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IRS To Open 2025 Tax Season on January 27

IR-2025-8

The Internal Revenue Service announced January 27, 2025, as the start of the upcoming tax filing season.

The agency is expecting more than 140 million individual returns for tax year 2024 to be filed ahead of the April 15 filing deadline, with more than half of those coming with the help of a tax preparer.

Taxpayers in 25 states will be able to use the Direct File program to prepare and file their taxes in 2025. The Direct File program also will have expanded functionality to allow give more people the opportunity to use it. In addition to supporting taxpayers claiming the Earned Income Tax Credit, Child Tax Credit, and Credit for Other Dependents, Direct File will also allow taxpayers claiming the following credits to use the program:

- Child and Dependent Care Credit;
- Premium Tax Credit;
- Credit for the Elderly and Disabled; and
- Retirement Savings Contribution Credit.

Direct File also will support expanded deductions this filing season, adding deductions for Health Savings Accounts to the list of previous deductions supported: the stand deduction and deductions for student loan interest and educator expenses.

During a January 10 press teleconference announcing the beginning of the tax season, IRS Commissioner Daniel Werfel highlighted that taxpayers using Direct File will have access to a new chatbot to help them with using the program.

The IRS is expecting more than 30 million taxpayers will be eligible to use Direct File across the 25 states in which it is available, although the Direct File program has been in the crosshairs of Congressional Republicans with the GOP controlling both chambers and the White House, the program could be in jeopardy.

For those not eligible or wanting to use Direct File to prepare their taxes, the Free File program will be an alternative option to file taxes to the IRS without cost beginning on January 10. The agency said that "eight private-sector partners will provide online guided tax software products for taxpayers with an Adjusted Gross Income (AGI) of $84,000 or less in 2024," with one partner offering a product in Spanish.

Nine out of 10 taxpayers who file electronically and are expecting a refund should receive it within 21 days and "often sooner," Werfel said.

During the call, he also highlighted improvements to the "Where's My Refund?" online tool with a voicebot option to help people who prefer to call the IRS rather than use the tool online, as well as improved functionality to the individual taxpayer online accounts, including viewing details of their tax return, ordering account transcripts and making payments. Simplified notices that are sent to taxpayers also will be available in the online accounts.

"We anticipate our enhancements to the individual online account will increase the number of taxpayers creating and using these accounts by more than 600,000 over last year," Werfel said.

The commissioner also used the call to campaign for continued funding for the agency, noting that cuts could lead to a decrease in the workforce and other setbacks on the ongoing modernization efforts.

"We have a very complicated tax system, so the phone calls will keep coming," Werfel said. "People will still come to our walk-in centers, and the incoming forms and outgoing credits and refunds won't change, and so if we don't have the right staffing levels, the performance will backslide, and will see inevitability slower processing delays and potential backlogs,"as well as money for technology upgrades and other losses of the customer support improvements.

Standards of Identity for American Single Malt Whisky Established

The standards of identity for distilled spirits regulations are amended by the Alcohol and Tobacco Tax and Trade Bureau to add "American single malt whisky" as a type of whisky that is produced in the United States and meets certain criteria.

Regulations, 27 CFR, Part 5, Secs. 5.1, 5.66, 5.72, 5.74, 5.143; Treasury Decision TTB-199, Alcohol and Tobacco Tax and Trade Bureau, 89 FR 102726, effective January 19, 2025

NTA Releases Annual Report to Congress and Purple Book

IR-2025-4

National Taxpayer Advocate Erin Collins identified the lengthy processing and uncertainty regarding the employee retention credit as being among the ten most serious problems facing taxpayers.

"Although the [Internal Revenue Service] has processed several hundred thousand claims in recent months, it was still sitting on a backlog of about 1.2 million claims as of October 26, 2024," Collins noted in her just released 2024 Annual Report to Congress. "Many claims have been pending for more than a year, and with the imminent start of the 2025 filing season, the IRS will shift its focus and resources to administering the filing season, resulting in even longer ERC processing delays."

Collins is calling on the IRS to provide more specific information with claims denials, more transparency on the timing of claims processing, and allowing taxpayers to submit documentation and seek an appeal before disallowing a claim that was not subject to an audit.

In addition to ERC processing, Collins identified delays in processing of tax returns as another serious problem taxpayers are facing, including delays associated with the more than 10 million paper 1040 returns and more than 75 million paper-filed returns and forms overall each year, as well as issues surrounding rejections of e-filed returns, most of which are valid returns. These delays end up delaying refunds and can be particularly hard on low-income filers who are receiving the Earned Income Tax Credit.

"We recommend the IRS continue to prioritize automating its tax processing systems, including by scanning all paper-filed tax returns in time for the 2026 filing season and processing amended tax returns automatically," the report states.

Another processing issue identified in the report deals with delays in processing and refunds for victims of identity theft.

Collins reported that the delays in addressing identity theft issues grew to 22 months in fiscal year 2024, affecting nearly 500,000 taxpayers.

"The IRS has advised us that it has begun to prioritize resolution of cases involving refunds over balance-due returns rather than following its traditional 'first in, first out' approach," the report states. "This is somewhat good news, but I strongly encourage the IRS to fix this problem once and for all during the coming year."

Other issues in the top 10 include:

- Taxpayer service is often not timely or adequate;
- The prevalence of tax-related scams;
- Employment recruitment, hiring, training, and retention challenges are hindering transformational change within the industry;
- The dependence on paper forms and manual document review in processing Individual Taxpayer Identification Numbers is causing delays and potential security risks;
- Limited taxpayer financial and tax literacy;
- The IRS's administration of civil tax penalties is often unfair, inconsistently deters improper behavior, fails to promote efficient administration, and thus discourages tax compliance; and
- Changes to the IRS's criminal voluntary disclosure practice requirements may be reducing voluntary compliance and negatively impacting the tax gap.

Collins also called on Congress to ensure the IRS receives adequate

REFERENCE KEY

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

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funding specifically for taxpayer services and technology upgrades, noting that many improvements that are highlighted in the report were made possible by the Inflation Reduction Act, which provided supplemental funding to the agency.

"Much of the funding has generated controversy – namely, the funding allocated for enforcement," the report notes. "But some of the funding has received strong bipartisan support – namely, the funding allocated for taxpayer services and technology modernization."

