insero

2025 Tax Seminar

January 23, 2025

Agenda for Today

A Slice of History and Background

Opening Thoughts on Government Funding

- Other than a few short occasions, prior to 1915, the US Government was funded in large part by tariffs (along with an excise tax on whiskey)
- The Income/Estate tax debate was brought about mainly by Theodore Roosevelt in the early 1900's as part of his Progressive movement to empower labor, reduce large concentrations of wealth, bust trusts
- Tariffs for decades were seen as essential to the growth of US industry, but came to be seen as detrimental as the economy became more global

Opening Thoughts…

- Thus, the problem; Tariff reduction equals less government revenue. What to do?

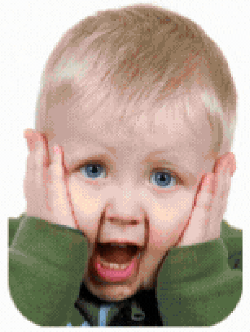
- TR had other priorities and left it to his protégé WH Taft, who did not follow TRs policies

- Wilson got elected, on different platforms, but did get the income tax passed in 1913 via the 16th Amendment to the Constitution. More on this later…

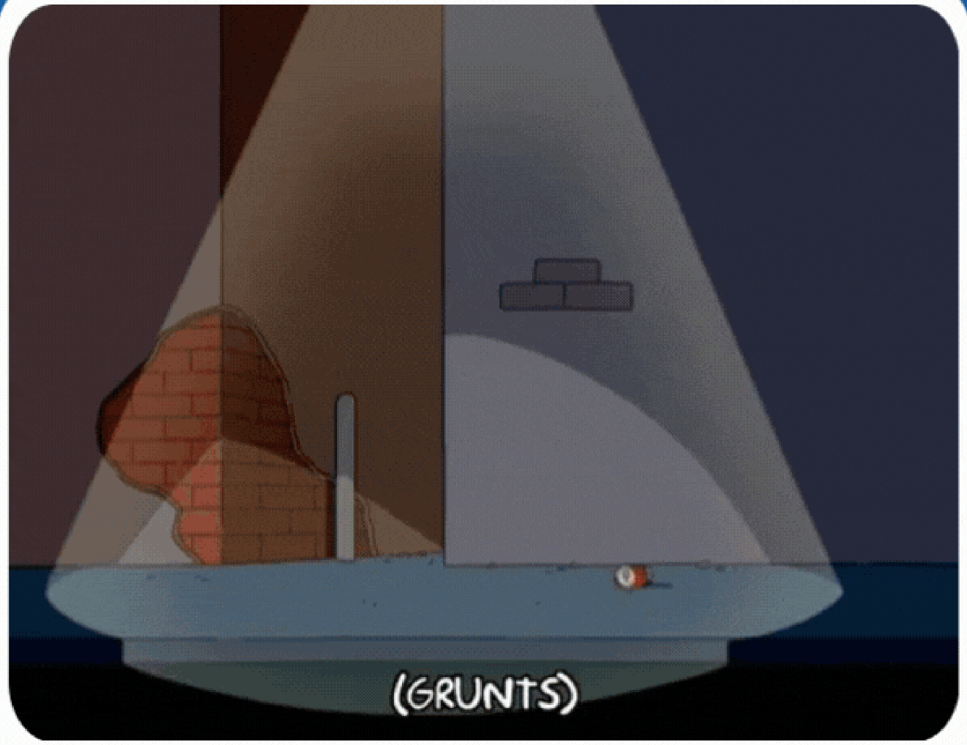
- Voila. A way to reduce tariffs, continue to fund the government, and attempt to level out huge concentrations of wealth

Government Today

No budget passed on time since 1996



(Source: US Senate budget committee)



