Tax Tips
NEWSLETTER

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Self-Employment Tax and the Limited Partner—Continued

before LLCs and LLPs came into existence, allows limited partners (that is, partners with no personal liability or management rights) to exclude all but their guaranteed payments from their SE tax calculation. In 1977, the business entity known as the LLC was first authorized under Wyoming state law. LLPs didn't come into existence until the 1990s. It is apparent that these entity types weren't considered when IRC Sec. 1402(a)(13) was drafted. Currently, most taxpayers and practitioners treat LLC and LLP members as exempt from SE tax on nonguaranteed payment income.

Proposed regulations. 20 years after the first LLC laws were passed, the IRS finally issued proposed regulations dealing with SE tax for LLC members and LLP partners. Prop. Reg. 1.1402(a)-2 provides that LLC members and LLP partners are not treated as limited partners for purposes of the SE exclusion under IRC Sec. 1402(a)(13) if any of the following applies:

1) They have personal liability for debts of the business (by reason of being an owner).
2) They have the authority to contract on behalf of the business.
3) They participate in the business for more than 500 hours during the year.

The proposed regulations also prohibit LLC members and LLP partners in service businesses, such as attorneys, accountants, and doctors, from being treated as limited partners. The proposed regulations have yet to be finalized. Does this mean practitioners can continue to exempt from SE tax an LLC member's or LLP partner's share of distributive income? The IRS doesn't think so.

Recent court cases. In a 2011 case involving three attorneys operating as an LLP, the IRS successfully argued that the partners were liable for SE tax on their share of partnership income [*Renkemeyer, Campbell, & Weaver, LLP*, et al., 136 TC 137 (2011)]. The Tax Court ruled that the exclusion afforded to limited partners under IRC Sec. 1402(a)(13) was intended to apply to individuals who invest in businesses rather than actively work in them. In this case, the IRS was focused on the level of involvement of the partners. Because the partners actively performed services in their capacity as partners, the income earned was deemed SE income rather than a return on their investment.

More recently, in the 2017 case of *Castigliola*, the Tax Court again found in favor of the IRS [TC Memo 2017-62 (2017)]. *Castigliola* also involved three attorneys, this time operating as a Professional Limited Liability Company (PLLC). The attorneys all took reasonable guaranteed payments and paid SE tax. The Court rejected the argument that they should be treated as limited partners with respect to their distributive share of the PLLC's income. Since all three had management authority, this was a member-managed PLLC, which caused the attorneys to appear more like general partners than limited partners.

Observation: The *Castigliola* decision raises the possibility that LLC members in a manager-managed LLC (who do not actively participate in management decisions) could successfully argue that the limited partner exception applies to their distributive share of LLC income (provided that reasonable guaranteed payments for services are made).

Moving Forward. While there may still be some ambiguity in the minds of LLC and LLP owners, as well as some practitioners, the IRS clearly intends to follow the guidelines laid out in Prop. Reg. 1.1402(a)-2. This is certainly an area the IRS seems to be focusing on more and more these days. In March 2018, the IRS's Large Business and International (LB&I) division announced that increased enforcement of self-employment tax for LLC and LLP owners was among five new high priority compliance campaigns.

Conclusion. Practitioners should review their LLC and LLP clients and discuss with them the potential risks of not reporting the correct SE income. In particular, LLC and LLP businesses that are member-managed, or have owners with the ability to exercise control over the business, should be examined. Also, LLCs and LLPs in which the members/partners are actively involved in the business (more than 500 hours per year) are at risk of IRS scrutiny. Practitioners also should pay attention to LLCs and LLPs that operate any type of service business where the members/partners are key contributors (such as attorneys, accountants, engineers, or physicians).

Is an LLC or LLP the best option? In certain circumstances, perhaps an S corporation or a limited partnership could be used instead. Can it be argued that the owners' distributive share of income is a return on their investment? Careful consideration should be given to these questions, and the opportunity to address them is now.

