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2022 West Virginia Tax Institute

Panel Discussion - Things to Consider for 2022/2023

Agenda

- IRS staffing and budget issues
- Increasing exam activity and areas of focus
- Partnership exam activity
- IRS penalty and abatement issues
- 2023 filing season and other items of interest

IRS staffing and budget issues

IRS staffing and budget issues

- Staffing has been a major obstacle for IRS over last decade.

- Agency has lost approximately 20,000 employees since 2010, dwindling their workforce to current level of approximately 74,000.

- Back in March 2022, the IRS was already planning to hire an additional 10,000 employees. The new personnel were to concentrate on an increasing focus on partnership audits as well as assisting with return backlog and technology modernization.

IRS staffing and budget issues

- In her February 2022 congressional testimony, National Taxpayer Advocate Erin Collins pointed out that the IRS had only successfully filled 179 of the 5,000 open positions for customer service representatives.

- She further testified that low pay was affecting the IRS' ability to hire employees.

- Exacerbating the IRS' current staffing issues is the fact that almost 25% of the agency's current workforce are eligible for retirement. Accordingly, there could be an additional 18,000 vacancies if experienced employees chose to retire.

IRS staffing and budget issues

- The IRS began the 2022 filing season with a backlog of approximately 24 million items.
  - 17.6 million tax returns
  - 6 million items of unaddressed taxpayer correspondence

- The combination of processing delays and questions regarding new legislation and programs caused the 2021 call volumes to triple from the prior year to a record 282 million calls.
  - Customer service representatives only answered about 32 million of these calls, or roughly 11%.

- As of August 12, there was approximately 14 million paper filed returns for individuals and businesses for the 2022 tax year waiting to be processed.

IRS staffing and budget issues

- The Inflation Reduction Act provides nearly $80 billion in additional IRS funding.
- The funds are allocated as follows:
  - $45.6 billion for enforcement
  - $25.3 billion for operations support
  - $4.8 billion for business systems modernization
  - $3.2 billion for taxpayer services
- A directive from the Treasury Secretary aims to ensure none of the funding is used to increase taxes or examinations on taxpayers who make less than $400k.

IRS staffing and budget issues

- The Treasury Inspector General for Tax Administration (TIGTA) issued the Major Management and Performance Challenges Facing the IRS report on October 13.

- The report acknowledges that it will be a significant challenge for the IRS to administer the new tax provisions contained in the Inflation Reduction Act and effectively use the additional funding to address the challenges of improving taxpayer service, modernizing outdated technological infrastructure, and increase equity in the tax system through additional enforcement actions.

IRS staffing and budget issues

- The report identifies the top challenges facing the IRS in 2023 as:
  - Improving taxpayer service
  - Protecting taxpayer data and IRS resources
  - Modernizing IRS operations
  - Administering tax law changes
  - Increasing domestic and international tax compliance and enforcement
  - Reducing tax fraud and improper payments

IRS staffing and budget issues

- Over the next six years, the IRS estimates that it will need to hire 52,000 employees just to maintain current staffing levels.
- Comparing FYs 2016 and 2020, there were 55 percent fewer correspondence examinations and 59 percent fewer field examinations conducted in 2020.
- The number of examination staff decreased 9.9 percent from FY 2017 to 2020.
  - 10,101 employees in 2017
  - 9,116 employees in 2020

Increasing exam activity and areas of focus

Increasing exam activity and areas of focus

- Employment tax credits – ERC and FFCRA paid sick and family leave credits

- On Aug. 31, 2022, the TIGTA issued a report covering its assessment of the processes and procedures followed by the IRS in ensuring "the accuracy and validity of COVID-19 related employer tax credits on original and amended tax returns."

- The report notes that the IRS has identified **11,096** "suspicious" Forms 941 reporting "more than $2 trillion in credits claimed. In addition, in April 2022, the IRS implemented new processes to identify potentially fraudulent claims by businesses with questionable characteristics."

Increasing exam activity and areas of focus

- ERC for Q4 2021 – Limited to eligible “recovery startup business”
    - IRS is relying solely on employer attestation, signed under penalties of perjury, that it is an eligible recovery startup business (began carrying on a trade or business after February 15, 2020).
    - TIGTA analysis of Q3 2021 Forms 941 filed as of January 31, 2022 found 928 business entities making this representation and claiming nearly $17.5 million in refundable ERCs despite having EINs issued before February 15, 2020.
    - TIGTA analysis of Q4 2021 Forms 941 filed as of February 16, 2022 identified 26 businesses that attested under penalties of perjury that they were an RSB but did not identify as such on their third quarter Form 941.

Increasing exam activity and areas of focus

- The American Rescue Plan Act extended the statute of limitations for assessment of payroll tax returns on which the ERC is claimed to 5 years.
- Treasury has issued regulations providing that erroneous refunds of the ERC will be treated as underpayments of Social Security or Medicare taxes, subject to significant penalties.
- IRS audits of ERC claims have already begun.

Increasing exam activity and areas of focus

- If an ERC claim was made in error, given the extended statute of limitations, the payroll tax return audit may conclude after the statute of limitations for amending the income tax return is closed.

