Welcome

36th Annual Managing Tax Audits and Appeals Seminar

October 7, 2022

Crowell

IRS Independent Office of Appeals

Andy Keyso, Chief, Appeals

Amy Giuliano, Attorney-Advisor

David Fischer
Eleanor McWaters
Crowell & Moring LLP

Agenda

- Introduction
- Proposed IRS Appeals Treasury Regulation and Interim Guidance
- Return to Office Post-pandemic
  - Conferences: In-person and video
  - Paperless/electronic initiatives
- Reduction in Backlog of Docketed Cases
- Hiring and Appeals Statistics
- Exam Participation in ATCL Cases
- Managerial Oversight

IRS Independent Office of Appeals

- Mission: resolve disputes, without litigation, in a manner that is fair and impartial to the government and to the taxpayer, promotes a consistent application and interpretation of, and voluntary compliance with, the Federal tax laws, and enhances public confidence in the integrity and efficiency of the Internal Revenue Service.
- Independence: IRS Appeals is separate and independent of the IRS office that conducted the examination
- No new issues, no new facts
- Considers “hazards of litigation”

Proposed Treasury Regulation

- Released in September, public hearing scheduled for November 29, 2022
- Reflects changes made by the Taxpayer First Act of 2019 (TFA)
- New Section 7803(e)(1) established the IRS Independent Office of Appeals "to codify the role of the independent administrative appeals function within the IRS."
- New Section 7803(e)(4) codified that the right to Appeals "shall be generally available to all taxpayers."

Proposed Treasury Regulation

- Twenty-four exceptions to the general availability of appeals to taxpayers:
  - Include frivolous positions, whistleblower awards, administrative decisions made by other agencies, denials of access under the Privacy Act, pending taxpayer criminal prosecution, challenges to the validity of Treasury regulations
  - The exceptions "generally predate the enactment of the TFA"
- Notable provisions:
  - Appeals and the Office of Chief Counsel may determine how settlement authority in tax controversies before the Tax Court will be handled between the two offices
  - Chief Counsel would be able to return specific cases to Appeals for issue reconsideration once the case is on the Tax Court docket

Interim Guidance to Appeals Officers Regarding Arguments that Regulations are Invalid

- IRS Appeals has released interim guidance instructing Appeals Officers not to consider hazards relating to challenges to the validity of Treasury Regulations or other guidance (Sept. 26, 2022)
- Can consider hazards following a final decision by a court that a regulation or other guidance is invalid
- Treasury and Appeals are considering this issue and expect to issue Regulations; interim guidance expires Sept. 14, 2024

Return to Office Post-pandemic

- Appeals Conferences
  - IRS Appeals employees returned to the office this summer
  - Return to in-person Appeals conferences
  - Taxpayers have a choice of form of conference: in-person, telephone, videoconference
- Electronic Submissions and Taxpayer Digital Communication
  - Secure email
  - Paperless case files
  - Online portal through which to communicate with Appeals
- Document Digitization

Video Conferencing

- During the COVID-19 pandemic, Appeals expanded access to video conferences
  - The March 2021 interim guidance required IRS employees to conduct video conferences when requested by taxpayers
- IRS Appeals requests input as IRS prepares to update the Internal Revenue Manual with permanent guidelines
- Public comments can be sent to AP.Taxpayer.Experience@irs.gov by November 16, 2022
- See IR-2022-154

Document Digitization

- IRS released interim guidance providing steps and procedures for IRS Appeals to determine what records should be digitized
- National Archives and Records Administration memorandum directed that Federal agencies create, retain, and manage all temporary and permanent records in electronic format by December 31, 2022

Reduction in Backlog of Docketed Cases

- Appeals adopted a plan to reduce the significant inventory of certain docketed Tax Court cases (AUR/Corr Exam) that have been referred to Appeals for settlement (April 22, 2022)
  - Deploy additional resources to work docketed examination cases
  - Prioritize docketed casework
  - Streamline initial contact of affected taxpayers
  - Apply streamlined case processing approaches
  - Recognize that:

    "some of these cases may not necessarily reflect a dispute between the taxpayer and the IRS but rather result from communication challenges during the pandemic, and applying our professional judgment to settle these efficiently" and that

    "some of these cases do not raise legal issues that warrant a Tax Court trial and applying our professional judgment and accepting oral testimony where appropriate to settle these efficiently."

