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UPDATE FOR ACCOUNTANTS & FINANCIAL PLANNERS

9/22/2022

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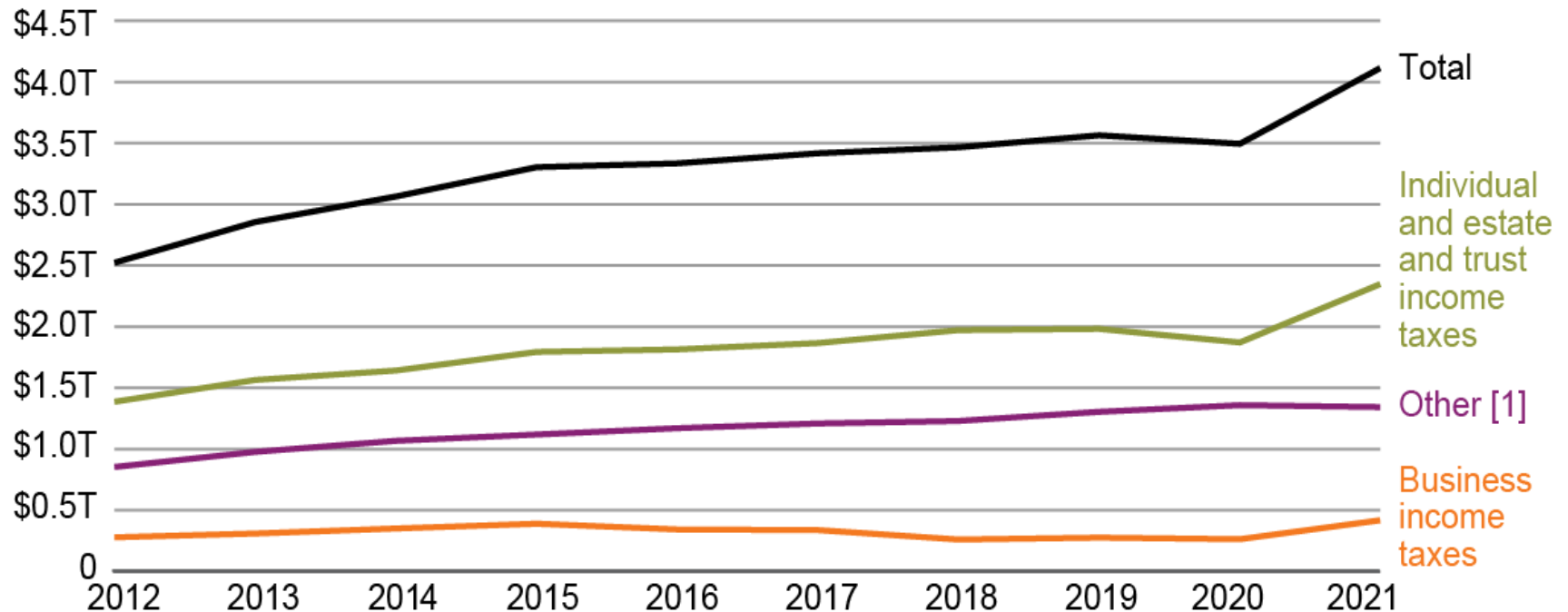
What's New at the IRS & Audit Examinations

By Eric J. Rollinger, JD, CPA

IRS Trends – Gross Collections by Type of Tax

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Gross Collections by Type of Tax, Fiscal Years 2012–2021



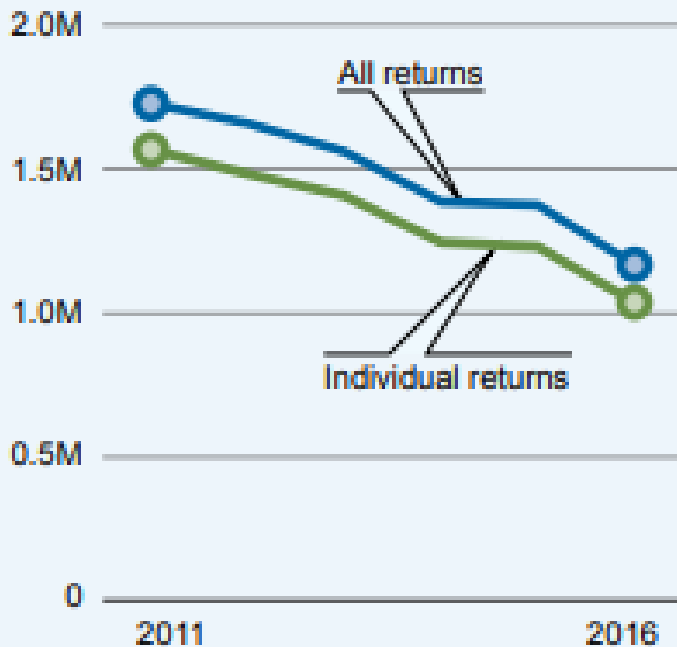
[1] Includes employment, estate and gift, and excise tax forms.

SOURCE: IRS Data Book Table 1

The IRS collected over \$4.1T of gross taxes in FYE 9/30/21 up from \$2.5T in FYE 9/30/12, which is more than a 64% increase

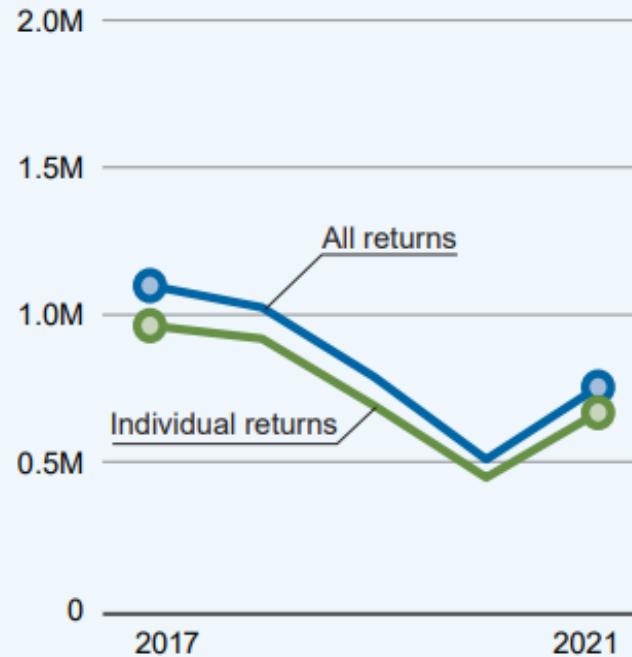
IRS Trends – Number of Returns Examined

Number of Returns Examined, Fiscal Years 2011–2016



SOURCE: IRS Data Book Table 9a

Number of Returns Examined, Fiscal Years 2017–2021



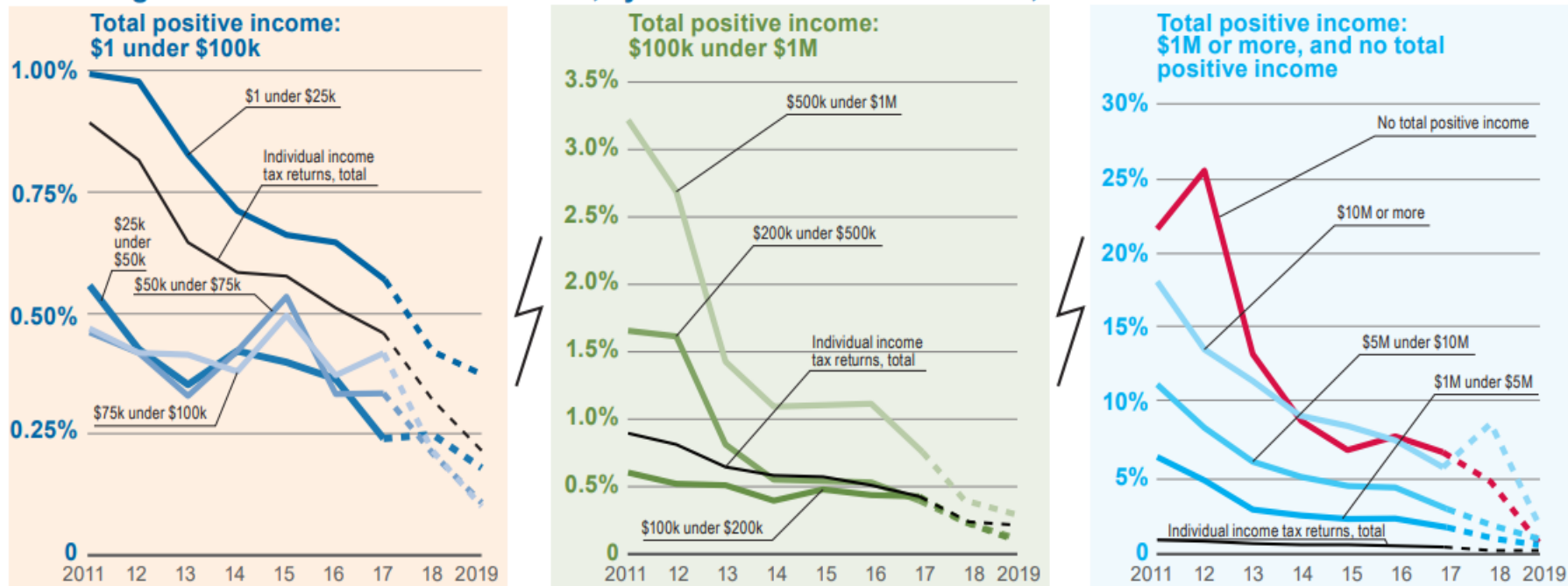
SOURCE: Selected IRS Data Books, Table 18

The IRS audited over 1.72M returns in FYE 9/30/11 and under 510K in FYE 9/30/20, which is more than a 70.3% drop before an increase to over 738K in FYE 9/30/21 making the drop only 57.1%

IRS Trends – Number of Individual Returns Audited by Size of Income

INTERNAL REVENUE SERVICE DATA BOOK, 2021

Percentage of Individual Returns Examined, by Size of Total Positive Income, Tax Years 2011–2019



NOTE: Represents total returns (closed and in-process) examined for each classification, as a percentage of the total number of returns filed for the tax year for that classification. Percentages for recent tax years (dashed segments) may increase as additional examinations are opened, as these recent years are still within the statute of limitations.

SOURCE: 2021 IRS Data Book Table 17

Audit Rate for all Individual Income Tax Returns for FYE 9/30/11 was about .9% and in FYE 9/30/21 was under .2%, which is more than a 77% decrease

IRS Trends – 2011 to 2021 Percentages of Returns Selected for Audit by Type

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Audit Rate for Individual Income Tax Returns in FYE 9/30/11 was about .9% and in FYE 9/30/21 was under .2%

Audit Rate for Partnership Returns in FYE 9/30/11 was .5% and in FYE 9/30/21 was .1%

Audit Rate for S Corp Returns for FYE 9/30/11 was .4% and in FYE 9/30/21 was .1%

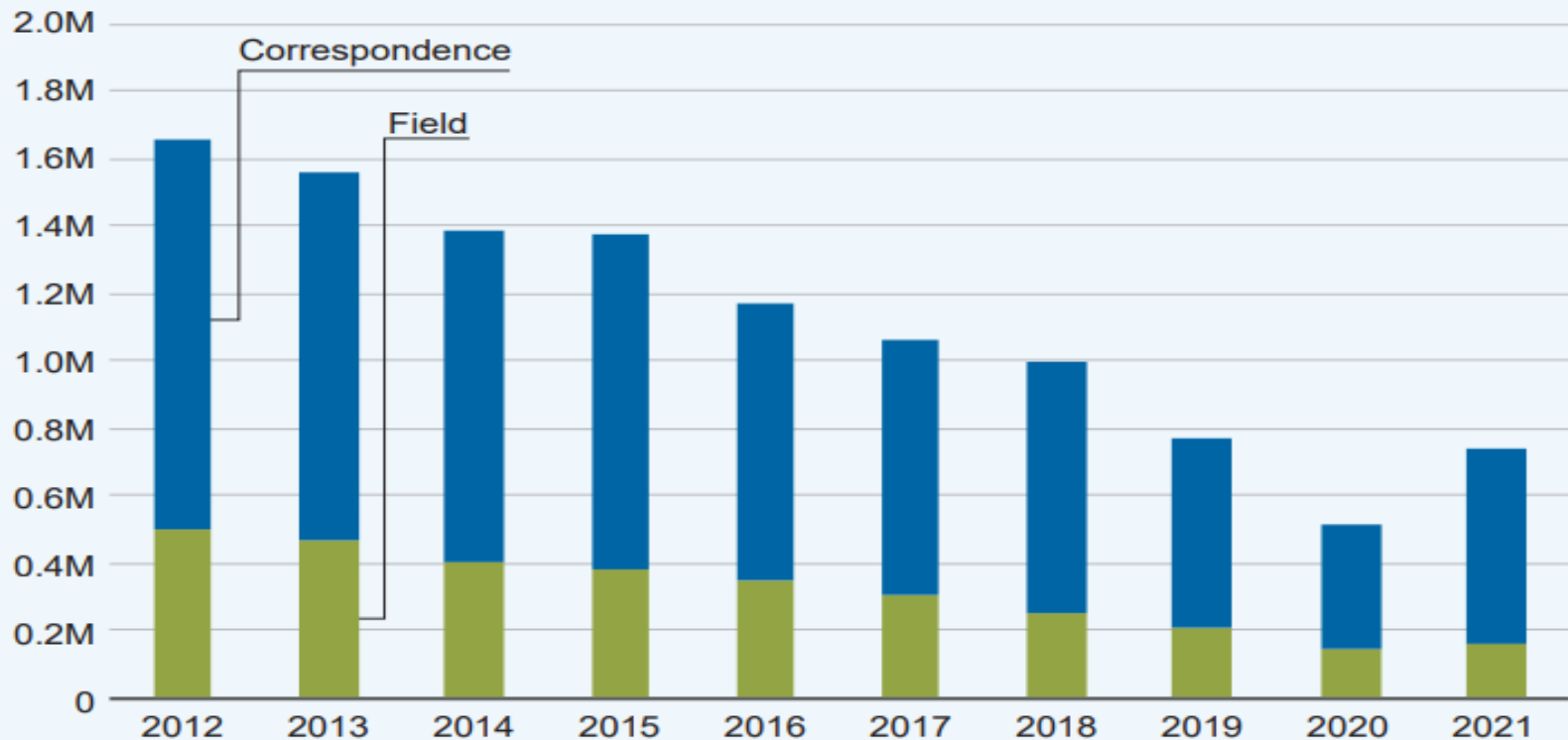
Audit Rate for C Corp Returns for FYE 9/30/11 was 1.4% and in FYE 9/30/21 was 2.9%