July 2020 AFRs

For July 2020, the Section 7520 rate for valuation purposes is 0.6%, while the applicable federal rates (AFRs) are as follows (Rev. Rul. 2020-14):

	Short-term (≤ 3 yrs)	Mid-term (> 3 yrs but ≤ 9)	Long-term (> 9 yrs)
Annual	.18%	.45%	1.17%
Semiannual	.18%	.45%	1.17%
Quarterly	.18%	.45%	1.17%
Monthly	.18%	.45%	1.17%

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Tax Planning

Mid-Year Planning

CARES Act, Notice 2020-51

Background. For the second year in a row, taxpayers face massive uncertainty. The COVID-19 emergency presents unique challenges and opportunities for tax practitioners to become more than technicians and move into the role of trusted advisors. In addition to the usual mid-year planning ideas, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) offers several possible actions that may help your clients save tax dollars and solve cash-flow issues.

Adjust tax withholding and estimated payments. To prevent unexpected tax bills or larger than anticipated refunds when ready cash is needed, now is the time to adjust a client's tax withholding or estimated payments due on September 15, 2020 and January 15, 2021. The IRS released an updated version of Form W-4 which takes TCJA changes into account. The revised version is more complicated than prior versions, but it may increase the accuracy of withholding amounts. The IRS also released "Tax Withholding Estimator," a tool to assist taxpayers in completing the new Form W-4 which is available at **www.irs.gov/individuals/tax-withholding-estimator**. Your client will need to provide their most recent paystub(s) and details of other sources of income for an accurate tax projection. A copy of their most recent tax return would also help to recalculate the correct amount of tax withholding or estimated payments due to changes in circumstances.

Capitalize on investment income tax rates. Income from an investment held for more than a year is generally taxed at preferential capital gains rates of 0%, 15%, and 20% for most investments. The rate that applies is determined by taxable income. For example, the 0% rate applies if 2020 taxable income doesn't exceed $80,000 (for joint filers), $53,600 (for heads of household), or $40,000 (for other individuals). The 20% rate doesn't kick in until taxable income exceeds $496,600 (for joint filers), $469,050 (for heads of household), or $441,450 (for other individuals). If your client's income hovers around these threshold amounts, the following techniques may be utilized to reduce income:

- Deductible IRA contributions.
- Deferral of bonuses.
- Contribute to or increase amounts contributed to employer retirement plans.
- If over 70½, make contributions to a qualified charity with a direct distribution from an IRA.
- For a cash-basis business owner, delay sending invoices and accelerate deductible expenses.

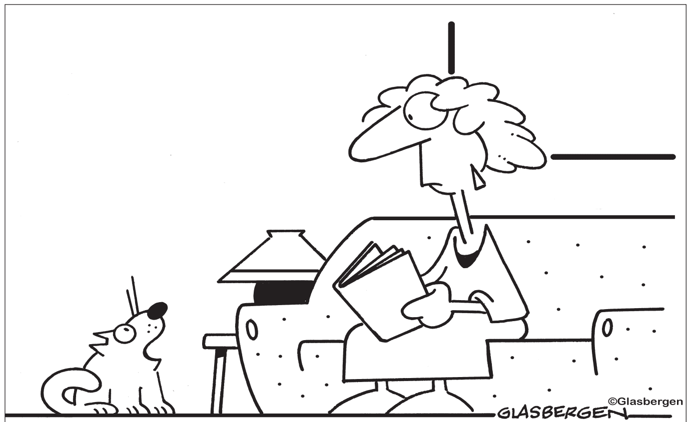
Retirement plans. If clients are affected by COVID-19, the CARES Act provides taxpayer-friendly provisions for retirement plan distributions taken prior to the end of 2020. For taxpayers under age 59½, COVID-19-related withdrawals up to $100,000 from a qualified retirement account [IRA, 401(k), 403(b), etc.] aren't subject to the normal 10% early withdrawal penalty. While all 2020 withdrawals are still subject to income tax, there are a couple of options to limit the tax burden. First, the client may elect to spread the income tax payments over three years rather than pay all of the tax in 2020. They also may recontribute the amount withdrawn to an eligible retirement account within the next three years rather than the standard 60-day rollover timeframe. (No tax is due if the amount is recontributed within the three-year window. An amended return will need to be filed for a refund.) Even if your client doesn't need the cash, this is an opportunity to move funds out of an employer-sponsored plan and into an IRA that the client can control.