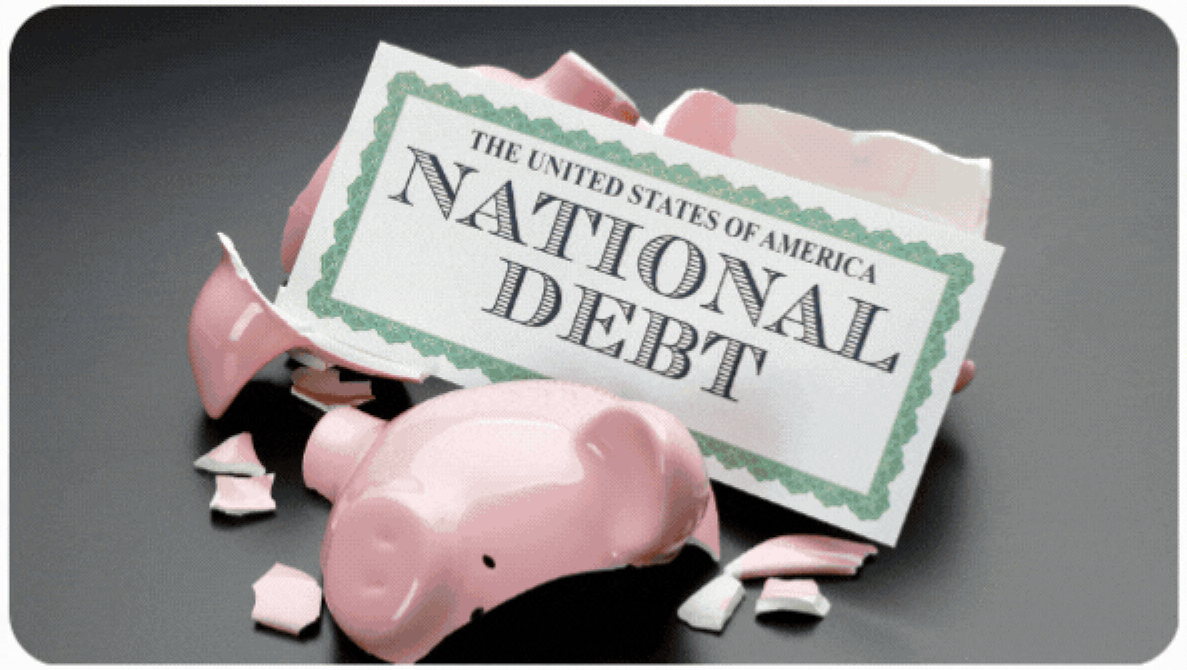
Funded via Continuing Resolutions - aka - CR's, which essentially kick the can down the road, such as the one we are under now, which expires on March 14, 2025

Budget Deficit = Excess of spending over collections for a given year.
Cash basis

Government Today

Have not had a budget surplus in 25 + years
(Source: US Treasury Fiscal data)

What happens? Government borrows to fund the difference



National Debt = cumulative outstanding borrowings

As of November 2024 the approximate National Debt is…

$35 Trillion

Government Today Continued....

Just exactly how big is $35 Trillion?

Said another way, it is 35,000 x $1 Billion

So, if we were able to pay $1 BILLION / DAY, it would take us 35,000 DAYS to pay off the debt in its entirety.

35,000 DAYS = ~ 96 YEARS

Take a minute to comprehend that

Government Today

1981

In 1981 the share of US debt to GDP was 32%.
It is 123% as of November 2024
(Source: US Treasury Fiscal data)

Does this sound sustainable?

$

So why do we have no annual budgets and have CR's and regular (annual?) fights about the debt ceiling?

$

Revenue has increased steadily with occasional annual exceptions over the course of our history.
(Source: US Treasury Fiscal data)

1950

Spending has increased much faster. Until the 1950's or so, accumulating national debt was avoided.
(Source: US Treasury Fiscal Data)

Fast Forward to Today…

What is on the table for
legislative tax discussions in 2025?
EVERYTHING!

Specifics:

TCJA Expiring Provisions

Generally, items related to personal tax returns

TCJA Non Expiring Provisions

Generally, items relating to business tax returns

- IRS funding
- Self-employment taxes
- Budget discussions/debt ceiling/spending issues

REVIEW OF TCJA EXPIRING PROVISIONS

TCJA EXPIRING PROVISIONS (NOT EXHAUSTIVE)

A few topics of worthy of discussion....

- Bonus depreciation
- Qualified Business Income deduction
- Tax rates / brackets
- SALT cap
- Miscellaneous deductions
- Standard deduction
- Personal exemption
- Child credit
- Estate exemption
- Return of Alternative Minimum Tax (AMT)
- Excess loss limitation (through 12/31/28)

QBI / Tax Rates Example: FACTS

S Corp income of $500,000 - all of which is eligible for QBI deduction

State PTET election in place in 2025, not 2026, in the amount of $35,000 which has NOT been deducted to get to the $500,000

Spouse works in the S Corp, has salary of $75,000

Interest income of $5,000, no other investment income

Mortgage interest of $11,000

Charitable contributions of $5,000

SALT total – RE tax plus income tax on salary- $13,000

TWO kids

Example Results

This example ignores differences due to bonus depreciation, interest expense limitation, and other various tax factors.

	2025	2026
Taxable Income from Pass-Through	465,000	500,000
199A/QBI Deduction	(93,000)	0
Taxable Income to Shareholder	372,000	500,000
Taxable Income with Wages and Interest, before SD	452,000	580,000
Standard Deduction	(MFJ) 30,000	(MFJ) 16,700
Itemized Deduction	26,000	64,000 (less 3% limitation 58,588)
Taxable Income	422,000	521,412
Individual Tax Rate (marginal)	32%	35%
Regular Tax	89,166	140,508
Alternative Minimum Tax	83,418	148,147
Child Tax Credit	4,000	2,000
Total increase of approximately $59,000		

REVIEW OF TCJA NON-EXPIRING PROVISIONS

TCJA PROVISIONS NOT EXPIRING, BUT UP FOR DISCUSSION

Business interest expense limitation:
- Note that depreciation/amortization is NOT added back any longer
- This is a thing when considering acquisitions and any type of borrowing

Amortization of R&D costs over 5 years:
- Started for 2022 tax year
- Greater clarity needed

Corporate tax rate of 21%
- Will it go higher?
- Will it go lower?