IRS Trends – Correspondence v. Field Audits

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INTERNAL REVENUE SERVICE DATA BOOK, 2021

Number of Returns Examined, by Examination Type, Fiscal Years 2012–2021

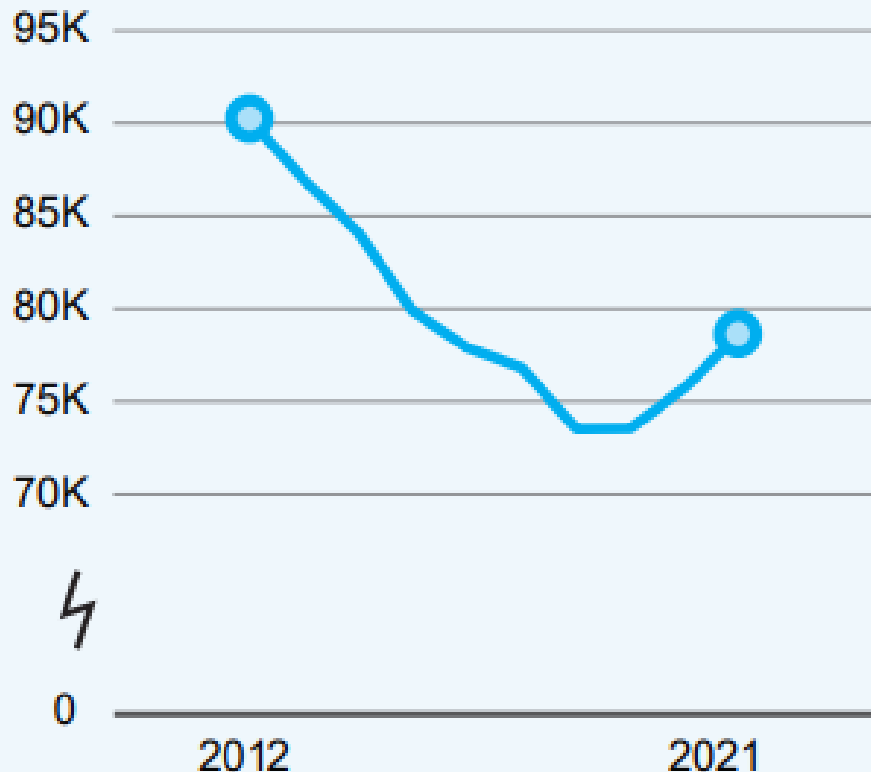


SOURCE: Selected IRS Data Books, Table 18

In FYE 9/30/2012 about 30.3% [502,180 of 1,657,698] of IRS audits were field audits, but in FYE 9/30/21 it was only about 21.6% [159,487 of 739,959].

IRS Trends – Number of Employees

Full-time Equivalent Positions Realized, Fiscal Years 2012–2021



SOURCE: Selected *IRS Data Books* Table 32

The number of IRS full-time equivalent employees was 90,280 in FYE 9/30/2012 and was 78,661 in FYE 9/30/21, which is a drop of about 12.9%.

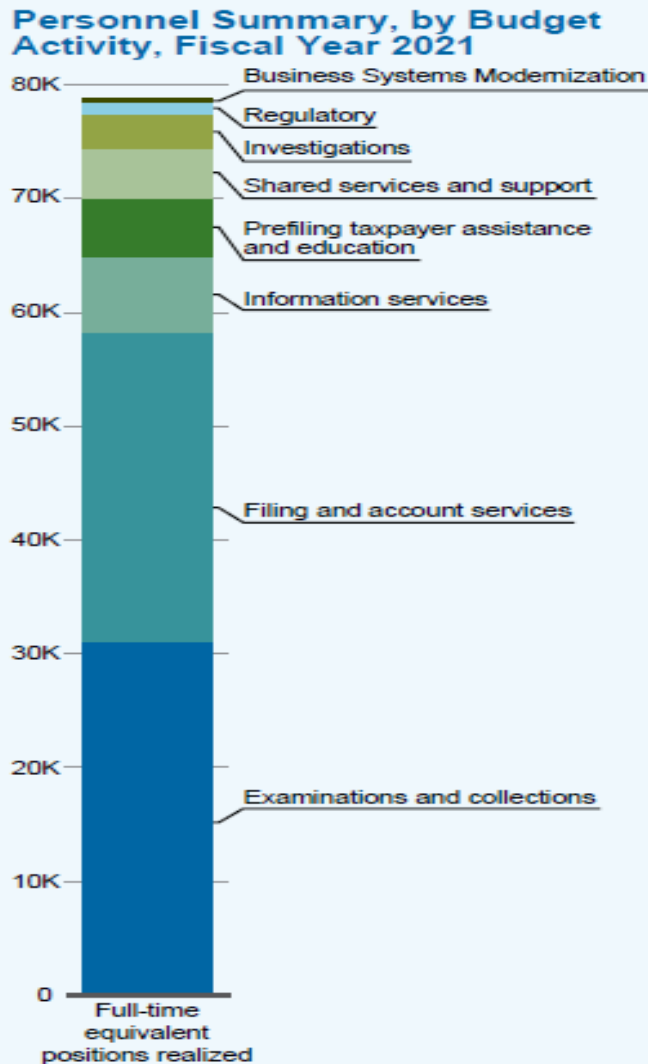
The U.S. population was only about 314M as of 9/30/12 and was over 332M as of 9/30/21, which was an increase of over 5.7%.

The number of IRS full-time equivalent employees reached a low of 73,519 and 73,554 respectively for FYEs 9/30/18 and 9/30/19

During FYE 9/30/21 the IRS had more than 61,000 employees teleworking at one time

IRS Personnel Summary by Activity

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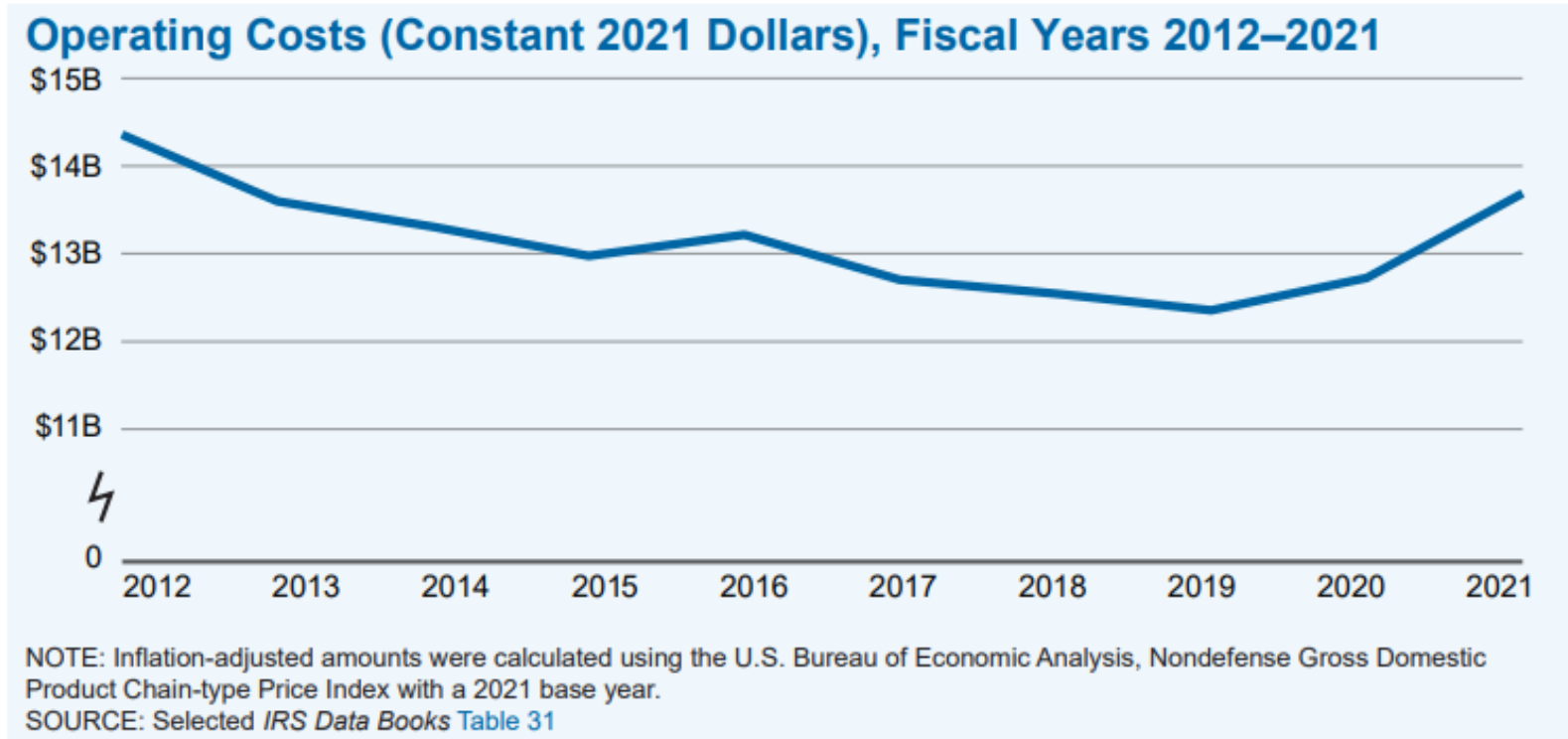
SOURCE: 2021 IRS Data Book Table 32

Of the 78,661 full-time equivalent employees in FYE 9/30/21 about 44.6%, which is under 35,000 employees, were dedicated to enforcement, which includes Examinations & Collections, Investigations, and Regulatory services employees

Of the 78,661 full-time equivalent employees about 40.1%, which is under 32,000 employees, were dedicated to taxpayer services, which includes Filing and Account services and Prefiling taxpayer assistance and education employees

IRS Trends – Inflation Adjusted Budget

10



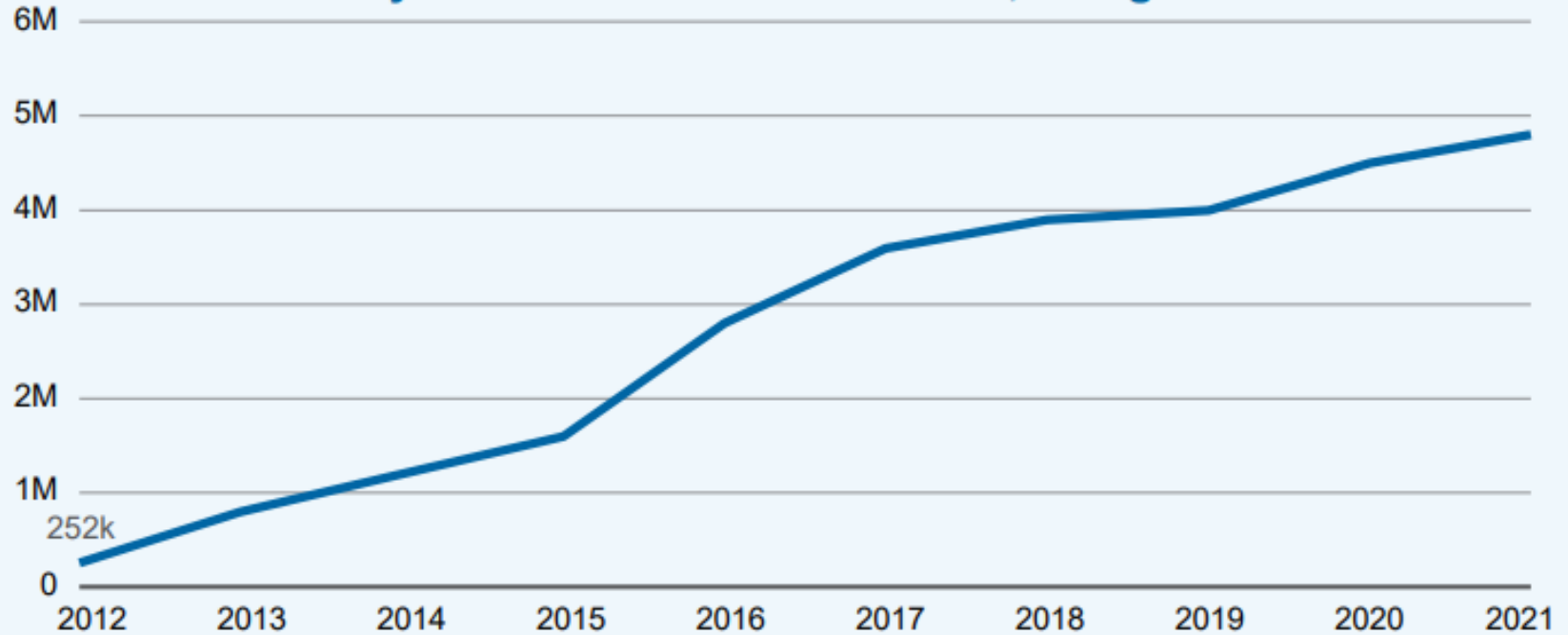
The IRS inflation adjusted budget dropped steadily from \$14.1B for FYE 9/30/12 to \$12.3B for FYE 9/30/19, which was a 12.7% drop.

The IRS budget has increased since the FYE 9/30/19 low and was \$13.7B for FYE 9/30/22

IRS Trends – Number of Identity Protection Pins

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Number of Identity Protection PINs Generated, Filing Seasons 2012–2021



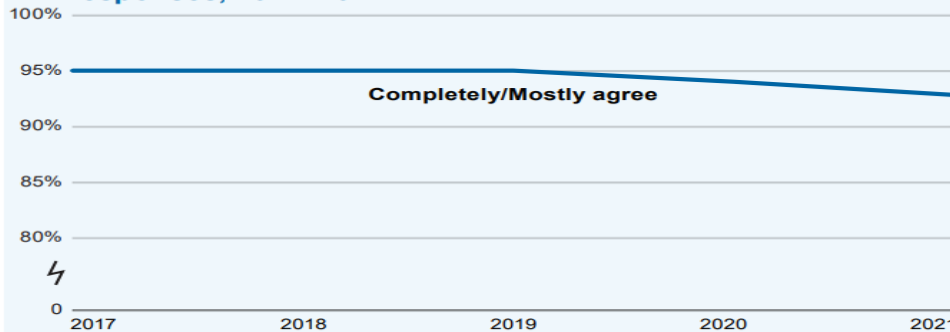
SOURCE: Selected *IRS Data Books*, Table 9

IRS Trends – Taxpayer Attitudes

It Is Every American's Civic Duty To Pay Taxes

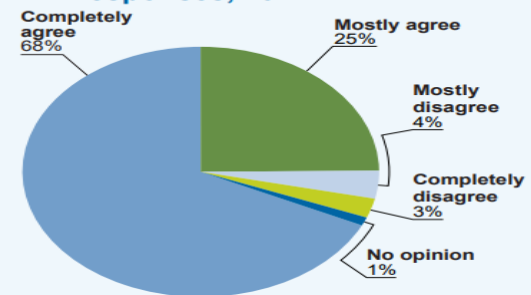
- Most taxpayers still view paying their fair share of taxes as their civic duty, but in 2021, this perspective continued a one-point decline that began in 2020.

