PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

February 2023
Vol. 35 Issue 2

15 Things to Keep in Mind for 2022 Tax Filings

Tax Law Changes Continue to Muddy the Waters

The 2022 tax filing season is in full swing, but most people will not file their returns until the April filing deadline. If the IRS owes you money, it's most certainly in your best interests to file as soon as possible, but don't file your 2022 return without first considering these 15 critical points to keep in mind.

1. The due date of the return. The filing deadline for personal income tax returns is April 18, 2023, not April 15. The reason is that April 15 is a Saturday, and April 17 (the next business day) is a holiday – Emancipation Day – in the District of Columbia. So, the deadline goes the next business day, April 18. This applies regardless of whether or not you live in the District of Columbia.

2. A filing extension does not extend the payment deadline. An extension of time to *file* your return is available if you submit Form 4868 on or before the April 18 filing deadline. In that case, you'll have until October 16, 2023, in which to timely *file* your return. The filing extension is automatic. However, getting an extension of time to *file* your return does not extend the due date for *paying* the tax. The tax must be paid by April 18. If you don't pay by the April deadline, the IRS will assess penalties and interest. One of the IRS's best-kept secrets is the fact that you can get an extension of time to *pay* taxes. That application is made on Form 1127. By filing that form on or before the April 18 deadline, you can get up to six additional months to pay without penalties (but interest still applies). The payment extension is not auto-

IN THIS ISSUE

matic. You must show that financial hardship will result if you are forced to pay on time. For more on this, see my book, ***The IRS Problem Solver.***

3. File on time even if you can't pay. Even if you can't pay the tax, you must file the return on time. Failure to file the return carries a penalty of up to 25 percent of the tax owed. While penalties can be canceled for reasonable cause, the IRS and the courts regularly rule that not having the money to pay is not reasonable cause for not filing the return. It may be reasonable cause for not paying on time (depending on the facts), but not having the money is not an impediment to filing a return, such as would be an illness, injury, or missing financial records, etc. See my ***Problem Solver*** for more details on penalty cancellation procedures.

4. The FBAR filing deadline. If you have an interest in, or signature authority over, offshore financial accounts, you may be required to file a FinCEN Form 114 (the FBAR form). April 18, 2023, is the deadline for filing that form with the Department of Treasury. The report is required if the combined balance of all foreign accounts is more than $10,000 at any point during calendar year 2022. Failure to report foreign accounts can trigger both civil and criminal penalties. An automatic extension to October 16, 2023, is available. Note that FinCEN Form 114 is NOT filed with your tax return. The form must be efiled through FinCEN's efiling system. Note also that there are potential overlapping foreign disclosure requirements between Form 114 and IRS Form 9838. The latter is filed as part of your tax return, if required. The foreign asset reporting regime is lengthy and complex. You need to consult counsel if you believe you may have a filing requirement for either of these forms.

5. Reporting digital asset transactions. If, at any time during 2022, you received, sold, exchanged, gifted, or otherwise disposed of a digital asset, you must answer ''Yes'' to the Digital Assets question on the tax return. The question applies to any type of digital asset, not just virtual currencies. Please see the detailed article below on how to report digital assets.

6. Increase in the standard deduction. For 2022, the standard deduction amount has been increased for all filers. The amounts are: (a) $12,950 (Single or Married Filing Separately); (b) $25,900 (Married Filing Jointly or Qualifying Surviving Spouse); and (c) $19,400 (Head of Household).

7. Expiration of certain health-related credits. The credit for sick and family leave for self-employed individuals was allowed to expire. As such, these credits may no longer be claimed. Likewise, the health coverage tax credit was not extended. It is no longer available for any year starting in 2022.

8. Credit for child and dependent care expenses. The changes to the credit for child and dependent care expenses implemented by the American Rescue Plan Act were not extended. As such, for 2022, the credit for child and dependent care expenses is nonrefundable. The dollar limit on qualifying expenses is $3,000 for one person and $6,000 for two or more persons. The maximum credit is 35 percent of employment-related expenses if AGI is $15,000 or less. The maximum amount allowed is reduced as AGI increases above $15,000.