Appeals Case Inventory and Staffing

	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022
Total Staffing*	1,207	1,230	1,286	1,404	1,471
Total Receipts	92,430	85,286	57,573	72,216	68,604
Total Closures	94,832	73,207	62,997	66,522	65,944
Cycle Time**	194	229	289	372	369

* Total On-Rolls at Month or Year End PP19. FY22 is PP17 ending August 27, 2022

** Closed (non-docketed) Cycle Time (days)

FY 2022 Receipts, Closures, and Cycle Time data is August month end.

Pilot Program – ATCL Conferencing Initiative Report (Sept. 2021)

- Results from survey of taxpayer satisfaction re IRS Appeals pilot program in May 2020 to test Exam's attendance at Appeals Conferences
- ATCLs who participated were positive:
  - Hearing from both sides in real time helped their understanding of cases, narrowed disputes
  - Particularly useful in complex cases, or where expert reports involved
- Taxpayer concerns:
  - Initial conferences devolved into prolonged disputes over immaterial nits
  - Settlement discussions should only be between Appeals and the taxpayer
  - Line between initial meeting to narrow scope of disagreement and settlement negotiations was not clearly defined
  - Danger of Appeals becoming more like a mediation
  - Appeals raising and asking for Exam's input on new theories

Conferencing Initiative – Moving Forward

- ATCLs have sole discretion to decide if Exam is to remain in the room for the non-settlement discussion portion of the conference; settlement discussions held between the taxpayer and Appeals only
- ATCLs to consider:
  - Will interactive session enhance ATCL's understanding of case?
  - Case is factually complex or involves disputed facts?
  - Expert reports?
  - Issue of first impression, little or conflicting precedent?
- ATCL to solicit views of taxpayer and Exam
- Guidelines and best practices identified in Pilot Program to continue
- Effect on Exam when multiple cycles are at issue

Managerial Oversight

- Process under which management is briefed on large cases
- Cases included determined by dollar amount
- Allows “line of sight” into case progression
- Different than proposal in 2016 to shift settlement authority from ATCLs to their managers
- Updates on program

Questions?

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Navigating Privilege in the Audit Context

Protecting the Privileges, Managing Waiver Issues, and Recent Developments

S. Starling Marshall

Reid Tomasello

October 7, 2022

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Overview of the Attorney-Client and Federally Authorized Tax Practitioner Privileges

The Attorney-Client Privilege

Three Key Questions:

- Is it a direct communication to or from an attorney, or does it summarize or restate such a communication?
- Does the communication involve the seeking or rendering of legal advice, rather than business or other non-legal advice?
- Has the confidentiality of the communication been strictly preserved?

The Attorney-Client Privilege (cont'd)

Waiver

- Attorney-client privilege can be easily waived
- Privilege can be waived even if you do not intend to waive
- Common ways privilege may be waived:
  - Disclosure to a third party or
  - Placing the communication at issue (may potentially constitute subject matter waiver)

The Attorney-Client Privilege (cont'd)

Possible Exceptions to the "Strictly Preserved" Requirement

- In limited circumstances, a disclosure to a third party may not waive the attorney-client privilege:
  - Joint defense privilege
  - Common interest doctrine
  - *Kovel* doctrine
    - ***Practice Tip** – Document explicitly why the third party is being engaged and what the scope of the engagement is

Question – True or False?