To qualify for these special rules, your client, or their spouse or dependent must have been diagnosed with COVID-19 or been affected financially as a result of a layoff, reduction in hours, or another inability to work due to COVID-19.

Decreased income levels may make 2020 a very good year to convert funds from a traditional IRA to a Roth IRA. Given the current economic situation, it is unlikely that tax rates will decrease in the near future.

Since the CARES Act suspended Required Minimum Distributions (RMDs) for 2020, rolling that distribution to a Roth IRA could be a very good move. No RMD for 2020 means that 100% of the distribution can be classified as a rollover.

Taxpayers who received what would have been an RMD, but for the CARES Act RMD waiver for 2020, may repay the distribution by August 31, 2020. The repayment is treated as a rollover, but doesn't count towards the one rollover per 12-month period limitation. (Notice 2020-51)



"I have 473 dead mice saved for my retirement, but they're not earning any interest buried under the porch."

Small business planning. Businesses have multiple possible strategies to minimize 2020 tax liabilities which are highlighted here:

- *Net operating losses (NOLs).* The CARES Act temporarily removed the elimination of the ability to carry back NOLs arising after 2017, and the limited benefit of NOLs carried forward to subsequent years to 80% of taxable income.
- *Excess business losses (EBLs).* The CARES Act retroactively removed the limitation on EBLs that the TCJA implemented for 2018 through 2020.
- *Business interest expense.* The CARES Act relaxed the limitation on the deductibility of business interest expense from 30% of adjusted taxable income (ATI) to 50% of ATI.
- *Qualified improvement property (QIP).* The CARES Act includes a technical correction to the TCJA that is retroactive to 2018, allowing for faster depreciation of QIP.

Conclusion. In these turbulent economic times, the tax practitioner has an opportunity to share solutions and options to assist clients with cash flow, lower tax liabilities, and become a trusted advisor on their client's team.

Tax Quick Hits

Health Care

IRS issues proposed regulations on certain medical care arrangements. The IRS has issued proposed regulations (REG-109755-19) on the treatment of amounts paid for certain medical care arrangements, including Direct Primary Care (DPC) arrangements, Health Care Sharing Ministry (HCSM) memberships, and certain government-sponsored health care programs. Specifically, the proposed regulations would treat payments for DPC arrangements as expenses for medical care under IRC Sec. 213. Because of this, a Health Reimbursement Arrangement (HRA) provided by an employer would generally be able to reimburse an employee for DPC arrangement payments. Similarly, payments for membership in an HCSM would be treated as Section 213 medical care expenses. Therefore, an HRA provided by an employer would generally be able to reimburse an employee for HCSM membership payments. The regulations are proposed to apply to tax years that begin on or after the date they are adopted as final (Prop. Reg. 1.213-1 and News Release IR 2020-116).

Income Tax

2020 vehicle depreciation limits. The IRS has released the Section 280F depreciation deduction limits for passenger autos (including trucks and vans) first placed in service during 2020. For passenger autos acquired after September 27, 2017, placed in service during 2020, and subject to bonus depreciation under IRC Sec. 168(k), the depreciation limits are $18,100 for the first year, $16,100 for the second year, $9,700 for the third year, and $5,760 for each succeeding year. For passenger autos placed in service during 2020 that are not subject to Section 168(k) bonus depreciation, the depreciation limits are $10,100 for the first year, $16,100 for the second year, $9,700 for the third year, and $5,760 for each succeeding year. The IRS also has released the lease inclusion amounts for lessees of passenger autos first leased in 2020 (Rev. Proc. 2020-37).

IRS issues proposed regulations on like-kind exchanges. Due to the Tax Cuts and Jobs Act (TCJA), the Section 1031 like-kind exchange rules are limited (subject to a transition rule) to exchanges of real property completed after December 31, 2017. Recently, the IRS released proposed regulations that reflect this change. Specifically, the proposed rules would amend existing regulations to add a definition of *real property*. According to the IRS, this definition is consistent with legislative intent and includes (1) real property eligible for like-kind exchange treatment under pre-TCJA law and (2) shares in a mutual ditch, reservoir, or irrigation company described in IRC Sec. 501(c)(12)(A) if the state in which the company is organized views the shares as real property. In addition, the proposed regulations would provide a rule addressing a taxpayer's receipt of personal property that is incidental to real property received in the exchange. Taxpayers may rely on the proposed regulations, if followed consistently and in their entirety, for exchanges of real property beginning after December 31, 2017 and before the final regulations are published (REG-117589-18).

