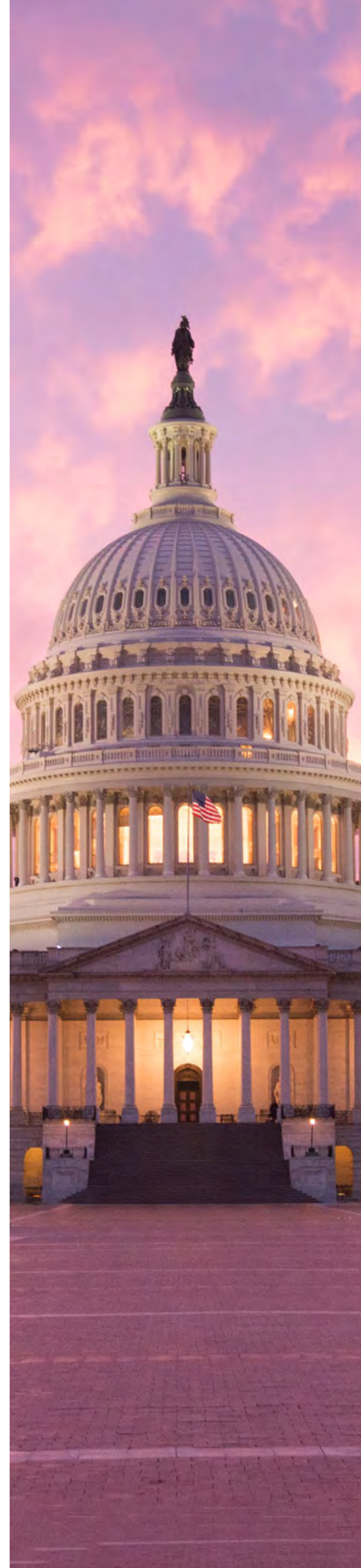

Advanced Markets

Central Intelligence

January 2021

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Summary of select tax provisions of the Consolidated Appropriations Act 2021,
Consolidated Appropriations Act, enacted December 27, 2020.

Facts

The Consolidated Appropriations Act 2021 (hereinafter the "Act") was passed with large bipartisan majorities on December 21, 2020, and was signed into law on December 27. The Act (5,593 pages) includes many stimulus and economic assistance provisions, extends many provisions of the CARES Act, and includes one provision related to life insurance contracts. The following is a summary of those specific provisions, which may be interesting to our readers:

- The Act contained amendments to IRC §7702. These changes originally appeared in the Health and Economic Recovery Omnibus Emergency Solutions Act ("HEROES Act") in mid-2020. Interestingly, this bill passed the House of Representatives in May 2020, but was roundly rejected in the Senate and never was discussed or voted upon. The provisions reappeared in their original form in the Act. In short, the provisions amend §7702 to change the minimum fixed interest rate assumptions (the greater the rates guaranteed in the contract or 4% and 6% depending on the type of contract) built into life insurance legal requirements. These fixed rates have been used unchanged since 1985. The new minimum rate assumptions are indexed to current market rates. Significant among the uses of the new rates are those for the CVAT and GPT testing. These new testing guidelines provided by the Act allow for floating alternative rates, including an NAIC rate tied to corporate bond rates and a new rate derived from an average of mid-term applicable federal rates. While the effective date of the new §7702 amendments is January 1, 2021, the provisions include a transitional rule that provides that the minimum alternative rate for 2021 is set at 2%. These changes apply only to testing done for new sales after the effective date of the changes. We expect further guidance and perhaps IRS published rates before they are needed toward the end of the year. We will follow developments related to these provisions and will report them.
- The IRS had interpreted the CARES Act to mean that Paycheck Protection Program loans must be expended on a narrow range of expenses and that eligible "payroll costs" included only compensation for services. The Act requires that 60% of loan proceeds be expended for an expanded range of payroll costs (now including group health and life insurance, covered supplier costs, PPE and coronavirus protection equipment, etc.). It also provides for simplified forgiveness procedures and application and sets forth the guidelines for businesses that participated in the first round but now need a "second draw." Generally, to be eligible for a second draw, a business must employ no more than 300 employees and show that it has suffered a reduction in gross revenues of 25% or more for corresponding quarters between 2019 and 2020.
- The Act provides that Flexible Spending Accounts (FSAs) may (but are not required to) permit participants to carry over unused FSA balances from a plan year ending in 2020 to a plan year ending in 2021, and from a plan year ending in 2021 to a plan year ending in 2022, but expenses made in 2020 are not refundable in 2021.
- The Act extends through 2021 the CARES Act provision that taxpayers who do not itemize may take an "above-the-line" deduction for charitable contributions to certain public charities up to $300 per taxpayer. Likewise, the CARES Act increased the charitable deduction limitation for itemizing taxpayers from 60% to 100%; the Act extends this increase through 2021.
- The Act provides for a second round of "recovery rebates" paid directly (and automatically for most) to eligible taxpayers in the amount of $600 per taxpayer — and an additional $600 for each qualifying child (as defined). As under the CARES Act, eligibility begins to phase out at $75,000 of AGI for single taxpayers ($150,000 married filing jointly) and phases out completely at $87,000 and $174,000, respectively (in all cases with no qualifying children). [Reduced by 5% of AGI in excess of the lower threshold.]
- The Act extends refundable tax credits for wages paid to employees on paid sick and family leave for coronavirus-related reasons through March 31, 2021. These credits were provided by the Families First Coronavirus Response Act and expired on December 31, 2020.