She reported that telephone service has improved dramatically, correspondence processing has improved dramatically, and in-person has become more accessible following the IRA funding, as well as technology improvements including increased scanning and processing of paper-filed tax returns electronically; increases in electronic correspondence; expansion of secure messaging; the ability to submit forms from mobile phones; and increases in both chatbot and voicebot technology.

"I want to highlight this distinction so that if Congress decides to cut IRA funding, it does not inadvertently throw the baby out with the bathwater," she reports.

Purple Book and Legislative Recommendations

Congress should require that federal tax return preparers meet minimum standards before being able to file tax returns and allow the Department of the Treasury to revoke the Preparer Tax Identification Number for those who are sanctioned, National Taxpayer Advocate Erin Collins requested in the annual legislative recommendations provided to Congress.

"While some tax return preparers must meet licensing requirements (e.g. certified public accountants, attorneys, and enrolled agents), most tax return preparers are not credentialed," the report states. "Numerous studies have found that non-credentialed preparers disproportionately prepare inaccurate returns, causing some taxpayers to overpay their taxes and other taxpayers to underpay their taxes, which subject them to penalties and interest charges."

Collins notes that the "Obama, Trump, and Biden administrations have each previously recommended that Congress authorize the Treasury Department to establish minimum competency standards for federal tax preparers. To protect taxpayers and the public, we likewise recommend that Congress provide this authorization as well as authorization for the Treasury Department to revoke the Preparer Tax Identification Numbers (PTINs) of preparers who have been sanctioned for improper conduct."

Another recommendation among the 10 that were specifically highlighted in the report from the NTA is for Congress to expand the U.S. Tax Court's jurisdiction to hear refund cases.

"Under current law, taxpayers seeking to challenge an IRS tax due adjustment can file a petition in the U.S. Tax Court, while taxpayers who have paid their tax and are seeking a refund must file suit in a U.S. district court or the U.S. Court of Federal Clams. Litigating in a U.S. district court or the Court of Federal Claims is generally more challenging – filing fees are relatively high, rules of civil procedure are complex, the judges generally do not have tax expertise, and the proceeding without a lawyer is very difficult."

In making the recommendation, she adds that "a U.S. district court or the Court of Federal Appeals effectively deprives many taxpayers of the right to judicial review of an IRS refund disallowance."

Collins also is recommending that Congress mandate a timely processing of claims for a refund or a credit.

"Under current law, there is no requirement that the IRS pay or deny" a refund, the report states. "The taxpayer remedy is to file suit in a U.S. district court or the U.S. Court of Federal Claims. For many taxpayers, that is not a realistic or affordable option".

She notes that while the IRS generally processes refund claims, some can linger for months or even years without being paid out, prompting a request for legislation requiring the IRS act on claims for credit or refund within one year of filing and imposing certain consequences on the IRS for failing to do so.

The report also recommends legislation that enables the Low-Income Taxpayer Clinic Program to assist more taxpayers in controversies with the IRS through removing the per-clinic annual grant cap of $100,000 and to lower the match requirement to 25 percent from the current 100 percent to allow for an expansion of coverage to additional taxpayers.

Other legislative recommendations among the 10 that were highlighted include:

- Allowing the limitation on theft loss deduction in the Tax Cuts and Job Acts to expire so scam victims are not taxed on amounts stolen from them;
- Extending the reasonable cause defense for the failure-to-file penalty to taxpayers who rely on return preparers to e-file their returns;
- Promoting consistency with the Supreme Court's *Boechler* decision by making the time limits for bringing all tax litigation subject to equitable judicial doctrines;
- Removing the requirement that written receipts acknowledge charitable contributions must be "contemporaneous;"
- Requiring that math error notices describe the reason(s) for the adjustment with specificity, informing taxpayers they may request abatement within 60 days, and be mailed by certified or registered mail; and
- Providing that assessable penalties are subject to deficiency procedures.

Recommendations in general cover a range of subject areas including strengthening of taxpayer rights; improving the filing process; improving assessment and collection procedures; reforming penalty and interest provisions; strengthening taxpayer rights before the office of appeals; strengthening the Office of the Taxpayer Advocate; strengthening taxpayer rights in judicial proceedings; and other miscellaneous recommendations.

Congress over time has enacted more than 50 legislative recommendations made by the National Taxpayer Advocate over time, with more than 20 specifically enacted in the Taxpayer First Act.

IRS Updates Guidance on Section 530 Relief for Employee Status Controversies

Rev. Proc. 2025-10

The IRS has provided updated guidance on the implementation of section 530 of the Revenue Act of 1978 (P.L. 95-600), as amended, regarding controversies involving whether individuals are "employees" for employment tax purposes. Section 530 (which is *not* an Internal Revenue Code section) provides relief for employers who are involved in worker classification status disputes with the IRS and face large employment tax assessments as a result of the IRS's proposed reclassifications of workers.

Section 530 Safe Harbor

Section 530 provides that an employer will not be liable for federal employment taxes regarding an individual or class of workers if certain statutory requirements are met. Section 530 relief applies only if the taxpayer did not treat the individual as an employee for federal employment tax purposes for the period at issue, and meets each of the following requirements for that period:

- the taxpayer filed all required federal tax returns, including information returns, on a basis that is consistent with the taxpayer's treatment of the individual as not being an employee (reporting consistency requirement);
- the taxpayer did not treat the individual or any individual holding a substantially similar position as an employee (substantive consistency requirement); and
- the taxpayer had a reasonable basis for not treating the individual as an employee (reasonable basis requirement).

Rev. Proc. 85-18, 1985-1 CB 518, provided instructions for implementing section 530 relating to the employment tax status of independent contractors and employees.

Updated Guidance

The updated guidance clarifies provisions in Rev. Proc. 85-18 regarding the definition of employee, the section 530 requirement for the filing of required returns, and the reasonable basis safe harbor rules. The updated guidance also includes new provisions that reflect certain statutory changes made to section 530 since 1986.