9. The Child Tax Credit (CTC). None of the changes to the CTC imposed by the American Rescue Plan Act were extended. As a result, the following rules apply to 2022: (a) the credit is $2,000 for each qualifying child; (b) the amount that can be claimed as a refundable credit is limited as it was in 2020, except that the maximum refundable amount is increased to $1,500 for each qualifying child; (c) a child must be under age 17 at the end of 2022 to be a qualifying child; and (d) bona fide residents of Puerto Rico are no longer required to have three or more qualifying children in order to claim the credit.

10. The Earned Income Tax Credit (EITC). The enhancements for citizens without a qualifying child implemented by the American Rescue Plan Act don't apply in 2022. This means that to claim the EITC without a qualifying child, you must be at least age 25 but under age 65 at the end of 2022. If you are married filing a joint return, either you or your spouse must be at least age 25 but under age 65 at the end of 2022. It doesn't matter which spouse meets the age requirement.

11. The standard mileage rates. Adjustments have been made to the standard mileage rates for deducting vehicle expenses. For business miles, the rate is 58.5 cents a mile from January 1, 2022, to June 30, 2022, and 62.5 cents a mile from July 1, 2022, to December 31, 2022. For volunteer miles, the rate is 14 cents a

mile from January 1, 2022, to December 31, 2022. For medical miles, the rate is 18 cents a mile from January 1, 2022, to June 30, 2022, and 22 cents a mile from July 1, 2022, to December 31, 2022. A mileage log is required to support any deduction for miles driven in any of the three categories above.

12. AGI limit for traditional IRAs. If you are covered by a retirement plan at work, the deduction limit for contributions to a traditional IRA is reduced based on modified AGI as follows: (a) more than $109,000 but less than $129,000 for a married couple filing a joint return or a qualifying surviving spouse; (b) more than $68,000 but less than $78,000 for a single individual or head of household; and (c) less than $10,000 for a married individual filing a separate return. If you either live with your spouse or file a joint return, and your spouse is covered by a retirement plan at work, but you are not, the deduction is phased out if your modified AGI is more than $204,000 but less than $214,000. If modified AGI is $214,000 or more, you can't take a deduction for contributions to a traditional IRA.

13. AGI limit for Roth IRAs. The Roth IRA contribution limit is reduced as follows: (a) For married filing jointly or qualifying surviving spouse and modified AGI is at least $204,000, you can't make a Roth contribution if your modified AGI is $214,000 or more; (b) For single, head of household, or married filing separately and you didn't live with your spouse at any time in 2022 and modified AGI is at least $129,000, you can't make a Roth contribution if your modified AGI is $144,000 or more; and (c) For married filing separately, you lived with your spouse at any time during the year, and your modified AGI is more than zero, then you can't make a Roth IRA contribution if your modified AGI is $10,000 or more.

14. Alternative minimum tax (AMT) exemption amount. The AMT exemption amount is increased to $75,900 ($118,100 if married filing jointly or qualifying surviving spouse; $59,050 if married filing separately). The income levels at which the AMT exemption begins to phase out are increased to $539,900, and $1,079,800 if married filing jointly or qualifying surviving spouse.

