







2024
National Income Tax
Workbook

Chapter 5: Business Entity
Tax Issues







1

Chapter Issues
P 145

-  Pass-Through Entity Tax
-  Beneficial Ownership Interest Reporting
-  I.R.C. §501(c)(3) Charitable Organizations, Maintaining Tax-Exempt Status
-  Change in Tax-Exempt Status
-  Electing Out of the Centralized Partnership Audit Regime

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Learning Objectives
P 145

-  Understand the federal tax treatment of pass-through entity payments of state and local tax
-  Know when a refund of pass-through entity credits may be included in income under the tax benefit rule
-  Understand the FinCEN beneficial ownership interest reporting requirements
-  Recognize the actions that can jeopardize the tax-exempt status of an I.R.C. 501(c)(3) organization

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Learning Objectives

P 145

Explain how an I.R.C. §501(c)(3) organization can change its tax-exempt status to a different §501(c) organization

Understand what partnerships are eligible to elect out of the centralized partnership audit regime

Know the advantages and disadvantages of electing out of the centralized partnership audit regime

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Introduction

P 146

- State laws allow pass-through entities to pay state & local taxes at the entity level
 - Deduction is taken at the federal-level with corresponding or offset at the owner-level
 - Discussion of I.R.C. §111, tax benefit rule
- Corporate Transparency Act (CTA)[87 F.R. 59498] – prevent & combat money laundering, terrorist financing, corruption, tax fraud and other illicit activity
 - Discussion of filing requirements
 - Beneficial Owner
 - Non-compliance
- Issues of Tax-Exempt organization compliance and loss of status is increasingly more common
- New revenue procedures that allows an exempt organization to change its designation is provided.
- Electing out of the centralized partnership regime is reviewed.

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Issue 1

Pass-Through entity tax

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Tax Cuts & Jobs Act
P 147

Limited limit on state & local taxes on Schedule A, itemized deduction

\$ 10,000 for all filing statuses exempt MJS (\$ 5,000)

State & local taxes (SALT) include:

- Personal property tax
- Income tax
- War profits and excess profits
- General sales tax

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Tax Cuts & Jobs Act of 2017 P 147

- I.R.C. §164(b)(6) – taxes imposed at the entity level, that are reflected on Schedule K-1 (or similar) will reduce the recipients distributive or pro rata share of income
- 36 states have passed a SALT “work around”

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Mechanics of State Pass-Through Entity Tax (PTET)
P 147

- Partnership or S Corp pays the tax & deducts it
- The entity passes it through to its partners or shareholders on their Schedule K-1
 - Reducing adjusted gross income (AGI)
- Partners or owners received a credit/offset against their state tax liability

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Mechanics of State Pass- Through Entity Tax (PTE) P 147	<ul style="list-style-type: none"> • Notice 2020-75, 2020-49, I.R.B. 1453 – intent to issue proposed regs <ul style="list-style-type: none"> • Separately state taxable income/loss are not subject to SALT limitations • Specified income tax payments (SITP) – as any amount paid by a partnership or an S corporation to a state, a political subdivision of a state, or the District of Columbia <ul style="list-style-type: none"> • satisfies its income tax liability imposed by the domestic jurisdiction on the partnership or the S corporation.
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Notice 2020-75 P 147 & 148	<ul style="list-style-type: none"> • PTE makes an SITP during a tax year, • PTE can deduct the SITP when computing its taxable income for the tax year in which the payment is made. • Partners and S corporation shareholders receive a federal deduction for these entity-level payments, • Benefit that is similar to what was provided to PTE owners before the SALT limitation was enacted.
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Notice 2020-75 P 147 & 148	<ul style="list-style-type: none"> • I.R.C. § 164(b)(2) -- a tax imposed by a state, a possession of the United States, or a political sub- division of any of the foregoing, or by the District of Columbia • Deduction by a partnership is not disallowed under I.R.C. § 703(a)(2) (B), • I.R.C. § 1363(b)(2) -- Income taxes for which a deduction by an S corporation is not disallowed (deductions for taxes paid to foreign countries or possessions).
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<p>Notice 2020-75 P 147 & 148</p>	<p>Does not differentiate between the character of the income (i.e., capital or ordinary)</p> <p>Does not specify that the payment must be for trade or business activities versus for investment activities.</p>
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<p>Notice 2020-75 P 147 & 148</p>	<p>Not-separately stated item</p> <p>I.R.C. § 702 or 1366 -- determining the PTE owner's own federal income tax liability for the tax year.</p> <p>Schedule K-1 reporting of a partners, or an S corporation shareholder's distributive or pro rata share of non-separately stated income or loss</p>
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<p>Notice 2020-75 P 147 & 148</p>	<p>Example 5.1 – Deduction of PTET Payment</p> <p>Any SITP made by a PTE is not taken into account in applying the SALT deduction limitation</p> <p>Example 5.2 – PTET Payment Does Not Reduce Itemized Deductions</p>
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Polling Question #1

1. A pass-through entity is which of the following?

- a. Sole Proprietorship
- b. The IRS
- c. S Corporation**
- d. Non-profit organization

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Practitioner
Note
P 148

- Notice 2020-75 was issued in November 2020, but the proposed regulations have not yet been published.
- AICPA requesting Additional Guidance
- Forthcoming Regulations Regarding the Deductibility of Payments by Partnerships and S Corporations for Certain State and Local Income Taxes
- §163 and S469 Regarding Nonpassive vs. Passive Income and Interest Expense Tracing (March 6, 2023).

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Tax Benefit Rule

I.R.C. §111 – refundable PTE tax credits may be includable in income tax	Include recovered losses, credits, or deductions only if the amounts claimed in a prior year provided a tax benefit.	Tax year originally included on a tax return if it reduces the tax liability for that or any other year.
Itemized deductions give rise to a tax benefit because they reduce tax liability.	A net operating loss (NOL) that can be carried over creates a tax benefit in the original tax year of the NOL.	I.R.C. §111(b)(3) does not apply to <ul style="list-style-type: none"> • Investment tax credit • Foreign tax credit

P 149

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Tax Benefit Rule P 149

- Example 5.3 – State Tax Refund Included in Income
- Figure 5.1 – Portion of Refund Included in Cheyenne’s Income
- Example 5.4 – Refund Not Included in Income

FIGURE 5.1
Portion of Refund Included in Cheyenne’s Income

Tax Item	2024 Itemized Deduction	2024 Standard Deduction	Difference
Adjusted gross income	\$250,000	\$250,000	\$ 0
Itemized or standard deduction	(16,000)	(14,600)	1,400
Taxable income	<u>\$234,000</u>	<u>\$235,400</u>	<u>\$1,400</u>