All Responses, 2017–2021



NOTE: Blended phone and online responses began in 2017.
SOURCE: 2021 IRS Comprehensive Taxpayer Attitude Survey

All Responses, 2021

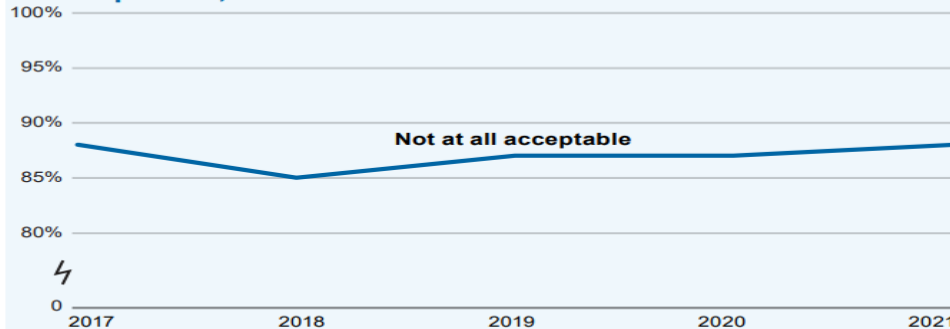


NOTES: Responses include both phone and online survey responses. No opinion includes: Don't know/Not applicable/No response. Pie chart does not total 100% due to rounding.

What Is an Acceptable Amount To Cheat on Income Taxes?

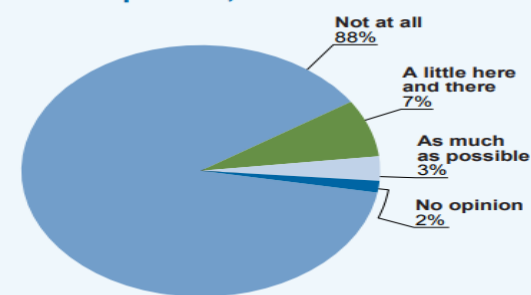
- Most taxpayers still agree that cheating on their income taxes is not at all acceptable. The percentage agreeing increased one point this year.

All Responses, 2017–2021



NOTE: Blended phone and online responses began in 2017.
SOURCE: 2021 IRS Comprehensive Taxpayer Attitude Survey

All Responses, 2021



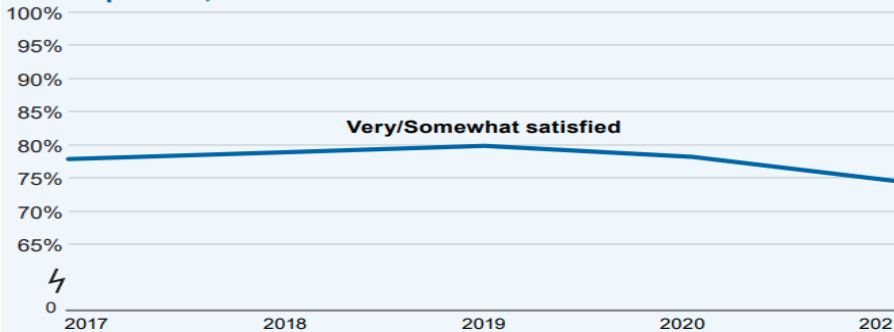
NOTES: Responses include both phone and online survey responses. No opinion includes: Don't know/Not applicable/No response.

IRS Trends – Taxpayer Satisfaction

Satisfaction with Personal Interactions with the IRS

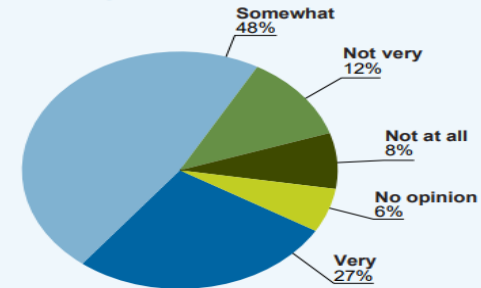
- Though most taxpayers are satisfied with their personal interactions with the IRS, the percentage of those who are satisfied declined a statistically significant three points.

All Responses, 2017–2021



NOTE: Blended phone and online responses began in 2017.
SOURCE: 2021 IRS Comprehensive Taxpayer Attitude Survey

All Responses, 2021

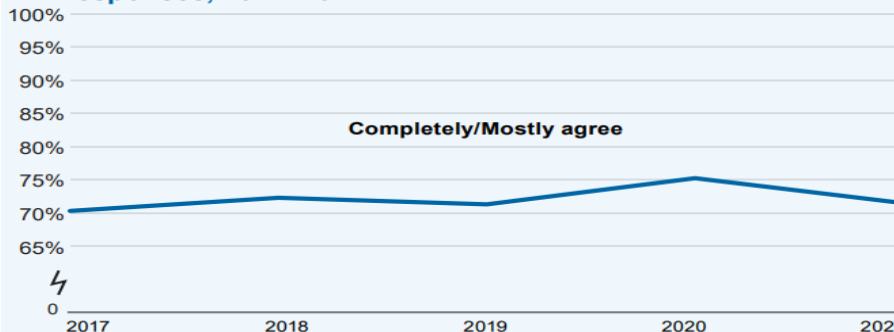


NOTES: Responses include both phone and online survey responses. No opinion includes: Don't know/Not applicable/No response. Pie chart does not total 100% due to rounding.

Trust in the IRS To Protect Tax Records from Cyber Criminals

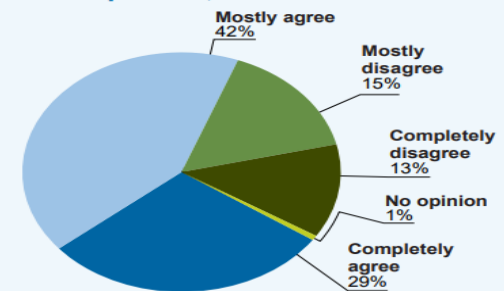
- The percentage of taxpayers agreeing that they trust the IRS to protect tax records from cyber criminals decreased a statistically significant four points in 2021.

All Responses, 2017–2021



NOTE: Blended phone and online responses began in 2017.
SOURCE: 2021 IRS Comprehensive Taxpayer Attitude Survey

All Responses, 2021

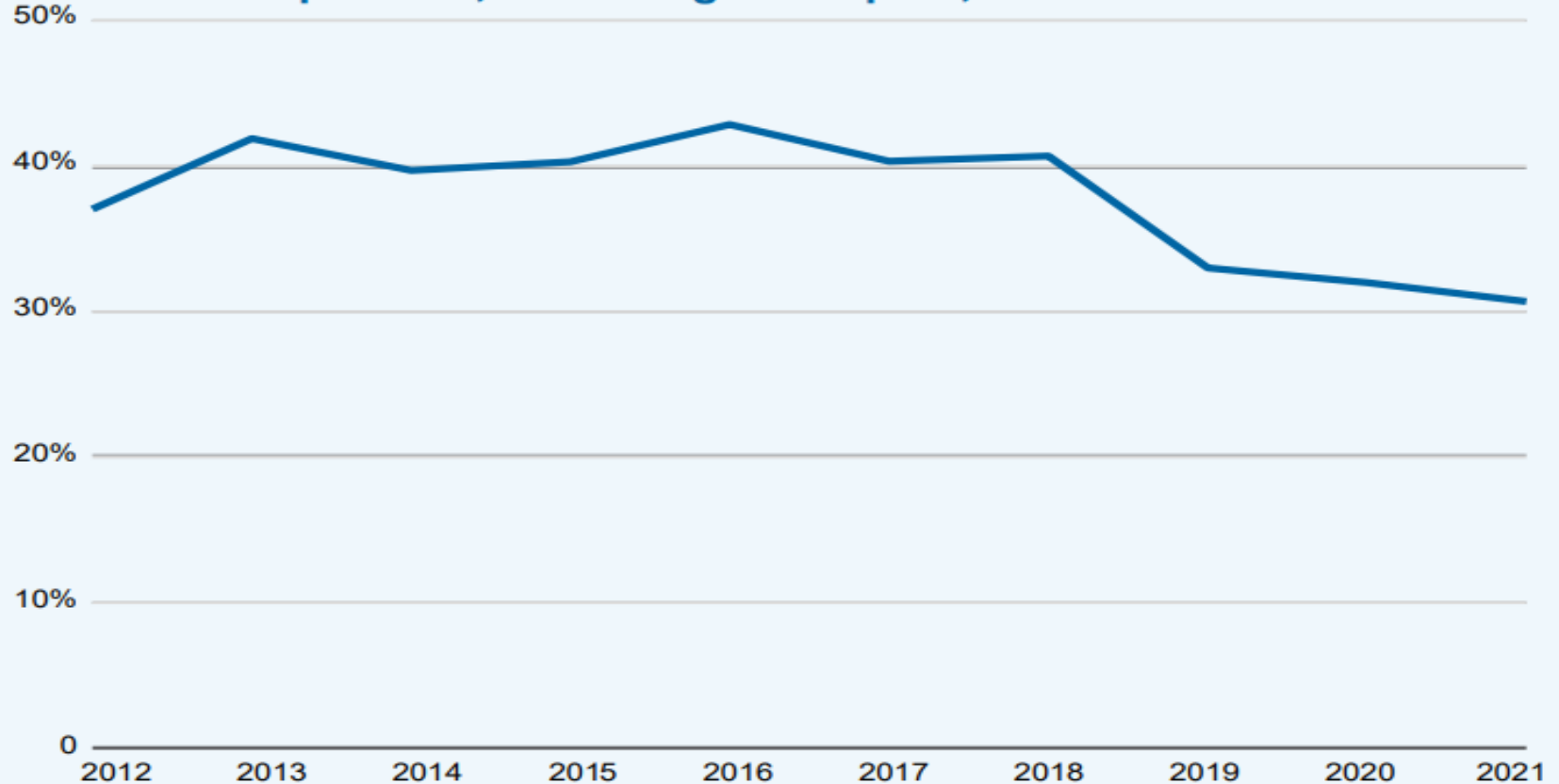


NOTES: Responses include both phone and online survey responses. No opinion includes: Don't know/Not applicable/No response.

IRS Trends – Offers in Compromise

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Offers in Compromise, Percentage Accepted, Fiscal Years 2012–2021



SOURCE: Selected *IRS Data Books* Table 25

For FYE 9/30/21, taxpayers proposed 49,285 offers in compromise to settle existing tax liabilities for less than the full amount owed. IRS accepted 15,154 offers, amounting to more than \$220.9 million, during the year

IRS Trends – Criminal Investigations

Table 18. Criminal Investigation Program, by Status or Disposition, Fiscal Year 2012

Status or disposition	Total	Legal source tax crimes [1]	Illegal source financial crimes [2]	Narcotics-related financial crimes [3]
	(1)	(2)	(3)	(4)
Investigations initiated	5,125	2,291	1,880	954
Investigations completed	4,937	2,057	1,903	977
Referrals for prosecution	3,701	1,401	1,518	782
Investigations completed without prosecution	1,236	656	385	195
Indictments and Informations [4]	3,390	1,161	1,486	743
Convictions	2,634	892	1,123	619
Sentenced	2,466	824	1,098	544
Incarcerated [5]	2,009	673	850	486
Percentage of those sentenced who were incarcerated [5]	81.5	81.7	77.4	89.3

Table 24. Criminal Investigation Program, by Status or Disposition, Fiscal Year 2021

Status or disposition [1]	Total	Legal source tax crimes [2]	Illegal source financial crimes [3]	Narcotics-related financial crimes [4]
	(1)	(2)	(3)	(4)
Investigations initiated	2,581	953	967	661
Investigations completed [5]	2,766	1,052	979	735
Referrals for prosecution	1,982	575	761	646
Investigations completed without prosecution	784	477	218	89
Indictments and informations [6]	1,856	536	742	578
Convictions [7]	1,263	426	536	301
Sentenced	1,268	454	492	322
Incarcerated [8]	993	344	385	264
Percentage of those sentenced who were incarcerated [8]	78.3	75.8	78.3	82.0

FYE 9/30/12: 4,937 CIs; 3,390 charges [68.7%]; 2,634 convictions [53.4%] and 2,009 incarcerations [40.7%]

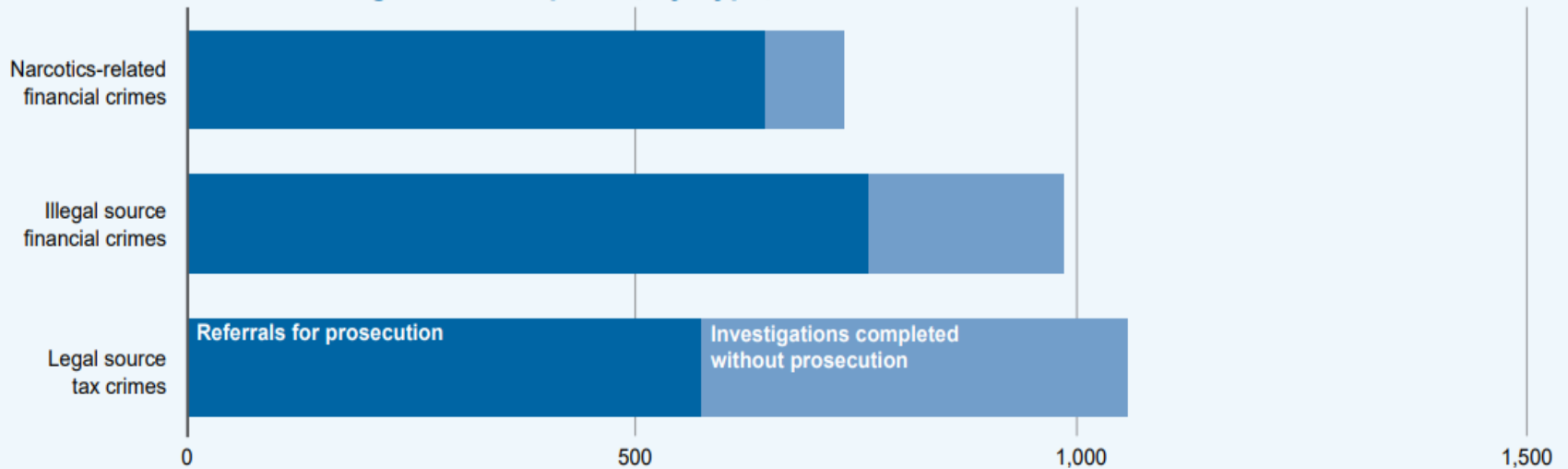
FYE 9/30/21: 2,766 CIs; 1,850 charges [66.9%]; 1,263 convictions [45.7%] and 993 incarcerations [35.9%]