ERC UPDATE

Employee Retention Credit Recap / Timeline

MAR 2020

CARES Act
Not so much of a big deal because could not claim if PPP loan was taken. Available through 12/31/2020

DEC 2020

Consolidated Appropriations Act
Greatly liberalized the qualifications, greatly increased the credit amount and extended to 6/30/2021.
IRS in great difficulty

MAR 2021

American Rescue Plan
Extended ERC to 12/31/21 and added additional qualifications

NOV 2021

Infrastructure Act
Removed Q4 2021 from credit eligibility

Employee Retention Credit Recap / Timeline Continued...

2021

2022/2023

SEPT 2023

JAN 2024

Calendar 2021
Filing of obvious claims,
IRS enters 2nd level of distress. Various "guidance" pronouncements issued by IRS

Calendar 2022/2023
Nefarious players enter the market,
charging contingent fees and often using questionable (at best) qualification arguments

IRS on life support
Issues more "guidance" and numerous warning to taxpayers to beware of scams

IRS issues moratorium on filings
They will not process any claims filed after that date until further notice

January 31, 2024
Proposed date for ending ERC claims. Bill was passed by H of R in January 2024, along with many other tax provisions, including, notably, a 6 year statute of limitations. Never passed by Senate due to clashes regarding other issues, primarily the child credit extension

Employee Retention Credit Recap / Timeline Continued...

FEB-MAR 2024

VDP #1
2,600 taxpayers, $1B

Claim Withdrawal procedures initiated
7,300 taxpayers $677M

AUG-NOV 2024

VDP #2 ???
Taxpayers, $???

IRS Action
Actively chasing and pursuing bad actors. Audit notices galore

APRIL 2025

ERC
Statute expires for 2021 ERC claims

Employee Retention Credit Today

Will Congress enact longer SOL, and if so, in what legislative vehicle? IRS is begging for an extension.

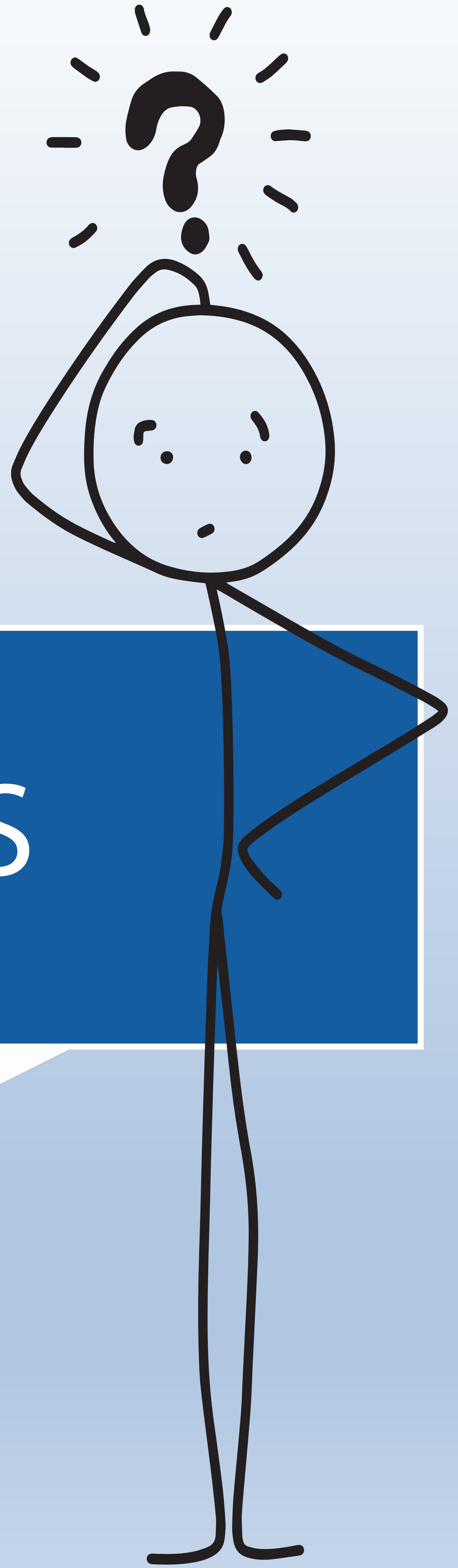
MANY audits are in progress, many still behind the scenes.