IRS issues proposed and temporary regulations on consolidated NOLs. The IRS has issued proposed and temporary regulations addressing the use of Net Operating Losses (NOLs) by consolidated groups. Among other things, the proposed regulations withdraw and repropose certain rules relating to the absorption of consolidated NOL carryovers and carrybacks. The temporary regulations allow certain acquiring consolidated groups to make an election to waive all or a part of the preacquisition portion of the extended carryback period for certain losses attributable to certain acquired members. This is in response to the CARES Act's retroactive extension of the Section 172 carryback period for 2018–2020. The temporary regulations were effective on July 2, 2020 and comments on the proposed regulations are due by August 31, 2020 (REG-125716-18 and TD 9900).

IRS releases additional final regulations on qualified business income deduction. The IRS has released additional final regulations (TD 9899) on the Qualified Business Income (QBI) deduction under IRC Sec. 199A. The final rules allow a shareholder in a Regulated Investment Company (RIC) [as defined in IRC Sec. 851(a)] to take a QBI deduction with respect to certain income of, or distributions from, the RIC. In addition, the regulations provide guidance on (1) the treatment of previously disallowed losses that are included in QBI in subsequent years and (2) interests held in split-interest or charitable remainder trusts. The final regulations apply to tax years beginning after August 24, 2020. However, taxpayers may choose to apply the regulations to tax years beginning on or before August 24, 2020. Alternatively, taxpayers who chose to rely on regulations proposed in February 2019 (REG-134652-18) for tax years beginning on or before August 24, 2020 may continue to do so for such years (Regs. 1.199A-3 and -6; News Release IR 2020-128).

IRS issues proposed regulations on qualified transportation fringe benefit expenses. The IRS has issued proposed regulations (REG-119307-19) on the treatment of amounts paid for Qualified Transportation Fringe (QTF) and commuting expenses. The TCJA disallowed deductions for QTF expenses and deductions for certain expenses of transportation and commuting between an employee's residence and place of employment. Specifically, the proposed regulations explain how to determine the amount of nondeductible expense and apply certain exceptions provided under IRC Sec. 274(e) that may allow expenses to be deductible. The guidance includes definitions and special rules to clarify and simplify the calculations. The proposed regulations modify and build on guidance provided in Notice 2018-99 and are proposed to apply for tax years that begin on or after the date they are adopted as final (Prop. Regs. 1.274-13 and 1.274-14 and News Release IR 2020-125).

Other Tax Matters

Interest rates to decrease for third quarter 2020. The interest rates for tax overpayments and underpayments for the quarter beginning on July 1, 2020 will decrease from the prior quarter. For noncorporate taxpayers, the rate for both underpayments and overpayments will be 3%. The 3% rate also applies to estimated tax underpayments for the third quarter of 2020. For corporations, the overpayment rate will be 2%, with a 0.5% rate applicable to over-payments exceeding $10,000. The underpayment rate for corporations will be 3%, except for large corporate under-payments, which will be 5% (Rev. Rul. 2020-13 and News Release IR 2020-113).

IRS proposes two methods to report partner tax basis capital. The IRS is seeking public comments on a proposed requirement for partnerships to use only one of two alternative methods to report partner tax basis capital accounts for partnership tax years ending on or after December 31, 2020. The first method, known as the *modified outside basis method*, requires a partnership to report each partner's basis in his partnership interest, reduced by the partner's allocable share of partnership liabilities (as determined under IRC Sec. 752). The second method, known as the *modified previously taxed capital method*, requires a partnership to report each partner's share of previously taxed capital, as calculated under a modified version of Reg. 1.743-1(d) (Notice 2020-43).