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Tax Benefit Rule P 150

- Cross-Reference – Recovery Exclusion
 - Tax benefit items in a tax year are considered as a group
 - A group of tax benefit items for one year must be kept separate from a group of tax benefit items for another year
 - A recovery exclusion is any amount in the group of tax benefit items that did not create a tax benefit

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Maines v. Commissioner, 144 T.C. 123 (2015)
P 150

Whether refundable state tax credits were included in federal income

Married New York residents who received a credit for state property taxes

Credit was limited to actual property taxes paid by their partnership

Court found the credit to be like a refund of overpaid property taxes

Held that the property tax credit that reduced the taxpayers’ state tax liability

The refundable portion of the property tax credit was subject to the tax benefit rule

Included in income to the extent that the taxpayers received a corresponding tax benefit for prior-year property tax deductions.

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Tax Benefit Rule

P 150

- Example 5.5 – Refundable Credit Included in Income

FIGURE 5.2
Sylvia's State Taxable Income

Item	Amount
Federal adjusted gross income	\$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	\$320,000
State tax rate	× 6.75%
State tax liability	\$ 21,600
SITP credit	(30,000)
State tax refund	<u>\$ 8,400</u>

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Ordering Rules

P 151

- A state income tax refund from an SITP may be excludable from federal taxable income
- Estimated and withholding tax payments were applied last; and
- Claimed the federal standard deduction.
- Example 5.6 – Ordering of Estimated Tax Payment

FIGURE 5.3
Sylvia's State Taxable Income with Estimated Tax Payment Applied First

Item	Amount
Federal adjusted gross income	\$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	\$320,000
State tax rate	× 6.75%
State tax due (6.75%)	\$ 21,600
Estimated tax payments	10,000
SITP credit	(30,000)
State tax refund	<u>\$18,400</u>

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Ordering Rules

P 151

- Example 5.6 – Ordering of Estimated Tax Payment
- Refund is entirely of PTET credit
- Offsets Sylvia's federal tax liability
- Sylvia must include the credit in her taxable income
- Sylvia did not itemized deductions, and it is not includable in her income

FIGURE 5.4
Sylvia's State Taxable Income with Estimated Tax Payment Applied Last

Item	Amount
Federal adjusted gross income	\$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	\$320,000
State tax rate	× 6.75%
State tax due	\$ 21,600
SITP credit	(30,000)
Estimated tax payments	10,000
State tax refund	<u>\$18,400</u>

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MI Flow-Through Entity

Estimated Tax Payments required

\$ 500 expected annual income tax liability

Entity Name & EIN

Calendar tax year payments even if Fiscal year filers

Irrevocable Election – 15th day of third month

Election effective 3 years

www.michigan.gov/taxes/business-taxes/flowthrough-entity-tax

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Payments & Filing through MTO

Welcome to the Michigan Treasury Online (MTO) homepage where you can interact with the Michigan Department of Treasury on behalf of Michigan registered businesses.

Registration Services

Click a tile below to access role specific actions for your business.

Start a New Business Registration

Manage Business Registration

Tax Services

Click a tile below to access role specific actions for your business.

Personal Services Assessment (PSA)

Flow Through Entity (FTS) Tax

Manufacture Reseller (MR) Sales Tax

Identical Mail/Purchase (IM/P) Sales Tax

Sales, Use, and Withholding (SUW) Tax

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MI 1040 Subtraction

Subtractions from Income (all entries must be positive numbers)

10. Income from U.S. government bonds and other U.S. obligations included in MI-1040, line 10. Include U.S. Schedule B if over \$5,000.	10.	00
11. Amount included in MI-1040, line 13, from military retirement benefits due to service in the U.S. Armed Forces or Michigan National Guard, or transfer-related retirement benefits	11	00
12. Gains from federal column of Michigan MI-1040D and MI-4197	12	00
13. Income attributable to another state. Explain type and source.	13	00
14. Taxable Social Security benefits or military pay (not retirement) included on MI-1040, line 10.	14	00
15. Income earned while a resident of another state	15	00
16. Michigan state and local income tax refunds received in 2023 and included on MI-1040, line 10 including your absolute share of refund received from an electing flow-through entity	16	00
17. Michigan Education Savings Program (MESP) contributions from 2008 through 2022	17	00
18. Michigan Education Trust	18	00
19. Oil, gas, and nonferrous metallic minerals income. Enter amount from line 7 of Form 9988, Michigan Report of Oil, Gas, and Nonferrous Metallic Minerals Extraction Income and Expenses	19	00
20. Resident Tribal Member income exempted under a State/Tribal tax agreement or pursuant to Revenue Administrative Bulletin 1988-47	20	00
21. First-Time Home Buyer Savings Program. Enter amount from line 3 of Form 5792, Michigan First-Time Home Buyer Savings Program. Include Form 5792.	21	00
22. MRTMA/marital deduction expense subtraction	22	00
23. Miscellaneous subtractions (see instructions). Describe.	23	00

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MI 1040
Refundable Credits & Payments

REFUNDABLE CREDITS AND PAYMENTS		FEDERAL	MICHIGAN
24	Property Tax Credit. Include MI-50ACK or MI-50ACK-2		
25	Farmstead Preservation Tax Credit. Include MI-50ACK-4		
27	Earned Income Tax Credit. Multiply line 27a by 34% (0.34) and enter result on line 27b	27a	27b
28	Michigan Historic Preservation Tax Credit (refundable). Include Form 3282		
29	Credit for allocated share of tax paid by an electing flow-through entity (see instructions)		
30	Michigan tax withheld from Schedule K-1, line 8. Include Schedule W (do not submit W-2s)		
31	Estimated tax, extension payments and 2022 credit forward		
32	2022 AMENDED RETURN ONLY. Taxpayers completing an original 2022 return should skip to line 33. Amended returns must include Schedule AM (see instructions)		
32a	<input type="checkbox"/> If you had refund credits forward on the original return, check box 32a and enter the amount as a negative number on line 32c		
32b	<input type="checkbox"/> If you paid with the original return, check box 32b and enter the amount paid with the original return, plus any additional tax paid after filing, as a positive number on line 32c. Do not include interest or penalty		
33	Total refundable credits and payments. Add lines 25, 26, 27b, 28, 29, 30, 31 and 32c		

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Polling Question #2

1. How much is the SALT limitation?

a. \$ 5,050

b. \$ 10,000

c. \$ 35

d. \$ 5,500

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Issue 2

Beneficial Ownership Interest Reporting

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Corporate Transparency Act P 152

In September 2022, Financial Crimes Enforcement Network (FinCEN) issued a final rule implementing the beneficial ownership information reporting requirements of the Corporate Transparency Act (CTA) [87 F.R. 59498].

These requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while minimizing the burden on entities doing business in the United States.

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Corporate
Transparency Act
P 152

These regulations went into effect on January 1, 2024.

↓

The final rule requires certain entities to file FinCEN reports that identify two categories of individuals:

(1) the beneficial owners of the entity and	(2) individuals who have filed an application with specified governmental authorities to create the entity or register it to do business.
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The Corporate Transparency Act P 152

- January 1, 2021: 31 U.S. Code §5336
- Identify beneficial owners
- Reporting Companies
- Entities organized in US & Territories/Possessions
- Entities operating in US & Territories/Possessions

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Reporting Companies P 152

- Domestic Corporations (both C & S)
- Domestic Limited Liability Companies – regardless of how they're taxed
- Other Domestic Entities created by State or Tribal Filings
 - Limited Partnerships
 - Family Limited Partnerships
 - General Partnerships
- Foreign Entities
 - Corporations
 - Limited Liability Companies
 - Registered to do business in a U.S State
 - Registered to do business in a Tribal Community

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**Figure 5.5 –
Determining if an Entity is a Reporting Company P 153**

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**National Small Business United v. Yellen
Case No. 5:22-cv-01448 (N.D. Ala.)**

- Federal District Court, Northern District of Alabama, Northeastern Division
- Exceeds “the Constitution’s” limits on Congress’s power”
- Article 1 of the Constitution
- Encroaches on State Sovereignty – 9th & 10th Amendments
- Violates privacy & right against self-incrimination – 4th, 5th & 9th Amendments
- Enjoined Dept. of Treasury & FinCen
- Cannot enforce against the plaintiffs
- March 11, 2024 – DOJ appealed on behalf of Dept. of Treasury (11th Circuit)

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Trial Courts Findings

- Article 1 – unconstitutional
- 1st, 4th & 5th Amendments – court did not decide
- Exceeds Congressional Authority
 - Under the Commerce Clause Powers
 - Over Foreign affairs & national security
 - Over Taxes

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Who are the Plaintiffs?

- Issac Winkels et. al.
- National Small Business Association (NSBA)
- Named Members on March 1, 2024
- 65,000 Business Members
- Unnamed Members – limited or not at all
- Non-parties – fully enforceable

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**Firestone et al. v Yellen et al.,
Docket No. 3:24-cv-01034 (D. Or. Jun 26, 2024)**

- Article 1 – unconstitutional
- 1st Amendment
- 4th Amendment – unlawful search & seizure
- 5th Amendment – privilege against coerced self-incrimination & violated Due Process Clause
- 8th Amendment – imposes excessive fines & cruel/unusual punishment
- 9th Amendment – infringes upon privacy
- 10th Amendment – interferes with the rights of States

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Firestone et al. v Yellen et al.,
Docket No. 3:24-cv-01034 (D. Or. Jun 26, 2024)

- Supreme Court & The 4th Amendment
- *“reporting requirements are by no means per se violations of the Fourth Amendment,”*
- *“a contrary holding might well fly in the face of the settled...history of self-assessment of individual and corporate income taxes in the United States.”*
- Shultz, 416 U.S. at 59-60
- *“neither incorporated nor unincorporated associates can plead an unqualified right to conduct their affairs in secret.”*
- Schultz, 416 U.S. at 67-68 (quoting US v Morton Salt Co., 338(U.S. 632, 652 (1950))

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Firestone et al. v Yellen et al.,
Docket No. 3:24-cv-01034 (D. Or. Jun 26, 2024)

- Court denied the Preliminary Injunction
- No congressional overreach
- *“...any time a [government] is enjoined by a court from effectuating statutes enacted by representatives of its people, it suffers a form of irreparable injury.” (Maryland v. King, 567 U.S. 1301, 1303 (2012)(cleaned up))*
- Not unconstitutional
- *“If this court were to enjoin enforcement of the CTA it would interfere with Congress’s judgement, supported by extensive factual findings, about how best to combat money laundering, the financing of terrorism, tax fraud, and other serious crimes that affect the national economy or national security.” (NDAA §6402(3))*

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Community Associations Institute, et al. v Yellen et al.
Docket No. 1:24-cv-1597 (E.D. Va. Oct 24, 2024)

- Community Associations – primarily HOAs
- Claim exemption under Tax-Exempt – CTA requires I.R.C. 501(c) status only
 - HOAs are not I.R.C. 501(c) organizations
- “Community Associations unlikely to engage in financial crimes”
- Judge – “Any policy fix lies with Congress, not with this Court.”
- *“Any person forming a corporation or limited liability company within the United States” thus “typically provides less information at that time of incorporation than is needed to obtain a bank account or driver’s license.” (H.R. Rep. No. 116-227, at 2 (2019))*

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Community Associations Institute, et al. v Yellen et al.
 Docket No. 1:24-cv-1597 (E.D. Va. Oct 24, 2024)

- FinCen violated Administrative Procedures Act (APA) – failing notice & comment period
- FAQs are arbitrary & capricious under APA
- 4th Amendment
- 1st Amendment – compels speech & impairs individuals’ freedom of association
- Violates Commerce Clause
- Seek to enjoin the CTA against community associations
- Judge – “Plaintiffs are wrong”

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Texas Top Cop Shop et al. v Garland et al.
 Case 4:24-cv-00478

- December 3, 2024
- Exceeds “the Constitution’s limits on Congress’s power”
- 1st & 4th Amendment violation -- privacy
- Enjoined the Corporate Transparency Act & The Reporting Rule
- Preliminary Injunction (Nationwide Stay) – enforcement action only
- Named Plaintiffs & U.S. Reporting Companies

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Case & Judge’s Takeaways

- Plaintiffs agree they are Reporting Companies & have identified Beneficial Owners
- Judge references similar battle with Affordable Care Act
 - Conflicting court decisions
 - Supreme Court ruled was not congressional overreach
 - Congress did not repeal it
 - Congress did decrease the penalty for non-compliance

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What's Next?