- The CARES Act modified IRC §127 to permit employers to pay employees on a tax-free basis up to $5,250 toward the employee's outstanding student loans and interest (or reimburse the employee for loan and interest payments made). This provision expired on December 31, 2020. The Act extends the provision through December 31, 2025.
- In the much-publicized "No Surprises" provision, the Act provides long (150 pages) and complicated guidelines designed to prevent balance-billing for medical services provided when no in-network provider is available. The provisions include extensive dispute resolution requirements and procedures.

Takeaway

There is a lot to unpack in this Act, so we will continue to monitor updates and report them in these pages as they become available.

Democrats take slimmest possible majority in the US Senate, January 6, 2021.

Facts

On November 3, 2020, Georgia held an election for both of its seats in the US Senate. Ordinarily only one seat would be up for election, but the other seat had been filled by the appointment of Kelly Loeffler by the Georgia governor after Senator Johnny Isakson had retired for health reasons. For that reason, Senator Loeffler's seat came up for re-election out of rotation. Runoff elections were required for both seats, and in the January 5th runoff elections, Democrats Raphael Warnock and Jon Ossoff defeated the Republican incumbents Kelly Loeffler and David Perdue. Thus, the balance of US Senate seats held by each major party is 50%. According to Section 3 of Art. I of the US Constitution, "[t]he Vice President of the United States shall be President of the Senate, but shall have no Vote, unless they be equally divided." Thus, Vice President Kamala Harris will break any tie vote on issues before the Senate. This majority makes it more likely that the incoming Biden administration will be able to enact parts of its agenda that otherwise might have faced defeat if legislators vote along party lines. However, the majority is the slimmest possible, providing only a simple majority dependent upon consensus. Thus, it seems reasonable that bolder proposals will still face some difficulty. Due to complicated Senate rules, however, revenue-increasing proposals are easier to pass with a simple majority while revenue-decreasing proposals (such as tax cuts) generally require a super majority vote to survive death by filibuster. In short, while the Democrats have a bare majority in the Senate, one or more Senators crossing party lines can make all the difference in a vote tally.

Takeaway

Significantly, as the majority party in the Senate, the Democratic party will now control the Senate's legislative agenda, including which bills will make it to the Senate floor for a vote. It appears that tax reform will likely be part of the agenda and there is a general expectation that there will be increased taxes, especially for wealthy and high-income clients. It should be noted that while tax increases are anticipated, it is not yet possible to know what specific changes will be attempted or whether they will ultimately be successful. As always, we will track developments here as they unfold.

IRS issues final regulations on $1M deduction limitation for certain employees under TCJA 2017, TD 9932, IRC §162(m), December 11, 2020.

Facts

Generally, IRC §162 sets forth the deductions from income that a business is entitled to for trade or business expenses, including under §162(1) "a reasonable allowance for salaries or other compensations for personal services actually rendered." However, §162(m) imposes a limitation on that deduction, providing that "[i]n the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee

remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000." The Tax Cuts and Jobs Act of 2017 ("TCJA") amended certain definitions and provided transition relief and grandfathering rules. In December 2019, the IRS issued proposed regulations and final regulations that largely (but not entirely) follow proposed regulations issued in December 2020.

- The regulations expanded the definition of "publicly held corporation" to include 1) certain entities that own or control businesses subject to the limitation and 2) affiliated groups with one or more publicly held corporation.
- The definition of "covered employee" is expanded to capture the CEO, CFO, the three highest-compensated officers (whether or not the employee is an executive officer), and any other employee who was a covered employee in any previous tax year.
- These definition changes do not apply to compensation payable under a contract in effect on November 2, 2017, unless materially modified after that date.
- Balances in nonqualifed deferred compensation plans as of November 17, 2017, are grandfathered.