Among other things, the updated guidance amplifies guidelines in Rev. Proc. 85-18 which interpreted the word "treat" for purposes of determining whether a taxpayer did not treat an individual as an employee for section 530 purposes. Under the updated guidance, with respect to any individual, actions that indicate "treatment" of the individual as an employee for section 530 purposes include:

- withholding of income tax or FICA taxes from any payments made;
- filing of an original or amended employment tax return;
- filing or issuance of a Form W-2; and
- contracting with a third party to perform acts required of employers.

Provisions in Rev. Proc. 85-18 that explained how refunds, credits, abatements, and handling of claims applied to taxpayers who were under audit or otherwise involved in administrative or judicial processes with the IRS at the time of enactment of section 530 are no longer applicable and were not included in the updated guidance. Section 530 relief remains available at any stage in the administrative or judicial process if the requirements for relief are met.

Effect on Other Documents

Rev. Proc. 85-18, 1985-1 CB 518, is modified and superseded.

IRS Ruling Examines Employer-Employee Scenarios Regarding Section 530 Relief, Reduced Employment Tax Rates, Tax Court Review

Rev. Rul. 2025-3

The IRS has provided guidance that addresses, in several fact scenarios, the application of Section 530 of the Revenue Act of 1978 (P.L. 95-600), Code Sec. 3509 rates, and the requirements to issue a "Notice of Employment Tax Determination Under IRC §7436" (Code Sec. 7436 Notice).

Section 530 (which is *not* an Internal Revenue Code section) provides that a taxpayer will not be liable for federal employment taxes regarding an individual or class of workers if certain statutory requirements are met.

If an employer does not meet the requirements for Section 530 relief, Code Sec. 3509 may allow the employer to remit unpaid taxes at reduced rates if the employer fails to deduct and withhold income tax or the employee share of FICA tax regarding any of its employees because the employer treated that employee as a nonemployee.

Code Sec. 7436 provides that the Tax Court may review two types of employment tax determinations made by the IRS and the proper amount of employment tax, penalties, and additions to tax resulting from a determination that (1) one or more individuals performing services for a person are employees of that person for employment tax purposes, or (2) the person is not entitled to relief under Section 530(a) regarding such an individual.

The guidance examines five fact situations and provides a determination on whether Section 530 or the reduced rates of Code Sec. 3509 would apply, and whether the IRS would issue a Code Sec. 7436 Notice.:

Final Regulations Provide Rules for Clean Electricity Production and Clean Electricity Investment Credits

T.D. 10024

The IRS has released final regulations regarding the Code Sec. 45Y clean electricity production credit and the Code Sec. 48E clean electricity investment credit, which replace the Code Sec. 45 electricity production credit and the Code Sec. 48 energy investment credit, respectively, for qualified facilities and properties placed in service after 2024.

These final regulations establish detailed rules for:

- determining greenhouse gas (GHG) emissions rates resulting from the production of electricity;
- petitioning for provisional emissions rates;
- and determining taxpayer eligibility for these credits in various circumstances.

Before finalizing these regulations, the Treasury Department and the IRS reviewed over 1,800 written comments, attended two days of public hearings, and consulted extensively with scientific and technical experts from across the Federal government. The regulations generally apply to qualified facilities and properties placed in service after December 31, 2024, and are effective on the date that they are published in the Federal Register.

Clean Electricity Production Credit Regulations

The regulations for the Code Sec. 45Y credit are organized into the following five sections:

1. Reg. §1.45Y-1 provides an overview of the regulations, including generally applicable rules and definitions. It also provides the rule for calculating the credit for a combined heat and power system (CHP) property.
2. Reg. §1.45Y-2 provides the rules relating to qualified facilities.
3. Reg. §1.45Y-3 provides the rules for meeting the prevailing wage and apprenticeship requirements.
4. Reg. §1.45Y-4 provides the general application of the credit, including rules that attribute production to the taxpayer, rules for the expansion of a facility and incremental production, and rules for retrofits of an existing facility.
5. Reg. §1.45Y-5 provides the rules pertaining to the determination of a GHG emissions rate for a facility, including one that produces electricity through combustion or gasification (C&G facility).

Clean Electricity Investment Credit Regulations

The regulations for the Code Sec. 48E credit are organized into the following five sections:

1. Reg. §1.48E-1 provides an overview of the credit, including generally applicable rules and definitions. It also includes the rules for calculating the credit.
2. Reg. §1.48E-2 provide the rules relating to a qualified facility, a qualified investment, qualified property, and an energy storage technology (EST).
3. Reg. §1.48E-3 provides the rules for meeting the prevailing wage and apprenticeship requirements.
4. Reg. §1.48E-4 provides the general application of the credit, including rules regarding the inclusion of qualified interconnection costs in the basis of a low-output associated qualified facility, rules for expansion of a facility and incremental production, rules for retrofitting an existing facility, rules for the ownership of a qualified facility or an EST, rules regarding the coordination of the credit with other credits, and rules for credit recapture.
5. Reg. §1.48E-5 provides rules pertaining to the determination of facility's GHG emissions rate.

Proposed Regs Issued for Code Sec. 45W Commercial Clean Vehicle Credit

Proposed Regulations, NPRM REG-123525-23

The Treasury and IRS have issued proposed regulations on the Code Sec. 45W qualified commercial clean vehicle credit enacted by the Inflation Reduction Act of 2022. The regulations affect eligible taxpayer place a qualified vehicle in service during the tax year and manufacturers of such vehicles.

Commerical Clean Vehicle Credit

Under Code Sec. 45W, a taxpayer may claim tax credit for a qualified commercial clean vehicle placed in service during the tax year as part of the general business credit. A vehicle is qualified if it is acquired after 2022 for use or lease by the taxpayer (not for resale) and is treated as a motor vehicle under title II of the Clean Air Act that meets certain electric motor and battery requirements. It must be made by a qualified manufacturer primarily for use on public streets, roads, and highways.

The credit allowed for qualified commercial clean vehicles is equal to the lesser of:

- 15-percent of the basis of the vehicle (30-percent if the vehicle is not powered by a gasoline or diesel internal combustion engine), or
- the incremental cost of the vehicle.

The credit is limited to $7,500 for a vehicle having a gross vehicle weight rating (GVWR) of less than 14,000 pounds, and $40,000 for other vehicles.