- Judge indicated – CTA is likely unconstitutional
- Decision will be appealed
- The Administration & Congress may correct the legislation
- The Administration & congress may repeal the act entirely

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Appeals Roster – Conflicted Circuits

<ul style="list-style-type: none"> • 11th Circuit – National Small Business v Yellen <ul style="list-style-type: none"> • Unconstitutional • March 11, 2024 -- DOJ • 4th Circuit – Community Associations Institute et al. v Yellen et al. <ul style="list-style-type: none"> • Constitutional • November 12, 2024 	<ul style="list-style-type: none"> • 9th Circuit – Firestone et al. v Yellen et al. <ul style="list-style-type: none"> • Constitutional • November 19, 2024 -- Firestone • 5th Circuit – Texas Top Cop Shop et al. v Garland et al. <ul style="list-style-type: none"> • Unconstitutional • December 5, 2024 -- DOJ
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MICPA Advises – December 4, 2024

- Long legal battle which could reinstate enforcement
- Attorney's at Dykema – companies should be prepared to comply
- Small business owners should still file, or be prepared to file, by Jan 1, 2025

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NATP Advises – December 12, 2024

- Reporting Rule is suspended
- FinCen accepting voluntary filings
- Courts are conflicted

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FinCen – December 12, 2024

- Accepting Voluntary filings
- "...not subject to liability if they fail to do so while the order remains in force."
- District courts denying to enjoin CTA citing it is constitutional
- "The government continues to believe – consistent with the conclusions of the U.S. District Courts for Eastern District of Virginia and the District of Oregon – that the CTA is constitutional."

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What Do Businesses Do?

- Businesses legally obligated to comply with the Reporting Rule on voluntary basis
- Enforcement is temporarily suspended
- Be prepared to file if stay is lifted

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Polling Question #3


1. Reporting BOI is done through....

- a. Tax software
- b. The attorney
- c. The IRS website
- d. The FinCen website

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Cross-Reference – Unauthorized Practice of Law P 152

- Involves interpreting laws and giving advice regarding a client's rights and obligations under those laws.
- See the "Ethics" chapter in this book for information about how a tax practitioner can comply with his or her ethical duties to not engage in the practice of law, to protect confidential client information, and the duty of competence when assisting with CTA reporting.



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Highlighted 23 Exempt Entities P 154

-  Public accounting firm – Sarbanes-Oxley Act of 2002
-  Certain tax-exempt entities & subsidiaries
-  Entities assisting a tax-exempt entity
-  Large operating companies: 20 full-time employee & \$ 5,000,000 gross receipts

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23 Exempt Entities **P 154**

Certain types of securities reporting issuers

A U.S. governmental authority

Certain types of banks

Federal or state credit unions, §101 of the Federal Credit Union Act

Any bank holding company, §2 of the Bank Holding Company Act of 1956 or any savings/loan holding company, §10(a) of the Home Owners' Loan Act

Certain types of money transmitting or money services business

Any broker or dealer, §3 of the Securities Exchange Act of 1934, registered under §15 of the Securities Exchange Act (15 U.S.C. 78o)

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23 Exempt Entities **P 154**

Securities exchanges or clearing agencies, §3 of the Securities Exchange Act of 1934, and that is registered under 6 or 17A of the Act

Certain other types of entities registered with the Securities & Exchange Commission under the Securities Act of 1934

Certain types of investment companies, §3 of the Investment Company Act of 1940, or investment advisers under §202 of the Investment Advisors Act of 1940

Certain types of venture capital fund advisers

Insurance companies, §2 of the Investment Company Act of 1940

State-licensed insurance producers with operating presence at a physical office within the United States, and authorized by a State, and subject to supervision by a States' Insurance Commissioner or a similar official or agency

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23 Exempt Entities **P 154**

Commodity Exchange Act registered entities

Any public accounting firm registered in accordance with §102 of the Sarbanes-Oxley Act of 2002

Regulated public utilities, 26 U.S.C. 7701(a)(33)(A), that provides telecommunications services, electrical power, natural gas, or water & sewer services within the United States

Any financial market utility designated by the Financial Stability Oversight Council, §804 of the Payment, Clearing & Settlement Supervision Act of 2010

Certain pooled investment vehicles

Certain types of tax-exempt entities (I.R.C. §501(c), §501(a); Political organizations I.R.C. §527(e)(1), §527(a); Charitable or split-interest trusts I.R.C. §4947(a))

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23 Exempt Entities P 154

Entities assisting a tax-exempt entity described in (ix) above

Large operating companies with at least 20 full-time employees, more than \$ 5,000,000 in gross receipts or sales and an operating presence at a physical office within the United States

The subsidiaries of certain exempt entities

Certain types of inactive entities that were in existence on or before January 1, 2020

Any entity/class of entity that Secretary of the Treasury, with written concurrence of the Attorney General and the Secretary of Homeland Security has, by regulation, determined should be exempt from requirements.

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Practitioner Note – Sole Proprietor
P 155

It is not a reporting company.

Filing a document with a government agency to obtain an IRS employer identification number

Filing a document for a fictitious business name (d/b/a), or a professional or occupational license

Does not create a new entity

Does not make a sole proprietorship filing such a document a reporting company.