If a Taxpayer is under Criminal Investigation there is about a 35.9% - 40.7% change over last 9 years will go to jail

IRS – Criminal Investigations by Type

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Number of Criminal Investigations Completed, by Type, Fiscal Year 2021



SOURCE: 2021 IRS Data Book Table 24

For FYE 9/30/21: 1,052 of the 2,766 Criminal Investigations completed were of the legal-source tax crimes type, which involve activities, industries, and occupations that generate legitimate income or threats to the tax system

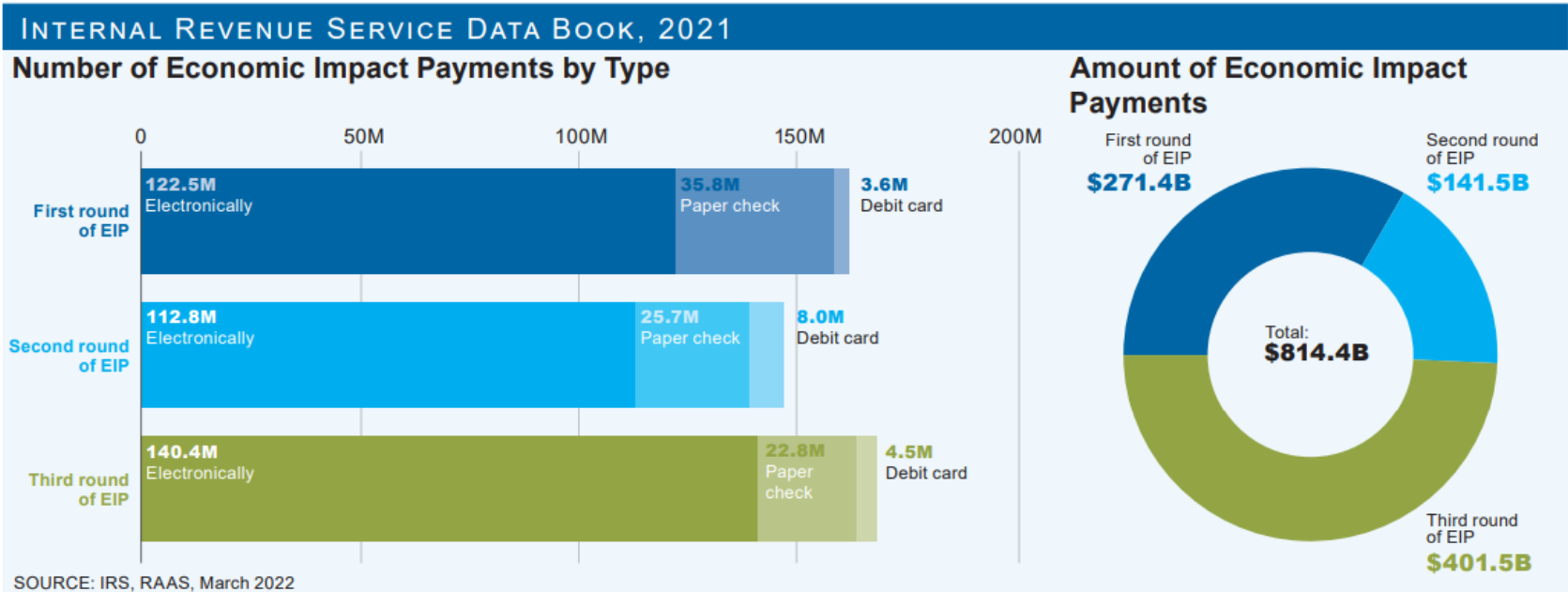
FYE 9/30/21 legal-source tax crime type: 1,052 CIs; 536 charges [50.9%]; 426 convictions [40.5%] and 344 incarcerations [32.7%]

IRS Trends – FYE 9/30/20 to 9/30/21

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- During FYE 9/30/21 toll-free live call volume increased 21.2% to more than 21.7M calls answered, up from almost 17.9M in FYE 9/30/20.
- During FYE 9/30/21 IRS.gov website usage increased 24.7% to just shy of 2.0 billion site visits in FYE 9/30/21, up from FYE 9/30/20 record-breaking number of about 1.6 billion.
- During FYE 9/30/21, the IRS processed more than 261.0 million tax returns and other forms, including 167.9 million individual income tax returns, an increase of 6.8% from FYE 9/30/20.

IRS & COVID-19 – Economic Impact Payments



IRS & COVID-19 – Employer Credits Claimed

COVID-19 Employer Credits Claimed, by Type of Credit

[Money amounts are in billions of dollars]

Type of credit	Number of employers	Employer credit amount reported on Forms 941, 943, 944, and CT-1	Number of Forms 7200 processed	Advance amount paid to employers using Form 7200
	(1)	(2)	(3)	(4)
Total [1]	1,163,228	69.3	109,532	18.6
Employee retention credit	457,856	58.2	n.a.	n.a.
Sick and family leave credit	781,094	10.1	n.a.	n.a.
COBRA premium assistance credit	23,030	1.0	n.a.	n.a.

n.a.—not available

[1] Some Form 941 filers reported multiple credits; however, filers (employers) are only counted once toward the total. Therefore, the total number of credits claimed exceeds the total number of employers.

NOTES:

Includes credits reported on the following forms: 941 (employer's quarterly tax return); 943 (employer's tax return for agricultural employees); 944 (employer's annual tax return); and CT-1 (railroad retirement tax return). Form 7200 (advance payment of employer credits due to COVID-19) allowed employers to request an advance payment, which would then be reconciled on the appropriate employment tax return. The last day to file Form 7200 was January 31, 2022. While counts include all credits claimed, amounts include only the amounts paid, not the amounts claimed.

Includes all returns processed as of March 31, 2022.

SOURCE: Small Business/Self Employed, Examination Deputy Operations, Headquarters Examination, Specialty Exam Policy.

IRS & Inflation Reduction Act

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- The Inflation Reduction Act was signed into law on 8/16/22
- The Inflation Reduction Act increases the IRS budget by \$80B over the next 10 years
- \$45.6B of the \$80B is designated for enforcement

Inflation Reduction Act & Op-Ed of Commissioner Rettig

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- Commissioner Rettig published an op-ed on Yahoo Finance on 8/26/22 stating that it is “absolutely false” that “the IRS is hiring 87,000 armed special agents to harass taxpayers”
- The Commissioner also stated that “The investment of these important resources is designed to support honest, compliant taxpayers,” “Our investment is designed around a Treasury directive that audit rates do not rise relative to recent years for households making under \$400,000” and “Overall, current IRS staffing is far below historical norms. In 1992, the IRS had 117,000 employees — 38,000 more than today. Back then, the agency was dealing with fewer taxpayers; the U.S. population has grown almost 30% since 1992.”

Handling a “Routine” Examination – Understanding What Caused the Audit

22

About **6 in 10** audits arise from a high Discriminant Index Function (DIF) score

- All returns are assigned a DIF score
- Returns with high DIF scores are reviewed by “Classifiers” who use subjective judgment to determine returns recommended for audit
- A final decision on whether or not to audit is made by the particular audit group.

About **1 in 10** audits arise from IRS activity targeted at specific industries (Market Segment Specialization Program – MSSP)

About **1 in 10** audits arise from other audits and by information provided by tipsters such as neighbors, ex-spouses, etc... who can receive rewards

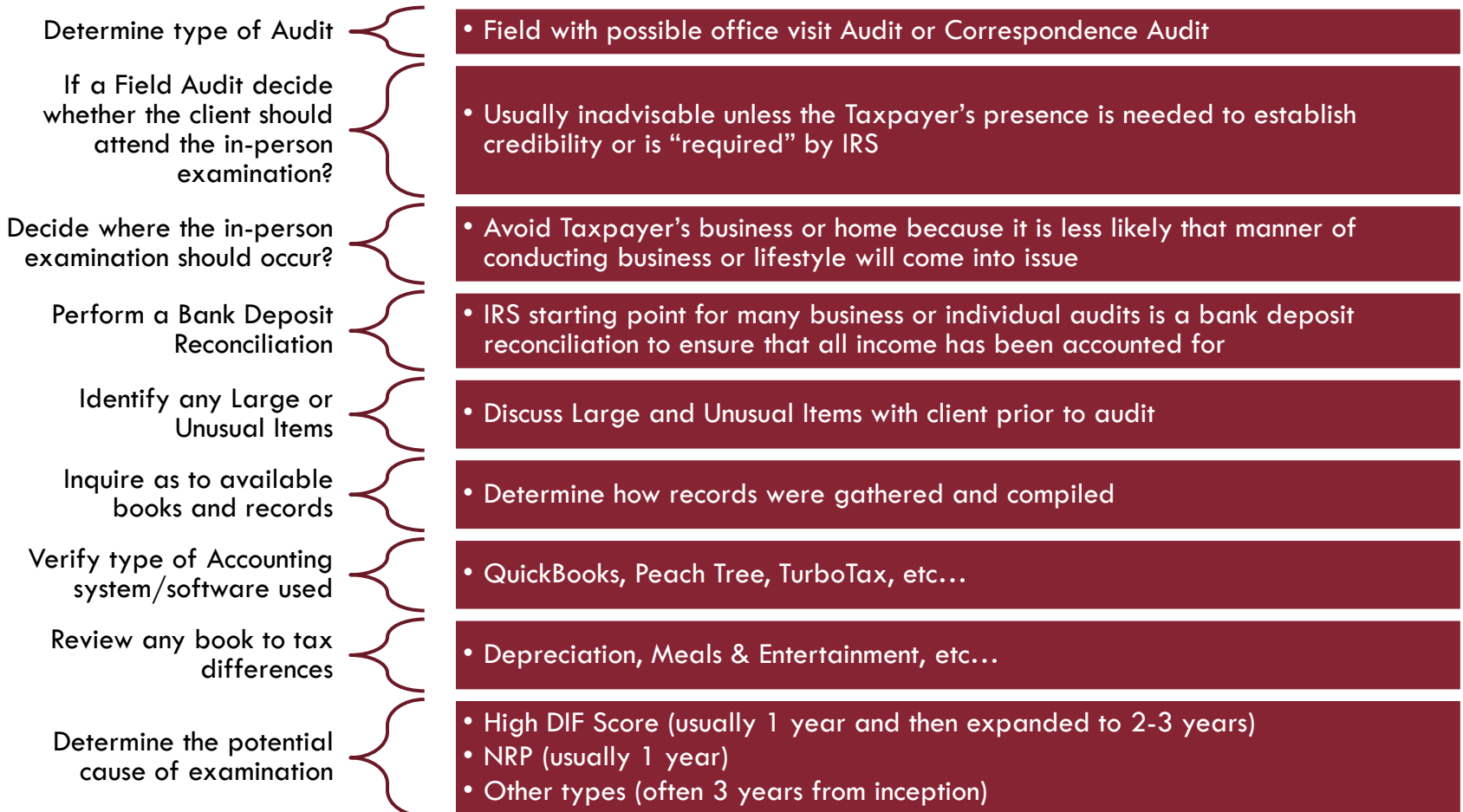
About **1 in 10** audits arise from scrutiny of disreputable tax return preparers

A small number of audits arise from the National Research Program (NRP)

- NRP is a random sampling program initiated in 2001, which was first used for individual returns and expanded to include entity and employment tax returns
- Its purpose is to minimize the number of “no change” returns to under 12%

Handling a “Routine” Examination – Strategy & Best Practices

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Handling a “Routine” Examination – Time & Effort in Preparation

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- Time and effort required depends on:
 - The nature of the audit
 - The shape of taxpayer’s records
 - The knowledge and experience of the representative
 - Whether the IRS conducts an economic reality check
 - Whether there is potential criminal exposure

Handling a “Routine” Examination – Potential Large or Unusual Items

25

- Foreign income
- Claiming persons other than children, grandchildren or parents as dependents or two persons claiming the same dependent
- Schedule C losses for a business on modest gross income
- Travel and Meals on Schedule C disproportionate to income
- Office-in-home deduction
- High medical expenses well over 7.5% of AGI floor
- High interest deductions in relation to income
- High qualified residence interest deduction on married filing separate return
- High rental losses
- Bad debts (especially business bad debts by individuals)
- High percentage of business use of a vehicle
- Casualty losses
- Obvious inaccurate description
- Claiming material participation in activities with losses (especially with high income W-2 income)
- Acknowledging a foreign bank account (necessitates filing of FBAR)
- Large miscellaneous/other expenses
- Large cryptocurrency gains/losses

Handling an “Egg Shell” Audit – What It Is & Representation

26

What is an “egg shell” audit?