All communications between a corporation's in-house counsel and its employees are privileged

The Attorney-Client Privilege (cont'd)

Application to Communications with In-House Counsel

- *Upjohn* doctrine – The privilege applies to communications by any company employee when:
  - (1) the communication concerns matters within the scope of the employee's duties and
  - (2) the employee is aware that the information is being furnished to enable the attorney to provide legal advice to the company
- Just because the person is an attorney does not mean the communication is privileged
- Communications that are deemed business advice or tax preparation work are not privileged

The Attorney-Client Privilege (cont'd)

***Upjohn* Warning Should Make Clear:**

- The attorney is collecting facts to provide legal advice to the company;
- The attorney represents the company and not the employee individually;
- The communication is protected by attorney-client privilege, which is controlled exclusively by the company;
- The company can waive the privilege to a third-party, including the government; and
- The employee must keep the communication confidential

***Practice Tip –** Document that the warning has been given

The Attorney-Client Privilege (cont'd)

Recent Developments re *Upjohn*

- *Mardiros v. City of Hope*, 2021 WL 3126987 (C.D. Cal. June 3, 2021)
  - Declined to extend *Upjohn* to the question of whether the attorney-client privilege applies to communications with former employees
- *Hinkel v. Colling*, 2021 WL 1341357 (D. Wyo. Mar. 31, 2022)
  - Held that *Upjohn* is not applicable to the question of discoverability of materials held by two former testifying experts
- *Att'y Gen. v. Facebook, Inc.*, 164 N.E.3d 873 (Mass. 2021)
  - Distinguished questionnaires and interview notes in *Upjohn* from requests for information regarding certain apps (fact work product)

The Attorney-Client Privilege (cont'd)

Tax Return Preparation Work Is Not Privileged

- Courts look closely at any communications regarding advice related to the preparation of tax returns
- This can include communications regarding what needs to be reported on tax returns
- The line between what is and is not privileged can be very gray and judges do not always agree where to draw the line

Federally Authorized Tax Practitioner Privilege

I.R.C. Section 7525

- Applies to "tax advice" by a federally authorized tax practitioner
- Operates much like the attorney-client privilege – same strict confidentiality and waiver principles apply
- But comes with additional restrictions:
  - Applies only in civil tax matters with the IRS or the DOJ
  - Does not apply to promotions of tax shelters

The Attorney-Client Privilege (cont'd)

Other Advisory Relationships

- Many courts have applied the attorney-client privilege to documents prepared by an accountant after he is retained by an attorney to assist in providing legal advice
- *Walsh v. CSG Partners, LLC*, 544 F. Supp. 3d 389 (S.D.N.Y. 2021)
    - Finding no privilege existed where financial advisor provided information the company did not have as opposed to improving comprehension between the company and its counsel

The Attorney-Client Privilege (cont'd)

Dual-Purpose Communications

- *In re Grand Jury*, 23 F.4th 1088 (9th Cir. 2022)
  - "primary purpose" test
  - "because of" test
  - Joins many other circuits in adopting the "primary purpose" test
  - ***Practice Tip** – Highlight the legal advice that is provided in the communication and the weight of its importance

Overview of the Work Product Doctrine

Question – True or False?

The Work Product Doctrine only protects communications made in anticipation of litigation

Work-Product Doctrine

Protects Materials Prepared in Anticipation of Litigation

- Work-product doctrine protects:
  - Documents and tangible things,
  - Prepared in anticipation of litigation,
  - By a party or that party's representative
- Also protects against disclosure of attorney mental impressions
- Different waiver rules apply than with attorney-client privilege

Work-Product Doctrine (cont'd)

Waiver of Work-Product Protection

- Work product can be shared with third parties if the disclosure is not inconsistent with the adversarial process
- However, if the work product is disclosed to an adversary or a possible conduit to an adversary, the protection is likely waived
- Waiver issues often arise in the context of disclosures of work product to a company's independent auditor

Work-Product Doctrine (cont'd)

Common Work-Product Doctrine Issues

- When are tax accrual workpapers protected?
- When is a tax opinion provided in anticipation of litigation?
- Application of the doctrine is complicated when materials are created for both business and litigation related reasons
- Claiming work product protection may trigger need to issue a litigation hold

Disclosure and Waiver Issues

Question – True or False?