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Beneficial Ownership P 155

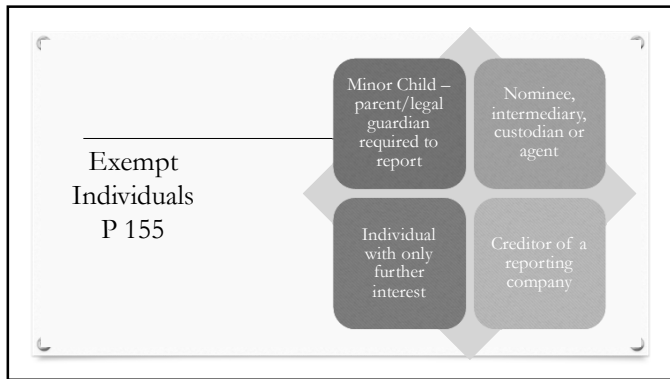
Directly controls 25% ownership

Indirectly controls 25% ownership

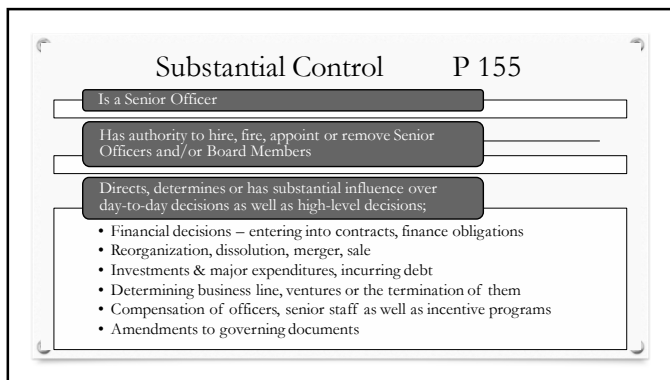
Exercise substantial control

Substantial influence

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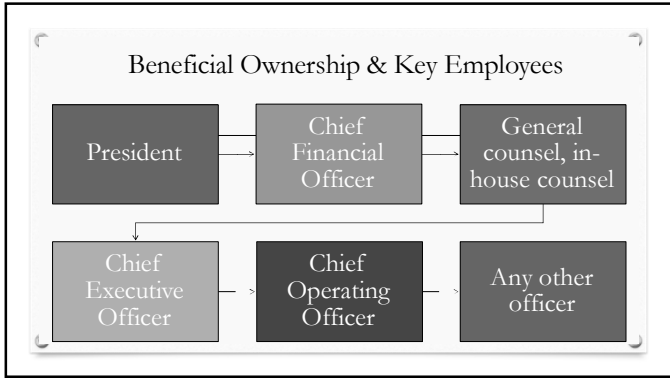
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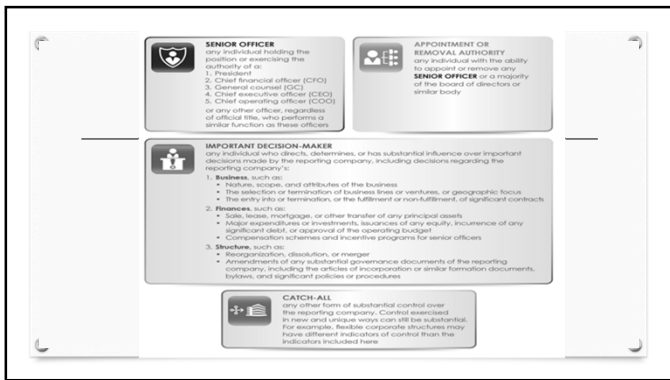
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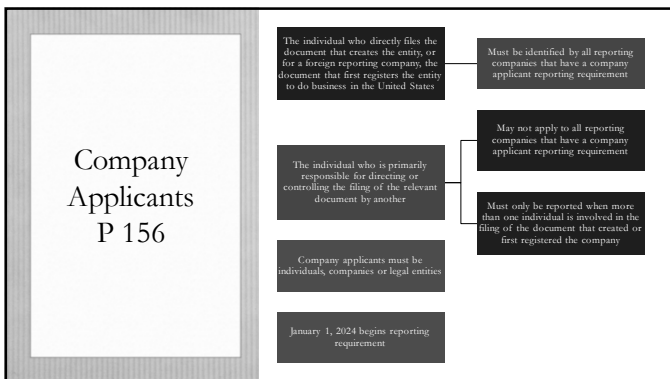
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Beneficial Owner & Company Applicant Documents P 157

What happens when they expire?
30 days from any change Rule?

- Full Legal Name
- Date of Birth
- Complete current address – cannot be PO Box
- Unique ID
 - Non-expired US passport
 - Non-expired state, local or tribal ID
 - Non-expired state driver's license
 - Non-expired foreign passport (if don't have a U.S. ID)
- Image of the ID

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FinCEN Identifier P 157

✓ A FinCEN identifier is a unique identifying number that FinCEN will issue to individuals who have provided FinCEN with their beneficial ownership information (BOI) (Individual FinCEN identifiers)

¥ Given to reporting companies that have filed initial BOI reports (entity FinCEN identifiers).

👤 Once a beneficial owner or company applicant has obtained a FinCEN identifier, the reporting entity may report the identifier in place of the otherwise required personal information in their BOI reports.

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When to File

Companies Created or Registered before January 1, 2024

- Will have until January 1, 2025, to file its initial beneficial ownership information report.

Companies Created or Registered after January 1, 2024

- 2024 only -- 90 days to file its initial beneficial ownership information report.
- Begins when company receives notice of its creation or registration is effective; OR
- After a secretary of state or similar office first provides public notice of its creation or registration, whichever is earlier.
- Starting in 2025 -- 30-days

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Updated Reporting
P 158-159

Update or report changes within 30 days

<p>The following are some examples of the changes that would require an updated beneficial ownership information report:</p> <ul style="list-style-type: none"> • A change to the information reported for the reporting company, such as registering a new business name 	<p>A change in beneficial owners, such as a new CEO or a sale that changes who meets the 25% ownership interest threshold</p>	<p>A change to a beneficial owner's name, address, or unique identifying number previously provided to FinCEN (if a beneficial owner obtained a new driver's license or other identifying document that includes a changed name, address, or identifying number, the reporting company also would have to file an updated beneficial ownership information report with FinCEN, including an image of the new identifying document.)</p>
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70

FinCen Enforcement
P 159

- \$ 500 per day for willfully failing to report or willfully providing false information
- Civil Fine up to \$ 10,000
- Up to 2 years imprisonment
- Initial filing
- 30 days from "any information change"

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FinCen Enforcement
P 159

- Unauthorized disclosure
- Use of beneficial ownership data
- Criminal fine up to \$ 250,000
- 5 years in prison
- Conduct of financial wrongdoing
 - Up to \$ 500,000
 - 10 years in prison

72

Issue 3

§501(c)(3) Charitable Organizations
& Maintaining Tax-exempt status

73

Overview
P 160

- Organizations described in section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible contributions under I.R.C. § 170.
- Ongoing compliance issues that may result in denial or revocation of tax-exempt status, or a change in that status:
 - Failing the organizational or operational test by, for example, engaging in more than insubstantial nonexempt activities or deviating from the exempt purpose reported on the application for tax-exempt status
 - Filing Form 1023-EZ when the charitable organization is ineligible to file the short form
 - Failing to maintain public charity status by not generating public support from grants and donations
 - Earning too much income from unrelated business activities
 - Not complying with annual notice or return filing requirements

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Failing the
Organizational
or Operational
Test
P 160

- Engage in non-exempt activities
- Deviated from exempt purpose
- Filing incorrect 1023
- No public support from grants or donations
- Too much unrelated business activities
- Non-filing & non-compliance

75

Exempt Purposes

P 160

- Charitable – Treas. Reg. 1.501(c)(3)-1(d)(2)
- Religious
- Educational
- Scientific
- Public Safety
- Preventing Cruelty to children or animals

76

Religious Organizations

P 160

- The particular religious beliefs of the organization must be truly and sincerely held.
- The practices and rituals associated with the organization's religious belief or creed cannot be illegal or contrary to clearly defined public policy.
- Example 5.7 – Insubstantial Religious Purposes

78

Educational Organizations

P 160

- Primary purpose is to promote and advance education may be exempt under section 501(c)(3).
- Instruction or training
- Purpose of improving or developing his or her capabilities, or
- the instruction of the public on subjects useful to the individual and beneficial to the community.
- This advancement of education may include grants, scholarships, and awards; promotion of the arts, humanities, and science; job training; publishing scientific journals; and advocacy.