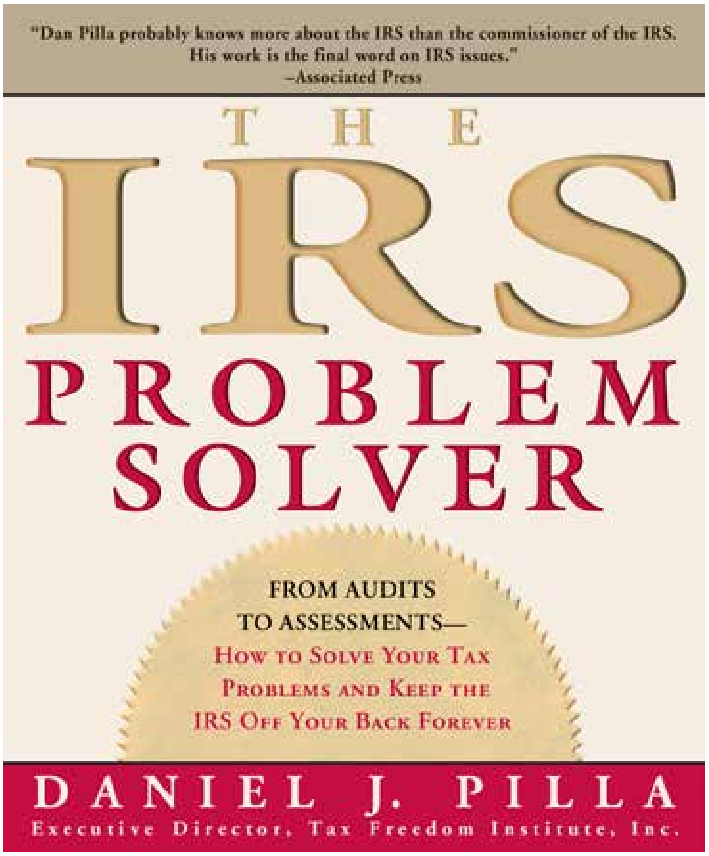
15. Adoption Credit. The adoption credit and the exclusion for employer-provided adoption benefits were both increased to $15,950 per eligible child. The amount begins to phase out if modified AGI exceeds $239,230 and is completely phased out if modified AGI is $279,230 or more.

TO GET MORE HELP

To get qualified help with tax preparation and tax planning issues, contact the Taxpayers Defense Institute Consulting Member nearest you. See the list below.

Taxpayers Defense Institute Consulting Members

Name	Ability Level	Territory (City located)	Phone	Email
Donald MacPherson	Attorney	AZ (Glendale)	800-BEAT IRS	mac@beatirs.com
Donald MacPherson	Attorney	S California	800-BEAT IRS	mac@beatirs.com
Lawrence Stephens	CPA	CA:Northern (Modesto)	(209) 543-0490	lhs@saccon.com
James Olson	CPA	Colorado (Golden)	(720) 328-8624	Financial.Forensics.LLC@comcast.net
Julius Janusz	Enrolled Agent	CT (New Britain)	(860) 225-2867	tax@jjtax.com
Steven Klitzner	Attorney	FL (Miami)	(305) 682-1118	Steve@FloridaTaxSolvers.com
Darrin Mish	Attorney	FL (Tampa)	(813) 229-7100	dmishesq@getirshelp.com
Patricia Gentile	Attorney, CPA	MA, NH (Nashua, NH)	(800) 880-8388	PGentileCPA@comcast.net
Charles Markham	Enrolled Agent	MA (Norwell)	(781) 659-6600	charles@markhamandcompany.com
Manuel Mendoza	Enrolled Agent	MD (Bethesda)	(301) 962-1700	mendoza@mendozaco.com
Daniel J Pilla	EA, US Tax Court	MN (Stillwater)	(800) 553-6458	support@taxhelponline.com
Chris Churchwell	CPA	MO (Joplin)	(417) 781-1829	chris@chtaxgroup.com
Tom Zeiders	Attorney	OK, Tulsa	(918) 743-2000	tom@tax-amnesty.com
Robyn McQuown	CPA	OK, Norman	(702) 265-1159	mcquown@cox.net
Mitchell Gerstein	CPA	PA (Bala Cynwyd))	(484) 434-2041	mgerstein@isdanerllc.com
Kenneth Eichner	CPA	TX (Houston)	(713) 781-8892	kde@kdepc.com
Dionne Cheshier	Enrolled Agent	TX (Dallas)	(972) 514-1424	dionne@cheshiertaxresolution.com
Frank Rooney	Attorney	VA (Arlington), MD & DC	(703) 527-2660	rooneyf@irsequalizer.com



LAST CHANCE!

GET YOUR COPY TODAY!

IRS Problem Solver CD Package

Package includes:

Book and 5 CDS—4 audio presentations of the book and 1 with a PDF workbook.