Installment agreement denied due to cryptocurrency holdings. The taxpayers, the Strashnys, timely filed their 2017 tax return without paying the tax due. In June 2018, the IRS assessed the approximately $1.1 million amount due (including a failure to pay penalty). In July 2018, the Strashnys sent the Form 9465 (Installment Agreement Request), requesting to pay the 2017 balance due over a six-year period. In requesting a Collection Due Process (CDP) hearing in response to IRS Notice CP90, the Strashnys expressed their continued interest in an Installment Agreement (IA) and claimed a levy notice should not have been sent before the IA was addressed. During the CDP hearing, the settlement officer noted that no actual levy could occur until the IA was rejected and the Strashnys had more than $200,000 in annual wages and were drawing $19,000 a month from their $7 million cryptocurrency holdings. The Tax Court ruled that the Strashnys could pay in full immediately and had not shown any hardship or special circumstances to warrant an installment agreement [*Alexander Strashny, et ux*., TC Memo 2020-82 (Tax Ct.)].

Individual Income Tax

Virtual Currency Update

Rev. Rul. 2019-24

Background. Believe it or not, Bitcoin has been around for more than ten years. First released in 2009 by a computer programmer, virtual currency has since been propelled to the top of the IRS's list of compliance concerns. The IRS published initial guidance on the taxation of virtual currency six years ago with Notice 2014-21. More recently, the IRS addressed the federal income tax treatment of hard forks and airdrops in Rev. Rul. 2019-24. In conjunction with that guidance, the IRS published a list of FAQs that cover a variety of other virtual currency transactions.

Rev. Rul. 2019-24. Hard forks and air drops are transactions involving cryptocurrency. (As a reminder, *cryptocurrency* is a type of virtual currency that utilizes cryptography to validate and secure transactions that are digitally recorded on a distributed ledger, such as blockchain.) A hard fork typically results in the creation of a new cryptocurrency on a new distributed ledger, in addition to the original (or legacy) cryptocurrency that is held on the legacy distributed ledger. In other words, a hard fork may produce two blockchains and two virtual currencies.

An airdrop is a method of dispersing cryptocurrency units to multiple taxpayers' distributed ledger addresses. If a hard fork occurs, an airdrop is typically used to distribute units of the new cryptocurrency to addresses containing the legacy currency. However, a hard fork isn't always followed by an airdrop.

In Rev. Rul. 2019-24, the IRS held that a taxpayer doesn't have gross income under IRC Sec. 61 as a result of a hard fork if he doesn't receive units of a new cryptocurrency. However, a taxpayer does recognize ordinary income as a result of an airdrop following a hard fork if he receives units of new cryptocurrency. The amount of income recognized equals the fair market value of the new cryptocurrency upon receipt. That amount then becomes the taxpayer's basis in the new currency.

IRS Virtual Currency FAQs. The IRS FAQs on virtual currency transactions cover a lot of ground, with a focus on addressing issues faced by taxpayers who hold virtual currency as a capital asset. Highlights of the FAQs are covered here, and the complete list can be accessed at **www.irs.gov**, using the search term "virtual currency."

Calculating gain or loss. When virtual currency is sold, any capital gain or loss must be recognized on the sale, subject to limitations on the deductibility of capital losses. Basis in virtual currency is the fair market value (FMV) of the currency on the date the currency is received, including any fees or other acquisition costs. A taxpayer who owns multiple units of the same type of virtual currency (often acquired at different times and different basis amounts) may choose which units are deemed to be sold, exchanged, or otherwise disposed of. The taxpayer must specifically identify which units of virtual currency are involved in the transaction and substantiate his basis in those units.

A taxpayer identifies a specific unit of virtual currency either by documenting its unique digital identifier (such as a private key, public key, and address) or by producing records that show the transaction information for all units of a specific virtual currency held in a single account, wallet, or address. The records must show: (1) The date and time each unit was acquired; (2) The basis and FMV of each unit at the time it was acquired; (3) The date and time each unit was sold, exchanged, or otherwise disposed of; (4) The FMV of each unit when sold, exchanged, or disposed of, and the amount of money or the value of property received for each unit. If a taxpayer can't identify specific units of virtual currency, they're deemed to have been sold, exchanged, or otherwise disposed of on a first-in, first-out (FIFO) basis.

