

National Tax Advisory



ABOUT US

Prager Metis' National Tax Advisory Group is here to help you interpret and navigate tax changes from international, federal, state and local tax and administration.

Our National Tax Advisory Group of professionals offers a wide breadth of tax knowledge and experience. Our team is uniquely positioned to help you prepare for the impact of tax-related changes affecting your personal and professional world.

The National Tax Advisory Group is a leading resource for clients looking to stay current with tax-related developments. The group also assists with resolving complex tax matters in a wide range of areas, including transaction planning, high-level federal, state and local tax research activities, tax position analysis, Internal Revenue Service (IRS) rulings controversy, and much more.

Our team will help you stay abreast of current tax developments. Prager Metis will be communicating tax alerts regularly through a variety of channels, including newsletters, articles, client briefings and webinars.

SUPREME COURT AGREES TO HEAR FBAR PENALTY CASE OF US V. BITTNER

The FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR) must be filed for foreign accounts with a maximum value (either individually or when aggregated) over \$10,000 during the year. The annual filing deadline of the FBAR is April 15th but there is an automatic extension for filing until October 15th.

The non-willful penalty is \$10,000 for non-filing of the FBAR. The penalty for willful non-filing of the FBAR can be assessed at 50% of the maximum account value per year but capped for all years of non-filing at 100% of the maximum account value.

The Supreme Court has agreed to hear arguments on whether penalties assessed for non-willful non-filing of the FBAR applies per form or per bank account. Currently, there is a split in the circuits on the appropriate penalty application. The Ninth Circuit in *United States v. Boyd*, applied the penalty per form, thus limiting the penalty to \$10,000 per year. The Fifth Circuit in *United States v. Bittner* applied the FBAR penalty per account. Additionally, the Second Court of *United States v. Kaufman*, on this same issue that has not yet been decided.

The Court will hear oral arguments on the case on November 2, 2022, and a decision would be expected before June 30, 2023.

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NY STATE GUIDANCE ON RETROACTIVE LAW CHANGE ALLOWING NYC PASSTHROUGH ENTITY TAX BEGINNING IN 2022

In response to a recent NY State law change (NY Governor Hochul signed [S.B. 09454](#) into law on August 31, 2022 allowing a retroactive effective date of January 1, 2022 for NY City's Passthrough Entity Tax (PTET), the NY State Department of Taxation issued technical guidance for the eligibility, election procedures and estimated tax requirements for 2022 (see [Technical Memorandum TSB-M-22\(1\)c. \(1\) dated October 11, 2022](#)). As originally enacted, the NYC PTET had an effective date of January 1, 2023. The NYC PTET tax rate is 3.876 percent.



Eligibility Rules

- NY City eligible partnerships (including LLCs taxed as partnerships) must have a NYC filing requirement, may not be a publicly traded partnership, and must have at least one partner or LLC member that is a NYC resident. Partners and LLC members will be treated as NYC residents if they are NYC residents for at least half of the tax year.
- Eligible NYC resident S corporations must be subject to the City minimum tax and must have all NYC resident shareholders.

In both cases of partnerships and S corporations, in order to be eligible for the NYC PTET, a state level PTET election must have been made.

Election Procedures

- The election must be made by an authorized person of the entity, i.e., a partner or member of a partnership/LLC or a shareholder or officer of the S corporation.
- The election is made online through the entity's NY State Business Services account using the 2022 NYC election application. <https://www.tax.ny.gov/online/>
- For tax years beginning on or after January 1, 2022, the annual election must be made on or before March 15, 2023.
- For tax years beginning on or after January 1, 2023, the annual election must be made on or after January 1st but no later than March 15 of that year.

Estimated Tax Payment Requirements

- For the 2022 tax year, the entity is not required to make estimated tax payments (however, the entity may make optional payments to secure tax deductions for 2022 depending on its method of accounting.)
- NYC personal income tax estimated tax payments must be made for 2022 for city resident partners and S corporation shareholders as if they are not entitled to a credit for the NYC PTET taxes.
- For tax years beginning on or after January 1, 2023, PTET quarterly estimated tax payments are due March 15th, June 15th, September 15th, and December 15th.