- Checking qualifications, employment returns, using VDP data, AI, etc…

HUNDREDS of THOUSANDS (more?) of claims are still outstanding.
Some filed as early as 2021, but most filed in 2022/2023, and many are questionable.

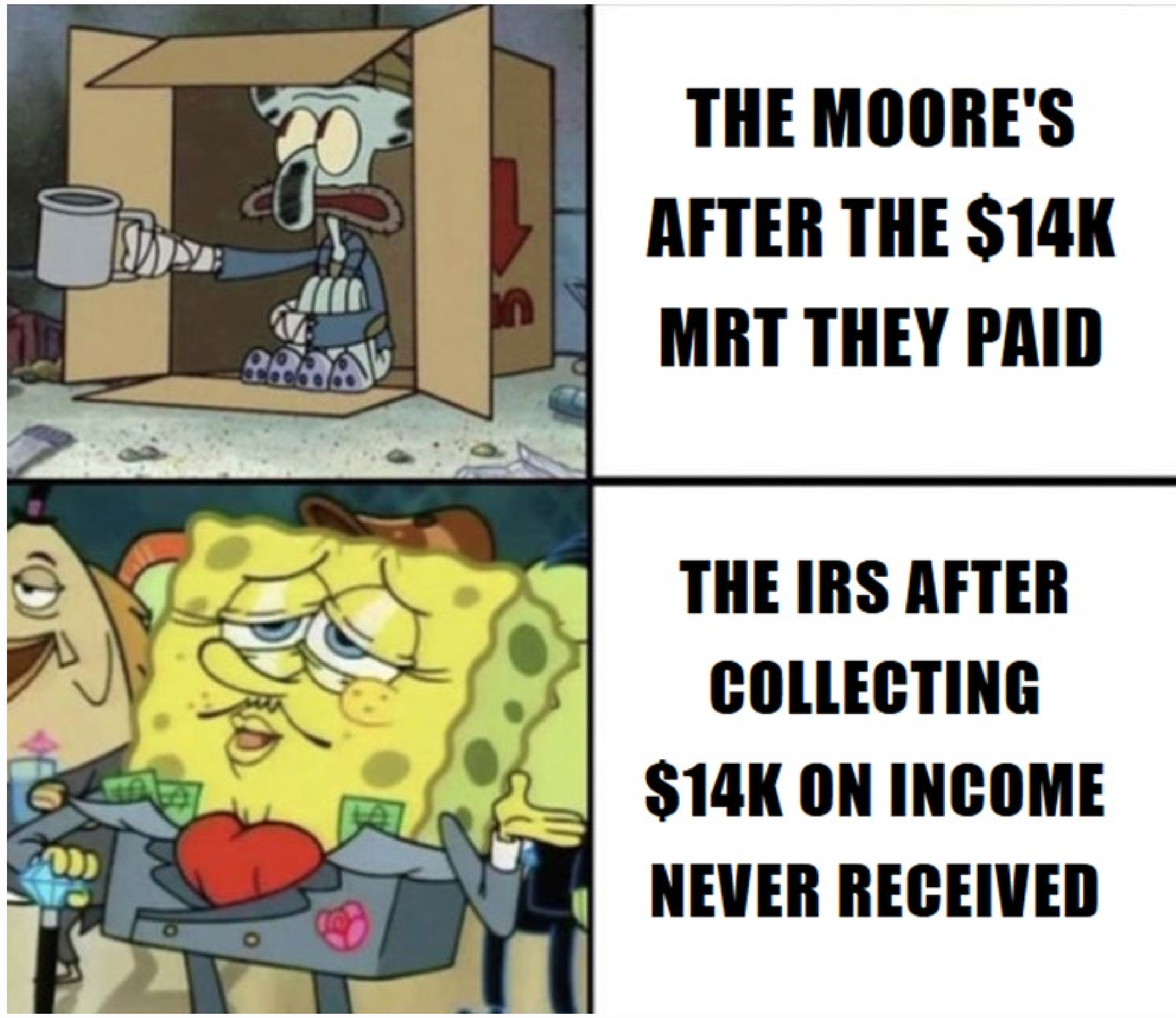
Taxpayers who claimed for 2021 are waiting for either checks or for the audit notice.

REVIEW RELEVANT TAX CASES



Tax Cases of Interest - Moore (SCOTUS)

- TCJA included a "Repatriation Tax" on earnings of foreign Corps, ***regardless of whether any cash was distributed***
- This tax was assessed to US shareholders of foreign corporations
- Was a major offset (IE: a "pay for") to the tax reductions in TCJA
- This caused the Moore's, minority owners of a foreign corp, to pay $14,729 (not a typo) in federal tax in 2017
- They were upset and, acting like the fine American citizens that they no doubt are, filed suit against the US. They lost. They appealed. They lost again. They appealed to SCOTUS…
- Why do they care so much and why did SCOTUS accept a $14k case?



Moore Continued...