- A civil IRS examination with underlying criminal issues

Representation in an egg shell audit should be limited to:

- Tax controversy attorneys
- Attorney with a CPA under a *Kovel* agreement to assist
 - *United States v. Kovel*, 296 F.2d 918 (2nd Cir. 1961)

Tax return preparers should NOT handle egg shell audits

- IRC § 7525 Confidentiality privileges relating to taxpayer communications with federally authorized practitioners in respect to tax advice may only be asserted in noncriminal tax matters, which is similar to the Maryland Accountant-Client Privilege per MD. Code § 9-110

Handling an “Egg Shell” Audit – Objectives & Possible Outcomes

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□ There are 2 objectives:

1. Main objective is to prevent a criminal investigation or keep the matter a civil examination
2. Lesser objective is to avoid civil fraud penalties and minimize adjustments
 - IRC § 6663 imposes a 75% penalty on portion of underpayment attributable to fraud

□ There are 3 likely outcomes:

1. Revenue Agent does not discover criminal issues
2. Revenue Agent discovers some or all criminal issues but is convinced to keep matter a civil examination
3. Revenue Agent makes a referral to Criminal Investigation Division (CID)

Handling an “Egg Shell” Audit – Strategy & Best Practices

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Perform your
due diligence
and prepare
thoroughly for
the examination

- Review all returns and information available
- Have “heart-to-heart” meeting with client
- Consider a forensic examination
- Perform a bank deposit analysis, net worth / lifestyle analysis, and identify all possible criminal offenses
- Inquire about Revenue Agent

Consider
assertion of
privileges

- Attorney – Client Privilege
- Federally Authorized Tax Practitioner Privilege
 - Only applies to tax advice in non-criminal tax matters per IRC §7525
- Fifth Amendment Privilege
- Joint Defense Privilege
- Spousal Privilege

Handling an “Egg Shell” Audit – Strategy & Best Practices

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Control the examination

- Pick the location (preferably your office)
- Limit Client participation if possible
- Make and maintain the record
 - Ensure that you don't make any damaging statements that the IRS agent will note in the record
 - You can request a copy of the record including IRS agent's notes

Control the copies

- Only give information requested and maintain an accurate record of all copies that have been provided

Avoid False Statements

- False statements can lead to obstruction charges

Remain Calm and Collected at all times

- Maintaining a good rapport can be the difference between a criminal referral or no referral

Handling an “Egg Shell” Audit – Signs of a Criminal Referral

30

Firm indications of Fraud exist

- I.R.M. 25.1.2 – describes indications of fraud including omissions, inability to explain large items, substantial overstatements, two sets of books, fictitious items, etc...

Warning signs

- Revenue Agent goes AWOL
- Revenue Agent starts to focus on the “intent” of the client toward sensitive issues
- Revenue Agent focuses on net worth analysis or bank records
- Excessive copy requests
- 3rd party contacts
- Search and seizure warrants
- Summons or subpoenas for records
- Revenue Agent requests admissions from taxpayer

Handling an “Egg Shell” Audit – Frequently Charged Tax Crimes

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- IRC § 7201 – willful attempt to evade or defeat tax (evasion)
- IRC § 7202 – willful failure to collect or pay over tax (employment tax)
- IRC § 7203 – willful failure to file a return, supply information, or pay tax due
- IRC § 7206 – fraud or false statements (including aiding or assisting in preparation of false returns)
- IRC § 7212 – willful attempt to interfere with administration of internal revenue laws (obstruction)
- 18 USC § 286 – conspiring to defraud the government
- 18 USC § 371 – conspiring to commit offenses to defraud the government

Handling an Administrative Appeal & Beyond – Overview & Protest Letter

32

- When a matter can not be resolved with the examiner an examination report will be issued and the Taxpayer receives a 30-day letter giving the Taxpayer 30 days to file an Appeal usually via a Protest Letter
- Instructions concerning the required content of the Protest are found in IRS Publication 5 and the 30-day letter itself
 - A formal written protest letter will be required by an individual in order to obtain a conference when the total amount of the proposed additional tax, interest and penalties exceeds \$25,000 for any tax period

Handling an Administrative Appeal & Beyond – The Appeals Conference

33

The Appeals Conference takes place at the IRS office assigned and is attended generally by a single IRS Appeals officer

At the Appeals Conference a Taxpayer will have a greater opportunity to resolve a controversy than existed with the examiner

- Appeals officers will consider court decisions contrary to the IRS as well as hazards of litigation
 - A particular issue may be settled at a certain number of cents on the dollar based on risk of litigation
- Appeals generally handles matters on a “20% - 80% rule”
 - Conceding matters with a low chance of prevailing (under 20%), making no concessions with a high chance of prevailing (over 80%), and otherwise “horse-trading” for the most part

Most tax matters are resolved at Appeals along lines that are better than they would be resolved by a court

- About 90% of all cases heard by Appeals are resolved

Handling an Administrative Appeal & Beyond – Tax Court

34

- If a case can not be resolved by Appeals the IRS will issue a Statutory Notice of Deficiency or 90-day letter giving the Taxpayer 90 days to file a Petition
 - The time period for a filing a Tax Court Petition is statutory and cannot be extended
 - Note that 90 days is generally less than 3 months
- The Tax Court will not hear the case of a business entity not in good standing under state law on the date it files its Tax Court Petition
- Payroll tax matters such as the Trust Fund Recovery Penalty are not within the jurisdiction of the Tax Court
- Most Taxpayers prefer Tax Court over other litigation options because you can litigate without first paying

Handling an Administrative Appeal & Beyond – Other Litigation Options

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Instead of filing a Petition with the Tax Court, you can pay the full liability, file a claim for refund with the IRS (which will, in all likelihood, be denied) and then sue the IRS for a refund in U.S. District Court or in the U.S. Court of Federal Claims

- If not heard back from IRS within 6 months of claim for refund may file suit for refund immediately in District or Claims Court
- If you wish to file a refund suit, you must file no later than 2 years from the date of disallowance

“Full Payment Rule”

- District Courts generally require all principal, interest and penalties paid prior to filing suit
- Claims Court generally requires only tax principal paid prior to filing suit

A jury trial is available in U.S. District Court

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Tax Tactics in Selling a Corporation

By David S. De Jong, LLM, CPA
& Mark W. Schweighofer, LLM

Stock Sale – Tax Advantage

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About 30% of sales of corporations are stock sales rather than asset sales.

They give the seller a single level of tax at capital gains rates rather than potentially two levels in a C corporation (or an S corporation of less than five years) or a mixture of ordinary income with capital gain in an S corporation.

Stock Sale – Business Advantage

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- Agreements with customers, vendors or others may affectively prohibit or restrict an asset sale or make it inadvisable.
- Technology transfers are facilitated.
- Gets rid of hard to dispose of assets.
- Avoids the possible need to collect receivables.

Acquiescing in an Asset Sale

39

A seller agreeing to an asset sale can mitigate tax loss by:

- Negotiating with a buyer for an added price to cover all or a portion of the taxes.
- In a C corporation, taking added amounts as compensation to reflect prior years underpayment (gets rid of double taxation but still leaves a single layer of ordinary income).
- In a C corporation, allocating significantly to personal goodwill.

Personal Goodwill on Sale of Business

The “modern generation” of tax cases attempting to distinguish personal goodwill from institutional goodwill consists of seven cases between 1998 and 2014, all but one decided by the US Tax Court with the lone exception being a Federal District Court decision out of Washington state.

The seven cases have arisen in four different tax contexts:

Sale of a business by a C corporation with an allocation to personal goodwill (to avoid double income taxation).

Martin Ice Cream Co. v. Commissioner, 110 TC 189 (1998)

Solomon v. Commissioner, TC Memo 2008-102

Kennedy v. Commissioner, TC Memo 2010-206

United States v. Howard, 106 AFTR2d 2010-5533 (E.D. Wash) aff'd, 108 AFTR2d 2011-5993 (9th Cir)

Personal Goodwill in Other Contexts

41

Liquidation of a corporation with the shareholders continuing business in unincorporated form with the same intangibles (to avoid income taxation on the change in business form).

Norwalk v. Commissioner, TC Memo 1998-279

Liquidation of a corporation with family members of the shareholder having the opportunity to create their own similar business (to avoid income or gift tax on a transfer to next generation).

Bross Trucking, Inc. v. Commissioner, TC Memo 2014-107

Valuation of a corporation upon death of the shareholder with a carveout of personal goodwill (to avoid estate tax on a transfer to next generation).

Estate of Adell v. Commissioner, TC Memo 2014-155

Martin Ice Cream (1998)

In 1971 Arnold Strassberg teamed with his son, Martin, to start an ice cream distribution business. Martin Ice Cream became an early distributor of Haagen-Dazs. By the late 1980s, father and son were not getting along and Haagen-Dazs became interested in distributing directly to larger stores.

In 1988, Martin Ice Cream dropped the distribution of Haagen-Dazs products into a subsidiary and spun it off to Arnold. Individually and on behalf of the new corporation, Arnold entered into an agreement to sell “records” and “sellers’ rights” for \$1.4 million plus an earnout to Haagen-Dazs. There was no breakout between the entity and individual. However, both father and son entered into restrictive covenants for \$750,000 and \$250,000 respectively.

The Tax Court found that “rights” constituted most of the value and were never corporate assets. The rights arose out of the personal relationships with the supermarket owners, and the success of this aspect of the business was dependent entirely upon Arnold. The Court noted that personal relationships are not corporate assets in the absence of restrictive covenants.

Norwalk (1998)

43

Robert DeMarta and William Norwalk were 75% and 25% owners respectively of a marginally profitable CPA firm with six other professionals operating in corporate form with a Shareholder Agreement which did not restrict post-termination competition. The corporation was liquidated and the two individuals became partners in a larger partnership. IRS claimed that goodwill was distributed to the shareholders on liquidation of the corporation.

The Tax Court noted that goodwill is a “vendible asset” which can be sold with a professional practice. Citing Martin Ice Cream, the Court stated that there is no salable goodwill unless key employees have entered into covenants not to compete as the goodwill is that of the individual accountants who service clients. The Court held that there were no transferable “customer-based intangibles” belonging to the corporation. In other words, the goodwill transferred to the partnership was that of the individual CPAs.

Solomon (2008)

Solomon Colors, Inc. pulverized and sold ore as a small part of the operation of a family business started in 1927. The customers in this division were developed by the personal relationships of stockholder Robert Solomon since 1955 and his son, Richard, since 1979. The corporation sold the division in 2000 for \$100,000 for fixed assets plus an additional \$150,000 for a noncompete agreement and \$550,000 for a customer list. Additionally, \$850,000 was paid to the two individuals for their rights in the customer list along with an added \$60,000 for personal noncompetes including their wives.

IRS claimed that the corporation distributed the customer list to the Solomons individually, citing that sellers of the list were both corporate and individual while the enumeration of customers was on corporate stationary. The taxpayers argued that the payments to the individuals were for goodwill including customer relationships.

The Court disagreed with each side and determined that all payments to the individuals were really for their individual covenants not to compete. Distinguishing Martin Ice Cream, the Court did not find here that the value of the business was in the personal relationships while distinguishing a manufacturing business from a distributorship.

Kennedy (2010)

Ten years after forming an employee benefits consulting business incorporated midway through the period, in 2000, James Kennedy was approached to sell the business, KCL International, Inc., to a larger company with the purchase price basically tied to projected annual income with a 40% down payment. The business consisted of Kennedy and one employee, both of whom had customer relationships but not restrictive covenants. Late in the negotiating process, it was decided to allocate 25% of the price to a consulting agreement and 75% to individual goodwill beyond a \$10,000 allocation to corporate fixed assets and going concern value including corporate relationships.

IRS argued that the individual could not transfer goodwill without ownership of the client list and that the payments to Kennedy were for his consulting, restrictive covenant or both. Kennedy argued that Martin Ice Cream applied and that he owned the goodwill as there had been no prior noncompete.

Although noting that a payment to a service provider can be considered as being for goodwill in certain circumstances, the Court noted that the lack of economic reality here and the afterthought in allocating 75% of the price to personal goodwill. The lack of economic reality holding was based in part that Kennedy continued to work for 18 months without pay.

Howard (2011)

46

Larry Howard was a dentist since 1972 and employed since 1980 by his 100% owned Howard Corporation pursuant to an employment contract with restrictive covenants for three years. An allocation in the purchase agreement of the assets of the practice was made to personal goodwill.

The Government argued that the covenants transferred all goodwill to the corporation, distinguishing Martin Ice Cream where there had been no such transfer. The taxpayer argued that the covenants could have been terminated at any time by Dr. Howard as he was a 100% owner. The Court decided for the Government, opining that termination would not change the characterization of 32 years of goodwill.

Bross Trucking (2014)

Chester Bross entered the road construction industry in 1966, creating Bross Construction, Inc. for that purpose in 1972. Major customers were the highway departments of three states. In 1982, he formed Bross Trucking, Inc. to haul construction-related materials and coal for Bross Construction and other customers. He had no restrictive covenants. In response to Government investigations, he had Bross Trucking cease business in 2003 although it retained its licenses and certain other assets. At the same time, Chester's three sons, who had no involvement with Bross Trucking, created a new corporation to provide services similar to but more extensive than their father's entity, acquiring no tangible assets from Bross Trucking.

IRS attempted to argue that appreciated goodwill had been distributed to Chester Bross which was then given to his sons. The taxpayers argued that any goodwill was personal. Citing Martin Ice Cream and Solomon, the Tax Court noted that goodwill could be either corporate or personal but that any corporate goodwill was lost in the regulatory investigations, creating the "antithesis of goodwill." The Court indicated that the only corporate attribute of goodwill that might exist is a workforce in place of several mechanics and administrative staff in that drivers were independent contractors, although half of the new company's employees did not come from Bross Trucking and that the remaining attributes stemmed from the personal relationships of Chester Bross.

Adell (2014)

In 1999, Franklin Adell had created a corporation to own rights to an urban religious satellite channel. Later that year, with others, he created a nonprofit entity to provide programming.

Franklin, a widower, died in 2006. At the time of his death, he and his son, Kevin, were taking a combined \$8.5 million in compensation from the entity owning the channel, STN.com, Inc. The corporation was valued by the estate at \$9.3 million using a discounted future earnings method and adjusting out personal goodwill. The estate subsequently revised its valuation to \$4.3 million using an adjusted book value method which threw out goodwill as personal. The IRS valued the corporation at \$26.3 million using a discounted cash flow method.

The Tax Court determined that the IRS valuation failed to account for personal goodwill, most particularly that of the son who was President of STN and shared the relationships with his father.

Conclusion on Personal Goodwill

The seven leading tax cases dealing with personal goodwill go in different directions but are reconcilable. Under facts indicating close personal relationships are responsible for sales and profits and provided that the goodwill has not been transferred to the company through restrictive covenants, personal goodwill can exist apart from any institutional goodwill/going concern value. In the tax context, it is as difficult as in the marital context to break out personal goodwill – and its “cousin”, the covenant not to compete – from the value of a business as a whole.

Need to Liquidate S Corporation in Year of Asset Sale

50

- A sale of substantially all assets in an S corporation (not a C corporation for five years) will cause a second taxable event when followed by a corporate liquidation. But, with adequate planning, it should not cause double taxation.
 - ▣ Flow through of share of gain/loss on sale of assets.
 - ▣ With the cessation of business, liquidation of the stock interest in the corporation at a gain or loss.

Treatment of Capital Losses

- If liquidation of the stock interest will result in a loss and assets were sold at a gain, it is imperative that the capital loss liquidation be recognized in the same year as the capital gain. Otherwise, the seller will be using \$3,000 of losses each year unless and until there are other capital gains.

