

Current Federal Tax Developments

Week of February 14, 2022

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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF FEBRUARY 14, 2022
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SECTION: 41

MORE INFORMATION PROVIDED BY IRS ON OPERATION OF NEW RESEARCH CREDIT AMENDED RETURN PROCEDURES

Citation: “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, 2/9/22

The IRS has provided more information on its new policies related to claims for refund for research credits under IRC §41 in updates to its frequently asked questions (FAQ) page on research credit claims.¹ The IRS originally disclosed its new policies in FAA20214101F and an accompanying press release on October 15, 2021.

Under the revised IRS policy, every claim must contain five items of information at the time the claim is submitted. A claim omitting any of that information is deemed to not be a valid claim for refund and, in the view of the IRS, will also not qualify as an informal claim to preserve the taxpayer’s right to continue the challenge if the statute of limitations has passed on filing the claim when the claim is rejected.

Research Credit Claim Based on Research Credit From a Passthrough Entity

The first addition to the FAQ deals with the situation where a taxpayer files an amended return based on a research credit from a passthrough entity. The new question reads as follows:

13. How do taxpayers who file a claim for refund that includes the Research Credit comply with the requirement to provide the five items of information when the claim is based on a Research Credit from a pass-through entity? (Updated February 8, 2022)²

The IRS finds that the answer depends on whether this is a partnership and, if so, if it was covered by the BBA audit regime for the year in question. The answer provides that the partners in BBA covered partnership do not provide the information, but rather the partnership does in its administrative adjustment request:

If a claim for refund that includes the Research Credit is based on a Research Credit from a BBA partnership, the BBA partnership does not file an amended return. Instead, the BBA partnership must file an administrative adjustment request (AAR) and attach the five items of

¹ “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022, <https://www.irs.gov/businesses/corporations/research-credit-claims-section-41-on-amended-returns-frequently-asked-questions> (retrieved February 10, 2022)

² “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022

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information to that AAR. As part of the AAR process, the BBA partnership will also submit Forms 8985 and 8986 to the IRS and send Forms 8986 to its partners. The BBA partnership is not required to provide the five items of information again on the Forms 8985 and Forms 8986. The BBA partners do not need to attach the five items of information to their original returns to which their Forms 8986 are attached.³

For other passthrough entities, the equity holders will need to include the information with their own amended returns claiming a refund.

If a claim for refund that includes the Research Credit is based on a Research Credit from a non-BBA pass-through entity (such as a TEFRA partnership, S corporation, or other non-TEFRA/non-BBA partnership), the non-BBA pass-through entity may include the five items of information with its amended return. Partners or shareholders are required to include the five items of information with their amended tax return claiming the Research Credit. Partners or shareholders should receive the five items of information from the partnership or S corporation in which they are a partner or shareholder, for example, in the form of an amended Schedule K-1 (and any statements attached thereto).⁴

E-Filed Amended Returns and The Required Information

The IRS also answered a question regarding the impact electronically filing the amended return has on providing the required information:

**14. Are taxpayers who e-file their amended tax return claiming a refund involving the Research Credit required to provide the five items of information with their e-filed amended tax return?
(Updated February 8, 2022)**

Yes. Please note, however, pass-through entity taxpayers (and their partners or shareholders) who e-file their amended tax returns should follow the requirements for providing the five items of information as stated in FAQ #13.⁵

Under What Conditions Can the Taxpayer Take the IRS Action Up with the Office of Appeals?

The final new question looks at when the taxpayer may challenge a determination related to a research credit claim by taking the case to Appeals. Not surprisingly, the

³ “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022

⁴ “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022

⁵ “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022

IRS takes the position that if a claim is rejected for being deficient or unprocessable, the taxpayer does not have the right to take up that decision with the Office of Appeals:

15. If the IRS determines that a claim for refund involving the Research Credit is not valid, may a taxpayer challenge the determination before the IRS Independent Office of Appeals (“Appeals”)? (Updated February 8, 2022)

Under existing IRS procedures, refund claims that are disallowed on the basis of a timeliness determination are eligible for consideration by Appeals. However, the Appeals resolution process is not available for refund claims that are rejected on the basis that they are deficient or otherwise not processible.