- Constitutional issues/16th Amendment
  - Direct tax = Apportionment to by state population. NOT GOOD!
  - Indirect = No apportionment
  - Pollock case - indirect (property tax) must also be apportioned
  - 16th Amendment overturned Pollock and allowed taxation from whatever source derived, without apportionment. *Viola!* Problem solved!
  - Moore's claimed that this is property tax and must be apportioned
    - Court said, "Ha! nice try. This is income, not property"

- Unrealized income?
  - "But wait!", said the Moore's, "This is UNREALIZED income. Where is THAT in the 16th Amendment?
    - Court said. "Ah, but it IS realized income...just not realized by YOU. Nothing prevents Congress from taxing you on the realized income of a company you own

Moore Saga Continued...

Moore's said,

"We understand pass through taxation and agree that it is Constitutional. But our situation is different and is contrary to Constitutional intent."

Court (after a bit of a huddle, mainly to swat away various arguments),

"C'mon man. Yes, this IS the same thing. Congress has the ability to tax either one, and by the way, if you mean for us to invalidate about 1/3 of the tax code on THIS argument, you're crazy!

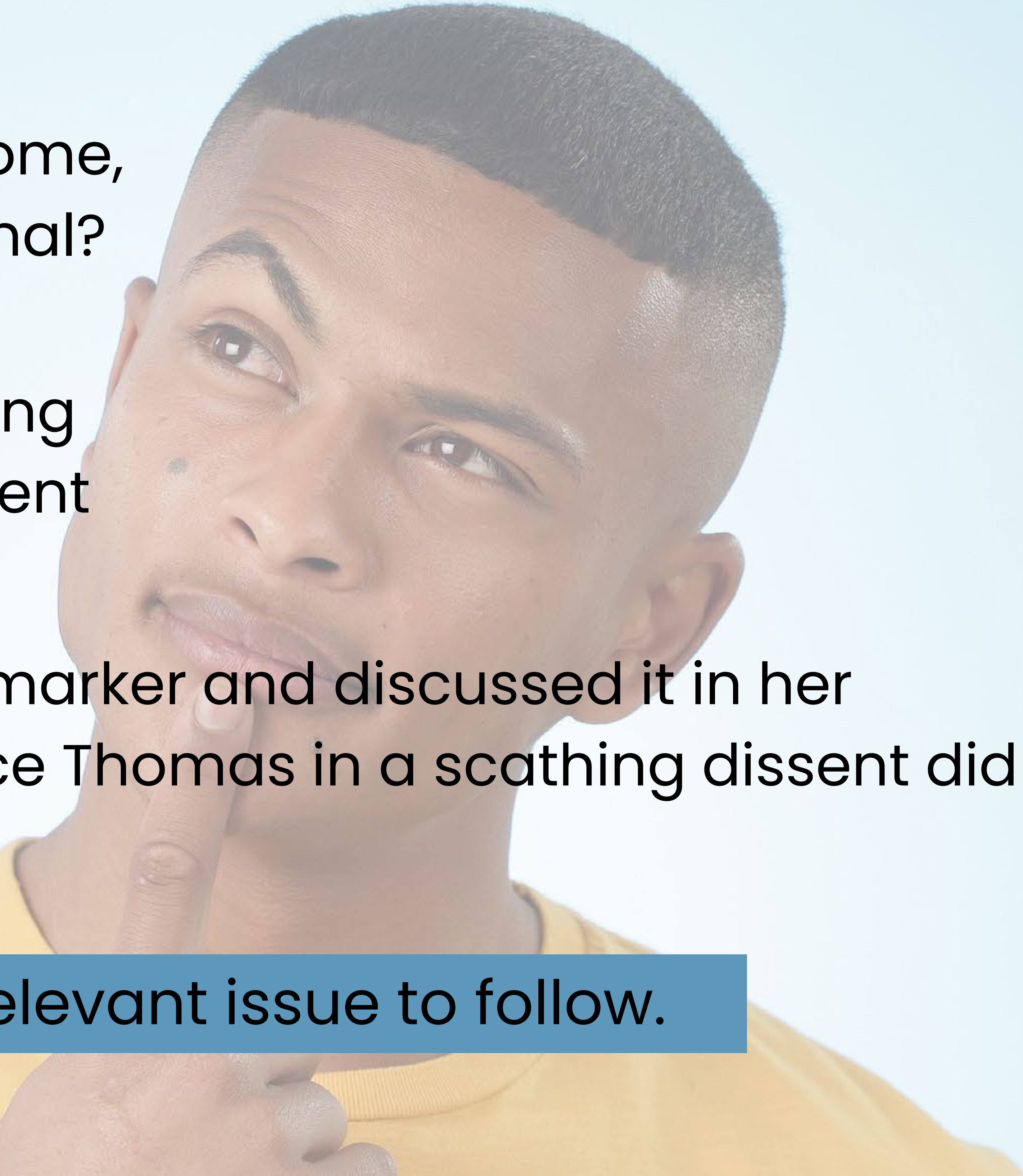
Result? ....Moore's go home unhappy.....

