

Federal Tax Update – March 2021

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INDIVIDUALS

Public Law 117-2, the American Rescue Tax Plan of 2021:

- Creates a \$1,400 credit in 2021 for most individuals with an additional \$1,400 for each dependent phased out at adjusted gross income between \$150,000-\$160,000 for married couples, \$112,500-\$120,000 for heads of household and \$75,000-\$80,000 for single individuals; an advanced payment is based on 2020 AGI (2019 if the 2020 return is unfiled) and may not be offset by federal and state tax debt or unpaid support.
- Makes taxfree the first \$10,200 of unemployment benefits received by an individual in 2020 if the return shows modified adjusted gross income of less than \$150,000; an exclusion of up to \$20,400 is available on a joint return if each spouse had over \$10,200 in benefits.
- Excludes discharge of most government, school and private student loans from income for 2021-2025.
- Modifies the child tax credit for 2021 to increase the amount to \$3,600 for a child under 6 and to \$3,000 for a child 6-17 (up from age 16) with a phaseout at 5 percent of excess modified AGI to the pre-2021 level beginning at \$150,000 for married couples, \$112,500 for heads of household and \$75,000 for single individuals; an advanced payment of 50 percent of the credit is available July 1, 2021 with a phased-in repayment

obligation on the first \$2,000 in overpayments by those with modified AGI over \$60,000-\$120,000 for married couples, \$50,000-\$100,000 for heads of household and \$40,000-\$80,000 for singles.

- Modifies the earned income tax credit for 2021 to allow higher 2019 income to be used in computations while lowering the minimum age for eligibility for those without children from 25 to 19 (to 24 for students) and eliminating the upper age limit of 65 while increasing the maximum credit from \$543 to \$1,502 by adjusting the minimum income necessary for the credit as well as the phaseout amount.
- Permanently raises the disqualifying investment income limitation for the earned income credit from \$3,650 to \$10,000 adjusted for COLA, modifies the childless earned income credit to be claimed by individuals whose children do not have social security numbers and allows the earned income credit to be claimed on a married filing separate return if the individual lives with a qualifying child for more than one-half of the year and does not live with spouse for the last six months of the year (or have a separation or divorce instrument).
- Modifies the dependent care credit for 2021 to create refundability, increases the cap on qualifying expenses from \$3,000 to \$8,000 for those with one child and from \$6,000 to \$16,000 for two or more children and increases the credit rate to 50 percent of expenses for those with adjusted gross income under \$125,000 phasing down to 20 percent at \$185,000 and phasing out from 20 percent to zero between \$400,000 and \$440,000.

In *In Re: Petty*, 127 AFTR2d 2021-_____, a Florida Bankruptcy Court noted that issuance of a Form 1099-C by the mortgage lender to charge off the debt for accounting purposes does not make the debt legally uncollectible, stating that the form should not have been issued in the absence of actual discharge.

In *Clay v. Commissioner*, 127 AFTR2d 2021-_____, the Eleventh Circuit Court of Appeals agreed with the Tax Court that casino profits divided among members of a Native American nation are taxable as such income was not exempted in the settlement agreement with the nation as the treaty exemption applies only to transferred land and money.

In *Mathews v. Commissioner*, TC Memo 2021-28, the Tax Court reached a different result than in a prior case, here as to gross income from ministry shown on a Schedule C where the preparer wrote down \$11,000 in income and \$31,000 in expenses that did not exist; the Court disallowed the deductions but did not tax the full-time trucking company employee on the phony gross receipts.

In *Martin v. Commissioner*, TC Memo 2021-35, the Tax Court disallowed a decade-old net operating loss for lack of substantiation of the losses in the early years.

In *Chiarelli v. Commissioner*, TC Memo 2021-27, the Tax Court denied a deduction for alleged contributions to Goodwill and the Salvation Army of almost \$100,000 of household items described as being in excellent condition; however, the taxpayer left huge portions Form 8323 unanswered; in *Pankratz v. Commissioner*, TC Memo 2021-26, the Tax Court declined to excuse noncompliance and permit the charitable deduction of amounts in excess of \$3.5 million for a building and oil and gas projects where the taxpayer did not review his own return to see if the required appraisals were included.

In *Pichardo v. Commissioner*, TC Summary Opinion 2021-7, the Tax Court reiterated that employee business expenses under pre-2018 law were only deductible if the employee was barred from reimbursement by written policy or ad hoc decision with the employee having to prove the inability to get reimbursement; the taxpayer lost on this issue but would also have lost for inadequate substantiation.

In Announcement 2021-7, IRS announced that amounts paid for personal protective equipment such as masks and hand sanitizers for the primary purpose of preventing COVID may be deducted as medical expenses subject to the 7.5 percent floor and are eligible for reimbursement under various flexible spending arrangements.

RETIREMENT AND ESTATE PLANNING

Public Law 117-2, the American Rescue Tax Plan of 2021, increases the time period for defined benefit plans to make up certain actuarial shortfalls from seven to 15 years, effective for 2019 plan years.

In *Catania v. Commissioner*, TC Memo 2021-33, the Tax Court agreed with IRS that a withdrawal from an IRA between ages 55 and 59½ for living expenses is subject to the penalty for early withdrawal though withdrawn funds were in an employer plan until moved to an IRA at age 55.

In Notice 2021-21, IRS extended the period for opening IRAs and/or making 2020 contributions until the lengthened individual return deadline of May 17, 2021.

BUSINESS

Public Law 117-2, the American Rescue Tax Plan of 2021:

- Increases for 2021 the maximum exclusion on employer paid dependent care from \$5,000 to \$10,500.
- Extends the employer payroll tax credit for paid sick and family leave for six months through September 30, 2021, restarting the 10-day limit on April 1, 2021,

expanding it thereafter to include time off for vaccinations and increasing the maximum from \$10,000 to \$12,000.