If the client discloses a privileged communication, the privilege with respect to undisclosed related communications is waived

Disclosure and Waiver Issues

Intentional Disclosure

- In limited circumstances, intentional disclosure may not operate as subject matter waiver
  - E.g., if company is compelled to disclose in a jurisdiction outside of the United States
- Under Federal Rule of Evidence 502(a), a waiver only extends to other communications if:
  - The waiver is intentional;
  - The communications involve the same subject matter; and
  - They ought in fairness to be considered together

Disclosure and Waiver Issues (cont'd)

Unintentional Disclosure

- An inadvertent disclosure may not result in waiver
- Under Federal Rule of Evidence 502(b), a disclosure does not operate as a waiver if:
  - The disclosure was inadvertent;
  - Reasonable steps were taken to prevent the disclosure; and
  - Reasonable steps were taken to rectify the disclosure promptly

Disclosure and Waiver Issues (cont'd)

Disclosure to an Auditor

- Constitutes waiver only as to communications about the matter actually disclosed
- *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156 (9th Cir. 1992)
  - Pennzoil acquired Chevron stock and argued the objective was tax deferral, not to obtain control
  - As part of acquisition planning, Pennzoil had disclosed two tax memoranda to an auditor
  - Chevron sought to compel disclosure of all documents touching on the tax deferral question
  - Court found that disclosure to the auditor did not constitute wavier as to all communications concerning the hope for tax deferral

Disclosure and Waiver Issues (cont'd)

Implied Waiver

- Placing a privileged communication at issue can result in an implied waiver, possibly even subject matter waiver
- An implied waiver can sometimes result simply from taking a certain position that indirectly implicates the privileged advice, even if the advice is not disclosed or referenced
- Implied waiver can be a significant concern in penalty cases in which the taxpayer's good faith belief is at issue

Practical Takeaways

Practical Takeaways

- If a privilege position is likely to be disputed, have counsel perform the legal analysis and provide a litigation assessment
- Keep privileged emails on one topic, and do not use large distribution lists
- Properly mark and segregate all privileged documents or work product
  - Work product may only be created once you anticipate litigation, in which case you must have a litigation hold in place
- If a privilege claim is contested, have an attorney confirm the claim and prepare a privilege log

Practical Takeaways (cont'd)

- If disclosing, take reasonable steps to make clear that there is no intent to waive privilege
- Document *Upjohn* warnings
- Take clear notes of who is present during meetings and conference calls
- To make asserting the *Kovel* doctrine easier, document explicitly why the third party is being engaged and what the scope of the engagement is
- With respect to dual purpose documents, highlight the legal advice that is provided in the communication and the weight of its importance

Questions?

S. Starling Marshall
+1.212.895.4263
smarshall@crowell.com

Reid Tomasello
+1.202.624.2518
rtomasello@crowell.com

crowell.com

A New Wave of Partnership Audits – What to Know Now and How to Prepare

The BBA, LB&I Active Campaigns, Schedules K-2/K-3, Recommendations, and Recent Developments

Charles C. Hwang

Reid Tomasello

October 7, 2022

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Overview of the Bipartisan Budget Act

The Bipartisan Budget Act ("BBA")

In General

- Provides rules for a new centralized partnership audit regime
  - Streamlines the procedure for auditing partnerships and partners by eliminating the partnership categories that existed under TEFRA
  - Audits are at the partnership level
  - Partnership Representative has been substituted for Tax Matters Partner
- Effective for partnership taxable years beginning on or after January 1, 2018
- Adjustments are determined at the partnership level
- Partnership related items
- Section 6226 "push out" election
- "Pull in" procedure

The Bipartisan Budget Act ("BBA") (cont'd)

Imputed Underpayments

- Tax due at the partnership level is called an imputed underpayment ("IU")
- Seven step process to compute the IU
- Negative Adjustments
- Positive Adjustments
- The discretionary "zero-adjustment rule" of Treas. Reg. § 301.6225-1(b)(4)

The Bipartisan Budget Act ("BBA") (cont'd)