Moore Saga Continued…

- What DIDN'T the court say?

- What exactly, *is* unrealized income, and is taxation of it constitutional?
  - The Opinion specifically referenced this Omission, saying that it is a problem for a different day
  - Justice Barrett threw down a marker and discussed it in her concurring opinion, and Justice Thomas in a scathing dissent did likewise

In today's tax climate, this is a relevant issue to follow.



Tax Cases - Loper Bright (SCOTUS)

- 114 Page decision, quoting Marbury, among other seminal cases
- Essentially shifts power (back) to the Judicial branch (and, perhaps to Legislative branch, should Congress choose to use it) from Executive, in cases where Congressional intent has not been explicit

- Overturns famous *Chevron* decision, which held that courts should defer to administrative agencies and rules when statutes are ambiguous or vague
- Loper Bright establishes that courts are to exercise their own independent judgment in reaching decisions; and, in fact, makes the case that this is the very foundation of the American Judicial system *(Marbury - statutory interpretations belong with the courts not the Executive branch)*

Loper Bright Continued… Why Do We Care?

- IRS is an administrative agency, which has issued tens of thousands of pages of regulations, which largely interpret federal tax statutes
- Are tax statutes sometimes vague?

Implications?

- Will Congress start to write more precise laws in future legislation?
- Will Congress delegate rulemaking authority?
- Will Loper Bright spawn re-examination of many cases that are in process at the moment?
- Will IRS change how and when it issues regulations and other rulings?
- Will more tax cases be brought, which challenge IRS rulemaking authority?
- Will Congress seek to "re-write" certain vague (intentionally or unintentionally) statutes?

Loper Bright Continued...

Time will Tell...

To Note:

Loper Bright does not stand for the proposition that the IRS is "wrong", necessarily; it merely imposes upon the court the obligation to do its own due diligence to determine whether (1) IRS has acted within its authority (i.e. if the statute is sufficiently vague), and (2) whether the IRS regulations are substantively and objectively "correct" in describing and carrying out Congressional intent.

Tax Cases - Soroban and its Progeny

What the heck is self-employment (SE) income anyway and how do we measure it?!

Background:

- SE income forms the basis of the ultimate receipt (?) of Social Security upon reaching eligibility age, while also providing for a separate tax to fund these retirement payments
- No one cares, in the moment, about receiving SS payments. They care about reducing SE tax currently
- In 1977, Congress enacted IRC 1402(a)(13), known as the Limited Partner(LP) exception. Interestingly, this was originally enacted to prevent “investment type” income from entering into the earnings base of a recipient, thereby reducing future government outlays. Why?
  - In 1977, the SE tax was 7% of the first $16,500 of earned income, or $1,155/year (SSA)
  - In 1977, the average SS recipient received $243/month = $2,916/year (SSA)
  - Government was looking to reduce payments, not increase tax collections

Soroban Continued...

- In 1997, Treasury Proposed Regulations defining an LP. Much uproar ensued, because the Senate worried that this definition exceeded the IRS's authority (Loper Bright, anyone?) because it differed with state law, and Congress imposed a moratorium on those proposed regs becoming final
- Meantime, LLCs proliferated, the SE tax rate and earnings base increased dramatically, (notably with the Medicare component being unlimited) and.....here we are. SE tax planning is an integral part of tax planning, because in many instances the SE tax is greater than the income tax
- Taxpayers, particularly hedge fund operators, and their advisors have become creative in structuring their tax affairs around this issue
- IRS has, predictably and publicly, attacked many of these arrangements and have won several cases-mainly where the taxpayers were just dumb. Emboldened, they are now expanding their reach in these audits, as they promised they would

Soroban Continued…

- *Soroban* is a hedge fund, claiming the LP exclusion for its members. IRS audited, adjusted SE earnings, Soroban went to Tax Court and asked for Summary Judgement

- Tax Court said a "functional analysis" of the partners activities must occur. So, this awaits trial or Appeal to District Court (Second Circuit)