Filing of NYC PTET Return

On or before March 15, using the online business services account, the entity is required to file its annual PTET return. PTET returns will be filed on a calendar year basis. For fiscal year taxpayers, the entity will compute its NYC PTET taxable income for the fiscal year that ends within the NYC PTET calendar year. The NY State and NYC PTET taxes will be reported on the same PTET return.

Passthrough Owner Credits & Personal Income Modification

On the NYC PTET return, the entity will report for each NYC resident partner, member or shareholder the amount of PTET tax that will be available as a credit against their NYC resident personal income tax when the owner files their NY State income tax return. Furthermore, the NYC PTET will be an addback modification for purposes of their NY State income tax return reported on Form IT-225.

FORGIVENESS OF STUDENT LOAN DEBT: STATE CONFORMITY WITH THE U.S. EXCLUSION FROM INCOME

President Biden announced his plan to provide forgiveness of up to \$10,000.00 per borrower of student loan debt in September, 2022. Pursuant to the American Rescue Plan, any student loan debt forgiveness between 2021 and 2025 will not attract U.S. tax.

The debt relief may trigger income tax in some states, however: not all states conform to the Internal revenue Code ("IRC") in the same way. Most states have what is known as "rolling conformity": that is, if the U.S. tax code is changed, the state automatically follows the U.S. change. Some states, however, adopt a "fixed-date conformity". This is where most of the state-by-state deviation on taxing student loan forgiveness arises.



As of this date, the only states that have actively made a decision to decouple from the American Rescue Plan tax-free treatment of student loan forgiveness are Indiana and North Carolina. The governor of North Carolina, Roy Cooper, has called for the tax to be waived. It is thought that states which do not conform to the American Rescue Plan exclusion from income for student loan debt forgiveness will adopt a provision conforming directly to the treatment of student loan debt forgiveness under the IRC rather than allow the relief to be subject to income tax in their jurisdictions. California is one of these: presently, few believe that tax could be avoided under its existing regulations.



Currently, seven states may tax the forgiveness of student loan debt. They are:

Arkansas
California
Indiana
Minnesota
Mississippi
North Carolina
Wisconsin.

Note: on Friday, October 21, 2022, the U.S. Court of Appeals for the 8th Circuit ruled that the policy to cancel thousands of dollars in student loan debt should be put on hold while challenges play out. Six states (Arkansas, Iowa, Kansas, Missouri, Nebraska and South Carolina) petitioned the Court to block the student loan forgiveness policy proposed by President Biden after a federal judge in Mississippi had dismissed the states' case for lack of standing. The Biden administration replied on Monday, October 24, 2022 to the Court of Appeals, arguing that the states do not have standing in the case and would not suffer any irreparable harm as a result of the relief.

SMALL BUSINESS TAXPAYER EXEMPTION FROM INVENTORY FINAL REGULATIONS



Final regulations were issued during 2021 that are applicable for tax years beginning in 2022 ([TD 9942](#)). The final regulations clarified eligibility for immediate inventory expensing. As a reminder, the Tax Cuts and Jobs Act of 2017 (TCJA) simplified accounting for Inventory for eligible small businesses. Eligible businesses have the opportunity to treat inventories as nonincidental materials and supplies (NIMS) or as conforming to their applicable financial statements (AFS) or books and records if a taxpayer does not have an AFS. The final regulations have clarified that inventory can be treated as nonincidental materials and supplies (NIMS), however NIMS are not eligible for immediate deduction under the de minimis safe harbor election under IRC Section 1.263(a)-1(f). The NIMS retain their character as inventory until the goods are sold to the customer or when they have been paid for, whichever occurs later. Therefore, treating inventories as NIMS, does not provide immediate expensing of inventory.

The final regulations also provided guidance for taxpayers that choose to follow the AFS inventory method and the non-AFS inventory method. The regulations clarify that costs which are normally required to be capitalized to inventory but are being expensed in a taxpayer's AFS, or non-AFS books and records, can also be expensed for tax purposes. The final regulations define books and records to include both work papers and physical inventory counts. For taxpayers without an AFS that decide to follow the non-AFS inventory method, if a physical count is taken but not actually used to capitalize costs to inventory, then such amounts may be deductible in the year paid or incurred. However, if the taxpayer uses a physical count to capitalize costs to inventory and then makes a journal entry to expense these costs in its financial statements, this journal entry would be ignored for tax purposes and the taxpayer would be required to capitalize the costs in accordance with the physical count. A taxpayer adopting the method of accounting for inventory used in its non-AFS books and records should carefully evaluate their accounting procedures to determine how to account for inventory under the small business exemption. For taxpayers that are currently expensing inventory, be sure to consult your tax advisor to ensure your accounting for inventories is a permitted method.