Normally $99.95 but get your's

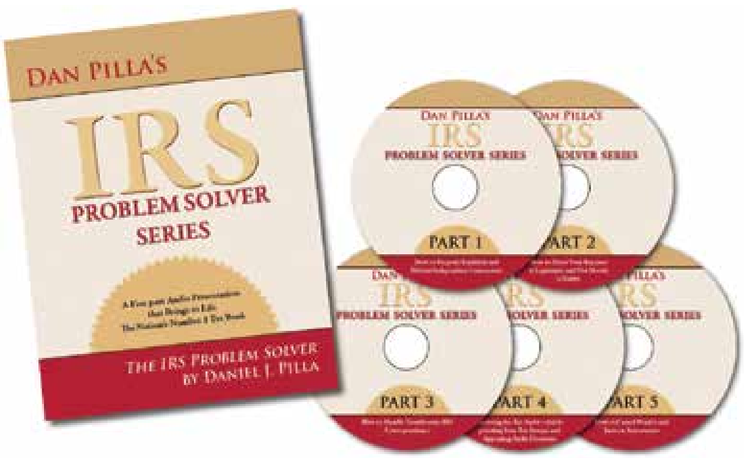
NOW for ONLY $75.

Limited packages available!

CALL US FOR SPECIAL

651 439-1606

LIMITED PACKAGES AVAILABLE

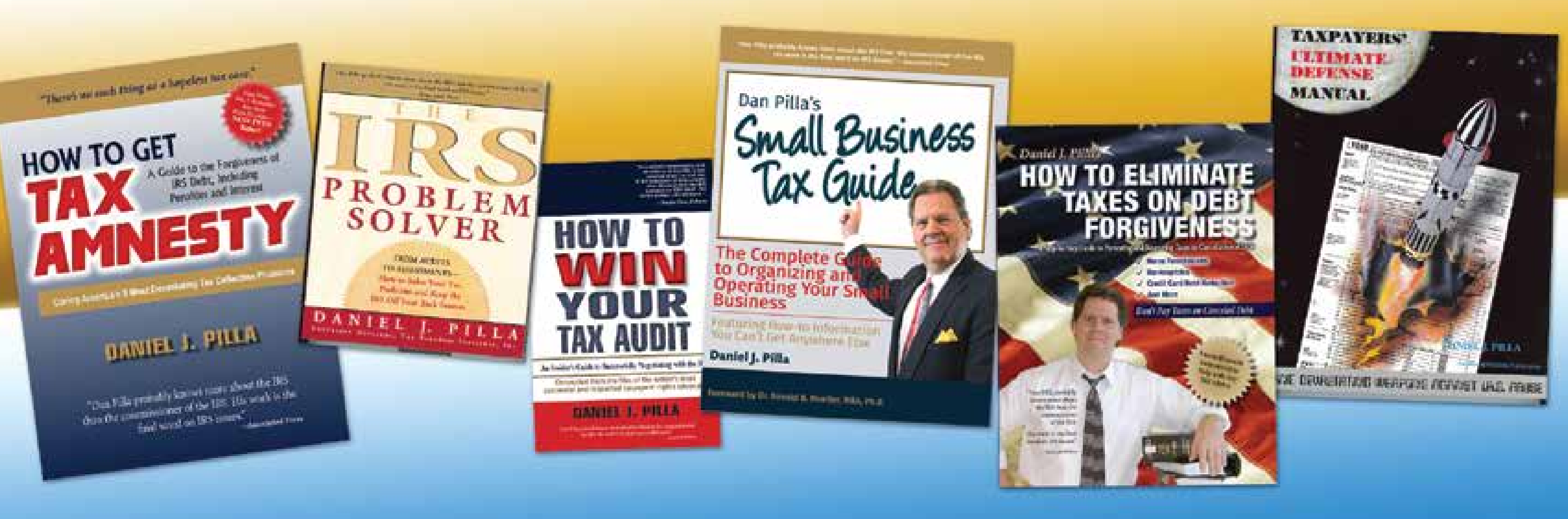


(651) 439-1606

Purchase a book from Taxhelponline.com and you will be eligible for 1 free 15 minute phone consultation with Dan, value $99. *Must order from us and call us to set up the appointment within 3 months of purchase.*

Check out all Dan's products here:

taxhelponline.com/shop/



Disclosing Digital Asset Transactions

As I reported in the Sept/Oct 2022 issue of this newsletter, the IRS is making digital currency cases a priority for its Criminal Investigation (CI) unit. The public is widely ignorant of how digital assets generally, and crypto-currency in particular, are treated for tax purposes. To help clear up this confusion, I am currently working on a special report that will address all the details. In the meantime, we need to address the reporting requirements for crypto assets for purposes of your 2022 tax return.