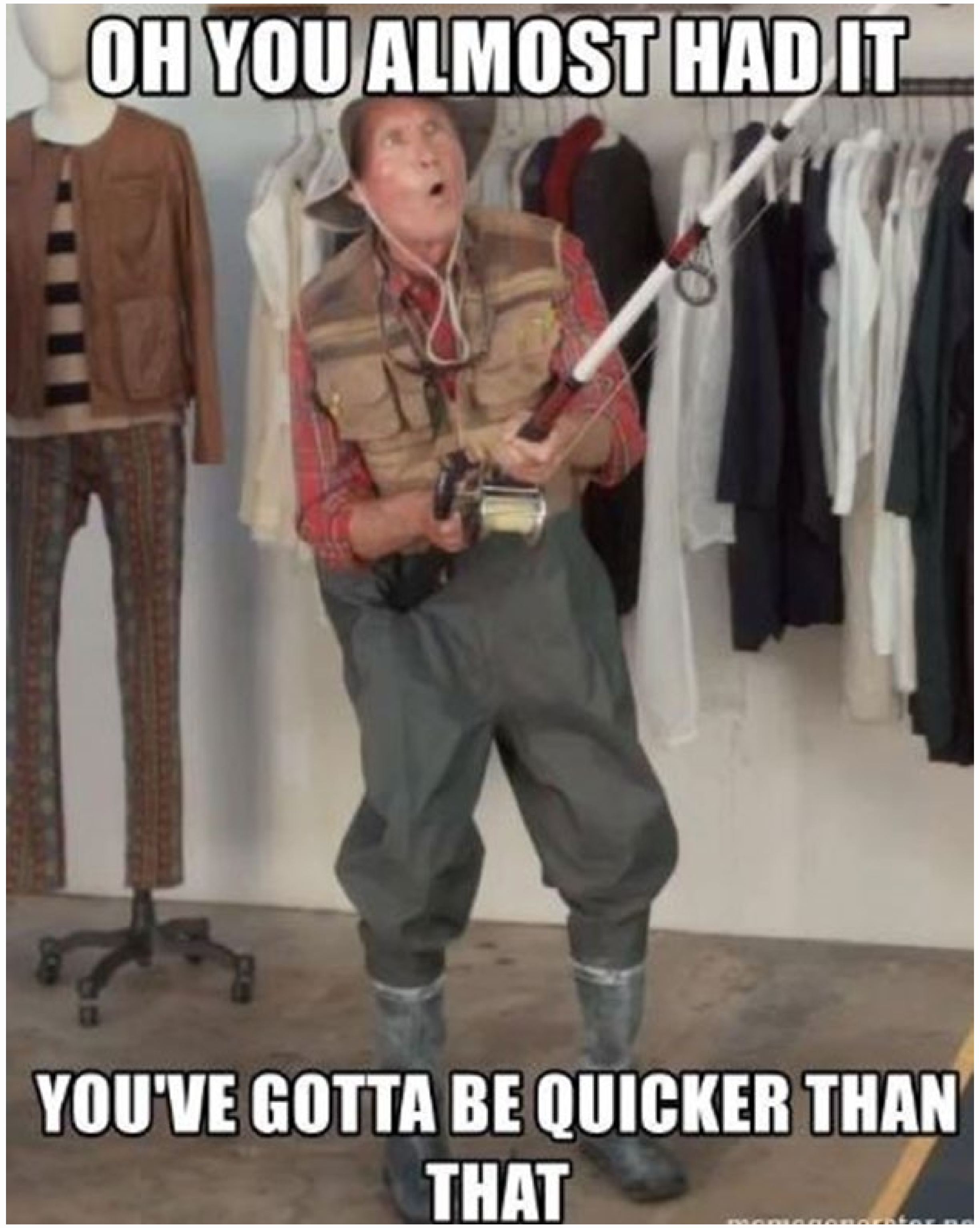
- Meanwhile, in Sirius, a similar case, an Appeal was filed to the Fifth Circuit. If there is a difference of opinion SCOTUS may have to weigh in

- Probably will take another few years before dust settles…or will it?

Soroban Continued…

- Will Congress step in?
- What if all earnings from pass throughs are deemed to be subject to SE tax, and not limited to the base amount, currently $176,000 (other than for Medicare tax purposed)?

Tax Cases: Stenson Tamaddon – aka - ST



- ST is an advisory firm specializing in, among other things, ERC claims. They sued IRS in Arizona (9th District Court) to issue a preliminary injunction to force the IRS to lift the moratorium, claiming “irreparable harm” to themselves, and to taxpayers/public

ST Case
Court Ruling

Summary:

We are sympathetic to your claims but there is not enough for us to issue a nationwide injunction, and it is not possible to issue an injunction limited to Plaintiff (ST). In short, your claims, while valid, do not override public policy considerations.