Payment for goods and services. Virtual currency received as payment for goods or services, must be included in income at FMV (measured in U.S. dollars) of the currency as of the date it was received. In most situations, virtual currency is listed on an exchange. For example, Bitcoin is listed on the Coinbase exchange which can been found at **www.coinbase.com**, among others. To calculate FMV, convert the virtual currency into U.S. dollars using the listed exchange rate. If the virtual currency is later exchanged for other property, gain or loss will be recognized. Gain is reported if the FMV of the property received exceeds the basis in the virtual currency (generally, its fair FMV on the date it was received). Loss is recognized if the FMV of the property received is less than the basis in the virtual currency. If the virtual currency was held for investment purposes for more than one year, any gain will be subject to preferential long-term capital gain rates.

Example: Mr. Orgeron digitally accepts 10 Bitcoins as payment for services. On the date of receipt, Bitcoins are worth \$1,000 each, as listed by Coinbase. Therefore, he recognizes \$10,000 (\$1,000 × 10) of business income. A month later, when Bitcoins are trading for \$1,500 on the Coinbase exchange, he uses two Bitcoins to purchase supplies for his business. At that time, Mr. Orgeron will recognize \$3,000 (\$1,500 × 2) in business expense and \$1,000 [(\$1,500 − \$1,000) × 2] of gain due to the Bitcoin exchange. Since he is not in the trade or business of selling Bitcoins, the \$1,000 gain is capital in nature.

Gifts of virtual currency. A taxpayer who receives virtual currency as a bona fide gift won't recognize income for tax purposes until he sells, exchanges, or otherwise disposes of the currency (IRC Sec. 102). The taxpayer's basis in the currency depends on whether gain or loss is recognized upon disposition (IRC Sec. 1015). For gain purposes, basis equals the donor's basis, plus any gift tax paid by the donor. For loss purposes, basis equals the lesser of (1) the donor's basis or (2) the virtual currency's FMV at the time it was received as a gift.

The taxpayer's holding period in the currency generally includes the time it was held by the donor. A taxpayer's basis in gifted cryptocurrency is zero if he doesn't have any documentation to substantiate the donor's basis. A lack of documentation also causes the taxpayer's holding period to begin after the day the gift of cryptocurrency is received.

Donations of virtual currency. A donation of virtual currency to a charitable organization doesn't result in income, gain, or loss, assuming the charity is a Section 170(c) organization. Also, the taxpayer will be eligible for a charitable contribution deduction. The deduction is generally equal to the FMV of the virtual currency at the time of donation if the taxpayer held it for more than one year. If the taxpayer held the currency for one year or less, the deduction is equal to the lesser of the currency's basis or its FMV at the time of contribution.

Reporting virtual currency transactions. Capital gains and losses from virtual currency transactions are reported on Form 8949 (Sales and Other Dispositions of Capital Assets). Ordinary income from virtual currency transactions is reported on Schedule 1 (Additional Income and Adjustments to Income) of Form 1040, Form 1040-SS, or Form 1040-NR, as applicable. The IRS reminds taxpayers to maintain records documenting receipts, sales, exchanges, or other dispositions of virtual currency and the FMV of the currency. Practitioners must ask their clients about any virtual currency holdings and check the appropriate box on Schedule 1 of Form 1040.

Conclusion. After five years of waiting, the additional guidance provided by Rev. Rul. 2019-24 and the IRS FAQs on virtual currency transactions are a step in the right direction. Although the FAQs don't address every situation your clients may encounter, they are a good place to start.

Internal Revenue Service

2019 IRS Data Book Released

News Release IR-2020-133

The IRS has released its redesigned 2019 *Internal Revenue Service Data Book*, which details IRS activities for fiscal year 2019 (October 1, 2018 through September 30, 2019). The Data Book has been reorganized with updated key material tables and additional information, including the IRS's response to COVID-19 along with information about returns filed, taxes collected, enforcement activities, taxpayer assistance, and the IRS budget and workforce and other selected activities. For the first time, the Data Book now includes the number of installment payment agreements set up by individuals and businesses with the IRS. Another addition is the number of Identity Protection Personal Identification Numbers (IP PINs) issued for filing years 2011–2020 to certain victims of tax-related identity theft.

During fiscal year 2019, the IRS collected more than $3.5 trillion in federal revenue and processed more than 253 million returns and other forms, of which 72.9% were filed electronically. Compared to fiscal year 2018, estate tax return filings were down by 24.5% and partnership filings were down by almost 7%.