Incremental Costs

The incremental cost of any qualified commercial clean vehicle is an amount equal to the excess of the purchase price for such vehicle over such price of a comparable vehicle powered by gasoline or diesel. Under the proposed regulations, this is determined by multiplying the manufacturer's cost of the components necessary for the powertrain of the qualified commercial clean vehicle by the retail price equivalent (RPE) of that vehicle, and then subtracting from that amount the product of the manufacturer's cost of the powertrain of the comparable vehicle and the RPE of that vehicle.

The IRS intends to provide RPE safe harbors for different segments of the vehicle market (BEVs, PHEVs, FCEVs, and PHFCEVs) for future calendar years like the safe harbors for the 2023 and 2024 calendar years provided in Notice 2023-9 and Notice 2024-5, respectively. No formal election will be required for a taxpayer to use a safe harbor RPE. A taxpayer may also rely on a qualified manufacturer's disclosed incremental cost calculations.

Qualified Vehicle

A qualified commercial clean vehicle must be acquired for use or lease and not for resale by the taxpayer. Under the proposed regulations, if a lease of a qualified vehicle would be treated as sale for Federal income tax purposes, then it will not be respected as a lease for purposes of the credit and the lessor may not claim the credit. If a lessor has claimed the credit, then the credit allowed will be recaptured.

The proposed regulations provide special rules relating to the credit eligibility of a vehicle resulting from certain transactions and uses. This includes a used qualified vehicle, the cancellation of the sale of qualified vehicle before being placed in service, the return of qualified vehicle to the seller within 30 days of being placed in service, and the resale of a qualified vehicle within 30 days of being placed in service.

Reporting Requirements

Form 8936 is used to claim the credit and it must be attached to the taxpayer's return for the tax year the qualified vehicle is placed in service. This includes a completed Schedule A (Form 8936) with all the relevant information such as the vehicle identification number (VIN). The proposed regulations provide that the credit can be claimed on only one return and no allocation or proration of the credit is generally allowed. A taxpayer may rely on certain certifications and information provided by the manufacturer for claiming the credit.

IRS Releases Draft Text of Proposed Regulations and Emission Rates for Code Sec. 45Z Clean Fuel Production Credit

Notice 2025-10; Notice 2025-11

The IRS has release draft text of proposed regulations addressing the Code Sec. 45Z clean fuel production credit. The forthcoming proposed regulations include intended rules on how to calculate the credit, allowed methodologies for determining emissions rates, unrelated party certification of emissions rates, how to claim the credit, and requirements for registration. The IRS has also released initial guidance regarding methodologies for determining emissions rates under Code Sec. 45Z and the initial emissions rate table.

Clean Fuel Production Credit

An eligible taxpayer may claim an income tax credit for clean transportation fuel and sustainable aviation fuel (SAF) produced after December 31, 2024, and sold before January 1, 2028. The credit effectively replaces pre-2025 credits for second generation biofuel under Code Sec. 40, other biofuels and renewable diesel fuels under Code Sec. 40A, and SAF under Code Sec. 40B. The credit is part of the general business credit.

A taxpayer calculates the Code Sec. 45Z clean fuel production credit by multiplying an applicable amount per gallon or gallon equivalent with respect to a transportation fuel by the emissions factor for such fuel. The applicable base amount per gallon is 20 cents, increased to 35 cents for SAF. However, an alternative applicable amount of $1.00 per gallon ($1.75 for SAF) may apply if the qualified facility satisfies prevailing wage and apprenticeship (PWA) requirements. All applicable amounts are adjusted for inflation after 2024. A transportation fuel's emissions factor is a calculation of the fuel's emission rate against the baseline emissions rate of 50 kg of CO2e per mmBTU.

Proposed Regulations

Notice 2025-10 provides draft text of proposed regulations related to the Code Sec. 45Z clean fuel production credit. The forthcoming proposed regulations would provide definitions, incorporating the statutory definitions under Code Sec. 45Z and provide additional or clarifying definitions to various terms. They would also provide general rules regarding the amount and timing of the credit. The rules would describe the credit calculation and clarify that a taxpayer is eligible to claim the credit only for the tax year in which a qualifying sale of a transportation fuel occurs. A taxpayer may produce a transportation fuel in an earlier tax year, but a qualifying sale may take place no earlier than the date the fuel is produced.

The forthcoming proposed regulations would provide certain special rules with respect to the credit. For example, a taxpayer must be registered as a producer of clean fuel at the time of production and produce their fuel in the United States. Also, anti-stacking rules will apply for purposes of determining if a facility is a qualified facility. Rules are also provided for facilities with multiple owners. The forthcoming proposed regulations would also provide rules for unrelated party certification of emissions rates for SAF transportation fuel.

Emission Rates

In addition to the release of draft text of proposed regulations, the IRS has also released Notice 2025-11 which provides initial guidance regarding methodologies for determining emissions rates under Code Sec. 45Z and provides the initial emissions rate table.

- For a transportation fuel established on the emissions rate table that is not a SAF, a taxpayer producing such fuel is directed to calculate emissions rates using the most recent determinations under the new 45ZCF-GREET model.
- For a transportation fuel established on the emissions rate table that is a SAF, a taxpayer producing such fuel is directed to calculate emissions rates using either determinations from fuel pathways approved under the most recent version of the CORSIA Program or the most recent determinations under the 45ZCF-GREET model.

Public Comments

The IRS is requesting public comments on the forthcoming proposed regulations and the emission rate methodologies. Comments may be submitted electronically or via mail by April 10, 2025.

Final Regs Issued for Allocation of Low-Income Communities Bonus Credit for Code Sec. 48E Clean Energy Investment Credit

T.D. 10025; Rev. Proc. 2025-11

The IRS has released final regulations concerning the allocation of low-income communities bonus credits under the environmental justice capacity limitation provisions of the Code Sec. 48E clean electricity investment credit. The regulations apply to applicable facilities placed in service after December 31, 2024, and during tax years ending on or after January 8, 2025. The IRS has also released the application and allocation procedures for the Capacity Limitation for 2025 and subsequent tax years.

Low-Income Communities Bonus Credit Program

The Inflation Reduction Act of 2022 (P.L. 117-169) added the clean electricity investment credit for qualified facilities and energy storage technology placed in service after December 31, 2024. The credit includes a bonus credit for eligible property in a qualified facility that receives allocations of environmental justice capacity limitation from the IRS.

