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Federal Tax Update for Individuals

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2022 Federal Tax Update for Individuals - Agenda

- Old legislation – Impact on 2022
- The Inflation Reduction Act
- Energy Tax Credits - Both New and Updated
- The IRS – Dealing with the Service and new funding objectives
- Inflation adjustments for 2023 - New Brackets and Standard Deduction limits

Old Legislation – Impact on 2022

- Child Tax Credit – Pre-2021 Rules
  - Nonrefundable
  - Credit amount - $2,000 ($3,000 & $3,600 in 2021)
  - Old phase-out amounts apply
  - Age of qualifying child decreases to under 17 years old

- Child & Dependent Care Credit – Pre-2021 Rules
  - Nonrefundable
  - Maximum qualifying expenses - $3,000 for one qualifying individual & $6,000 for two or more qualifying individuals ($8,000 & $16,000 in 2021)
  - Credit rate – ranges from 20% to 35% based on AGI (0% - 50% based on AGI in 2021)

Old Legislation – Impact on 2022

- Charitable Contribution Deduction – AGI Percentage Limitations
  - Donations of cash to publicly supported charities or foundations are limited to 60% of AGI (no limit in 2021).

- Charitable Contribution Deduction – Nonitemizers
  - $600 (joint) & $300 (all others) charitable contribution deduction for nonitemizers expired on December 31, 2021.

The Inflation Reduction Act

- Passed the House 220-213 and Senate 50-50 (Tie broken by Vice-President Harris). Every Democrat voted for it. No Republican did.
- Signed by President Biden on August 16, 2022.
- Greatly scaled-down version of the 2021 Build Back Better proposal.
- Will not reduce inflation, despite the name, as determined by the Congressional Budget Office (CBO).

The Inflation Reduction Act

Major Provisions of the New Law:

- Prescription Drug Price Reform.
    - Medicare recipients get a $2,000 annual cap on out-of-pocket prescription costs – starting in 2025.
- Massive funding increase for IRS (explained in detail below), intended to increase enforcement (More Audits) generating 181 Billion in revenue.

The Inflation Reduction Act

- Extension of Obamacare subsidies through 2025- would have expired at the end of 2022 otherwise (IRC Section 36B).
- Numerous tax credits for energy improvements adopted or expanded (explained in detail below).
- Massive investments in-climate change projects or initiatives – costing nearly $400 billion.

The Inflation Reduction Act

- Other Tax Items include a continued limitation on excess business losses on individual returns (IRC Section 461(L)(1)) – now extended through 2028.

Inflation Reduction Act – Energy Provisions

- Detailed Listing of Tax Credits and Incentives:
- To help navigate the many new and expanded credits and incentives that are included in the Inflation Reduction Act.
- Renewable Energy Generation Tax Credits:
  - Section 45 production tax credit.
  - Section 48 investment tax credit.
  - NEW: Section 45Y technology-neutral production tax credit.
  - NEW: Section 48E technology-neutral investment tax credit.

Inflation Reduction Act – Energy Provisions

- Clean Vehicles Tax Credits:
  - Section 30C alternative fuel refueling property tax credit.
  - NEW: Section 45W qualified commercial clean vehicles tax credit.
- Individual Clean Energy Provisions:
  - Sections 25C, 25D, and 45L - nonbusiness energy property credit.
  - Clean Vehicle personal tax credits - Sections 30D and 25E.

Section 45 Production Tax Credit (PTC)

Previous Law

- Under the previous law, the PTC provided a tax credit for electricity produced from certain renewable resources and sold to unrelated parties for the 10-year period after the property was placed in service.
- The credit started to phase down for projects that began construction in 2017 and was completely phased out for projects that began construction after December 31, 2021.
- The renewable resources that qualify for the PTC generally include wind, biomass, geothermal, hydropower, municipal solid waste, and marine and hydrokinetic energy.

Section 45 Production Tax Credit (PTC)

What's Changed?

- The Inflation Reduction Act extends the PTC for facilities that begin construction by the end of 2024. The provision provides a credit of $27.50 per MWh, adjusted for inflation and subject to certain wage and apprenticeship requirements.

Section 48 Investment Tax Credit (ITC)

- The ITC allows taxpayers to claim a credit based on the cost of energy property. The Inflation Reduction Act generally extends the credit for property with construction beginning by the end of 2024.
- Under the act, the ITC is expanded to include energy storage technology, including batteries. Energy property also includes costs for interconnection property directly related with the installation of energy property with a maximum net output of less than five mega-watt alternating current (MWac).
- In general, for energy property placed in service by the end of 2024, the act restores the credit to 30% of the cost basis, subject to specific wage and apprenticeship requirements.

Section 48 Investment Tax Credit (ITC)

- Energy property placed in service beginning in 2023 that satisfies the domestic content requirements is eligible for a 10-percentage point bonus credit, meaning the credit increases from 30% of cost basis to 40% of cost basis.
- Energy property placed in service within an energy community may also be eligible for a 10-percentage point bonus credit.
- Solar and wind facilities (and connected batteries) less than five MWac placed in service in 2023 and 2024 may qualify for an additional 10 percentage point bonus credit if located in a low-income neighborhood or on Tribal lands. The bonus credit is subject to an annual capacity limitation of 1.8 gigawatts.