79

P 161-162

Organizational Formalities

- Articles of incorporation and bylaws for a corporation must
 - limit the organization's purposes to exempt purposes in section 501(c)(3); and
 - must not expressly empower it to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those purposes [Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)].
 - This requirement may be met if the purposes stated in the organizing documents are limited by reference to section 501(c)(3).
- The organizational documents should prohibit inurement of earnings to private shareholders or individuals, prohibit political activity, and limit legislative activity.

80

Figure 5.7 – Dedication of Purpose

Article 5. The corporation is organized exclusively for charitable, religious, and educational purposes. No substantial part of the activities of the corporation shall be the carrying on of propaganda as it is defined within the meaning of I.R.C. § 501(c)(3), or otherwise attempting to influence legislation, and the corporation shall not participate in or intervene in (including the publishing or distribution of statements concerning) any political campaign on behalf of (or in opposition to) any candidate for public office. Notwithstanding any other provision of these articles of incorporation, the corporation shall not directly or indirectly carry on any activity that would prevent it from obtaining exemption from federal income taxation as a corporation described in I.R.C. § 501(c)(3), or cause it to lose such exempt status, or carry on any activity that is not permitted to be carried on by a corporation to which contributions are deductible under I.R.C. § 170(c)(2).

81

Dedication of Organizations Purpose P 162

- Example 5.8 – Broad Purposes
- Example 5.9 – Vague Purposes
- Treas. Reg. 1.501(c)(3)-1(b)(4) -- An organization does not meet the organizational test if its articles or the law of the state in which it was created provide that its assets will, upon dissolution, be distributed to its members or shareholders

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Assets
upon
Dissolution
P 162-163

Assets must be permanently dedicated to an exempt purpose.

If an organization dissolves, its assets must be distributed for an exempt purpose, to the federal government, or to a state or local government for a public purpose.

Organizing documents should contain a provision ensuring their distribution for an exempt purpose in the event of dissolution.

If a specific organization is designated to receive the organization's assets upon dissolution, the organizing document must state that the named organization must be a section 501(c)(3) organization when the assets are distributed.

84

Figure 5.8
P 163

Article 6. The property of the corporation is irrevocably dedicated to the purposes meeting the requirements for exemption. No part of the net earnings of the corporation shall inure to the benefit of or be distributable to any director or officer of the corporation, or any other private person, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered to or for the corporation and to make payments and distributions in furtherance of the purposes set forth in Article 5. In the event of dissolution or final liquidation of the corporation, all the remaining assets and property of the corporation shall, after paying or making provision for the payment of all of the liabilities and obligations of the corporation and for necessary expenses thereof, be distributed to such organization or organizations organized and operated exclusively for charitable or educational purposes meeting the requirements for exemption under I.R.C. § 501(c)(3), as the Board of Directors shall determine, or shall be distributed to the federal government, or to a state or local government, for a public purpose. In no event shall any of such assets or property be distributed to any director or officer, or any private individual.

85

Dedication of
Organizations
Purpose P 163

Treas. Reg. 1.501(c)(3)-1(b)(4) – An organization does not meet the organizational test if its articles or the law of the state in which it was created provide that its assets will, upon dissolution, be distributed to its members or shareholders.

Example 5.10 – Assets Not Dedicated to Exempt Purpose

Practitioner Note – Amending Articles

86

Operational Test P 163-164

Primary activities -- activities that accomplish one or more of the exempt purposes specified in section 501(c)(3).

Distribution of earnings -- net earnings do not inure in whole or in part to the benefit of private shareholders or individuals.

Action organizations -- not operated exclusively for one or more exempt purposes if a substantial part of its activities is attempting to influence legislation by propaganda or if it participates, or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

87

Form 1023-EZ Ineligibility P 164

Streamlined Application for Recognition of Exemption

Annual gross receipts of \$50,000 or less and \$250,000 or less in assets

The application must be submitted electronically on Pay.gov and must include the appropriate user fee.

File within 27 months from the date of their formation to be treated as described in section 501(c)(3) from the date formed.

If the organization does not file within 27 months of formation, the effective date of the exempt status will be the date of filing.

88

Ineligibility for Form 1023-EZ P 165

- Organizations gross revenue exceeds \$ 50,000 in first 3 years
- Can retroactively revoke an organizations status for misstatement or omission of material information on Form 1023
- Rev. Proc. 2023-5, 2023-1 I.R.B. 265 §12 -- A misstatement of material information
- Example 5.11 – Ineligible to File Form 1023-EZ

89

Maintaining Public Charity Status P 165

- Public Charity – broad sources of support
- Public Foundation – very limited sources of support
- I.R.C. §508(b) – every organization is automatically classified as a private foundation unless it meets one of the exemptions list in I.R.C. §508(c) or §509(a)

90

Maintaining Public Charity Status P 165

§509(a)

91

Public Support Tests P 166

- At least one- third of its support from contributions from the general public; or
- Meet 10% percent facts and circumstances test.
 - receives more than 10% but less than one-third of its support from the general public or a governmental unit
 - It normally receives a substantial part of its support from governmental units or the general public.
- Example 5.12 – Significant Public Support

92

P 156-167

Unrelated Business Taxable Income

- Income from a trade or business
- Regularly conducted by an exempt organization
- Not substantially related to the organization's performance of its exempt purpose or function.
- Use of the profits from an unrelated business in furtherance of an organization's exempt purpose
- A *trade or business* -- activity conducted with the intent to produce income from selling goods or performing services.
- Treas. Reg. 1.513-1(c) -- *regularly conducted* if they show a frequency and continuity and are pursued in a manner similar to comparable commercial activities of nonexempt organizations
- Example 5.13 – Not a Regularly Conducted Activity

93

P 156-167

Unrelated Business Taxable Income

*Substantially related – if it contributes importantly to accomplishing that purpose

- Facts & Circumstances – size & extent of the activities in relation to the nature & extent of the exempt function
- Gross income derived from exempt function & unrelated trade/business are not the same
- If a facility or asset required to conduct an exempt function is also used in commercial activities, its use for the exempt function does not alone make the commercial activities a related trade or business.
- The test is whether the activities contribute importantly to the accomplishment of exempt purposes.