For eligible property in an applicable facility that receives a capacity allocation, the credit rate is increased by:

- 10 percentage points if the applicable facility is located in a low-income community (Category 1) or on Indian land (Category 2); and
- by 20 percentage points if the applicable facility is part of a qualified low-income residential building project (Category 3) or a qualified low-income economic benefit project (Category 4).

Applicable Facility

The final regulations clarify that an applicable facility must be non-combustion and gasification qualified facilities (non-C&G facilities) that the IRS has determined have a greenhouse gas (GHG) emissions rate of not greater than zero and announced in published guidance by the opening date for a Program year.

The regulations adopt the statutory language establishing four categories of applicable facilities. For Category 3 and Category 4 facilities, detailed rules are provided for determining and sharing the financial benefit. For a Category 3 facility, at least 50% of the financial value of the electricity produced must equitably allocated by the facility to low-income occupants. A Category 4 facility must serve multiple qualifying low-income households with at least 50 percent of the facility's total output assigned to those households. The regulations provide rules for identifying and verifying low-income households.

Allocation Program

The bonus credit does not apply if the facility is placed in service before being awarded an allocation of Capacity Limitation. The regulations outline how the annual Capacity Limitation is allocated across the four facility categories (and sub-reservations for Category 1). If some categories or sub-reservations are over- or undersubscribed at the close of the application period for a Program year, the capacity may be redistributed.

At least 50 percent of the capacity limitation in each category is reserved for facilities meeting additional selection criteria relating to ownership and geographic factors. Special rules are also provided for small-scale residential solar facilities, which are expected to represent a significant portion of Category 1 facilities. These rules would reserve part of the Category 1 capacity limitation for behind the meter (BTM) facilities, including rooftop solar.

Application and Selection Process

Rev. Proc. 2025-11 provides the process to apply for an allocation of Capacity Limitation for the clean energy investment credit for 2025 and subsequent years. Guidance is provided for not only the application process, but also application review, documentation requirements, and placed in service reporting requirements.

An applicant must apply for an allocation of Capacity Limitation through the online applicant portal system (Portal), at https://eco.energy.gov/licbonus. The owner of the applicable facility is the person who must apply for an allocation of Capacity Limitation. For this purpose, A disregarded entity cannot be an applicant.

An applicant may submit only one application per applicable facility per Program year. For an applicable facility that has integrated operations with one or more other qualified facilities, the applicant may submit only one application for that applicable facility (including any other qualified facilities with integrated operations).

For Program year 2025, the application period will open on January 16, 2025, and close on the first Friday in August 2025. Beginning for Program year 2026, and for each subsequent year of the Program, the application period will open the first Monday in February and close the first Friday in August.

Final and Proposed Regulations Address Digital Content and Cloud Transactions

T.D. 10022; Proposed Regulations, NPRM REG-107420-24; Notice 2025-6

The Treasury and IRS have issued final regulations that provide rules for classifying digital and cloud transactions. The rules apply for purposes of the international provisions of the Code.

The rules retain the overall approach of the proposed regulations (NPRM REG-130700-14, August 14, 2019), with some revisions.

The Treasury and IRS also issued proposed regulations that provide sourcing rules for cloud transactions.

Background

Reg. §1.861-18 provides rules for classifying cross-border transactions involving digitized information, specifically computer programs, broadly grouped into the following categories:

Digital content is generally defined as any computer program or other content protected by copyright law, not just transactions involving computer programs.

- the transfer of a copyright;
- the transfer of a copyrighted article;
- the provision of services for the development or modification of a computer program; and
- the provision of know-how relating to the development of a computer program.

The 1998 final regulations focus on the distinction between the transfer of the copyright itself and transfer of a copyrighted article, using a substance-over-form characterization approach and by examining the underlying rights granted to the transferee. Transfers of copyrights and copyrighted articles are further characterized as complete or partial transfers, resulting in the transfers being characterized as either sales or licenses, in the case of a copyrights, or sales or leases, in the case of a copyrighted articles.

2025 Final Regulations

The 2025 final regulations maintain the basic framework for characterizing transfers of content and extend the characterization framework to digital content. Digital content is generally defined as any computer program or other content protected by copyright law, not just transactions involving computer programs.

The categories of transactions include:

- the transfer of a copyright in the digital content;
- the transfer of a copy of the digital content (a copyrighted article);
- the provision of services for the development or modification of the digital content; and
- the provision of know-how relating to the development of digital content.

The 2025 final regulations also provide for cloud transactions and characterize the transactions as a provision of services.

Cloud transactions are generally defined as transactions through which a person obtains on-demand network access to computer hardware, digital content, or similar resources.

The 2025 final regulations replace the de minimis rule and the concept of arrangement with a predominant character rule that applies to both digital content transactions and cloud transactions. Under the rule, a transaction with multiple elements is characterized based on the predominant character of the transaction.

Request for Comments on 2025 Final Regulations

The Treasury and IRS are considering whether the characterization rules should apply to all provisions of the Code and have requested comments on any specific areas that would be affected, with examples if appropriate. Comments are also requested on any guidance that would be needed and the approach the guidance should take. In addition to general comments, the Treasury and IRS also request comments on the desirability and effect of applying the rules in specific areas and the guidance needed.

Comments should be submitted 90 days after the Notice requesting comments is published in the Internal Revenue Bulletin, with consideration for comments submitted after that date that do not delay the guidance. Comments may be submitted electronically via the Federal eRulemaking Portal www.regulations.com or by mail to: Internal Revenue Service, CC:PA:01:PR (Notice 2025-6, Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C., 20044.

Proposed Sourcing Rules for Cloud Transactions

Gross income from a cloud transaction is sourced as services. Under the Code, gross income from the performance of services is sourced to the place where the service is performed.

To determine the place of performance, the proposed regulations would take into account the location of the employees and assets, including both tangible and intangible assets, that contribute to the provision of cloud transactions. The sourcing rules would apply on a taxpayer-by-taxpayer basis.