Recent Guidance and Commentary Regarding IUs

- CCA 202148006
  - Provides that adjustments to non-income items are "always a positive adjustment"
    - Controversial → this principle may not survive court review and we do not agree with the conclusion
- Commentary
  - Understating and overstating basis could give rise to an IU
    - Effect on Chapter 1 tax liability
  - Premature recognition of gain
  - Prop. Treas. Reg. § 301.6225-1(b)(4) says that adjustments to non-income items will generally not be taken into account
    - *But see* example 3; Notice 2021-13 (changes to partner's tax capital can give rise to IU)
  - Reallocation of distributive share can only be a positive adjustment. Section 6225(b)(2).
- Bottom line → misreporting is not just a compliance issue anymore, it is a major dollar issue

The Bipartisan Budget Act ("BBA") (cont'd)

Electing Out under Section 6221(b)

- Partnerships with 100 or fewer eligible partners may elect out
- Partnerships are not eligible
- Disregarded entities are not eligible
- Recurring (annual) election
- Form 1065, schedule B

LB&I Active Campaigns Directed at Partnerships

LB&I Active Campaigns Directed at Partnerships

Distribution in Excess of Partner's Basis Campaign

- Adequate basis is necessary to prevent section 731(a) gain
- Deemed distributions of money under section 752(b)

Partnership Losses in Excess of Partner's Basis Campaign

- Adequate basis is necessary to deduct losses
- Section 704(d) suspends unallowable deductions

Effect of Tax Capital Reporting

- Tax Basis Method required
- Proxy for outside basis

LB&I Active Campaigns Directed at Partnerships (cont'd)

Sale of a Partnership Interest Campaign

- Gain from sale of a partnership interest is generally treated as long-term capital gain under section 741
- Real property depreciation – 25%. Section 1250.
- Collectibles – 28%. Section 1(h)(4).
  - Non-fungible tokens ("NFTs")
- Unrealized receivables and inventory. Section 751(a).

Schedules K-2/K-3 Reporting

Schedules K-2/K-3 Reporting

In General

- New reporting requirement for tax year 2021
- Must report items of "international tax relevance"
  - Schedule K-2 → extension of Schedule K-1 of Form 1065
  - Schedule K-3 → partner's share of international income, deductions, credits, etc.
- Transition penalty relief provided under Notice 2021-39 for tax years that begin in 2021

Schedules K-2/K-3 Reporting (cont'd)

Who Must File?

- No need to file if partnership does not have "items of international tax relevance"
  - Misleading
  - For example, partnership with only domestic activity may be required to file because one of its partners may need certain information for use in their foreign tax credit determination
- Any partnership that files Form 1065 and has items relevant to determining U.S. tax, withholding tax, or reporting obligations of its partners under the international provisions of the Code.
- Problem → information gathering in tiered structures

Exceptions:

- If partnership knows it has no direct or indirect partners eligible to claim a foreign tax credit (instructions)
- Additional exception provided by FAQs:
  - All direct partners are not foreign partnerships, corporations, individuals, estates or trusts;
  - No foreign activity; and
  - In tax year 2020, partnership did not provide to its partners information re: foreign transactions (line 16c) or section 721(c) partnerships (line 20c)

Preparing for an Audit

Preparing for an Audit

LB&I "Large Partnership Compliance Program"

- Partnerships with more than $10 million in assets
- Large number of examiners have been hired
- Partnerships are starting to see audits of their 2018 and later returns
- *Burris Cypress Lake Ranch, LLC v Commissioner*
  - Ongoing case currently in Tax Court
  - First BBA case in the courts
  - Partnership Elected into BBA early SK1
  - Contested notices of final adjustment that asserted IU
  - Petition argues that the IRS erred in concluding that the partnership wasn't engaged in rental real estate trade or business
  - May provide procedural insights

SK1 What is PRS?

Swift, Kelly, 10/3/2022

Preparing for an Audit (cont'd)

Check the Audit Notice for Years at Issue

- 2018 and later → BBA
- 2017 and before → TEFRA

Check the Partnership Tax Return

- Election out?
  - Verify that election out was proper
- If so → each partner audited separately
- If not → identify Partnership Representative

Preparing for an Audit (cont'd)

Check the Partnership Agreement

- Who is the Partnership Representative?
  - Partnership can only revoke appointment of Partnership Representative during an administrative proceeding or by going through the AAR process
- What duties does the Partnership Representative have?
- If the agreement doesn't reflect BBA → review the procedures for handling communications with counsel

Prepare for Exam's Likely Areas of Inquiry

- Review the partnership's books and records, tax returns, and workpapers
- Gather relevant documents and other evidence
- Sit down with the IRS Exam Team and ask for areas of potential compliance risk

Questions?

