated group that included foreign corporations. The group was involved in medical care products, including BPDs. The foreign members of the group (F1) manufactured the BPDs and owned all the intellectual property (IP). F1 licensed U.S. branding and distribution rights to the taxpayer to enable the taxpayer to market and distribute the branded prescription drugs within the U.S.

Secondly, whether the reimbursement of all or a portion of the BPD fee by members to the remitting member constituted gross income to the remitting member generally depended on whether the remitting member benefits from the fee payment. In determining whether the remitting member is the beneficiary of payment of the BPD fee, several non-dispositive factors would be evaluated. This included whether (1) the parties intended that F1 would bear the economic burden of the fee; and (2) the taxpayer had an unconditional obligation to remit the amount received by F1 as payment of the BPD fee.

Chief Counsel Memorandum 202132009