The place of performance of a cloud transactions is established through a formula composed of a fraction that has three parts-the intangible property factor, the personnel factor, and the tangible property factor. The factors make up the denominator of the fraction. The numerator is the sum of each portion of each factor that is from sources within the United States. The gross income from a cloud transaction multiplied by the fraction is the U.S. source portion of the gross income.

Final Regulations Identify Partnership Basis Shifting Transaction as Reportable Transactions

T.D. 10028; IR-2025-6

The IRS has issued final regulation identifying certain partnership related-party basis adjustment transactions as transactions of interest (TOI), a type of reportable transaction under Reg. §1.6011-4. Taxpayers that participate and material advisors to these transactions, and substantially similar transactions, are required to disclose as much to the IRS using Form 8886 and Form 8918, respectively, or be subject to penalties.

Basis Adjustment Transactions

A transaction is covered by the regulations if a partnership with two or more related partners engages in any of the following transactions.

- The partnership makes a current or liquidating distribution of property to a partner who is related to one or more partners, and the partnership increases the basis of one or more of its remaining properties under Code Sec. 734(b) and (c) by more than $10 million ($25 million for tax years before 2025).
- The partnership distributes property to a partner related to one or more partners in liquidation of the partnership interest, and the basis of one or more distributed properties is increased under Code Sec. 732(b) and (c) by more than $10 million ($25 million for tax years before 2025).
- The partnership distributes property to a partner who is related to one or more partners, the basis of one or more distributed properties is increased under Code Sec. 732(d) by more than $10 million ($25 million for tax years before 2025), and the related partner acquired all or a part of its interest in the partnership in a transaction that would have been a basis adjustment transaction had a Code Sec. 754 election been in effect.

A basis adjustment transaction for this purpose would occur if a partner transferred an interest in the partnership to a related partner in a nonrecognition transaction, and the basis of one or more partnership properties is increased under Code Sec. 743(b)(1) and (c) by more than $10 million ($25 million for tax years before 2025).

Retroactive Reporting

The final regulations limit the disclosure rule for open tax years that fall within a six-year lookback window. The window is the seventy-two-month period before the first month of a taxpayer's most recent tax year that began before January 14, 2025. The basis increase threshold in a TOI during the six-year lookback period is $25 million.

A taxpayer has until July 13, 2025, to file disclosure statements for TOIs in open tax years for which a tax return has already been filed and that fall within the six-year lookback window. Material advisors have until April 14, 2025, to file their disclosure statements for tax statements made before the final regulations.

Guidance on Covered Gifts and Bequests Issued

T.D. 10027

Regulations under Code Sec. 2801, which imposes a tax on covered gifts and covered bequests received by a citizen or resident of the United States from a covered expatriate, have been issued.

Definitions

Reg. §28.2801-1 provides the general rules of liability imposed by Code Sec. 2801. For purposes of Code Sec. 2801, domestic trusts and foreign trusts electing to be treated as domestic trusts are treated as U.S. citizens. Terms used in chapter 15 of the Code are defined in Reg. §28.2801-2. The definition of the term "resident" is the transfer tax definition, which reduces opportunities to avoid the expatriate tax and is consistent with the purpose of the statute. The definition of "covered bequest" identifies three categories of property that are included in the definition and subject to tax under Code Sec. 2801. Reg. §§28.2801-2(i)(2) and (5) modify the definitions of an indirect acquisition of property.

Exceptions to the definitions of covered gifts and bequests are detailed in Reg. §28.2801-3. The timely payment of the tax shown on the covered expatriate's gift or estate tax return was eliminated from the regulations as it relates to the exception from the definitions of covered gift and covered bequest. A rule was added in Reg. §28.2801-3(c)(3) that would limit the value of a covered bequest to the amount that exceeds the value of a covered gift to which tax under Code Sec. 2801 was previously imposed.

Covered Gifts and Bequests Made in Trust

Reg. §28.2801-3(d) provides rules regarding covered gifts and covered bequests made in trust, including transfers of property in trust that are subject to a general power of appointment granted by the covered expatriate. Contrary to the gift tax rule treating the trust beneficiary or holder of an immediate right to withdraw as the recipient of property, the rules treat transfers in trust that are covered gifts or bequests as transfers to the trust, which are taxed under Code Sec. 2801(e)(4). Consistent with the estate and gift tax rules, the exercise, release, or lapse of a covered expatriate's general power of appointment for the benefit of a U.S. citizen or resident is a covered gift or covered bequest. Only for purposes of Code Sec. 2801, a covered expatriate's grant of a general power of appointment over property not held in trust is a covered gift or bequest to the powerholder as soon as both the power is exercisable and the transfer of the property subject to the power is irrevocable.

Liability for Payment and Computation of Tax

Reg. §28.2801-4 provides rules regarding who is liable for the payment of the tax. In general, the U.S. citizen or resident, including a domestic trust, who receives the covered gift or bequest is liable for paying the tax. A non-electing foreign trust is not a U.S. citizen and is not liable for the tax. The U.S. citizen or resident who receives distributions from a non-electing foreign trust is liable on the receipt of the distribution to the extent the distribution is attributable to a covered gift or bequest. Rules regarding the date on which a recipient receives covered gifts or bequests are explained in Reg. §28.2801-4(d)(8)(ii). Reg. §28.2801-4(a)(2)(iii) is reserved to address charitable remainder and charitable lead trusts.

The manner in which the tax is computed is set forth in Reg. §28.2801-4(e). The value of the covered gift or bequest is the fair market value of the property on the date of its receipt, which is explained in Reg. §28.2801-4(d). A refund is allowed under Code Sec. 6511 if foreign gift or estate tax is paid after payment of the Code Sec. 2801 tax. In that scenario, the U.S recipient should file a claim for refund or a protective claim for refund on or before the application period of limitations has expired.

Foreign Trusts

Reg. §28.2801-5 sets forth rules applicable to foreign trusts, including the computation of the amount of a distribution from a foreign trust that is attributable to a covered gift or bequest made to the foreign trust. The election by a foreign trust to be treated as a domestic trust is explained in Reg. §28.2801-5(d)(3).