Illustration – Albeit Extreme

52

- John Smith, a 50% stockholder, died in January 2022. At the time of his death, his basis in the stock was \$700,000. There was little debt on the books and the Corporation was valued at \$11 million as of death but three months later sold for \$12 million with allocation substantially to goodwill with a few dollars to fully depreciated fixed assets. The Estate's share of the proceeds and gain was essentially \$6 million, there being negligible basis in the assets sold.

Illustration – Albeit Extreme (ctd)

53

- However, after the sale, the Estate had a basis of \$5.5 million increased by \$6 million from its sale of the gain. However, the Corporation has only about \$12.4 million in cash, mostly from the sale. If the Estate receives \$6.2 million on liquidation against a basis of \$11.5 million, it will have a \$5.3 million capital loss which, if occurring in 2022, will reduce the Estate's net capital gain to \$700,000.

Structures for Stock Sales Treated as Asset Sales for Tax Purposes

54

- 338(h)(10) Election
- 336(e) Election
- F Reorganization

Stock Purchase With Election Under IRC Section 338(h)(10)

55

- Stock sale treated as an asset sale for tax purposes
- Buyer and Seller must join in election
- Only available if selling corporation is an 'S' corporation or a member of a consolidated group
- Only available in a "qualified stock purchase"
 - 80% of the voting power and value of a corporation during a 12-month period
- Election (Form 8023) must be filed by the 15th day of the ninth month after the acquisition date

Stock Purchase With Election Under IRC Section 338(h)(10)

56

- Effect
 - ▣ Immediately prior to the close of the transaction, selling corporation deemed to sell all of its assets to new target
 - ▣ Price is equal to the aggregate deemed sale price
 - ▣ Gain on sale flows through to selling corporations shareholders (in case of 'S' corporation)
 - ▣ If selling corporation is member of consolidated group, Net Operating Losses may be available
 - ▣ No additional gain on sale of stock
 - ▣ Can result in some ordinary income in 'S' corporation; potential BIG taxes
 - ▣ Closing of the Books election/straddle period taxes
 - ▣ Buyer essentially buys stock of "new" target, assets are stepped up to FMV

336(e) Election

57

- Similar to 338(h)(10) in terms of result
 - Must be a domestic corporation, member of consolidated group or an S corporation
 - Seller must sell at least 80% of the vote and value of the corporation to be sold and buyer must acquire 80% of the vote and value within a 12 month period

336(e) Election

58

- Benefits over 338(h)(10)
 - Buyer need not be a corporation (so partnership taxed entities, disregarded entities and individuals can be purchasers)
 - Can have multiple buyers (though all shareholders of seller must agree)
 - No joint election required; statement attached to seller's federal income tax return for the year of the acquisition

F Reorganization - Initial Structure

59

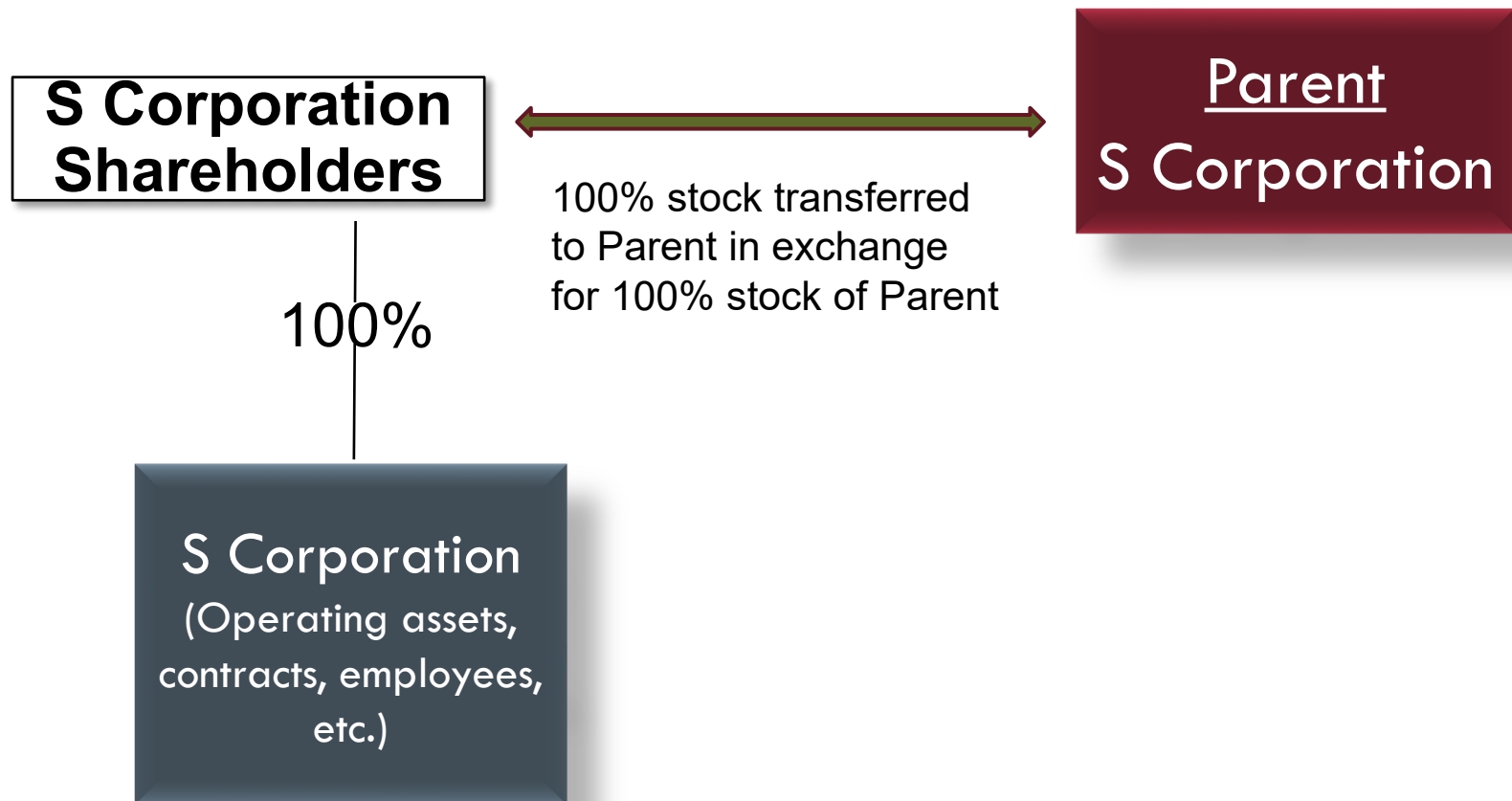
S Corporation shareholders

100%

S Corporation

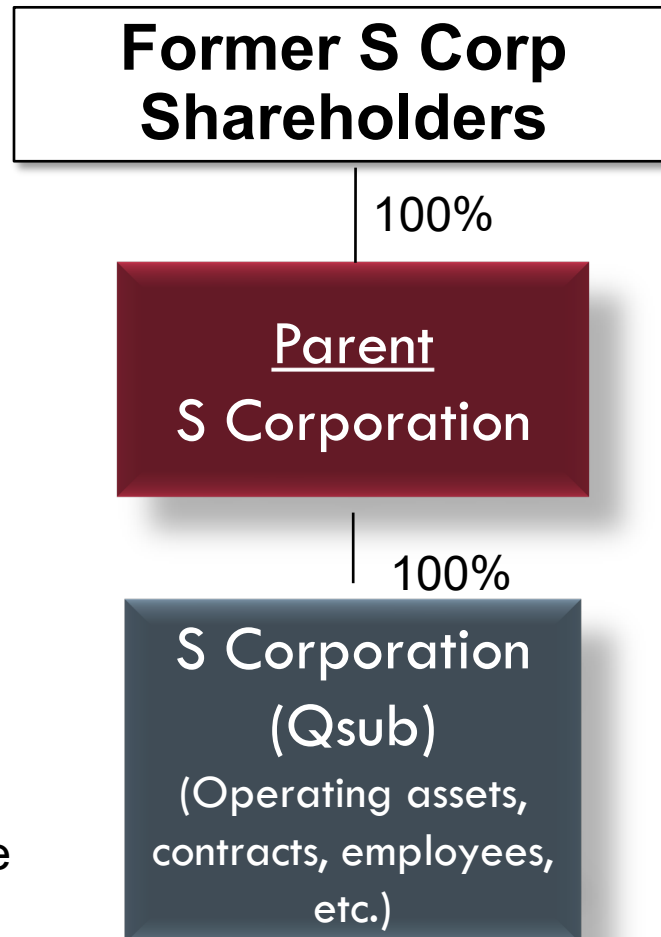
Formation of S Corporation Parent

60



Formation of S Corporation Parent: Result

61

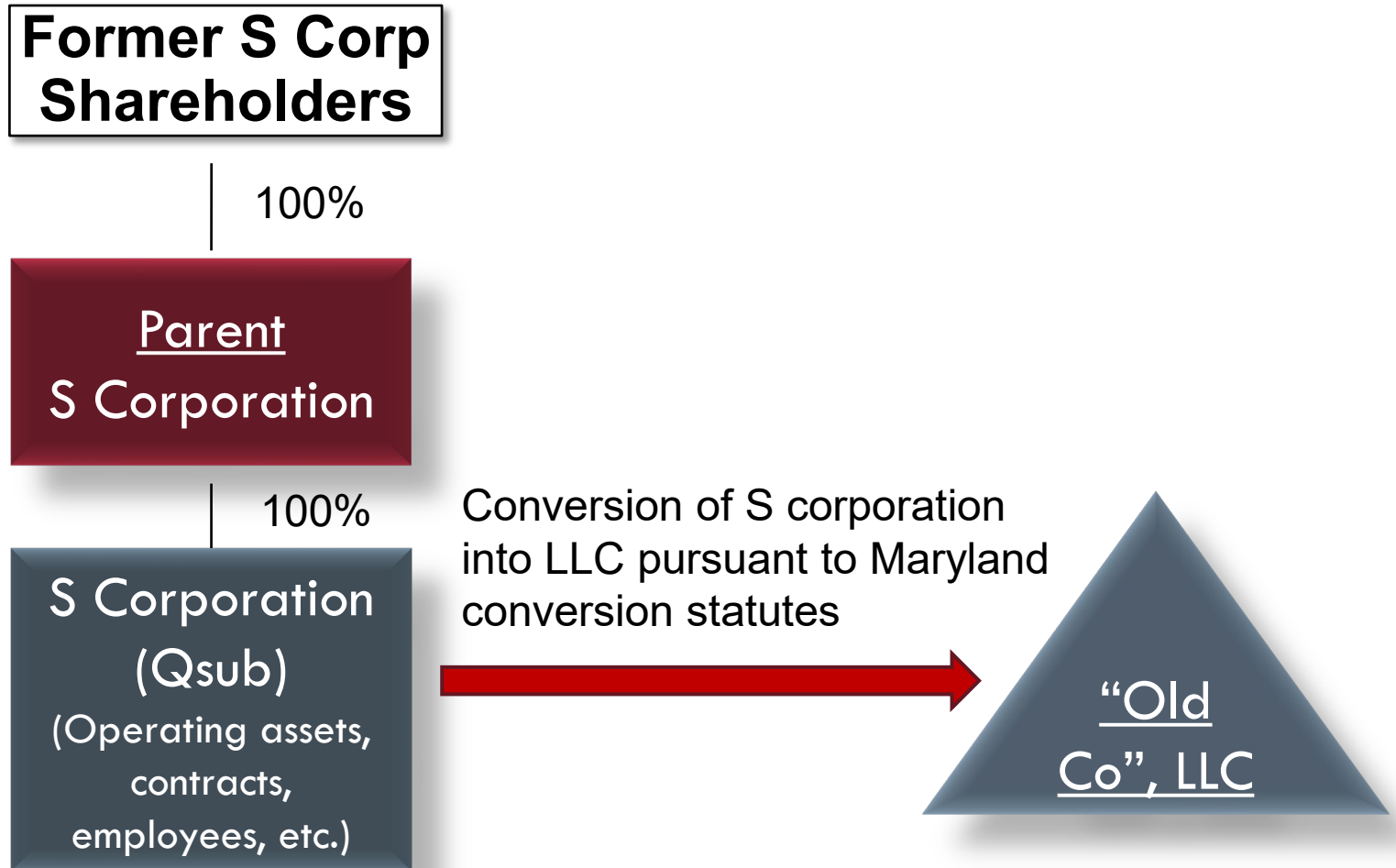


Parent files Form 8869 to make Qsub election for "Old" S corporation

Qualifies as IRC §368(a)(1)(F) tax-free reorganization per Rev. Rul. 2008-18

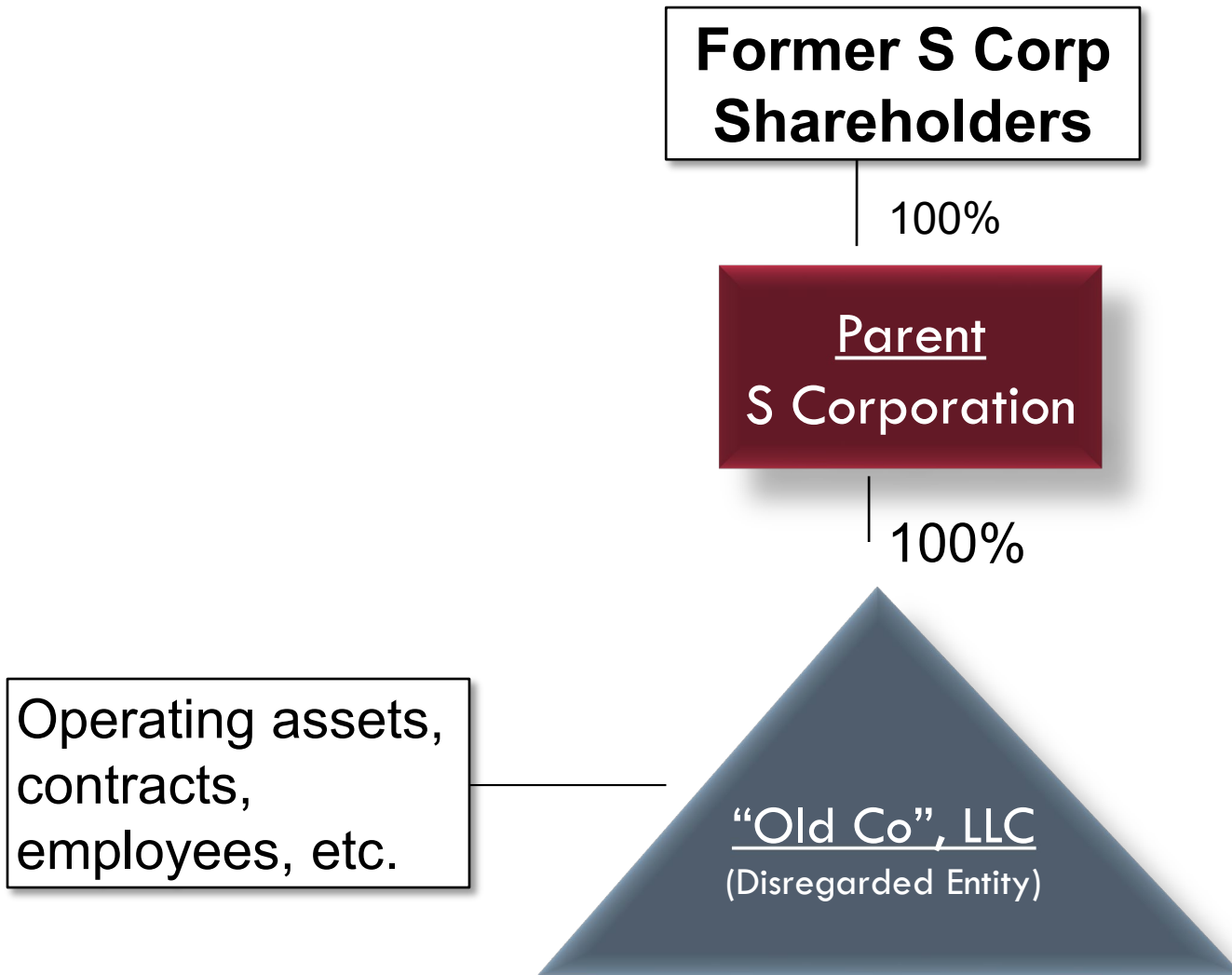
Conversion of “Old” S Corporation into LLC