These regulations are complex, and taxpayers should seek competent counsel to determine whether the statute and its regulations apply to any corporation, employee or compensation amount or type

Takeaway
Due to this guidance, the scope and reach of the §162(m) deduction limitation has been expanded. Employers who once thought themselves outside the statute's definitions may need to re-examine whether their deductions are still valid.

IRS Chief Counsel finds no basis for business deduction of premiums paid for "tax insurance" policies, Chief Counsel Advice Memorandum 202050015, December 11, 2020.

Facts
Taxpayer is a partnership seeking advice from the IRS on business deductibility of premiums paid on an insurance policy owned and funded by the partnership, but payable to the partners. The policy would be purchased to insure against potential loss of tax benefits. In the event of an adjustment to a deduction claimed for a charitable contribution, this "tax insurance" policy would reimburse the partners for any difference between the tax benefits they anticipated and claimed and the tax benefits they are ultimately determined to be entitled to receive, regardless of any trade or business activity of the partnership. Taxpayer sought to deduct the premiums for this insurance policy as a business expense deduction under IRC §162 (trade or business expenses) or §212 (expenses for production of income).

Holding
IRS Chief Counsel examined the deductibility of such a premium payment under the cited statutes and IRC §275 as well. Right out of the gate, the IRS notes that §§162 and 212 are to be interpreted consistently with the restrictions and limitations applicable to one extended to the other. Whether an expense is deductible under either statute is determined at the partnership level. Where an expense involves a contractual arrangement for reimbursement in the event of specified contingencies, such as the case here, the terms of the arrangement determine whether the expense is sufficiently related to activities recognized under each statute to support a deduction. Generally, the IRS found that the insurance premiums described above are not sufficiently related to the partnership's trade or business to support a deduction under either statute. In addition, IRC §212(3) allows the deduction of expenses related to the determination, collection, or refund of any tax such as expenses paid or incurred by a taxpayer for 1) tax counsel, or 2) in connection with the preparation of his tax returns, or 3) in connection with any

proceedings involved in determining the extent of his tax liability or 4) in contesting his tax liability. However, IRC §275 prohibits the deduction of federal income taxes. As before, the IRS found that the premium is not an expense related to determination, collection, or refund of taxes. (Note that very similar issues were considered under ILM 202052010, in which a promoter of a real property investment contemplated the purchase of insurance against any potential reduction of charitable deduction for a conservation easement. This pronouncement also concluded that the premiums were not deductible.)

Takeaway

Every deduction from gross income is allowed as a matter of legislative grace only if there is clear provision for it, and a taxpayer seeking a deduction must be able to point to an applicable statute and show that the taxpayer comes within its terms. For this reason, it is important to pay close attention to the language of the statute relied upon.

Tax Court upholds determination of valuation misstatement measure in failed charitable deduction case, *George Fakiris v. Commissioner,* No. 18292-12., T.C. Memo. 2020-157, November 19, 2020.

Facts

In the July 2017 edition of *John Hancock Central Intelligence,* we reported on the Tax Court Case of *Fakiris v. Commissioner,* in which a taxpayer was denied a charitable deduction for the contribution of a movie theater to a qualified charity because the taxpayer failed to relinquish all dominion and control over the contributed property as required by IRC §170 to constitute a charitable contribution. In this case, the US Tax Court considers the measure of the accuracy-related penalty under IRC §6662. In calculating the penalty under §6662, the IRS must determine the fair market value of property interest transferred in order to know whether the amount of the deduction claimed resulted in "gross or substantial valuation misstatements." The Tax Court in the case below determined the value of the charitable contribution to be zero and, therefore, the amount of the deduction claimed to be misstated in its entirety. The IRS appealed, arguing that the Tax Court below erred in treating the value of the property contributed to be zero. (Note that the IRS is arguing that the value of the property, rather than the value of the interest transferred, is the value to be determined, which would result in a substantially lower accuracy-related penalty under IRC §6662.)