Out of the 154.1 million individual income tax returns filed, around 89% were e-filed. Almost 120 million individual income tax return filers received a tax refund, totaling over $391.5 billion. The total cost of collecting $100 decreased to $0.33 in fiscal year 2019.

Selected highlights for fiscal year 2019 are shown in the tables presented here. The 86-page Data Book is available on the IRS website at **www.irs.gov/statistics/soi-tax-stats-irs-data-book**.

Comprehensive Taxpayer Attitude Survey (CTAS). The Data Book contains a section on taxpayer attitudes from CTAS. Started in 1999, CTAS gathers data on taxpayers' attitudes and service channel preferences through phone and online surveys.

In 2019, more than 2,000 taxpayers participated in CTAS. Approximately 95% of them agreed that it is their civic duty to pay their fair share of taxes. In addition, 87% of them agreed that cheating on their income taxes is unacceptable.

Individual Income Tax Re-turn Examination Coverage—By AGI

Adjusted Gross Income (AGI)	Returns filed in 2018 (% of total)	Exam coverage in FY 2019 (%)[1]
All returns	**100.00**	**0.15**
No AGI	0.42	0.31
$1–24,999	32.03	0.28
$25,000–49,999	23.94	0.13
$50,000–74,999	14.19	0.08
$75,000–99,999	9.11	0.06
$100,000–199,999	14.41	0.05
$200,000–499,999	4.78	0.03
$500,000–999,999	0.76	0.03
$1,000,000–4,999,999	0.33	0.05
$5,000,000–9,999,999	0.02	0.04
$10,000,000 or more	0.02	0.03

[1] The number of returns examined (closed and in-process) in FY 2019 as a percentage of the total number of returns filed in that AGI class.

Tax Return Preparers

Cybersecurity

IRS Pubs. 4557 and 5293

Background. At a time when many tax practitioners are working remotely, taking measures to protect sensitive client tax data is more important than ever. The Security Summit, which is the partnership between the IRS, state tax agencies, and the tax industry, has been working to fight back against criminals filing fraudulent returns for refund since it first convened in 2015. Although the IRS and its partners in the Security Summit have made progress against tax-related identity theft, cybercriminals continue to evolve. In fact, data thefts at tax professionals' offices are on the rise. Thieves use stolen data from tax preparers to create fraudulent returns that are harder to detect. Protecting taxpayer information isn't just good for clients and good for business, it's also the law.

Implementing a plan. The Federal Trade Commission's (FTC) Safeguards Rule requires that tax practitioners develop a written information security plan describing their program to protect client data. The plan must be appropriate to the company's size and complexity and take into account the sensitivity of the client information it handles. As part of the plan, a business must:

1) designate one or more employees to coordinate its information security program,

See "Cybersecurity—Continued" on page 5

IRS Examination Coverage—Fiscal Year 2019

	Returns filed in 2018	Returns examined in FY 2019			
Type and size of return	**All Returns**	**Total**	**% Covered**	**Field[1]**	**Correspondence**
United States, total	**199,365,492[2]**	**771,095**	**0.4**	**202,223**	**568,872**
Individual income tax returns, total	152,624,939	680,543	0.4	133,432	547,111
Corporation income tax returns, except Form 1120S, total	1,866,745	13,472	0.7	13,173	299
Small corporations[3]	1,729,622	8,500	0.5	8,355	145
Large corporations[4]	76,782	4,775	6.2	4,660	115
Estate and trust income tax returns	3,133,753	826	[5]	394	432
Estate tax returns, total	32,847	2,282	6.9	2,282	0
Gift tax returns	244,570	1,839	0.8	1,839	0
Employment tax returns	31,089,490	44,182	0.1	26,331	17,851
Excise tax returns	1,042,888	9,771	0.9	8,797	974
Partnership returns	4,223,801	7,478	0.2	6,296	1,182
S corporation returns	5,106,459	10,065	0.2	9,556	509

[1] Field examinations are generally performed by revenue agents, tax compliance officers, tax examiners, and revenue officer examiners in person. However, some field examinations may ultimately be conducted through correspondence in order to better serve the taxpayer.

[2] Does not include certain excise tax returns and returns of tax-exempt organizations, government entities, employee retirement plans, and information returns.