CALIFORNIA NON-RESIDENTS, POSSIBLE CALIFORNIA TAX ON THE SALE OF A PARTNERSHIP INTEREST

Under a recently issue California Legal Ruling, non-residents of California can now be subjected to California tax on a portion of their gain from the sale of an interest in a partnership operating in California, if any of the assets of the partnership are located in California and are "hot assets"; that is, assets given ordinary income treatment, such as inventory and unrealized receivables.

Prior to this ruling, a California non-resident could feel confident that when selling an interest in a partnership operating in California, all of the gain on the sale of would be treated as gain from the sale of an intangible asset, and subject to tax only in the state of tax residency. However, in this ruling the California Franchise Tax Board brings in and applies the federal tax law rules for ordinary income treatment on the portion of partnership property representing inventory or unrealized receivables and concludes that such ordinary income must be apportioned to, and taxed in California. Further, as with all California Legal Rulings which interpret existing law, the ruling can be applied retrospectively. Because Legal Rulings are generally interpretive of existing law, they have retroactive effect unless otherwise stated in the ruling.

- [Legal Ruling 2022-02](#) – Appropriate sourcing of Internal Revenue Code (IRC) section 751(a) gain from the disposition of a nonresident individual's partnership interest to the extent the IRC section 751 property is located in California.

California generally treats the sale of a partnership interest by an individual under the entity theory, as a sale of intangible personal property, a capital asset, sourced to the state of residence of the seller.⁷ If the intangible property has acquired a business situs in California, the gain on the sale of the partnership interest is sourced to California.

2022 SCHEDULES K-2 & K-3 (FORM 1065) DRAFT FILING INSTRUCTIONS RELEASED

The IRS on October 26 released draft instructions for the 2022 versions of Schedules K-2 and K-3 (Form 1065). The draft partnership instructions can be found [here](#) and the draft partner instructions [here](#).

Schedules K-2 & K-3 provided a significant amount of complication to the 2021 filing season. A significant population of pass-through entities were left wondering if the new schedules applied to them. The IRS made attempts at clarification but the guidance only raised more questions. In addition, the release of the information and timeliness of the guidance was problematic for a number of organizations. The IRS ultimately created a “good-faith effort” penalty abatement and safe harbor applicable primarily to domestic entities. This allowed for those pass-through entities that did file the K-2 & K-3 to worry less about completing the form perfectly, so long as they made a good faith effort. It also allowed those pass-throughs with mainly domestic activity, and no knowledge of the need for these schedules to omit the additional schedules.

In response to stakeholder input, the draft instructions provide a new filing exception. This exception is described on page 3 of the 2022 Partnership Instructions for Schedules K-2 and K-3. This exception is similar in concept to the exception provided last year with new and more concrete requirements. This new exception is for domestic partnerships, as defined under Section 7701(a)(2) and (4) which is generally for partnerships that are created or organized under the US law or any US State law. It contains four requirements to meet the exception:

1. No or limited foreign activity (as defined in instructions);
2. All direct partners are U.S. citizens/resident aliens (as defined in instructions);
3. Partner notification stating that partners will NOT receive a K2/K3 unless a request is made, must be sent to each partner dated no later than 2 months before the due date (without extension); and
4. The partnership does not receive a request by any partners for the schedules on or before one month prior to the due date (without extension) of the partnership’s Form 1065.

These requirements are defined more in the instructions and examples are provided. Most notably organizations will need to pay attention to the partner notification rule especially since it is without extension. Therefore, on or before January 15, 2023, notifications will need to be sent out to each partner of a partnership to avail the partnership of this exception. This notification requirement could be the determining factor if organizations file or do not file these schedules. As a reminder in 2021, the Schedule K-2 was 19 pages, which caused a significant number of preparation hours. Therefore, this exception will come as great relief to a number of domestic organizations. Organizations should contact their tax preparers soon to coordinate notification to the partners. Contact your Prager Metis advisor now to develop a plan for how and when these notifications should take place.

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