Charles C. Hwang
+1.202.624.2626
chwang@crowell.com

Reid Tomasello
+1.202.624.2518
rtomasello@crowell.com

Looking Over the Horizon

Areas of Interest in Federal and State Tax Audits

Eric Homsi

Irina Pisareva

October 7, 2022

Crowell

Agenda

- Recently Announced IRS Audit Campaigns
- Large Taxpayers and Digital Assets
- The Expansion of Tax Credit Universe
- State Audit Issues

Recently Announced IRS Audit Campaigns

Currently Active Audit Campaigns

- The Inflation Reduction Act, new funding for the IRS and focus on high net worth individuals:
  - Reporting of virtual currency transactions

- LB&I Active Campaigns | Internal Revenue Service (irs.gov)
  – Only one new audit campaign announced since our last tax seminar

- Audits of tax exempt organizations

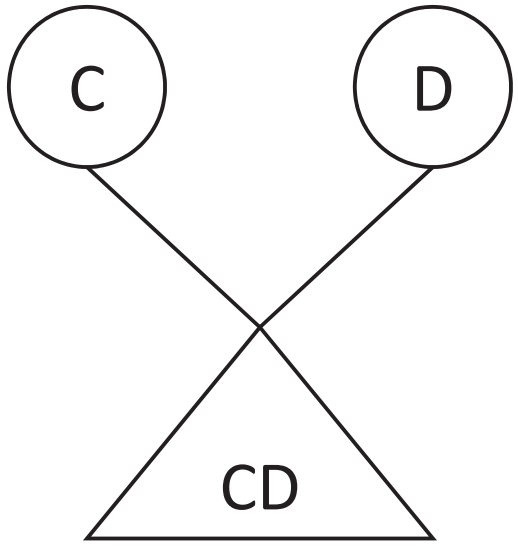
Partnership Losses in Excess of Partner's Basis

- Basis determined as of the end of the partnership year, before reduction by current year's losses
  - Disallowed losses from prior years are aggregated with current year losses before applying the basis limitation to current year losses
- If aggregate items of loss exceed basis, the limitation on losses is proportionately allocated to each item of loss
- Disallowed losses are carried forward to the next taxable year in which the partner has available basis
  - Disallowed losses retain their character in later years

Partnership Losses in Excess of Partner's Basis

- TCJA changes the rules under Section 704(d) for charitable contributions and foreign taxes
  - Charitable contributions and foreign taxes are now subject to the Section 704(d) basis limitation
  - Special rule under Section 704(d)(3)(A) for charitable contribution of appreciated property
    - Deductibility of contribution for built-in gain is not limited by Section 704(d)
    - Partner's basis in partnership interest is decreased (but not below zero) by the partner's share of the partnership's basis in the property contributed (Rev. Rul. 96-11, 1996-1 C.B. 140)
  - Effective for taxable years beginning after December 31, 2017

Partnership Losses in Excess of Partner's Basis - Example



Based on Treas. Reg. § 1.407-1(d)(4), Ex. 3.

- C has the following distributive share:
  - Long-term capital loss - $4,000
  - Short-term capital loss - $2,000
  - Taxable income - $4,000
- C's adjusted basis (before adjustment for any of the above items) is $1,000
- C's basis (without regard to losses) is increased from $1,000 to $5,000 under Section 705(a)(1)(A)
- C's total distributive share of losses is $6,000
- Since C has basis (without regard to losses) of only $5,000, C is allowed:
  - Long-term capital loss - $3,333 ($4,000 * $5,000/$6,000)
  - Short-term capital loss - $1,667 ($2,000 * $5,000/$6,000)
- C must carry forward to succeeding taxable years:
  - Long-term capital loss - $667
  - Short-term capital loss - $333