Other Rules

Reg. §28.2801-6 addresses special rules, including the determination of basis and the applicability of the generation-skipping transfer (GST) tax to certain Code Sec. 2801 transfers. Reg. §28.2801-6(d) discusses applicable penalties. Reg. §28.2801-7 provides guidance on the responsibility of a U.S. recipient to determine if tax under Code Sec. 2801 is due. Administrative regulations that address filing and payment due dates, returns, extension requests, and recordkeeping requirements with respect to the Code Sec. 2801 tax are also provided.

Due Date of Form 708

Form 708, United States Return of Tax for Gifts and Bequests from Covered Expatriates, is generally due on or before the 15th day of the 18th calendar month following the close of the calendar year in which the covered gift or bequest was received. The due date for Form 708 is further explained in Reg. 28.6071-1. Form 708 has yet to be issued by the IRS.

The regulations are generally effective on January 14, 2025.

Final Regulations Address Certain Disregarded Payments and Dual Consolidated Losses

T.D. 10026

The IRS has issued final regulations addressing certain disregarded payments that give rise to deductions for foreign tax purposes and avoid the application of the dual consolidated loss (DCL) rules (T.D. 10026). The IRS has also announced additional transition relief for the application of the DCL rules to certain foreign taxes under the GloBE Model Rules that are intended to ensure that multinational enterprises pay a minimum level of tax.

Background

Notice 2023-80, 2023-52 IRB 1583, describes, among other things, the interaction of the DCL rules with model rules published by the OECD/G20 Inclusive Framework on BEPS (the GloBE Model Rules) and requests comments on such interaction. The notice also announces limited transition relief from the application of the DCL rules to the GloBE Model Rules for legacy DCLs, which are generally DCLs incurred before the effective date of the GloBE Model Rules.

Proposed regulations (NPRM REG-105128-23) under Code Secs. 1502, 1503(d), and 7701 (the 2024 proposed regulations) would address certain issues arising under the DCL rules. In general, the 2024 proposed regulations would clarify how the DCL rules interact with the intercompany transaction rules in Reg. § 1.1502-13, modify how items arising from stock ownership are taken into account when computing the amount of a DCL, and address the application of the DCL rules to foreign taxes that are based on the GloBE Model Rules. The 2024 proposed regulations also include disregarded payment loss (DPL) rules, under which domestic corporations would be required to include amounts in income in certain cases involving disregarded payments. The 2024 proposed regulations further include an anti-avoidance rule applicable for both DCL and DPL purposes.

Final Regulations

T.D. 10026 finalizes the rules from the 2024 proposed regulations that relate to DPLs, including portions that are also relevant for DCLs, such as the anti-avoidance rule and the deemed ordering rule. The IRS intend to finalize, in future guidance, the remaining rules from the 2024 proposed regulations. The final regulations retain the basic approach and structure of the proposed rules, with certain revisions.

DPL rules overview. The DPL rules are a component of the check-the-box regulations and their purpose is to prevent certain arrangements involving disregarded entity classifications from avoiding the DCL rules. The DPL rules are intended to address this concern by (i) tracking whether certain payments involving a disregarded entity and its owner give rise to potential double deduction outcomes, and (ii) neutralizing any resulting double deduction outcome through an income inclusion similar to the one that the owner would have had with respect to the payments had the payments been regarded for U.S. tax purposes.

As revised under the final regulations, the DPL rules also treat the income inclusion as giving rise to a deduction, the use of which is suspended until the entity takes into account certain disregarded income, with the result that the rules are consistent with what would have occurred if certain disregarded payments were regarded for U.S. tax purposes.

Scope of DPL rules. Under the 2024 proposed regulations, the DPL or disregarded payment income (DPI) of a disregarded payment entity (DPE) would be determined by taking into account only items that both (i) give rise to deductions or income of the DPE under a foreign tax law, and (ii) are disregarded for U.S. tax purposes, but would be interest, structured payments, or royalties if the items were regarded. This limited application of the DPL rules would address transactions that are likely structured to avoid the DCL rules.

The final regulations provide a de minimis exception and do not apply the DPL rules to royalties paid pursuant to a license agreement executed before the date of the 2024 proposed regulations. These modifications are intended to further limit the application of the DPL rules to cases that are likely structured to produce double deduction outcomes.

In addition, the final regulations revise the DPE definition to exclude entities that are not related to a DPE owner. Also, where a DPE owner indirectly owns less than all the interests (but more than a minority interest) in a DPE, the final regulations remove the requirement that would apply the DPL rules on a proportionate basis based on value, because a DPE owner's proportionate interest can be determined under other reasonable methods.

Further, the final regulations clarify that a foreign branch owned by a domestic corporation through one or more partnerships may be a DPE, and that an entity that is treated as a partnership for U.S. tax purposes, but is a foreign tax resident, may be a DPE.

Foreign use issues. The final regulations narrow the definition of a foreign use for DPL purposes by excluding the deemed foreign use that may occur under the mirror legislation rule. This exception clarifies that any denial of a deduction for a disregarded payment under foreign hybrid mismatch rules is not treated as giving rise to a DPL or a foreign use of a DPL.

DPL cumulative register and deduction for DPL inclusion. The final regulations modify the determination of a DPL cumulative register so that a DPL does not decrease the register, thereby preventing a negative balance in the register. In addition, to reflect a DPL inclusion, the final regulations provide the DPE owner a deduction (not to exceed the DPL inclusion) to the extent that the DPE derives DPI in a year following the year of the DPL inclusion.

Finally, to prevent a single DPL from giving rise to more than one DPL inclusion, the final regulations terminate the certification period with respect to a DPL as a result of a DPL inclusion.

Computation of DPL or DPI for partial-year DPE status. The final regulations clarify that items incurred or derived in the portion of a foreign tax year that an entity or foreign branch is not a DPE are not taken into account for purposes of calculating DPI or DPL. On the other hand, if an entity or foreign branch is a DPE at all times during the foreign tax year, this proration rule does not apply even though the DPE owner's U.S. tax year may differ from the DPE's foreign tax year.

Reporting and documentation. The final regulations adopt the documentation and reporting requirements in the proposed regulations, with some modifications, such as to require additional reporting in Reg. § 1.1503(d)-1(d)(4)(iv) related to the suspended deduction. The IRS may request additional information regarding DPLs on audit, as necessary.