The 2022 tax return contains a check-the-box line which must be answered by all filers. The box is found on page 1 of Form 1040 or 1040-SR, next to the question regarding digital assets. To get a sense of how seriously the IRS takes this matter, note that this is the first question on the tax return following your name and address. See below.

WHAT IS A DIGITAL ASSET?

Per the Instructions for Form 1040, "Digital assets are any digital representations of value that are recorded on a cryptographically secured distributed ledger or any similar technology." For example, digital assets include non-fungible tokens (NFTs) and virtual currencies such as cryptocurrencies and stablecoins. If a particular asset has the characteristics of a digital asset, it will be treated as a digital asset for federal tax purposes.

WHO MUST CHECK THE "YES" BOX?

You must check the "Yes" box if at any time during 2022, you either, (a) received (as a reward, award, or payment for property or services); or (b) sold, exchanged, gifted, or otherwise disposed of a digital asset (or any financial interest in any digital asset). Consider the following specific examples. You must check the "Yes" box if at any time during 2022 you:

- Received digital assets as payment to you for property or services;
- Received digital assets as a result of a reward or award;
- Received new digital assets as a result of mining, staking, or similar activities;
- Received digital assets as a result of a "hard fork";
- Disposed of digital assets in exchange for property or services;
- Disposed of a digital asset in exchange or trade for another digital asset;

Form **1040** Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return **2022** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box. ☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying surviving spouse (QSS)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QSS box, enter the child's name if the qualifying person is a child but not your dependent:

Your first name and middle initial	Last name		**Your social security number**
If joint return, spouse's first name and middle initial	Last name		**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions.		Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ **You** ☐ **Spouse**
City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code	
Foreign country name	Foreign province/state/county	Foreign postal code	

Digital Assets At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)? (See instructions.) ☐ **Yes** ☐ **No**

- Sold a digital asset;
- Transferred digital assets for free (without receiving any consideration) as a bona fide gift; or
- Otherwise disposed of any other "financial interest" in a digital asset.

You have a "financial interest" in a digital asset if you are either, (a) the owner of record of a digital asset, (b) have an ownership stake in an account that holds one or more digital assets, including the rights and obligations to acquire a financial interest, or (c) you own a wallet that holds digital assets.

WHEN YOU NEED NOT CHECK THE "YES" BOX

The following actions or transactions, standing alone, generally don't require you to check "Yes":

- Merely holding a digital asset in a wallet or account without any trading activity;
- Transferring a digital asset from one wallet or account you own or control to another wallet or account that you own or control; or
- Purchasing digital assets using U.S. or other real currency, including through the use of electronic platforms such as PayPal and Venmo.

YOU MUST ANSWER THE QUESTION

You must answer "Yes" or "No" by checking the applicable box. Do not ignore the question.

HOW TO REPORT DIGITAL ASSET TRANSACTIONS

The manner by which you report the disposition of a digital asset depends on how you acquired it or disposed of it. The following chart provides generalized guidance on how to report digital asset transactions.

DIGITAL ASSET TRANSACTION	HOW TO REPORT
Received as compensation for services or because of reward or award	Wages or Other Income
Received because of a "hard fork"	Other Income
Received as payment for any property or services provided	Form 1040, Schedule C
Received through mining, staking, or similar activities	Form 1040, Schedule C for Businesses; or Other Income
Sold a digital asset	Form 1040 Schedule D, Form 8949
Exchanged for property or services	Form 1040 Schedule D, Form 8949
Exchanged or traded for another digital asset	Form 1040 Schedule D, Form 8949
Disposed of any other financial interest	Form 1040 Schedule D, Form 8949
Donated to charity	Form 1040 Schedule A, Form 8283
Disposed when held for sale to customers in a trade or business	Sale of Inventory, Part 1, Schedule C or other business tax return

If you are in doubt as to how to treat the disposition of a digital asset, be sure to consult the Taxpayers Defense Institute member nearest you.