Partnership Losses in Excess of Partner's Basis

- Partner must prove sufficient basis to support a loss deduction
  - *E.g., Tandon v. Comm'r*, T.C.M. 1998-66 , *aff'd* 210 F.3d 372 (6th Cir. 2000) (taxpayer denied partnership loss deduction for failing to establish adjusted basis in partnership interest). *Hastings v. Comm'r*, T.C.M. 2016-61 (same)
- Partner must track characterization of losses carried forward
- Partner may not deduct disallowed losses after disposing of partnership interest
  - *Sennett v. Comm'r*, 80 T.C. 825 (1983), *aff'd* 752 F.2d 428 (9th Cir. 1985) (taxpayer denied deduction for partnership losses previously disallowed under Section 704(d) where taxpayer paid to partnership taxpayer's share of general partner liabilities after disposing of partnership interest)

Large Taxpayers and Digital Assets

Large Taxpayers and Digital Assets

- All companies will have Metaverse presence sooner than you think
  - Mass adoption of digital technology will make digital assets and digital transactions commonplace for taxpayers of all sizes
  - Blockchains will be used for B-to-B services such as contract R&D and manufacturing
  - Banking and investment sector offers and will continue to offer investments in novel and not-so-novel digital assets such as cryptocurrencies, including stablecoins, crypto derivatives, tokenized versions of stocks (equity) and bonds, trading in tokenized versions of physical world assets (real estate, property, plant, and equipment, etc.)
  - Media, entertainment and art industries will continue to grow their digital offerings
  - Advertising will continue to expand into digital space

Large Taxpayers and Digital Assets – Cont'd

- "If you grow, they will audit":
  - Tax departments and tax counsels should review current portfolio of digital assets and technologies used by business
  - Tax professionals should be included in working groups developing digital strategies and markets:
  - Track federal, state and international developments concerning taxation of digital assets, sales and purchases
    - Engage with tax authorities and industry associations to provide input on current and future laws and administrative guidance
- Be consistent in your approach to "grey" areas:
  - sourcing, apportionment, transfer pricing and tax treaty application

The Expansion of Tax Credit Universe

The Expansion of Tax Credit Universe

- President Biden signed the Inflation Reduction Act of 2022 ("IRA") into law on August 16, 2022
- Creates or expands various tax credits for clean energy or energy efficiency, including:
  - Section 45 – Production tax credit
  - Section 48 – Energy investment tax credit
  - Section 45Q – Credit for carbon oxide sequestration
  - Section 45U – Zero-emission nuclear power production credit
  - Section 45V – Credit for production of clean hydrogen
- Provides enhanced credits for certain projects that meet labor or domestic content requirements

The Expansion of Tax Credit Universe

- The IRA provides for many credits to have two different values:
  - base rate
  - bonus rate equal to five times the base rate
- Bonus rate applies to projects that meet wage and apprenticeship requirements
  - Taxpayers generally must satisfy both the wage and apprenticeship requirements to qualify for the bonus rate
  - If taxpayer fails to meet both requirements, taxpayer may claim the relevant credit at the base rate

The Expansion of Tax Credit Universe

- Wage requirements ensure that laborers and mechanics are paid prevailing wages during the construction of a qualifying project, and, in some cases, for the alteration and repair of the project for a certain period of time after it is placed in service
  - Prevailing wages are the most recently published prevailing wages for the locality in which the project is located
- Apprenticeship requirements ensure that qualified apprentices perform no less than a certain percentage of the total labor hours for a project

The Expansion of Tax Credit Universe

- Wage and apprenticeship requirements generally apply to projects that begin construction 60 days after the Secretary has published relevant guidance with respect to the requirements
- Certain credits also provide an enhanced credit rate if certain domestic content requirements are satisfied
  - E.g., the Section 45 production tax credit and the Section 48 investment tax credit
- The domestic content requirements ensure that any steel, iron or manufactured product that is part of a project at the time of completion was produced in the United States