Note that the IRS implemented a one-year transition period during which time taxpayers who file a claim for refund involving the Research Credit will be informed of a deficient claim for refund through Letter 6426C or 6428. The letter will indicate which of the five items of information is missing and provide the taxpayers with 45 days to perfect the filing. See FAQs 7 and 8, and the IRS Press Release for additional details. As noted in FAQ 1, the IRS continues to accept input and plans to closely monitor the process and questions during the one-year transition period to determine if any modifications are necessary. As such, comments can be sent to irs.feedback.recredit.claims@irs.gov.⁶

**SECTION: 704
LB&I DIVISION ANNOUNCES NEW CAMPAIGN FOCUSING
ON LIMITS ON DEDUCTION DUE TO PARTNER'S BASIS
UNDER §704(D)**

Citation: Partnership Losses in Excess of Partner's Basis Campaign, Large Business and International Active Campaigns, IRS webpage, 2/8/22

The IRS has announced a new Large Business and International Division Active Campaign on partnership losses in excess of partner's basis.⁷

The limited summary on the IRS webpage states:

Partners that report flow-through losses from partnerships must have adequate outside basis as determined pursuant to IRC § 705 to deduct

⁶ “Research Credit Claims (Section 41) on Amended Returns Frequently Asked Questions,” IRS webpage, Updated February 9, 2022

⁷ Partnership Losses in Excess of Partner's Basis Campaign, Large Business and International Active Campaigns, IRS webpage, February 8, 2022 update, <https://www.irs.gov/businesses/corporations/lbi-active-campaigns> (retrieved February 12, 2022)

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the losses or else the losses are suspended per § 704(d) to the extent they exceed the partner's basis in the partnership interest.⁸

Tax Notes Today Federal described the program in an article discussing the release as follows:

The campaign focuses on section 704(d), which states that a partner's distributive share of partnership loss will be allowed only to the extent of the partner's adjusted basis in his partnership interest — that is, his outside basis — at the end of the partnership year in which the loss occurred.

The campaign notes that if the partner's share of losses exceeds his outside basis, the excess amount is suspended and may be carried over for use in another tax year in which the partner has outside basis available.⁹

SECTION: 6011

IRS EXPANDS LIST OF NOTICES PAUSED DUE TO PROCESSING BACKLOG

Citation: “IRS continues work to help taxpayers; suspends mailing of additional letters,” IRS News Release 2022-31, 2/9/22

After implementing a freeze limited to a single notice on January 27¹⁰ the IRS was criticized from many quarters, including the AICPA,¹¹ for taking such a limited action. The IRS has now announced they will be adding a number of other notices to put on

⁸ Partnership Losses in Excess of Partner's Basis Campaign, Large Business and International Active Campaigns, IRS webpage, February 8, 2022 update

⁹ Kristen A. Parillo, “New LB&I Campaign Focuses on Partnership Loss Limitation Rules,” *Tax Notes Today Federal*, February 9, 2022, <https://www.taxnotes.com/tax-notes-today-federal/basis/new-lbi-campaign-focuses-partnership-loss-limitation-rules/2022/02/09/7d5p3> (subscription required, retrieved February 12, 2022)

¹⁰ Ed Zollars, “IRS Will Suspend the Mailing of Automated Notices About Taxpayers Not Filing a 2020 Return for Which the IRS Has a Payment,” *Current Federal Tax Developments* website, January 27, 2022, <https://www.currentfederaltaxdevelopments.com/blog/2022/1/27/irs-will-suspend-the-mailing-of-automated-notices-about-taxpayers-not-filing-a-2020-return-for-which-the-irs-has-a-payment> (retrieved February 12, 2022)

¹¹ Ed Zollars, “AICPA Releases Response to IRS Announcement on Relief for Automated Notices,” *Current Federal Tax Developments* website, January 27, 2022, <https://www.currentfederaltaxdevelopments.com/blog/2022/1/27/aicpa-releases-response-to-irs-announcement-on-relief-for-automated-notices> (retrieved February 12, 2022)

pause while the IRS attempts to catch up on processing the backlog that already exists.¹²

The IRS news release begins by stating:

As part of ongoing efforts to provide additional help for people during this period, the IRS announced today the suspension of more than a dozen additional letters, including the mailing of automated collection notices normally issued when a taxpayer owes additional tax, and the IRS has no record of a taxpayer filing a tax return.