- Extends the employee retention credit for six months through 2021, increasing the maximum credit for 2021 from \$20,000 to \$28,000; businesses started after February 15, 2020 with gross receipts under \$1 million get a maximum credit of \$50,000 for 2021 and those whose receipts are less than 10 percent of the equivalent 2019 quarter have no ceiling.
- For 2021 and 2022 expands eligibility for the premium tax credit by eliminating the phaseout and reducing the required contribution toward the premium to 0 percent to 8.5 percent of household income and for 2021 treats a single week of receiving unemployment compensation as automatically meeting income eligibility rules.

In *Gaylor Land & Development v. Commissioner*, TC Memo 2021-30, the Tax Court denied a \$1.2 million deduction for a construction company's payment to a captive insurance company for lack of risk shifting and distribution where the risks tied back to one entity and were not spread out to show independence by the captive.

In *Purple Heart Patient Center v. Commissioner*, TC Memo 2021-38, the Tax Court denied a medical marijuana dispensary a deduction even for cost of goods sold where substantiation was destroyed and cost of goods sold could not be reliably estimated.

In *Max v. Commissioner*, TC Memo 2021-37, the Tax Court agreed with IRS that the process of designing clothing including fit testing and fabric testing, is not eligible for the research credit as the production process is nontechnical and concerned more with style, taste and seasonality.

In *Ward v. Commissioner*, TC Memo 2021-32, the Tax Court treated all distributions from an S corporation as compensation to an attorney who failed to take any salary for the entity.

In Chief Counsel Advice 202111012, IRS concluded that the inclusion of gambling expenses with gambling losses through 2025 applies only to individuals, even if in the business of gambling, and not to casinos or similar.

PROCEDURE

In *Walton v. Commissioner*, TC Memo 2021-40, the Tax Court ruled that an accuracy related penalty applies when gross receipts were understated on the return although the taxpayer claimed that she had told her CPA of the proper number while giving the preparer only the 1099s that she could locate.

In *United States v. Boyd*, 127 AFTR2d 2021-_____, the Ninth Circuit Court of Appeals reversed a California Federal District Court and found that IRS could impose only a single \$10,000 penalty per year for nonwillful failure to file an FBAR for 14 accounts; in *United States v. Giraldi*, 127 AFTR2d 2021-_____, a New Jersey Federal District Court agreed, however, the Courts remain deeply divided.

In *Kimble v. United States*, 127 AFTR2d 2021-_____, the Federal Circuit Court of Appeals agreed with the Court of Federal Claims that failure to report an inherited Swiss bank account on an FBAR for many years constituted willfulness despite the taxpayer respecting the wishes of her father to keep it secret in case of persecution and the need to leave the country; in *United States v. Gentges*, 127 AFTR2d 2021-_____, a New York Federal District Court found an individual to have willfully violated the FBAR reporting requirement where he did not review the return and the preparer's software defaulted to a "no" in the absence of input to the contrary.

In *Jones v. Mnuchin*, 127 AFTR2d 2021-_____, a Georgia Federal District Court once again found that the deprivation of passports to tax delinquents does not violate their constitutional rights, the Court rejecting arguments under the Privileges & Immunities Clause as well as the First, Fifth, Ninth and Fourteenth Amendments; in *Rowen v. Commissioner*, 156 TC No 8, the Tax Court found that the legislation restricting passports in the case of serious tax delinquents does not violate the Due Process Clause.

In *McNeil v. United States*, 127 AFTR2d 2021-_____, a District of Columbia Federal District Court ruled that the failure of IRS to send a prior notice to a taxpayer that his tax debt is "seriously delinquent" does not render an IRS attempt at passport revocation to be unenforceable.

In *Patrick's Payroll Services v. Commissioner*, 127 AFTR2d 2021-_____, the Sixth Circuit Court of Appeals agreed with the Tax Court that the language allowing substantive issues be brought up at a CDP hearing – "did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability" – requires that both of the two conditions be met and that the word "or" did not create disjunctive qualifications; in *Jeffers v. Commissioner*, 127 AFTR2d 2021-_____, the Seventh Circuit Court of Appeals agreed with the Tax Court that a taxpayer cannot raise substantive issues in a CDP hearing upon notice of levy where the taxpayer did not seek Appeals review following a notice of lien.

In *Sleeth v. Commissioner*, 127 AFTR2d 2021-_____, the Eleventh Circuit Court of Appeals found that the Tax Court did not err in rejecting innocent spouse equitable relief for a former wife on a single highly weighted factor – that she had knowledge of the excessive spending and unpaid tax liability; in *Spitulnik v. Commissioner*, TC Memo Bench Opinion (2021), the Tax Court denied innocent spouse treatment to a teacher, married to a law firm partner, where only one of seven factors, her health, favored relief

and she remained married to her husband, was aware of the liability and benefitted beyond support needs.

In In Re: Ransdell, 127 AFTR2d 2021-_____, a Florida Bankruptcy Court permitted a divorcee to discharge income taxes in bankruptcy where she and her former husband filed three years of returns without payment; the Court noted that this was a “close” case but noted that excessive personal spending including private schools and an expensive pony for her daughter is insufficient to show an attempt to evade taxes.

In In Re: Szczyporski, 127 AFTR2d 2021-_____, a Pennsylvania Federal District Court reversed a bankruptcy court’s decision and found that the shared responsibility payment in the Affordable Care Act was a tax and not a penalty, preventing discharge in bankruptcy until the statutory passage of time.

In Announcement 2021-59, IRS extended the individual income tax filing deadline until May 17, 2021; the extension does not apply to first quarter 2021 estimates.