State Disaster Benefits

IRS Issues Guidance on Taxation of State Disaster Benefits

During 2022, a total of 21 states paid some kind of financial benefits to their citizens. Since the benefits began to flow, people have asked repeatedly whether such benefits would be taxed by the IRS. Opinions swayed back and forth, depending upon how the payments were classified. Now that we are several weeks into the filing season for 2022 tax returns – and after millions of returns have already been filed – the IRS finally issued guidance on the question.

The guidance comes in the form of News Release IR-2023-23 (Feb. 10, 2023). The overarching conclusion is that, generally speaking (again, there's potential confusion), the benefits are not taxable. The IRS ruled that in "the interest of sound tax administration and other factors," citizens in many states are not required to report certain benefits as income on their 2022 tax returns.

The key questions in the analysis are: (1) whether the payments are for disaster relief, (2) whether they are unemployment compensation, (3) whether they constitute tax refunds, and (4) whether any other payments may be taxable. Let's address each type of payment individually.

1. GENERAL WELFARE AND DISASTER RELIEF

For payments that are classified as disaster relief assistance, the determination is that they are not taxable. The IRS says this applies to "payments related to general welfare and disaster relief." According to the News Release, the IRS determined that, "in the best interest of sound tax administration" and given this is an "issue only for the 2022 tax year," it will not challenge citizens who don't report disaster relief benefits on their 2022 tax returns.

This means that citizens in the following states do not need to report state payments on their 2022 tax returns: Alaska, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Maine, New Jersey, New Mexico, New York, Oregon, Pennsylvania and Rhode Island.

As to Alaska, however, there are additional nuances applicable to Alaska Permanent Fund payments, as mentioned below.

2. UNEMPLOYMENT COMPENSATION

Unemployment compensation is generally considered taxable income, and that has always been the case. However, the American Rescue Plan Act, passed in March 2021, contains a provision exempting from taxation the first $10,200 of unemployment compensation. So, the question of taxability of unemployment compensation is determined by the amount of compensation paid. Married individuals filing jointly may each exclude $10,200 of employment benefits. It applies to individuals with income under $150,000.

3. STATE TAX REFUNDS

If the payment is a refund of state taxes paid it may not be taxable in any event. If the recipient claimed the standard deduction on his federal return, or itemized deductions but did not receive a tax benefit for state taxes paid, the refund is not taxable. A person may not have received a tax benefit for state taxes paid if, for example, the $10,000 limit for state and local taxes applied. The only time state tax refunds are taxable is if state tax payments were deducted on a federal tax return in the first place.

Covid-related tax refunds were issued by four states in 2022. They are Georgia, Massachusetts South Carolina, and Virginia. All refund payments will be excluded from income for federal tax purposes unless the recipient claimed a deduction on the federal tax return for state taxes paid.

4. OTHER PAYMENTS

Other payments that may have been made by states are generally includable in income for federal tax purposes. This includes the annual payment of Alaska's Permanent Fund Dividend and any payments from states provided as increased or extended unemployment compensation (which is treated as explained above).

MORE IRS GUIDANCE

For a list of the specific payments from the various states, and how those payments are classified, the IRS provides a chart explaining the details. The chart is available here:

https://www.irs.gov/newsroom/state-payments

AMENDED RETURNS

Now that we are several weeks into the filing season, millions of people may have already reported non-taxable state benefits as income on their federal tax returns before the IRS issued its written guidance. So what should they do next?

The answer is simple: file an amended tax return, and do it as soon as possible. You have three years from the date the return is filed in which to amend it. Your amended return will remove the non-taxable state benefit, thus reducing your taxable income. That will lead to a refund. The sooner you get this done, the sooner you'll have your money in your own pocket, where it belongs.

Employee Retention Credit and Audit Targets

IRS Says Employee Retention Credit "Ripe" With Fraud

The Employee Retention Credit (ERC) was passed as part of the CARES Act in March 2020. It was intended to provide an incentive for businesses to keep employees on the payroll even if the business was subject to government pandemic shutdown orders, or the business had a substantial drop in gross receipts due to Covid business restrictions. The ERC handed out nearly $2 trillion dollars of taxpayer money to businesses since 2020, and still counting.