- During the May 19, 2022, AICPA Town Hall, Lisa Simpson, AICPA VP-Firm Services discussed the current struggles with non-CPA firms the AICPA refers to as ERC “Credit Mills”.

- AICPA member firms are seeing very aggressive marketing from these organizations.

Partnership exam activity

Partnership exam activity

- IRS is ramping up scrutiny of passthrough entities with particular focus on partnership taxation.

- The IRS increased partnership audits in the final quarter of 2021 and plans to conduct additional BBA partnership examinations in 2022.

- Audits of large partnerships are expected to escalate as the IRS implements the Large Partnership Compliance (LPC) Pilot Program.

Partnership exam activity

- The LPC program targets partnerships with over $10 million in assets.

- Data analytics of certain criteria will be used to identify partnerships with the highest risk of noncompliance.

- Entities selected for audit will not center on a single issue – the entire return will be subject to examination.

Partnership exam activity

- The Large Business and International (LB&I) Division of the IRS also has two active partnership campaigns.

- Partnership losses in excess of basis – focuses on the Section 705 outside basis requirements needed to claim flow-through losses from partnerships.

- Sale of partnership interests – addresses taxpayers who do not report the sale or do not correctly compute the gain or loss of a partnership interest disposition.
  - Purchase price allocation issues are also coming under scrutiny.

Partnership exam activity

- Procedural pitfalls with closing a CPAR examination. The close of a CPAR examination has 3 distinct stages, each with own rights and timeline.

- Notice of Preliminary Examination Changes

- Notice of Proposed Partnership Adjustments (NOPPA)

- Notice of Final Partnership Adjustments

Partnership exam activity

- Notice of Preliminary Examination Changes
  - Letter 5891, 30 Day Letter
  - Form 14791, Preliminary Partnership Examination Changes, Imputed Underpayment Computation and Partnership Level Determinations as to Penalties, Additions to Tax and Additional Amounts
  - Form 886-A, Explanation of Adjustments, for substantive issues, penalties (if applicable), and the imputed underpayment

- Taxpayer may appeal substantive changes from the field procedures at this stage.

- Although the IRS allows a taxpayer to also appeal the imputed underpayment, most taxpayers will elect to modify the imputed underpayment at the next stage of the exam procedure.

Partnership exam activity

- Notice of Proposed Partnership Adjustments (NOPPA)
  - After appeals finalizes their review, the IRS submits the NOPPA package to the taxpayer.
  - Starts the 270 day period in which taxpayer can modify the imputed underpayment.
  - Modification is essential in any CPAR exam.

Partnership exam activity

- Notice of Final Partnership Adjustments
  - Taxpayer has 45 days to pay imputed underpayment or pushout to partners.
  - Taxpayer has 90 days to petition tax court.

IRS penalty and abatement issues

IRS penalty and abatement issues

- IRS Notice 2022-36 – broad automatic relief for failure to file penalties for 2019 and 2020.

- Waives failure to file penalties for numerous categories of late filed income tax returns and informational returns.

- IRS granted a small window of time to obtain relief under this notice by filing missing returns by September 30, 2022.
  - Areas impacted by natural disasters have additional time to file and get relief under this notice:
    - Kentucky (certain counties) – November 15, 2022
    - Florida, NC, and SC – February 15, 2023

IRS penalty and abatement issues

- Certain international informational returns are also covered by this relief, such as Forms 5471 and 5472 attached to late filed Forms 1120 or 1065.

- It's important to note that many of these international informational returns carry severe penalties
  - $10,000 per Form 5471
  - $25,000 per Form 5472.

- Partnership and S corporations can also have steep penalties.
  - $205 or $210 per partner/shareholder per month

IRS penalty and abatement issues

- The IRS is granting this relief automatically and taxpayers that have paid late filing penalties will receive refunds.

- Note that taxpayers should still respond to any IRS notices that have statutory or regulatory deadlines to contest penalties.
  - For example, taxpayers should file a Protest or Collection Due Process Hearing Request in response to a 30-Day Letter or Final Notice of Intent to Levy, respectively.

- Relief afforded under the notice is separate and distinct from the traditional reasonable cause relief and the first time abatement program.

2023 filing season and other items of interest

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2023 filing season and other items of interest

- Amended returns attributable to ERC

- Notice 2021-49 – timing of disallowance of deduction
  - The deduction must be disallowed in the tax year during which the qualified wages were paid or incurred, regardless of the timing of the claim.

- 2020 and potentially 2021 returns may need to be amended.

- Partnerships that did not elect out of CPAR will need to file an Administrative Adjustment Request (AAR).

2023 filing season and other items of interest

- Section 163(j) interest expense limitation
  - The 163(j) adjusted taxable income formula drops depreciation and amortization for 2022, potentially decreasing ability to take current deductions.

- Schedules K-2/K-3
  - Limited exceptions to filing for 2021.
  - Notice 2021-39 offered transition relief for tax years that begin in 2021 from relevant penalties for taxpayers that made a “good faith effort” to comply with the requirements in the instructions.

2023 filing season and other items of interest

- SALT workarounds
  - Numerous states have adopted a pass-through entity tax election.
  - Will require careful consideration and analysis.
  - While benefits may be substantial, multistate businesses may face increased complexity in compliance.

Questions?

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