94

P 156-167

Unrelated Business Taxable Income

- Example 5.14 – Multiple Uses Activity
- Treas. Reg. 1.513-1(d)(4)(ii) -- Selling products
- Treas. Reg. 1.513-1(e) – excluded trade or business activities
- Other excluded activities – gaming, convention or trade shows, distributions of low-cost articles & qualified sponsorship activities

95

Filing Requirement P 168

- Practitioner Note – UBIT Filing Requirements
 - Form 990-T
- Exempt Organization filing requirements – I.R.C. §6033
 - Form 990 Series
 - Due 15th day of 5th month following close of calendar or fiscal year
 - If fail to file a return for 3 consecutive years – tax-exempt status is automatically revoked
 - §6033(a)(3), churches, religious orders, and certain other organization (other than a private foundation) with gross receipts in each tax year normally not more than \$5,000 do not have to file an annual return.

96

Filing Requirement P 169

- *Form 990-N* -- gross receipts \$50,000 or less can file a *Form 990-N* (e-Postcard), which is a notice, not a return.
- *Form 990-EZ* -- gross receipts that are less than \$200,000 and total assets at the end of the tax year that are less than \$500,000
- *Form 990* -- gross receipts greater than or equal to \$200,000, or total assets greater than or equal to \$500,000
- 6 month extension by filing Form 8868
- An organization is allowed only one 6-month extension for a tax year.

97

Revocation of Exempt Status P 169

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graph TD
    A[Failure to file a required Form 990 series notice or return for 3 consecutive years] --> B[The organization must then apply to reinstate tax-exempt status.]
    B --> C[Under I.R.C. § 6033(i), if a tax-exempt organization fails to file its required annual return or notice for 2 consecutive years, the IRS must notify the organization]
    C --> D[That the IRS has no record of such a return or notice from the organization for 2 consecutive years, and]
    D --> E[The IRS will revoke the organization's tax-exempt status if it fails to file the return or notice by the due date for the next return or notice required to be filed.]
    E --> F[Tax Exempt Organization Search Tool [www.irs.gov/charities-non-profits/search-for-tax-exempt-organizations]]
  
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Tax Exempt Organization Search Tool [www.irs.gov/charities-non-profits/search-for-tax-exempt-organizations]

98

Reinstatement of Exempt Status P 169-171

- Four reinstatement procedures
 - Streamlined Retroactive
 - Retroactive within 15 months
 - Retroactive after 15 months
 - Postmark date

99

Issue 4
Change in Tax-Exempt Status

100

Rev. Proc.
2024-5, 2024-
1 I.R.B. 252

- Allows for change in exempt status
- Currently recognized under §501(c)(3)
- Organization must request status change

101

<p>When to Request a Determination Letter</p>	<p style="text-align: right; font-size: small;">P 172</p> <ul style="list-style-type: none"> ▪ Rev. Proc. 2024-5 §3.01(1) <ul style="list-style-type: none"> ▪ has distributed its assets to another section 501(c)(3) organization or government entity; and ▪ otherwise meets the requirements for the section 501(c) status requested. ▪ Rev. Proc. 2024-5 automatically revoked under I.R.C. § 6033(f) ▪ Example 5.15 – Change from §501(c)(3) to §501(c)(4)
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<p>P 172-173</p>	<ul style="list-style-type: none"> ▪ File Form 1024 & 1024-A ▪ Indicate: <ul style="list-style-type: none"> ▪ that its assets have been distributed as of the submission date of its application; and ▪ provide a description of the assets distributed, the date of distribution and the name, employer identification number, and address of the recipient and agree to submission (postmark) date for recognition under the new paragraph of section 501(c). ▪ Practitioner Note – Optional Filing
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103

<p>Issue 5</p> <p>Electing Out of the Centralized Partnership Audit Regime</p>
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P 174

Centralized Partnership Audit Regime

- Bipartisan Budget Act of 2015 (BBA), Pub. L. No. 115-123.
- Partnership returns filed for tax years beginning on or after January 2018 Partnerships must designate a partnership representative on the partnership return for these years.
- An eligible partnership can elect out of the new rules.

105

Eligibility to Elect Out

P 174

■ A partnership must have issued 100 or fewer K-1s for the year.

■ Partners: Individual, a C corporation, a foreign entity that would be treated as a C corporation if it was domestic, an S corporation, or an estate of a deceased partner.

■ Not Eligible partners: partnerships, trusts, foreign entities that are not eligible foreign entities, disregarded entities, nominees or other similar persons that hold an interest on behalf of another person, and estates that are estates of a deceased partner.

106

How to Elect Out

P 174-175

- Made on a timely filed partnership return (including extensions) for the year the election is to be effective.
- A partnership must disclose to the IRS the names, correct taxpayer identification numbers (TINs), and federal tax classifications of all its partners and, if there is an S corporation partner, the names, correct TINs, and federal tax classifications of all persons to whom an S corporation partner is required to furnish statements during the S corporation partner's tax year ending with or within the partnership's tax year at issue.
- A partnership electing out must notify each of its partners within 30 days of making the election.

107

Advantages
to Electing
Out
P 176

Individual partners retain control over the results.

Not just one selected person makes decisions that bind all partners.

Adjustments are made only to the specific partners of the reviewed year.

The adjustment-year partners who may not have been reviewed-year partners carry no burden, and the reviewed-year partners who may not be adjustment-year partners are responsible for the adjustments.

108

Advantages
to Electing
Out
P 176

Audit adjustments are made in the audit year, not the year the audit is completed.

Once the examination is completed the partnership plays no further role.


Each partner receives a detailed computation of the proposed adjustments.

Each partner makes his or her own decision to protest or appeal the proposed adjustments.


Partners may obtain different results on appeal

109


Advantages
to Electing
Out
P 176




The statute of limitations for making partnership adjustments to a partner's return is determined at the partner level.



The adjustment to smaller-interest partners may never be made due to IRS tolerance levels.



For a large partnership, it takes more resources for the IRS to audit the individual partners.



The aggregate tax liability of the partners after adjustment is more realistic than an unadjusted, imputed underpayment under the centralized rules, which could be excessive.