62



Conversion of “Old” S Corporation into LLC: Result

63



Qualified Small Business Stock—IRC 1202

64

- Allows certain C corporation shareholders to exclude up to 100% of the gain on the disposition of C corporation stock
 - 50% for stock acquired after 1993 and before through February 17, 2009
 - 75% for stock acquired between February 18, 2009 and September 27, 2010
- Exclusion limited to the greater of \$10M or 10X adjusted basis in the QSB stock sold during the year
 - Stacking opportunities

Qualified Small Business Stock—IRC 1202

65

□ Requirements:

- QSB must be acquired in an “original issuance”
 - Generally in exchange for money, property or services
 - Can be acquired by gift or inheritance
 - In some cases partnership can distribute QSB to partners (does not work in the reverse)

Qualified Small Business Stock—IRC 1202

66

□ Requirements:

■ Active Business requirement (similar to 199A rules)

- At least 80% of assets, by value, must be held in the active conduct of a qualified trade or business
 - Any trade or business other than:
 - health, law, accounting, brokerage services, financial services, engineering, architecture, actuarial science, athletics, performing arts and consulting
- If corporation holds more than 50% interest in subsidiary, must look through to the subsidiary as well

Qualified Small Business Stock—IRC 1202

67

□ Requirements:

■ Gross Asset

- Aggregate gross assets of the corporation must not exceed \$50M at any time between 1993 and the date of the original issuance
 - Also tested immediately after the issuance
- Generally determined by adjusted basis (not FMV—different from 80% test, above)

Merger

68

- Taxable Merger
 - Merger under state law which fails to satisfy the requirements of Section 368 of the Code
 - Generally fully taxable – fair market value of cash and other property received less adjusted basis of stock
 - Useful in situations where shareholder approval cannot be obtained and an asset purchase is not desirable

Tax-Free Reorganization

69

- Must satisfy one of reorganizational forms under Section 368
 - ▣ Type A (Merger)
 - ▣ Type B (Stock for Stock)
 - ▣ Type C (Stock for Assets)
 - ▣ Triangular
 - Forward
 - Reverse

Tax-Free Reorganization

70

- Each must have the following elements:
 - Plan of Reorganization
 - Continuity of Business Enterprise
 - Continue to use target's business; or
 - Continue to use significant portion of historic business assets
 - Continuity of Business Interest
 - Percentage of consideration that must be in the form of Acquiror securities
 - IRS – 50% for ruling purposes
 - Nelson – 38% is sufficient
 - Unclear below 38% - 16% has been deemed too low
 - Valuation can be an issue with private company stock
 - Business Purpose
 - Substantial non-tax purpose

Miscellaneous Tax Considerations

71

- Miscellaneous Tax Considerations
 - ▣ New 83(b) Elections
 - ▣ Golden Parachute – (IRC 280G)

Need for New Section 83(b) Elections

72

- Revenue Ruling 2007-49
 - If stockholder exchanges, in either a tax-free reorganization or a taxable exchange, stock which is fully vested for stock which is substantially unvested, there is a transfer of property subject to Section 83 and new elections are required
 - The “spread” on the new election would be zero (0) so no downside
 - Election must be filed within 30 days

Golden Parachutes (IRC Section 280G)

73

- Targets excessive payments typically made to executives and high-level employees in connection with a change in ownership, such as a merger or acquisition
- As a penalty for those payments, Sections 280G and 4999 impose a 20% excise tax on individuals who receive “excess parachute payments”
- Additionally, the company making the payments is precluded from utilizing any deduction associated with an excess parachute payment

74

Cryptocurrency – Is An Audit Virtually Certain?

By Michael Y. Goldberg, LLM, CPA

Outline

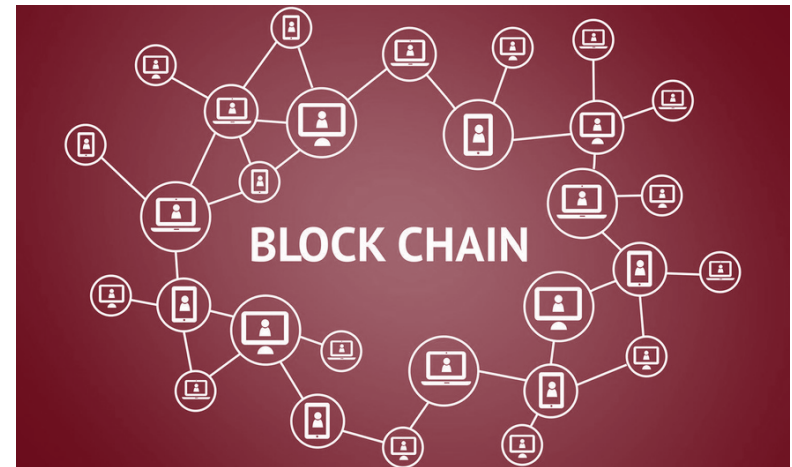
75

- What is Cryptocurrency?
- How is it taxed?
- Recent IRS Enforcement Action and “Education” Program
- Non-tax legal issues

What is Virtual Currency and/or Cryptocurrency?

76

- ❑ Digital asset
- ❑ Medium of Exchange
- ❑ Trustless
- ❑ Cryptocurrency uses cryptography
- ❑ No central authority
- ❑ Blockchain
- ❑ Not legal tender
- ❑ Anonymity
 - ❑ KYC issues
- ❑ #buzzwords



Bitcoin

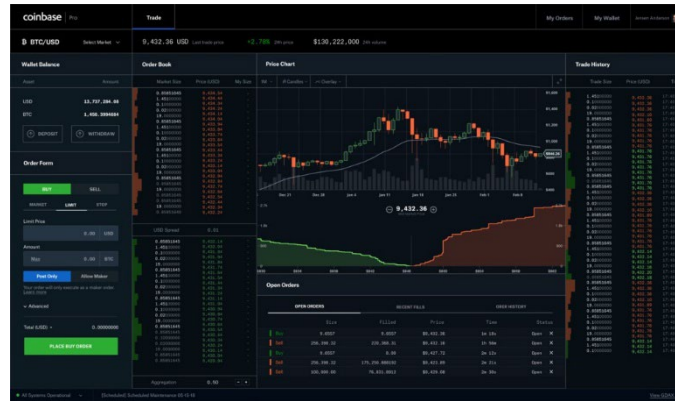
77

- ❑ Started in 2009 by Satoshi Nakamoto
- ❑ Decentralized Digital Currency
- ❑ No Central Bank
- ❑ Peer to Peer network
- ❑ In 2010, someone bought 2 Papa John's pizzas for 10,000 Bitcoin
- ❑ First users were black markets such as Silk Road
- ❑ In 2017, reached almost \$20,000 per Bitcoin; in 2021 reached \$66,000 per coin
- ❑ Criticism includes high energy consumption



How It Works











78



- Coins “held” in a wallet or on an exchange but are still on blockchain ledger
- Can purchase on an exchange such as Coinbase, Gemini, Binance, Kraken, etc.
 - ▣ New entrants such as Square, Venmo, and Robinhood

Common Virtual Currencies

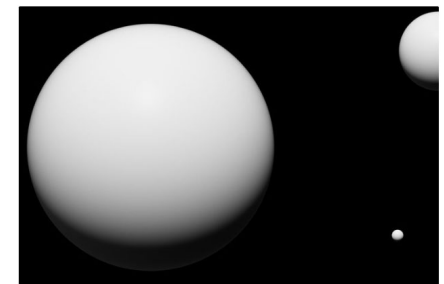
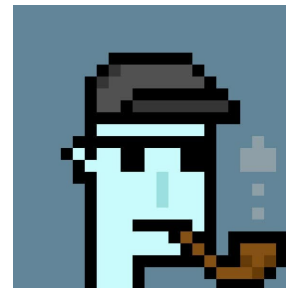
79

Rank ▲	Name	Symbol	Market Cap	Price
1	 Bitcoin	BTC	\$381,567,091,705	\$19,921.88
2	 Ethereum	ETH	\$176,570,575,126	\$1,442.49
3	 Tether	USDT	\$67,926,674,908	\$1.00
4	 USD Coin	USDC	\$50,237,014,823	\$1.00
5	 BNB	BNB	\$44,826,268,402	\$277.84
6	 Binance USD	BUSD	\$20,520,840,799	\$1.00
7	 XRP	XRP	\$18,618,243,077	\$0.3737
8	 Cardano	ADA	\$16,454,409,099	\$0.4814
9	 Solana	SOL	\$11,753,779,922	\$33.20
10	 Dogecoin	DOGE	\$8,202,562,204	\$0.06183

NFTs

80

- Non-fungible token
- The Merge sold for \$91.8m
- CryptoPunk #7523 sold for \$11.75m
- 94% decrease in trading on Open Seas from January 2022 to September 2022



Is Cryptocurrency Taxable?

81

- IRS Notice 2014-21 (issued March 25, 2014)
 - Treated as “property” NOT currency
 - Must be included in gross income if received in exchange for goods or services
 - Must track basis – IRC 1001, 1011, 1012
 - Is a capital asset
 - Determine fair market value through exchange or other reasonable manner
 - Difficult with coin to coin trades or hard forks
 - Dominion and Control – Rev Rul 63-225
 - No Like-Kind Exchanges under TCJA

Tax Reporting Issues

82

- Charitable Contributions
 - ▣ Report on Form 8283? Is a qualified appraisal required if FMV > \$5,000
 - ▣ AICPA proposes treating like publicly traded stock
- De *minimus* Exception
 - ▣ IRC 988 foreign currency transactions under \$200
- Sales of property are generally handled through specific identification
 - ▣ Unclear if FIFO, LIFO, Average Cost or other accounting methods are allowed
 - ▣ FIFO is allowed per IRS FAQs
- Transfers between exchanges



Securities Trading/ trading as a business

83

- ❑ Mark to Market Election (IRC 475(f))
- ❑ Weigh Business Deductions vs. SE Tax
 - ❑ No IRC 67 deduction for investment expenses (2018 through 2026)
- ❑ Inventory Subject to 263A?
- ❑ No Wash Sale Application – IRC 1091
- ❑ ICOs may be securities offerings per SEC

BLOG / CRYPTO TAXES

5 min read | Our Editorial Standards

Crypto Wash Sale Rule: A Simple Way To Reduce Your Tax Bill

No Wash Sale Rule

84



Is “Mining” Virtual Currency Taxable?

85

- What does mining mean?
 - ▣ For example, use computer resources to validate Bitcoin transactions and maintain the public Bitcoin transaction ledger
- Subject to self-employment income?
 - ▣ If done as a trade or business



FBAR/ FACTA Reporting

- AICPA Virtual Currency Task Force reached out to Treasury’s Financial Crimes Enforcement Network (FinCEN)
 - ▣ Virtual currency is not reportable **for now**
- “[I]n consultation with the IRS, [FinCEN] continue[s] to evaluate the value of incorporating virtual currency held offshore into the FBAR regulatory reporting requirements.”

Part III		Yes	No
You must complete this part if you (a) had over \$1,500 of taxable interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust.			
Foreign Accounts and Trusts (See instructions.)	7a At any time during 2018, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country? See instructions	<input type="checkbox"/>	<input type="checkbox"/>
	If “Yes,” are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority? See FinCEN Form 114 and its instructions for filing requirements and exceptions to those requirements	<input type="checkbox"/>	<input type="checkbox"/>
	b If you are required to file FinCEN Form 114, enter the name of the foreign country where the financial account is located ▶		
	8 During 2018, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If “Yes,” you may have to file Form 3520. See instructions	<input type="checkbox"/>	<input type="checkbox"/>

FinCEN Notice 2020-2

87

- Released December 30, 2020
- FBAR Regulations do not currently include a foreign account holding virtual currency as a reportable account
- FinCEN intends to propose amendments to the Bank Secrecy Act to include virtual currency as a reportable account

IRS Cryptocurrency Frequently Asked Questions (Released October 9, 2019)

88

- Expanded from 16 FAQs to 43 FAQs
 - How to calculate gain and loss
 - You may choose to specifically identify units
 - Otherwise use first in, first out (FIFO)
 - How to calculate income from receiving cryptocurrency
 - Through performing services, in exchange for goods, etc.
 - How to calculate a charitable deduction
 - Must maintain records that are sufficient to establish the positions taken on your return – IRC 6001

IRS Revenue Ruling 2019-24 (Released October 9, 2019)

89



First guidance since 2014



A hard fork does not result in income until the taxpayer is able to exercise dominion and control of the new cryptocurrency



A Revenue Ruling is the IRS's litigating position but does not necessarily represent a legally accurate position

Ethereum Merge

90

- ❑ Completed September 15, 2022
- ❑ Change from Proof of Work or Proof of Stake
 - ❑ 99.95% less energy consumed
 - ❑ More decentralized
 - ❑ Hopefully will make the network more efficient in the future
- ❑ Howey test – investors expecting profit based on work of others?

