Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

5 Things That Keep Tax Attorneys Up At Night

By **Amy Lee Rosen**

Law360 (August 21, 2019, 11:05 AM EDT) -- With several significant tax changes looming on the horizon, along with the government's continued crackdown on offshore tax avoidance and the possibility of future rate increases, tax practitioners may require powerful sleep aids to get a good night's rest.

Here, tax attorneys share their greatest fears and worries that keep them up at night.

Opportunity zones, such as this one in New Jersey, and increased tax rates are keeping tax attorneys up at night. (AP)

Expiring Tax Policy

Alexander Reid, a partner at Morgan Lewis & Bockius LLP, is already stressed out by the expiration of the tax breaks in the 2017 federal tax reform law, but there is also plenty to keep him busy before then.

“Working backward from the future to the present, we have on deck the 2025 expiration of the individual and estate tax cuts enacted as part of the Tax Cuts and Jobs Act,” he said. “Prior to that, in 2022 corporate debt will become more expensive because deductions for depreciation, amortization and depletion will not be included in the calculation of a corporation’s adjusted taxable income for purposes of the 30% income limitation on corporate interest deductions.”

To add more tension to the mix, the forthcoming election in 2020 is worrying because it adds uncertainty about whose vision of tax policy will prevail, considering the broad disagreement not only between the political parties but also within each party, he said.

“Presently we are currently confronting a national debt of $22 trillion with a shaky economy that continues to receive interest rate cuts from the Federal Reserve, and we have lots of changes that need to be made to the Tax Cuts and Jobs Act, but we lack any political will to address any these issues until after the election,” Reid said.

Foreign Bank Account Reports

Scott Michel, a member of Caplin & Drysdale Chtd., lies in bed at night thinking about the Report of Foreign Bank and Financial Accounts and foreign reporting requirements because even though they have been around for a long time — since around 2008 — tax authorities continue to devote significant resources to obtaining outsize penalties for reporting violations, even if little tax is involved.

"In doing so, they are pushing the edges of fairness — arguing, for example, that taxpayers are not entitled to rely on the advice of tax professionals; that 'willfulness' doesn’t mean willfulness as that term has been traditionally understood but something less; that individuals with little nexus to the U.S. should be punished as if they were experts on the U.S. tax system; or that a taxpayer’s signature on a return means that he or she should be deemed to know and understand every line of every form and schedule in 30 pages or more of tax filings," Michel said.

The U.S. has won this foreign reporting battle because almost every country in the world has signed on to the Foreign Account Tax Compliance Act, which entails vigorous information sharing with foreign governments and mandates that all non-U.S. financial institutions disclose U.S. customers to the Internal Revenue Service, Michel said.

"One can only wonder how much of the tax gap could be reduced if the same audit, appeals and litigation resources now devoted to pounding the rubble of the foreign reporting cases were instead aimed at traditional forms of domestic tax noncompliance and evasion," Michel said.

Opportunity Zones and Tax Rate Increases

Opportunity zones, created under the TCJA, allow an investor to reinvest capital gains within a 180-day window into designated **low-income areas** in exchange for certain tax benefits, which grow the longer the money is invested in a qualified opportunity fund, up until Dec. 31, 2026. If investments in the opportunity zone funds are held for five years, then 10% of capital gains on the prior investment will be forgiven, while 15% of capital gains will be forgiven if the investments are held for seven years. As such, an investor has until Dec. 31, 2019, to get the higher 15% tax benefit.

While many investors and practitioners are excited about the program and its generous tax benefits, some are worried tax rates may go up over the next seven years, which would mean that the deferred gains will be subject to higher taxes when they come due, according to Libin Zhang, a partner at Fried Frank Harris Shriver & Jacobson LLP.

“Federal tax rates for individual long-term capital gain last went up by over half in 2013,” he said. “If people anticipate tax rates going up as we get closer to 2026, there are only a few ways to trigger the deferred capital gains early while still keeping the benefit of tax-free appreciation after 10 years.”

Not only can federal taxes go up, but state taxes can increase as well, as seen by California's hike to a 13.3% income tax rate for top earners that was temporarily extended to 2030, Zhang said.

“California does not yet conform to the federal QOF rules, so some California investors have been lucky enough to lock in the 2017-2019 California tax rates that they pay currently on their capital gains,” he said.

Waiting for Accrual Accounting Guidance

The tax overhaul changed a provision of the tax code, Section 451(b), to help simplify accounting by matching information on a financial statement to income that is reported for tax purposes. Practitioners are still awaiting guidance on the provision.

Section 451(b) requires a corporation to declare income only when it is fixed and determinable under the "all-events test." “Fixed and determinable” means income is recognized when a corporation has a right to the income and the amount can be determined with reasonable accuracy. But the TCJA changed the rule so that if income is taken into account on a financial statement, such as through being declared as revenue under generally accepted accounting principles, then that income automatically meets the all-events test even if it is not fixed and determinable.

Kevin Spencer, a partner with McDermott Will & Emery LLP, said it bothers him that there is a lack of cogent guidance on Section 451(b) and how it intersects with Accounting Standards Codification 606, which was a 2014 announcement of new accountant standards for revenue recognition.

“Lots of taxpayers have this issue [of figuring out how ASC 606 intersects with Section 451(b)] and they need to file accounting method changes with their returns, and it’s a huge deal to not know what to do and likely have to change everything at the last moment,” he said.

The U.S. Department of the Treasury and the IRS did not immediately respond to questions from Law360 about when the Section 451(b) rules will be released.

Clients Facing Economic Hardship

Nina Olson, who retired in July as National Taxpayer Advocate, recommended in her final annual report to Congress in June that the IRS use data analytics to avoid collection activities against taxpayers who are economically at risk.

But so far the IRS has not indicated a willingness to act on the recommendation, which is surprising given its general goal of trying to use technology to make up for personnel shortfalls that are caused by budget restraints, according to Ted Afield, director of the Philip C. Cook Low-Income Taxpayer Clinic at Georgia State University College of Law.

“I lose sleep over whether the IRS will heed the [NTA’s] recommendation to proactively identify taxpayers suffering from economic hardship in order to avoid engaging in collection activity that could be financially ruinous for these taxpayers,” he said.

Usually the taxpayer advocate's office is concerned that the use of technology will result in worse taxpayer service, but here the opposite is true, Afield said. The technology could further congressional directives to help taxpayers who are financially at risk while protecting taxpayer rights, he said.

“This refusal serves as a stark reminder that, while the IRS can and should better utilize technology to address its budgetary shortfalls in a way that also protects taxpayer rights, this goal remains elusive, with the IRS deploying technological solutions in a manner that reduces taxpayer service while avoiding technological applications that could increase efficiency and enhance taxpayer rights,” he said.

--Editing by Tim Ruel and Neil Cohen.

All Content © 2003-2019, Portfolio Media, Inc.