These mailings include balance due notices and unfiled tax return notices. The IRS entered this filing season with several million original and amended returns filed by individuals and businesses that have not been processed due to challenges of the historic pandemic and is taking this step to help avoid confusion for taxpayers and tax professionals.¹³

The IRS does not provide an end date for the pause, noting:

These automatic notices have been temporarily stopped until the backlog is worked through. The IRS will continue to assess the inventory of prior year returns to determine the appropriate time to resume the notices.¹⁴

The IRS warns that this cessation of notices does not mean that the taxpayer or adviser may not continue to receive notices for a period of time:

Some taxpayers and tax professionals may still receive these notices during the next few weeks. Generally, there is no need to call or respond to the notice as the IRS continues to process prior year tax returns as quickly as possible.¹⁵

But the IRS goes on to state that if the taxpayer and/or adviser believes the notice is accurate, they should take action to deal with the situation:

However, if a taxpayer or tax professional believes a notice is accurate, they should act to rectify the situation for the well-being of the taxpayer. For example, the IRS cautions people with a balance due that interest and penalties can continue to accrue. In addition, IRS

¹² "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022, <https://www.irs.gov/newsroom/irs-continues-work-to-help-taxpayers-suspends-mailing-of-additional-letters> (retrieved February 12, 2022)

¹³ "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022

¹⁴ "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022

¹⁵ "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022

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employees may in select circumstances issue notices to particular taxpayers to resolve specific compliance issues.¹⁶

While not emphasized as much as in the earlier notice, the IRS does continue to note that some notices are required to be issued based on a deadline and will continue to be issued:

The IRS does not have the authority to stop all notices as many are legally required to be issued within a certain timeframe. The IRS will continue to assess other changes and system modifications that the IRS may be able to implement to assist taxpayers on an array of issues. The IRS will continue to make information available to taxpayers throughout the filing season.¹⁷

The News Release concludes with a table of notices that are covered by this suspension.

Individual Taxpayer Notices

Notice/Letter Number	Title	Description
CP80	Unfiled Tax Return	This notice is generally sent when the IRS credited payments and/or other credits to a taxpayer's account for the tax period shown on the notice, but the IRS hasn't received a tax return for that tax period.
CP59 and CP759 (in Spanish)	Unfiled Tax Return(s) - 1st Notice	IRS sends this notice when there is no record of a prior year return being filed.
CP516 and CP616 (in Spanish)	Unfiled Tax Returns – 2nd Notice	Request for information on a delinquent return as there is no record of a return filed.

¹⁶ "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022

¹⁷ "IRS continues work to help taxpayers; suspends mailing of additional letters," IRS News Release 2022-31, February 9, 2022

Notice/Letter Number	Title	Description
CP518 and CP618 (in Spanish)	Final Notice – Return Delinquency	This is a final reminder notice when there is no record of a prior year(s) return filed.
CP501	Balance Due – 1st Notice	This notice is a reminder that there is an outstanding balance on a taxpayer’s accounts.
CP503	Balance Due – 2nd Notice	This notice is the second reminder that a there is an outstanding balance on a taxpayer’s accounts.
CP504	Final Balance Due Notice - 3rd Notice, Intent to Levy	The IRS sends this notice when a payment has not been received for an unpaid balance. This notice is a Notice of Intent to Levy (Internal Revenue Code Section 6331 (d)).
2802C	Withholding Compliance letter	This letter is mailed to taxpayers who have been identified as having under-withholding of Federal tax from their wages. This letter provides instructions to the taxpayer on how to properly correct their tax withholding.

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Business Notices

Notice/Letter Number	Title	Description
<u>CP259</u> and <u>CP959 (in Spanish)</u>	Return Delinquency	IRS sends this notice when there is no record of a prior year return being filed.
<u>CP518</u> and <u>CP618 (in Spanish)</u>	Final Notice – Return Delinquency	This is a final reminder notice that we still have no record of a prior year tax return(s).