110

<p>Advantages to Electing Out P 176</p>	<p>A partner's adjustments for any partnership audit are more straightforward. Only the reviewed year's partners are adjusted, and any intervening-year adjustments are made directly on the intervening years.</p> <p>There is no need for a partnership representative, and no need to provide for complicated releases of liability for and indemnification of the partnership representative</p>
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<p>Disadvantages to Electing Out P 176-177</p>	<p>There will be closer scrutiny of the individual partner's return when the IRS proposes the adjustments from the partnership examination.</p> <p>All partners, including foreign partners, must have an identifying number to elect out.</p> <p>The types of partners and number of partners is limited.</p> <p>Protest and appeal of the partnership adjustments is done by each partner, raising the cost of appeal per partner and in the aggregate. Lower-income partners may not have the resources to appeal.</p>
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<p>Disadvantages to Electing Out P 176-177</p>	<p>There may be different results on appeal for different partners, which may be inequitable or unfair.</p> <p>Following the audit of each partner, the partnership may have to collect information about the audit and update its records.</p> <p>There is nothing to protect a partnership if the IRS determines the election is invalid (e.g. if a partnership interest is subsequently issued to an ineligible partner, or the number of partners increases).</p> <p>Revocation of the election requires IRS permission</p>
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113

Partnership Representative
P 177

- Treas. Reg. 301.6223-1(c)(2)
 - Partnerships must designate a Partnership Representative
 - Designation must be made on Form 1065, U.S. Return of Partnership Income
 - Designation is made for year in which it relates and effective when return is filed
- Practitioner Note – Due Diligence & Partnership Returns
- Treas. Reg. 301.6223-2(a)
 - Partnership Representative has sole authority to act on behalf of the partnership
 - Their decision(s) is(are) binding on the partnership & the partners
 - **Binding decisions:** the authority to determine how the partnership will proceed with regard to a proposed adjustment, the authority to enter into a settlement agreement on behalf of the partnership, and the authority to make the election to pay the underpayment on behalf of the partners or push out the underpayment to the individual partners.

114

Partnership Representative
P 177

- Treas. Reg. 301.6223-2(d)
 - No partner or any person, other than PR or DI, may participate in an administrative proceeding without IRS's permission
- Practitioner Note – Power of Attorney

115

Changing the Partnership Rep.
P 178

I.R.C. § 6223 regulations limit the times for changing a PR and the times for a PR to resign.

A PR designation can be changed after the IRS mails a notice of administrative proceeding (NAP) or in conjunction with the filing of a valid administrative adjustment request (AAR) by the partnership under I.R.C. §6227.






A PR or DI may submit a written notification of resignation only after the IRS issues a NAP.

Treas. Reg. §301.6223-1(c)(2) allows the partnership to change the PR through revocation when the partnership is notified that the partnership return is selected for examination as part of an administrative proceeding.

The partnership can change its PR before an administrative proceeding commences.

116

Partnership Agreement
P 178

-  Most LLCs (taxed as a partnership) and partnerships will need to address issues related to the PR in their LLC operating agreements and partnership agreements.
-  Partners may wish to ensure participation in decision-making and determine whether former partners will be mandated to pay taxes on an adjustment or whether they are relieved of that liability when they leave the partnership.
-  **Figure 5.10** shows sample partnership agreement language regarding the election out of the centralized partnership audit regime.
-  **Figure 5.11** shows sample language designating the PR and duties of the PR.
-  **Figure 5.12** shows sample partnership agreement language regarding adjustments.

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FIGURE 5.10
Sample Partnership Agreement Language—Electing Out

Electing Out.
Unless otherwise determined by majority vote of the members of the Company (majority vote), the Company will initially elect out of the centralized partnership audit regime to the extent permitted under the applicable laws and regulations.

FIGURE 5.11
Sample Partnership Agreement Language—PR

Designation of Partnership Representative.
If the Company does not elect out, _____ is hereby designated by the Company as the initial Partnership Representative (PR). The designated representative is eligible to serve as PR because he or she has a substantial presence in the United States and has the capacity to act as PR.

Changes in PR Designation. The Company may change the PR by majority vote, and in the following circumstances:

1. By designating a new PR on a duly filed income tax return for a subsequent tax year.
2. When the IRS mails a notice of administrative proceeding (NAP).
3. If the Company files a valid administrative adjustment request (AAR).
4. When the Company is notified that its return is selected for examination as part of an administrative proceeding.
5. Upon resignation of the current PR.
6. Upon any other revocation of the PR designation if that revocation has been approved by majority vote of the members.

Notification of Change in PR Designation.
Upon any resignation, the resigning PR shall notify the Company, and the Company shall notify the IRS. Upon any revocation, the Company shall notify the PR whose designation is being revoked, and the Company shall notify the IRS. The Company shall provide notification of any changes in the PR designation to _____.

Duties of PR.
The PR agrees to consult with and keep the members advised with respect to any income tax audits of a Company income tax return, including any NAP or Notice of Proposed Partnership Adjustment and any Notice of Final Partnership Adjustment.

Authority of PR. The Company must approve the following PR actions by majority vote:

1. A decision to not elect out of the centralized partnership audit regime.
2. A determination regarding how the Company will proceed regarding any proposed partnership adjustment.
3. Any decision, act, or election that binds all members for tax matters or adjustments at the audit level or in any judicial matters, including any decision to contest or continue to contest a tax deficiency, settle a dispute, or extend a statute of limitations.
4. A decision to not make the I.R.C. Section 6226 election to have the reviewed-year members pay the assessed amount.

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FIGURE 5.12
Sample Partnership Agreement Language—Adjustments

Final Partnership Adjustment.
Upon issuance of any Final Partnership Adjustment, unless otherwise determined by majority vote, the PR shall elect to have the reviewed-year members assessed instead of the Company, the Company shall compute the allocation for each member who was a member in the year audited individually based on the overall Company-level adjustment. It is the Company's responsibility to inform each member of his or her share of the assessment, along with his or her share of any additions to tax, penalties, or interest assessed at the Company level. Such members are responsible for their share of the assessment and any penalties, regardless of whether the member is still a member of the Company. If any such amount is required to be paid (and actually paid) by the Company, it will be recoverable from such member.

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Polling Question #4

1. Opting out of the Centralized partnership Audit Regime is done by

- a. Election on Form 1065
- b. Calling the IRS
- c. Calling Taxpayer Advocate
- d. Election on Schedule K-1

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Questions?

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