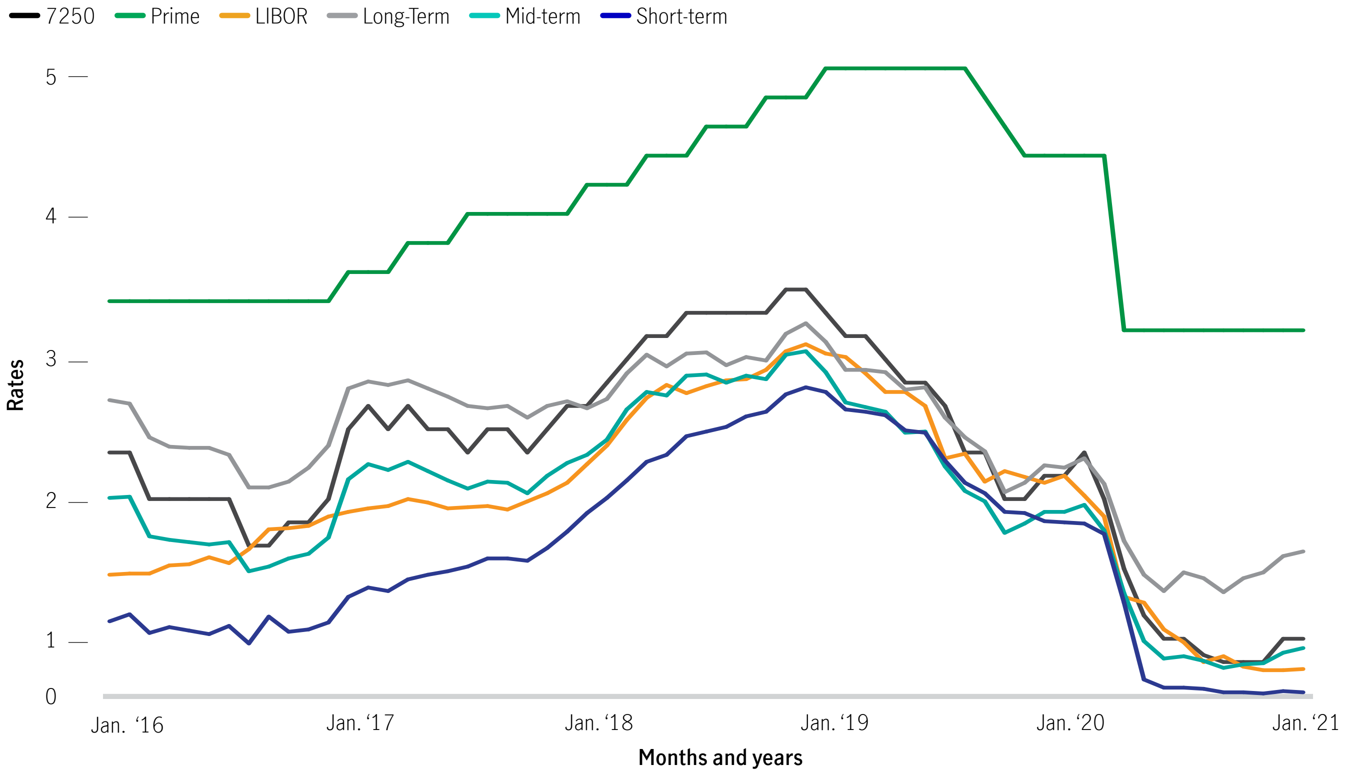
Holding

The Tax Court disagreed and upheld the determination and penalty below based on a valuation of the interest transferred, that is, zero. Relying on what the court considered the plain language of §6662 and further upon relatively recent US Supreme Court precedent (*U.S. v. Woods,* 571 U.S. 31, (2013)), the Court reiterated that the relevant valuation against which to measure the claimed deduction is that of the actual charitable gift. In this case, because the gift was determined not to constitute a charitable gift, that valuation must be zero. Since no gift was made, the Taxpayer could not claim to have made a charitable contribution of property in any amount greater than zero and IRS regulations under IRC §6662 provide that when the correct value of contributed property is zero and the value claimed is greater than zero, a gross valuation misstatement is deemed to exist.

Takeaway

This case is easier to understand if one considers a hypothetical where an actual charitable gift is considered to have been made, but the donor claims a charitable deduction grossly in excess of the value of the interest contributed. IRC §6662 would clearly compare the value of the *interest transferred* to the deduction claimed. The Tax Court simply applied this understanding of the statute.

The following are historical graphs of various rates that are commonly used by the Advanced Markets Group.



Take a look at how rates compare this month to last month:

	Short-term AFR	Mid-term AFR	Long-term AFR	7520	LIBOR	Prime
January '21	0.14%	0.52%	1.35%	0.60%	0.34%	3.25%
December '20	0.15%	0.48%	1.31%	0.60%	0.33%	3.25%

To read more and stay up-to-date on the latest industry news, please log on to the *Advanced Market's blog* on *JHSalesHub.com*. We can also be reached at *888-266-7498, option 3* or *option 4.*

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