When I say "handed out," I mean to say that not only does the credit reduce a qualifying company's employment taxes, but the credit is "refundable." That means that even if the company's employment tax liability falls below zero, it still gets a refund. In that way, the ERC works for businesses much like the Earned Income Tax Credit works for individuals. This is the key reason businesses have (and still are) lined up to claim the credit. Qualified businesses are getting what amounts to "free money" from the federal government.

Since the ERC's inception in 2020, firms have blown up all over America offering to assist companies in getting the ERC refund. Like anything else, the majority of these companies are legitimate enterprises helping business owners navigate a very complicated area of tax law.

To illustrate the complexity, including the creation of the ERC with the CARES Act in March 2020, the credit has gone through four different legislative changes, culminating in its repeal in November 2021 as part of the Infrastructure Investment and Jobs Act. It's one thing

Continued on page 10.

Did You Miss ...

Our Annual Taxpayers Defense Conference?

If you missed our annual Taxpayers Defense Conference, our self-study materials are available through **PillaTaxAcademy.com**. Self study courses are available for tax professionals, business owners and the average taxpayer. Courses for tax professionals include continuing education credit as well as video recordings and Dan's course lecture notes.

THE 2022 DEFENSE CONFERENCE THEME WAS TAX REFUNDS. Topics included the following:

- An analysis of what to expect from the revitalized IRS*
- Claim for refund law and procedures
- Addressing refund statute of limitations issues
- The 3-year rule and financial disability
- Employment tax refunds through the Employee Retention Credit
- 2 ethics sessions including negotiating with IRS* personnel and understanding the rules regarding legal positions taken on tax returns and with IRS submissions
- Our live role-playing and group debriefing sessions*
- Finally, as always, we had our popular and informative moderated discussion where all topics and problems are fair game.*

* not recorded – need to attend live sessions

DON'T DELAY IN ORDERING SELF-STUDY COURSE NOW.

Watch our site for the dates of the next conference.

The Taxpayers Defense Conference is widely regarded as simply the best tax seminar in the country for tax professionals—and for good reason. There is no place else you can go to get the up-to-date, cutting edge information you need to effectively represent your clients in problems resolution issues. And that's a fact.

If you missed one of our conferences go to *Pillataxacademy.com* for more information on our Self-Study Courses.

Questions? Contact Jean at:

800-346-6829

Continued from page 8.

to repeal a tax law, but it's quite another to repeal the law retroactively, which is what happened in November 2021. But — to add even more complexity — the repeal was only partial. Certain businesses falling into a narrow special category are allowed to claim the ERC through the end of 2021, while others are cut off as of September 30, 2021.

Based on the free-flow of trillions of dollars from Washington, it should come as no surprise that the IRS is now concerned about ERC fraud. In fact, Lia Colbert, the IRS's Commissioner of the Small Business Self-Employed Division, believes the ERC is an "area very ripe for fraudulent activity."

The alleged "fraud" problem centers on firms that solicit businesses to claim the credit. Given the complexity of the credit, it is unusual for smaller companies to attempt to go it alone. Rather, they pay others to calculate the credit for them, then prepare and submit employment tax returns on which the credit is claimed. The companies then collect a percentage of the refund as a fee for services.

This, by itself, is most certainly not an unethical practice. It is perfectly reasonable to engage a tax professional for representation in connection with a complicated area of tax law. Nor is it unethical for such a firm to base its fee on a percentage of the refund obtained through its services — as long as the refund is based squarely on the applicable provisions of the tax code.

So there's the rub. Does your ERC claim fall within the nuances of the law applicable to the period of time for which the claim was made? That question can only be answered on a case-by-case basis, and that's why the IRS will be lining up audit targets to determine the accuracy of ERC claims.

Any time government makes a decision to hand out free money, there is a significant risk of fraud. With millions of businesses taking trillions in free money from the federal government, it's naïve to believe there is no fraud associated with some claims. Whether that's the fault of unethical companies representing businesses, or unethical (or merely ignorant) business owners, it doesn't matter. The IRS has five years (not three) to audit an ERC claim and assess taxes with regard to erroneous claims. If the IRS can prove fraud with respect to any return, there is no statute of limitations on the agency's ability to assess taxes – along with the fraud penalty.

