



# Current Federal Tax Developments

July 31, 2023

Kaplan Financial Education



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## This Week We Look At:

Oversight Committee of House Ways & Means Committee holds a hearing on ERC issues, discusses potential amnesty program

IRS ending most announced revenue officer visits

Taxpayer finds out that there may very well be a tax consequence when you borrow against your life insurance policy and then let the policy lapse

2

<https://www.currentfederaltaxdevelopments.com>





## Congressional Hearing on Various Employee Retention Tax Credit Issues



Photo by [Darren Halstead](#) on [Unsplash](#)

- “The Employee Retention Tax Credit Experience: Confusion, Delays, and Fraud,” Oversight Subcommittee of the House Ways & Means Committee, July 27, 2023
  - Subcommittee hearing as Congress was getting ready to leave for the August recess
  - Most significant discussions were on fraud related to ERC mills and backlog issues (especially for PEOs)

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/29/congressional-hearing-on-employee-retention-credit-considers-potential-solutions-to-various-issues-including-fraud>

“Oversight Sub Hearing - Employee Retention Tax Credit Experience: Confusion, Delays, and Fraud,” Ways and Means Committee Republicans YouTube Channel, July 27, 2023, <https://www.youtube.com/watch?v=yotrB5DtdGA> (hearing begins between 25 and 26 minutes into the video. The first 25 minutes only contain an onscreen title slide and no audio)



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- “The Employee Retention Tax Credit Experience: Confusion, Delays, and Fraud,” Oversight Subcommittee of the House Ways & Means Committee, July 27, 2023
  - Appearing at the hearing:
    - Larry Gray, CPA, Partner, AGC CPA
    - Roger Harris, President, Padgett Advisors
    - Pat Cleary, President and CEO, National Association of Professional Employer Organizations (NAPEO)
    - Linda M. Czipo, President & CEO, New Jersey Center for Nonprofits

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  - Noted that ERC mills promising huge refunds that are available to everyone put legitimate professionals in a position to lose clients
  - Also noted the OPR guidance creates problems even with filing amended income tax returns even if pro not involved in the claim itself

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  - PEOs have specific complaints, as the IRS count treats each PEO filing as only a single claim and these more complex claims are being processed very slowly
  - Alternatively, it was noted how using the payroll system was a big advantage for not-for-profits
  - Also noted paper vs. electronic filing differences

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  - Issue of what to do about taxpayers who now regret having bought into a mill’s overly aggressive positions
    - Often have already paid significant fees
    - Also have filed the claim and may have spent the funds

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  - Subcommittee Chair Schweikert’s questions led to a consideration of options
    - Mr. Gray had already suggested a soft letter option
    - The Chair seemed to understand the fee issue but never stated he was going to back a “net received” amnesty

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  - Was some discussion of backlog issue though information recently shows a spike in claims filed - all of which would be paper Forms 941X
  - Also had some discussion on IRS guidance
    - Noted how last week’s memo did allow Mr. Gray to persuade one client to just say no
    - But never really discussed structural issues with guidance in situations like this

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  - Other actions this week
    - IRS issues final regulations for using deficiency procedures to collect excess credits (T.D. 9978; 88 F.R. 48118-48125)
    - IRS announces shift to ERC enforcement work, catching up on processing claims (IR-2023-135, July 26, 2023)

10

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Final regulations and preamble:

<https://www.taxnotes.com/research/federal/treasury-decisions/final-regs-address-re-capture-of-excess-employment-tax-credits/7h0hd>

IRS News Release on end of backlog, shift to enforcement

<https://www.irs.gov/newsroom/irs-commissioner-signals-new-phase-of-employee-retention-credit-work-with-backlog-eliminated-additional-procedures-will-be-put-in-place-to-deal-with-growing-fraud-risk>



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  - What’s next?
    - Congress out on recess and when they return will be focused on government funding, so unlikely we’ll see any action soon there
    - IRS has already promised to provide program to simplify returning ERC funds (but unlikely to fix the fee problem)

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## IRS to Mostly End Unannounced Collection Visits by Revenue Officers



Photo by [Dim Hou](#) on [Unsplash](#)

- “IRS ends unannounced revenue officer visits to taxpayers; major change to end confusion, enhance safety as part of larger agency transformation efforts,” IRS News Release IR-2023-133, July 24, 2023
  - IRS Revenue Officer will no longer initially visit a taxpayer’s location without giving prior notice
  - Initial contact via an appointment letter (725-B) and schedule an appointment

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/29/irs-to-end-most-unannounced-visits-to-taxpayers-by-revenue-officer>

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  - Will still be limited cases of no notice
    - Service of summonses and subpoenas
    - Seizure of assets (especially those at risk)
    - Such cases number less than a few hundred per year compared with prior tens of thousands visits

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## Letting Life Insurance Policy Lapse Can Create a Tax Liability One Taxpayer Learns



Photo by [Emil Kalibradov](#) on [Unsplash](#)

- *Doggart v. Commissioner*, TC Summary Op. 2023-25, July 27, 2023
  - In 2017 taxpayer was incarcerated
  - Had previously borrowed money from his life insurance policy, pledging the cash value as security
  - Stopped payments on the policy once incarcerated and the policy lapsed once cash value declined to the outstanding balance of loans (including interest)

<https://www.currentfederaltaxdevelopments.com/blog/2023/7/29/despite-receiving-no-cash-lapse-of-life-insurance-policy-triggers-taxable-income>

Court opinion:

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  - Prudential issues two 1099-Rs (2 policies) showing taxable distributions
  - Taxpayer did not file a 2017, arguing he had no income from life insurance since he received no cash in 2017
  - If it was taxable, should have been taxed back when received the funds
  - But that's not how the law works...

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- *Doggart v. Commissioner*, TC Summary Op. 2023-25, July 27, 2023
  - General tax rules under IRC §72 for life insurance cash outs
  - Opinion points out that receipt of cash initially when a bona fide loan exists is not taxable
  - But when cash value taken to pay the loan, there is a constructive distribution of that value, triggering the tax

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- *Doggart v. Commissioner*, TC Summary Op. 2023-25, July 27, 2023
- Many clients do not understand the issue, likely because of marketing related to the loans
  - Are pushed as a “tax free” source of income at some point in the future when policy taken out
  - Don’t understand the significance of the letters from the carrier when the policy is about to be surrendered to pay off loans

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- Many clients do not understand the issue, likely because of marketing related to the loans
  - Also fail to realize that the interest charged on the loan counts as it was indirectly paid by pledging the cash balance if the actual payment of the interest was not made (which it most often isn't)

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- May wish to notify clients of the tax rules regarding life insurance
  - The “tax free income” will only stay that way if the insured dies before the policy does
  - While the cash balance is then offset against the death benefit, most death benefits *are* tax free
  - But cashing out a policy is not

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