FORTUNE

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Cryptocurrency | Web3 | NFTs | Investing | Bitcoin

THE COINS · ETHEREUM

**Ethereum ‘merge’ will change crypto forever:
Everything you need to know**

IRS “Education” Program

91

- July 26, 2019 IRS began sending “education letters”
 - ▣ Letter 6173 – MUST
 - File delinquent returns
 - Amended returns to report virtual currency transactions
 - Provide a statement that explains why taxpayer is full compliance under penalties of perjury
 - ▣ Letter 6174 – May have misreported
 - ▣ Letter 6174-A
- IRS has multiple data sources and better analytics

Reporting Virtual Currency Transactions

Dear [Name]:

Why we're writing to you

We have information that you have or had one or more accounts containing virtual currency and may not have met your U.S. tax filing and reporting requirements for transactions involving virtual currency, which include cryptocurrency and non-crypto virtual currencies.

Why we're writing to you

We have information that you have or had one or more accounts containing virtual currency but may not know the requirements for reporting transactions involving virtual currency, which include cryptocurrency and non-crypto virtual currencies.

Infrastructure Investment and Jobs Act (November 15, 2021)

92

- Requires Form 1099-B for brokers beginning for the 2024 Tax Year
 - ▣ Treasury says they will not target non-brokers such as miners, hardware developers and others
- Adds \$10,000 of requirement if cryptocurrency is received as part of trade or business
 - ▣ Must file Form 8300 cash receipts

IRS Form 8300 (Rev. August 2014) Department of the Treasury Internal Revenue Service	Report of Cash Payments Over \$10,000 Received in a Trade or Business ▶ See instructions for definition of cash. ▶ Use this form for transactions occurring after August 29, 2014. Do not use prior versions after this date. For Privacy Act and Paperwork Reduction Act Notice, see the last page.	FinCEN 8300 Form (Rev. August 2014) OMB No. 1506-0018 Department of the Treasury Financial Crimes Enforcement Network
1 Check appropriate box(es) if: a <input type="checkbox"/> Amends prior report; b <input type="checkbox"/> Suspicious transaction.		
Part I Identity of Individual From Whom the Cash Was Received		
2 If more than one individual is involved, check here and see instructions ▶ <input type="checkbox"/>		
3 Last name	4 First name	5 M.I.
6 Taxpayer identification number ▶ <input type="checkbox"/>		

Cryptocurrency Enforcement

□ Forms 1099-K

CORRECTED (if checked)

FILER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no. COINBASE, INC. 548 MARKET ST #23008 SAN FRANCISCO, CA 94104 (888)908-7930		FILER'S TIN 45-5293997	OMB No. 1545-2205 <div style="text-align: center; font-size: 24pt; font-weight: bold;">2018</div> Form 1099-K	<div style="font-weight: bold; font-size: 14pt;">Payment Card and Third Party Network Transactions</div>
Check to indicate if FILER is a (an): Payment settlement entity (PSE) <input checked="" type="checkbox"/> Electronic Payment Facilitator <input type="checkbox"/> Other third party <input type="checkbox"/>		Check to indicate transactions reported are: Payment card <input type="checkbox"/> Third party network <input checked="" type="checkbox"/>		Copy B For Payee <small>This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.</small>
PAYEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code [REDACTED] STEPHENS CITY, VA 22655		PAYEE'S TIN [REDACTED]	1a Gross amount of payment card/third party network transactions \$9,325,750.47	
PSE'S name and telephone number		1b Card Not Present transactions		2 Merchant category code
Account number (see instructions) 39D78D38C8EB2402673C		3 Number of payment transactions 383		4 Federal income tax withheld
Form 1099-K (keep for your records)		5a January \$3,338,810.94 5c March \$947,239.25 5e May \$281,696.17 5g July \$630,455.69 5i September \$32,691.21		5b February \$2,946,224.58 5d April \$139,549.00 5f June \$169,733.68 5h August \$839,349.95
www.irs.gov/Form1099K		6 State VA 7 State identification no.		8 State income tax withheld
Department of the Treasury - Internal Revenue Service				

Office of Chief Counsel Memorandum

20124008 June 18, 2021

94

- No Section 1031 treatment for exchanges of BTC for ETH, BTC for LTC and ETH for LTC
 - ▣ Only applicable prior to January 1, 2018
- Chief Counsel's focus was on nature and character of property
- BTC or ETH to LTC
 - ▣ BTC are required to change from USD so had a special case in market and therefore different role in market than LTC
- BTC to ETH
 - ▣ Fundamentally different in overall design, intended use and actual use

Inflation Reduction Act August 16, 2022

95

- Invests approximately \$80 billion into IRS over 10 years
 - ▣ About \$45.6 billion for enforcement
 - ▣ About \$25.3 billion for operations support
 - ▣ About \$4.8 billion for system modernization
- Funds are allotted “to provide digital asset monitoring and compliance activities”
- Letter from Commissioner Rettig:

These resources are absolutely not about increasing audit scrutiny on small businesses or middle-income Americans. As we've been planning, our investment of these enforcement resources is designed around the Department of the Treasury's directive that **audit rates will not rise relative to recent years for households making under \$400,000**. Other resources will be invested in employees and IT systems that will allow us to better serve all taxpayers, including small businesses and middle-income taxpayers. Enhanced IT systems and taxpayer service will actually mean that honest taxpayers will be better able to comply with the tax laws, resulting in a lower likelihood of being audited and a reduced burden on them.

Trend Towards Increased Enforcement

SCHEDULE 1 (Form 1040 or 1040-SR) Department of the Treasury Internal Revenue Service	Additional Income and Adjustments to Income ▶ Attach to Form 1040 or 1040-SR. ▶ Go to www.irs.gov/Form1040 for instructions and the latest information.	OMB No. 1545-0074 2019 Attachment Sequence No. 01
Name(s) shown on Form 1040 or 1040-SR		Your social security number

At any time during 2019, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? Yes No

Form 1040	Department of the Treasury—Internal Revenue Service	2022	OMB No. 1545-0074	IRS Use Only—Do not write or staple in this space.
U.S. Individual Income Tax Return				
Filing Status <input type="checkbox"/> Single <input type="checkbox"/> Married filing jointly <input type="checkbox"/> Married filing separately (MFS) <input type="checkbox"/> Head of household (HOH) <input type="checkbox"/> Qualifying surviving spouse (QSS)				
Check only one box. 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.
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

Cryptocurrency Enforcement

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- *United States v. Coinbase*
 - ▣ John Doe Summons on 13,000 customers
 - ▣ Coinbase turned over information in March 2018
 - ▣ Similar litigation for Kraken, Poloniex, SFOX
- 2018 IRS Virtual Compliance Campaign
 - ▣ IRS teamed up with tax authorities in four other countries to launch the Joint Chiefs of Global Tax Enforcement
- Per IRS Chief Counsel there will be no voluntary disclosure program like OVDP
- In March 2021, IRS announced “Operating Hidden Treasure”
 - ▣ The effort is “all about finding, tracing, and attributing crypto to U.S. Taxpayers.”
- In July 2021, FinCEN appointed first ever chief Digital Currency Advisor, Michele Korver



Crypto Investor Pushback

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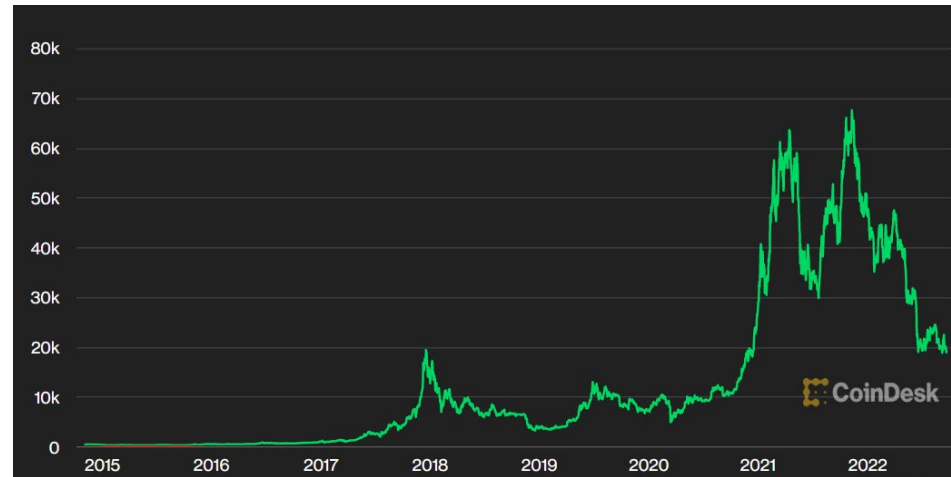
- Harper v. Rettig
 - ▣ U.S. Court of Appeals for the First Circuit ruled that Harper can take IRS to federal court over what he alleges as the agency's unlawful data collection practices
 - ▣ Formerly Anti-Injunction Act was interpreted to not allow this type of litigation. Supreme Court's *CIC Services, LLC v. IRS* 2021 decision allowed this litigation to continue
- Jarrett v. United States
 - ▣ Staked Tezos and reported about \$10,000 of income on his 2019 tax return; subsequently filed a refund suit
 - ▣ Jarrett argues that newly created tokens should not be taxable
 - ▣ Staking and mining by the taxpayer should be treated as property created by the taxpayer
- On December 20, 2021, government authorized a full refund of the Jarrett's claim (\$3,793) and filed a motion to dismiss
 - ▣ The Jarrett's are attempting to amend their complaint to be forward looking

Income Tax Collection

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	190,226.
8a	Taxable interest. Attach Schedule B if required	8a	1,018.
b	Tax-exempt interest. Do not include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required	9a	
b	Qualified dividends	9b	
10	Taxable refunds, credits, or offsets of state and local income taxes	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13	4,752,774.

□ Price

- 1/1/2017 - \$960
- 12/17/2017 - \$19,891
- 12/31/2018 - \$3,800
- 9/10/2019 - \$10,500
- 10/13/2019 - \$8,500
- 4/13/2021 - \$63,000
- 6/4/2021 - \$37,000
- 11/8/21 - \$67,500
- 9/21/22 - \$19,000



	63	Add lines 56 through 62. This is your total tax	63	1,202,162.
Payments	64	Federal income tax withheld from Forms W-2 and 1099	64	25,608.
	65	2017 estimated tax payments and amount applied from 2016 return	65	
If you have a qualifying child, attach Schedule EIC.	66a	Earned income credit (EIC) NO.	66a	
	b	Nontaxable combat pay election	66b	
	67	Additional child tax credit. Attach Schedule 8812	67	
	68	American opportunity credit from Form 8863, line 8	68	
	69	Net premium tax credit. Attach Form 8962	69	
	70	Amount paid with request for extension to file	70	
	71	Excess social security and tier 1 RRTA tax withheld	71	
	72	Credit for federal tax on fuels. Attach Form 4136	72	
	73	Credits from Form: a <input type="checkbox"/> 2439 b <input type="checkbox"/> Reserved c <input type="checkbox"/> 8885 d <input type="checkbox"/>	73	
	74	Add lines 64, 65, 66a, and 67 through 73. These are your total payments	74	25,608.
Refund	75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you overpaid	75	
	76a	Amount of line 75 you want refunded to you . If Form 8888 is attached, check here <input type="checkbox"/>	76a	
Direct deposit? See instructions.	b	Routing number	c Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
	d	Account number		
Amount You Owe	78	Amount you owe. Subtract line 74 from line 63. For details on how to pay, see instructions	78	1,176,554.
	79	Estimated tax penalty (see instructions)	79	

Cryptocurrency Criminal Enforcement

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- Department of Justice in June announced four separate cases involving alleged cryptocurrency-related fraud
 - ▣ NFT Scheme
 - Baller Ape
 - Allegedly used “rug pulling” and “chain hopping”
 - ▣ Ponzi Scheme and Unregistered Securities Scheme
 - EmpiresX – cryptocurrency investment platform that guaranteed returns – raised \$100m from investors
 - ▣ Initial Coin Offering Scheme
 - Titanium Blockchain Infrastructure Services
 - Allegedly falsified white papers, testimonials, and relationships with US Federal Reserve Board and companies like Apple, Pfizer, and Disney
 - ▣ Crypto Commodities Scheme
 - Unregistered Commodity Pool that could expect 500% to 600% returns based on trading bot

Criminal Crypto Tax Evasion

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- John McAfee, internet security creator
 - ▣ Allegedly did not file tax returns and made efforts to conceal income and assets
- Cryptocurrency ICO Bitqyck
 - ▣ Founders plead guilty to raising approximately \$24 million from more than 13,000 investors
 - ▣ Used funds for personal expenses and never distributed shares promised
- Volodymyr Kvashuk, ex- Microsoft engineer
 - ▣ Used colleagues test email accounts and bitcoin mixer to hide theft of digital gift cards
 - ▣ Ordered to pay \$8,344,586 in restitution and may get deported after prison term

Valuation Issues

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- Income Approach
 - ▣ No underlying cash flows
- Asset Approach
 - ▣ High transaction fees
- Market Approach
 - ▣ Exchanges may differ in value
 - ▣ Large transactions can move the market

Other Non Tax Legal Risks

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- FinCEN – Anti-Money Laundering and Bank Secrecy Act
- Securities Laws
- State and International Regulation
- Price Manipulation
- Lack of Stability
- Huge Energy Consumption

Executive Order on Ensuring Responsible Development of Digital Assets March 9, 2022

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- Whole-of-government strategy to:
 - ▣ Protect U.S. Consumers, Investors, and Businesses
 - ▣ Protect U.S. and Global Financial Stability
 - ▣ Mitigate Illicit Finance and National Security Risks
 - ▣ Promote U.S. Leadership
 - ▣ Promote Equitable Access to Safe and Affordable Financial Services
 - ▣ Support Technological Advances
 - ▣ Explore a U.S. Central Bank Digital Currency

About Stein Sperling

Stein Sperling, founded in 1978, provides a broad range of services to meet the business and personal needs of a broad range of clients. Our focus is on a team approach and our flexible and dynamic organizational structure offers our clients the benefit of our full range of legal resources in the following practice areas:

Business Law, Family Law, Civil Litigation, Injury Law, Criminal Law, Real Estate Law, Employment Law, Tax Law and Estates & Trusts

US News and World Report awarded Stein Sperling a Tier 1 National rating in 2022 for Tax Litigation and Controversy, one of only 36 Firms nationally to receive this designation.