Anti-avoidance rule. The anti-avoidance rule that applies with respect to both DCLs and DPLs is modified to make clear that the purpose of Code Sec. 1503(d) and the regulations thereunder is to prevent double deduction and similar outcomes. The final regulations also provide additional examples that illustrate the application, and nonapplication, of the anti-avoidance rule.

In addition, the final regulations add certain exceptions to the application of the anti-avoidance rule, as it applies to DCLs, for transactions or interpretations that would be addressed by rules in the 2024 proposed regulations. These exceptions to the anti-avoidance rule would be removed or modified if, after taking into account comments, the corresponding rules in the 2024 proposed regulations are finalized in a subsequent guidance project.

Deemed ordering rule. The final regulations also make a change in response to comments requesting clarification regarding the condition that the deemed ordering rule applies only if the laws of the foreign country do not provide applicable rules for determining which income is offset by the losses or deductions. The final regulations eliminate this condition from the deemed ordering rule for purposes of both the DPL and DCL rules.

Applicability Dates

DPL rules. The final regulations defer the proposed application of the DPL rules. Accordingly, the final regulations apply the DPL rules to tax years of DPE owners beginning on or after January 1, 2026. The preamble states that the use of a single applicability date obviates the need for additional rules clarifying application of the DPL rules in cases like the ones where a domestic corporation owns multiple disregarded entities.

Other rules. The final regulations apply the anti-avoidance rule to DCLs incurred in tax years ending on or after August 6, 2024, consistent with the approach in the 2024 proposed regulations. Further, consistent with the applicability date of the DPL rules, the anti-avoidance rule applies to DPLs for tax years beginning on or after January 1, 2026.

In addition, the final regulations apply revisions to the deemed ordering rule in Reg. §1.1503(d)-3(c)(3) to DCLs incurred in tax years beginning on or after January 1, 2026, and to DPLs in tax years beginning on or after January 1, 2026 (each consistent with the applicability date of the DPL rules). Finally, the final regulations apply the rule regarding the non-application of the 60-month limitation for an entity that, absent an election to change its classification, would become a DPE as of August 6, 2024.

Additional Transition Relief with Respect to GloBE Model Rules

The 2024 proposed regulations would address the application of the DCL rules to the GloBE Model Rules, including extending and broadening the transition relief announced in Notice 2023-80. However, the IRS has determined that additional transition relief for the application of the DCL rules and DPL rules to the GloBE Model Rules is warranted as such relief would allow additional time to consider future OECD guidance and legislation enacted by foreign jurisdictions that would implement the GloBE Model Rules.

Accordingly, when the 2024 proposed regulations addressing the application of the DCL rules to the GloBE Model Rules are finalized, the applicability date set forth in the 2024 proposed regulations will be modified. The final regulations will provide that the DCL rules will apply without taking into account QDMTTs or Top-up Taxes collected under an IIR or UTPR incurred in tax years beginning before August 31, 2025. The additional transition relief does not affect the application of the DPL rules because the DPL rules do not apply until tax years beginning on or after January 1, 2026. Taxpayers may rely on the guidance described in this paragraph until final regulations are published. The transition relief is limited to an additional year to minimize the double deduction outcomes that may result.

Mandatory Automatic Enrollment Rules Proposed

Proposed Regulations, NPRM REG-100669-24; IR-2025-9

The IRS proposed regulations to implement the automatic enrollment requirements that were added by the SECURE 2.0 Act of 2022 (P.L. 117-328) and take effect in 2025. The IRS would also amend existing regulations that apply to safe harbor automatic contribution arrangements. The proposed regulations would reflect additional changes made by the SECURE 2.0 Act, including consolidated notice requirements and pension-linked emergency savings accounts. The proposed regulations would affect participants in and sponsors of retirement plans that include a cash or deferred election or salary reduction agreement, such as 401(k) plans and 403(b) plans.

With respect to mandatory automatic enrollment requirements under

Code Sec. 414A, the proposed regulations would make clear that there would be no exceptions for certain categories of employees. However, the proposed regulations would cover exceptions for certain types of plans and businesses, such as grandfathered plans, governmental and church plans, and new and small businesses. For purposes of falling under an exception for small businesses, the method of counting employees would be the same as the method under COBRA continuation coverage requirements. The proposed regulations would also address the effect of mergers on a plan's grandfathered status.

With respect to existing regulations on automatic enrollment regulations under Code Sec. 414(w), the IRS proposed to amend them to clarify that the statutory requirement that every employee be automatically enrolled overrides the existing rules. These regulations would also be amended to reflect changes to the notice requirements enacted by the SECURE 2.0 Act. Specifically, the amended regulations would allow the automatic contribution arrangement notice to be consolidated with other safe harbor notices and the pension-linked emergency savings account notice, or to be satisfied by a notice to an unenrolled participant under Code Sec. 414(bb).

The regulations are proposed to apply to plan years that begin more than 6 months after the date that final regulations are issued. Before that date, a plan is treated as having complied with Code Sec. 414A if it complies with a reasonable, good faith interpretation of the statute.

(REG-100669-24)

TAX BRIEFS

Business Deductions

An individual taxpayer was liable for a tax deficiency. The deficiency was attributable to disallowed itemized and business expense deductions claimed, which were not substantiated.

Chopra, TC Memo. 2025-2, Dec. 62,603(M)

Participation Exemption Dividends Received Deduction

The IRS Chief Counsel found that Code Sec. 269 applied with respect to the deemed incorporation of a corporation. The claimed exclusion of the corporation's income for the first 11 months of 2018 from a US Sub's GILTI calculation was denied. The transactions relevant to the ruling were undertaken to avoid rules limiting the participation exemption DRD where the DRD would eliminate GILTI or subpart F income.

Chief Counsel Advice Memorandum 202501008

Supreme Court Docket

A petition for certiorari was filed in the following case:

Shands v. IRS (CA-D.C.).—A whistleblower was denied a whistleblower award in connection with amounts collected in IRS Offshore Voluntary Disclosure Initiative (OVDI) proceedings. Because each OVDI case was triggered by a taxpayer's voluntary disclosure, no individual OVDI case was a civil or criminal proceeding against any person. OVDI had no resemblance to the IRS-driven actions listed as examples of administrative actions.