The Expansion of Tax Credit Universe

- Considerations going forward:
  - Track effective and expiration dates of the IRA amendments to ensure eligibility to claim credits
  - Track the issuance of IRS guidance for when the wage and apprenticeship requirements will apply to benefit from safe harbor
  - Implement procedures to track compliance with wage and apprenticeship requirements
  - Implement procedures to track compliance with domestic content requirements

The Expansion of Tax Credit Universe

- President Biden signed the CHIPS Act of 2022 (“CHIPS Act”) into law on August 9, 2022
- Seeks to bolster the U.S. semiconductor supply chain and promote research and development of advanced technologies in the U.S.
  - Facilitates federal investments in the form of grants, loans, and loan guarantees to eligible entities and creates significant business opportunities for companies in the U.S.
  - Provides funding and new programs to boost advanced workforce training and research and development in a range of scientific and technology areas

The Expansion of Tax Credit Universe

- Creates the Advanced Manufacturing Investment Credit
  - A new 25-percent refundable tax credit for qualified investments in new and expanded domestic manufacturing of semiconductors, including costs of manufacturing specialized tooling equipment
  - Credits could be worth more than $20 billion in the aggregate for the semiconductor industry; however, the expected value could be significantly reduced by the minimum corporate tax on book earnings
  - Credits will be provided for property placed into service after December 31, 2022, and for which construction begins before January 1, 2027

State Audit Issues

Continuous Trouble with State Nexus

- *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018) changed the nexus paradigm for sales tax stating that physical nexus is not required
  - Every state with sales tax adopted a Wayfair-style rule – it only took 3 years
- Sales tax nexus spills over into the income tax nexus:
  - 8/2021 revisions to Multistate Commission's Statement of Information (SOI) concerning the Interstate Income Act of 1959 – added a new subsection C addressing activities via the internet
  - California: FTB TAM 2022-1 adopts SOI's Subsection C and added nexus via telecommuting example
  - New York: Draft corporate tax regulations incorporate SOI's Subsection C
  - More states to follow… Fast forward to 2024?

State Taxation of Digital Assets

- Uniformity projects undertaken by MTC and SST Governing Board
- Issues include:
  - Variations in definitions and ties to “tangible personal property” and “software”
  - Exemption for B-to-B services before the digital products reaches end customer
  - What transaction level records would be required
  - Sourcing and apportionment methodology
  - Penalty relief for inadvertent failures associated with transition
  - Conformity with federal rules
    - Impact of OECD Pillar 1, taxation of digital assets

Remote Workers

- Remote work raises potential state tax issues for the employer as well as the employee
- Similar issues may arise in the international context
- Failure to address the tax consequences of remote work can become a diligence issue in a subsequent sale of the company and negatively affect valuation
  - No one size approach, and companies will have to weigh the benefits and risks
- Employer issues
  - Does employee's remote work create nexus in the jurisdiction where the services are performed?
    - May expose company to additional income, franchise, gross receipts, etc. tax filing requirements

Remote Workers

- Employer issues (cont'd)
  - Does remote worker's payroll affect company apportionment factors?
  - Are there any sales tax consequences?
    - If employee is providing services, is the sales tax treatment of those services affected by where the services are provided?
  - Are payroll taxes being withheld and remitted to the appropriate jurisdiction?
- Employee issues
  - Does remote work create a taxable presence in the state where the services are performed?
  - Are income taxes being properly withheld from wages to avoid underpayment penalties and interest

Remote Workers

- Employee issues (cont'd)
  - If services are performed in multiple states, are the wages sourced to the location where the services are performed?
    - As a general rule, many (but not all) states source employee wages to the state where the services are performed
    - Rules can be very complex, and exceptions abound
      - Consider New York's "*convenience rule*," which is an exception to the general rule, where wages are source to New York if (a) the employee is assigned to an office in New York, (b) services are performed outside New York State at a location which is not an office of the employer, and (c) the services are performed at that location because of "convenience" rather than "necessity"
      - Consider further New York's "*home office rule*," which is an exception to the exception, where the "convenience rule" will not apply if the out-of-state services are performed at a "bona fide" home office
        - Whether a home office is bona fide is based on a facts and circumstances analysis
  - If employee is subject to tax in multiple states, is a credit available for taxes paid to other states?

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