[3] Includes returns with assets of less than $10 million.

[4] Includes returns with assets of $10 million or more.

[5] Less than .05%.

Upcoming Tax Dates

August 10
- Tip employees report July tips to employers
- Employers file Form 941 for second quarter if all taxes deposited in full and on time.

August 17
- Employers deposit July payroll and nonpayroll withholding taxes if monthly deposit rule applies. (CARES Act provides for deferral of employer portion of social security tax.)

September 10
- Tip employees report August tips to employers.

September 15
- Employers deposit August payroll and nonpayroll withholding taxes if monthly deposit rule applies.
- Third quarter 2020 estimated tax payment due for individuals, calendar-year corporations, estates, trusts, private foundations, and most exempt organizations.
- 2019 Form 1065 due for calendar-year partnerships on extension.
- 2019 Form 1120S due for calendar-year S corporations on extension.

September 30
- 2019 Form 1041 due for calendar-year trusts and estates on extension.

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Cybersecurity—Continued

2) identify and assess the risks to customer information in each area of operation,
3) review and evaluate the effectiveness of the current safeguards for controlling any risks to data,
4) design and implement a safeguards program that is regularly monitored and tested, and
5) select service providers that can maintain appropriate safeguards.

When signing a contract with a service provider, the business should make sure the contract requires the provider to maintain safeguards and oversee their handling of customer information. The program should be regularly evaluated and adjusted as time goes on. For example, updates should be made for changes in the firm's business or operations, and the results of security testing. The FTC requirements are designed to be flexible so that companies can implement safeguards appropriate to their own circumstances.

Pub. 4557 (Safeguarding Taxpayer Data), has information about critical security measures that all tax professionals should put in place and includes a checklist of items to include in a data security plan.

The IRS may treat a violation of the FTC Safeguards Rule as a violation of IRS Rev. Proc. 2007-40. This sets the rules for tax professionals participating as an Authorized IRS e-file Provider. Pub. 5293 (Data Security Resource Guide for Tax Professionals) provides a basic understanding of minimal steps that need to be taken to protect client data. It has information on ways that tax professionals can lower their cybersecurity risks and lists signs of data theft. The publication also provides guidance on how to report potential tax identity theft.

Hiring a cybersecurity professional. To protect their offices and client data, many tax practitioners hire a cybersecurity professional. Because every tax office is unique, practitioners should consider specific concerns they have. Those concerns should be presented to the cybersecurity professional, who can help safeguard both the practitioner's business and their clients' data.

The IRS provides the following points for tax practitioners to consider when evaluating and selecting a cybersecurity professional that fits their situation or business:

1) Talk to other business owners or professionals you know and trust for recommendations and references.
2) Ultimately select the person you trust most. Choose someone with whom you feel comfortable discussing the safety and security of your business and clients.
3) Ask questions of the candidates to learn just how much experience they have in data protection. Examples of questions that can be asked include: How does ransomware work and what can we do to protect our systems? What are the best options to securely back-up data and why are those options the best? Do you have suggestions regarding the following: data encryption, malware, firewalls, disaster recovery, and remote access tools? Have you ever created a security plan for a similar business? Can you do an assessment of my systems and processes to find vulnerabilities or weaknesses? If so, will you then provide recommendations to strengthen my security? Will you provide ongoing monitoring of my systems as security threats evolve? If so, how often do you recommend changes?
4) When hiring a cybersecurity professional, secure an agreement or engagement letter to ensure both parties understand the terms of the agreement.

Conclusion. Trusted advisors must take every precaution to ensure the high-risk data that is used in day-to-day activities is protected. Each year hackers and thieves implement more clever and effective methods of scamming citizens and businesses. It is vital that a tax practitioner have a written data security plan and perform a regular review of security protocols. Firms should make it a priority to educate their staff and clients on proper security steps. Protect your clients; protect yourself.

Individual Income Tax

Self-Employment Tax and the Limited Partner

IRC Sec. 1402(a)(13)

Background. Limited partners are not subject to self-employment (SE) tax on their distributive share of partnership income. IRC Sec. 1402(a)(13), which was enacted

See "Self-Employment Tax and the Limited Partner—Continued" on page 6

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