POTENTIAL ERC AUDIT ISSUES

So what may the IRS look at when it comes to an ERC claim? I identify and address five potential targets here.

1. Status as a business. Code § 3134(c)(2) requires that the entity claiming the credit was engaged in the activity to earn profit during the calendar quarter for which the credit is claimed. If the business showed losses in prior years, the IRS may claim that the company lacked a profit motive and is therefore not entitled to the ERC. This may be a long shot due to the fact that one of the elements of establishing a profit motive is that the business used employees to carry out business activities. People generally do not pay employees to assist them with carrying out activities engaged in for personal pleasure, enjoyment or recreation. Nevertheless, a string of losses by the business may open it up to the claim that the activity was not engaged in for profit. Chapter 4 of my ***Small Business Tax Guide*** presents all the details on how to prove that an activity was in fact engaged in for profit.

2. Employer eligibility. For an employer to be eligible for the ERC, the employer must meet one of two tests: (a) the company was required to suspend some or all of its operations due to government Covid-19 operational restrictions "limiting commerce, travel, or group meetings," or (b) there was a significant drop in revenue compared to the same quarter for tax year 2019. CARES Act § 2301(c)(2)(A); IRS Notice 2021-20, §II.B. The amount of lost revenue depends upon the particular quarter under examination. There are three different rules that apply depending on the period in question. For purposes of this discussion, employers must carefully apply the rules applicable to the quarter for which the credit is claimed. Most certainly, the IRS will scrutinize eligibility in this regard.

3. Employee eligibility. Employers are entitled to a refundable credit based on the number of qualifying employees on the payroll during the quarter for which the credit is claimed. The credit is capped at certain amounts, also depending on the quarter. Changes to the ERC have made calculating the credit particularly cumbersome. Moreover, not all employees qualify for purposes of the credit. See: CARES Act § 2301(e); IRS Notice 2021-49, § IV.D. To be sure, there's confusion on this point, and there's no doubt in my mind that this will be an audit target. For example, wages paid to the individual taxpayer claiming the credit do not count. Likewise, in the case of a corporation, wages to an individual who is (directly or indirectly) the majority owner of the corporation do not count. Moreover, any related person as defined in Code § 152(d)(2)(A)-(H) is not eligible. That provision sets out the tax code's "relationship test." Disqualified related persons include (but are not limited to): a child or a descendant of a child; a brother, sister, stepbrother, or stepsister; a father or mother, or an ancestor of either; a stepfather or stepmother; a niece or nephew; an aunt or uncle, etc. I anticipate that the IRS will evaluate the relationship test for any person on the company payroll.

4. Dollar amount at issue. The amount of the credit available is subject to two different sets of rules, depending on when the credit is claimed. This has made a monster out of the process of figuring the dollar value of the credit. And I'm sure mistakes were made by employers, and mistakes will be made by the IRS in future audits. Navigating the morass of arbitrary rules will not be easy for anybody involved.

5. Coordination with PPP Loans. Code § 3134(h)(1) provides that wages paid with proceeds from a forgiven Paycheck Protection Program (PPP) loan cannot be used for purposes of figuring the ERC. If a PPP loan was not forgiven, then wages paid with such loans do count for ERC purposes. Moreover, grants under the Shuttered Venue Operators program, as well as Restaurant Revitalization grants that were used for payroll expenses, cannot be counted for ERC purposes. Expect the IRS to carefully scrutinize whether firms claiming the ERC are double-dipping if they received benefits under any of these other programs that were used for payroll.

DON'T GO IT ALONE

If your business is considering claiming the ERC (amended returns can still be filed in some cases), be sure to consult counsel with experience in calculating the credit. If you already claimed the credit, don't be surprised if the IRS decides to audit the claim. In that case, make sure you consult counsel not just experienced with the ERC, but one who knows how to navigate the IRS's appeals process as well. For more on that, see ***How to Win Your Tax Audit***.