	IRS	ST	Court
Standing	NO	YES	YES
Serious Questions	NO	YES	YES
Unreasonable delay?	NO	YES	Close! but no
Irreparable harm?	NO	YES	YES
Likely to succeed on merits?	NO	YES	Maybe
Damage to Public?	NO	YES	Some
Benefit to public?	YES	NO	YES
Nationwide injunction?	NO	YES	Nope

IRS ACTIVITY

IRS ACTIVITY

IRS Initiatives

- Global High Net Worth
- Large Companies, especially C corporations
- Partnerships (ESPECIALLY partnerships)

- New/revised forms to deal with basis, sale of partnership interests, etc.
- Establishment of a separate "pass through" division in IRS and hiring to staff it. It has leaders now, so it is serious about this
- Audit campaigns still in process
    - Aircraft
    - Captive insurance
    - Anything foreign in nature-filings, withholdings, forms, etc
    - Inventory valuations/costs/methods, improper deductions, etc

IRS ACTIVITY CONTINUED…

- ERC audits as discussed
- LOTS of online tools
- Get documentation of anything paper filed. Keep mailing receipts, do whatever you can to establish filings of elections and the like. IRS is a mess in this area
- Pursuing SE tax on partners, as we saw with Soroban and others
- R&D Credits-new form issued which is quite onerous in its documentation requirements
- Audit/exam employees are largely new and inexperienced. Practicality is out the window in many cases

POTPOURRI OF TOPICS

POTPOURRI

- Secure Act 2.0 Notable Provisions
  - RMD Age increased from age 72 to either 73 or 75 (depending on DOB)
  - In '25 - "Super Catch up" contributions available for those aged 60-63 as ROTH (if prior year W-2 income is greater than $145,000)
    - But, see IRS Notice 2023-62 delays implementation of the ROTH Mandate to 2026
  - Regular catch-up contributions – also ROTH treatment (if prior year W-2 income over $145,000)
    - IRS Notice 2023-62
  - Penalty Reductions and eliminations in certain cases. Always check these exceptions if you are forced to take an early withdrawal
  - Additional tax credits for first implementation of an employer sponsored retirement plan. Easy to forget

POTPOURRI CONTINUED…

- Ok, so….what's going to happen in the next 6-12 months?
- House is ~ 220-215. Difficult to manage this slim a majority
- Senate 53-47
- Reconciliation process will almost certainly be employed, warts and all, for any tax legislation

UNCERTAINTY

- Factors not present in 2017, that have got to be part of the political calculus.
  - Interest rates much higher now
  - National Debt 2017 was $21T; it is $35T now

- Congressional make up is interesting. Consider…
  - 30% of Senate was not there in 2017 when TCJA was passed
  - 50% of House of Reps were not there in 2017
    - Split, as you would expect, about 50/50 between Republicans and Democrats.

      Source-Congressional Record

MY BETS?......

UNCERTAINTY!

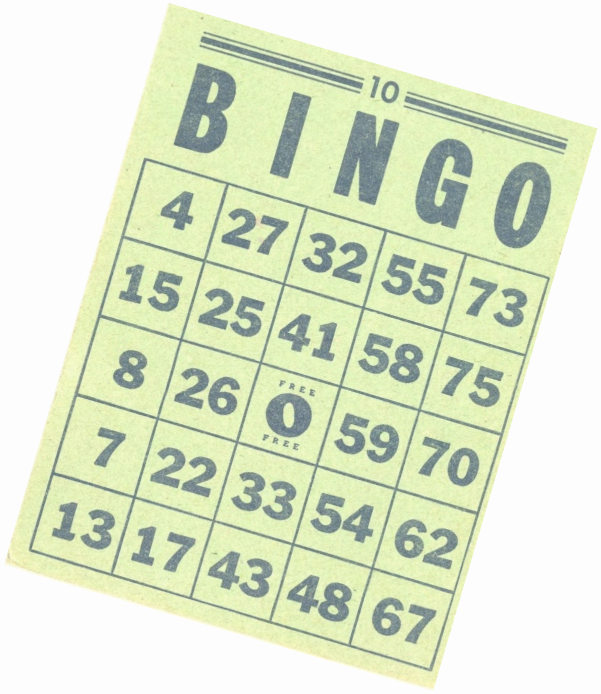
- SALT cap will be raised to $20,000. Need the votes and it won't cost that much, due to the retention of a higher Standard deduction
  - Future of PTET?

- This will be too big a bite to do all at once. I am thinking there will be a few smaller bills that will have some (but not much) bipartisan support. Those will get done. The controversial items will be in a Reconciliation Package. The first test will be the spending limit agreed to in negotiations, then how to stay under that amount

- Contrary to popular belief and Congressional emanations, I do not think that the wholesale extension of the TCJA is a slam dunk. It is quite possible that this is too heavy a lift, given the very slim margins, particularly in the House

UNCERTAINTY CONTINUED…

- The Reconciliation package will not get done soon. Recall that TCJA was not signed until December, 2017 under similar political circumstances, although it was more of an overhaul versus an extension. Still…..
- Retroactivity to 1/1/25? One never knows, of course, but I personally am doubtful that any tax increase will be retroactive (Constitutional issues?), but it is possible that some benefits may be retro-perhaps bonus depreciation.
- I believe that there will be at least a couple things that cause the tax community to say “Wow, I didn’t have THAT on my bingo card!”. For better or for worse.
- Revenue raisers will likely involve increasing penalties, again. This is common, and easy, although the revenue effect is small.



THANK YOU!

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