NEW: Sections 45Y and 48E Technology-Neutral Production Tax Credit (PTC) and Investment Tax Credit (ITC)

- Post-2024, the Inflation Reduction Act includes incentives for clean electricity production and investment, under an emissions-based framework that's neutral and flexible between clean energy technologies.
- Taxpayers may choose either the PTC under Section 45Y or the ITC under Section 48E, and a power facility of any technology type may qualify for the credits if the facility's carbon emissions are at or below zero.
- Taxpayers who satisfy the wage and apprenticeship requirements may be eligible for a PTC of at least $26 per MWh of electricity generated or an ITC equal to 30% of the basis of energy property.

Section 48 Investment Tax Credit (ITC)

- Standalone energy storage property is also eligible for the full 30% ITC, and clean energy projects smaller than five MWac may include the cost of interconnection equipment in the base for determining the ITC.
- Again, certain projects may receive 10% increases to their PTC and ITC rates if they comply with domestic content requirements or are constructed in energy communities.
- An additional 10% increase in ITC also applies for small projects in low-income communities or Tribal lands, subject to the same 1.8-gigawatt annual capacity limitation.

PREVIOUS LAW

TECH	Wind	Solar/Battery Charged by Solar	Standalone Battery
CREDIT	Section 45 PTC or Section 48 ITC	Section 48 ITC	No credit
CREDIT AMOUNT	Up to $26/MWh PTC or 30% ITC in 2022, depending on start of construction year	Up to 30% in 2022, depending on start of construction year	N/A
WAGE AND APPRENTICESHIP REQUIREMENTS	No	No	N/A
BONUS CREDITS	No	No	N/A
DIRECT PAY	No	No	N/A
TRANSFERABLE	No	Only to lessee	N/A

INFLATION REDUCTION ACT 2022-2024			
TECH	**Wind**	**Solar/Battery Charged by Solar**	**Standalone Battery**
CREDIT	Section 45 PTC or Section 48 ITC	Section 45 PTC (solar only) or Section 48 ITC (solar and battery)	Section 48 ITC, whether or not charged by ITC energy property
CREDIT AMOUNT	• $27.50/MWH in 2022, adjusted for inflation (PTC) • 30% of the basis of energy property (ITC) • Start of construction must be prior to January 1, 2025	• $27.50/MWH in 2022, adjusted for inflation (PTC) • 30% of the basis of energy property (ITC) • Start of construction must be prior to January 1, 2025	30% of the basis of the battery, if placed in service after December 31, 2022
WAGE AND APPRENTICESHIP REQUIREMENTS	• Credit amount subject to approximately 80% reduction if wage and apprenticeship requirements aren't met • Facilities that begin construction within 59 days of release of proposed regulations are deemed to satisfy both requirements • Wage for duration of construction and entire 10-year PTC or 5-year ITC recapture period • Apprenticeship requirements must be met during construction only	• Credit amount subject to approximately 80% reduction if wage and apprenticeship requirements aren't met • Facilities that begin construction within 59 days of release of proposed regulations are deemed to satisfy both requirements • Wage for duration of construction and entire 10-year PTC or 5-year ITC recapture period • Apprenticeship requirements must be met during construction only	• Credit amount subject to approximately 80% reduction if wage and apprenticeship requirements aren't met • Facilities that begin construction within 59 days of release of proposed regulations are deemed to satisfy both requirements • Wage for duration of construction and entire 5-year ITC recapture period • Apprenticeship requirements must be met during construction only

BONUS CREDITS	Additional 10% for PTC and 10% of basis for ITC if placed in service after December 31, 2022, if: • Domestic content requirements are met • Located in an energy community • For ITC only—located in a low-income community or on Tribal land and less than 5 MW, subject to 1.8 GW annual limitation	Additional 10% for PTC and 10% of basis for ITC if placed in service after December 31, 2022, if: • Domestic content requirements are met • Located in an energy community • For ITC only—located in a low-income community or on Tribal land and less than 5 MW, subject to 1.8 GW annual limitation	Additional 10% of basis for ITC if placed in service after December 31, 2022, if: • Domestic content requirements are met • Located in an energy community
DIRECT PAY	Only for taxable years 2023-2032 and only for: • Tax-exempt entities, states, or local governments • Tennessee Valley Authority • Indian Tribal governments • Any Alaska Native Corporation • Any cooperative engaged in furnishing electric energy to persons in rural areas Reduction if domestic content requirements aren't met	Only for taxable years 2023-2032 and only for: • Tax-exempt entities, states, or local governments • Tennessee Valley Authority • Indian Tribal governments • Any Alaska Native Corporation • Any cooperative engaged in furnishing electric energy to persons in rural areas Reduction if domestic content requirements aren't met	Only for taxable years 2023-2032 and only for: • Tax-exempt entities, states, or local governments • Tennessee Valley Authority • Indian Tribal governments • Any Alaska Native Corporation • Any cooperative engaged in furnishing electric energy to persons in rural areas Reduction if domestic content requirements aren't met
TRANSFERABLE	Yes, for taxable years beginning after 2022	Yes, for taxable years beginning after 2022	Yes, for taxable years beginning after 2022

INFLATION REDUCTION ACT 2025-2034 AND BEYOND		
TECH	Any Clean-Energy Generating Facility with a Greenhouse Gas Emissions Rate Not Greater than Zero (Wind or Solar, for Example)	Standalone Battery
CREDIT	May elect Section 45Y PTC or Section 48E ITC	May elect Section 48E ITC, whether or not charged by ITC energy property
CREDIT AMOUNT	• At least $26/MWh in 2025, adjusted for inflation (PTC) • 30% of the basis of energy property (ITC) • Phasedown starting in 2034 at earliest	• 30% of basis of the battery • Phasedown starting in 2034 at earliest
CREDIT REQUIREMENTS	• Credit amount is subject to approximately 80% reduction if wage and apprenticeship requirements aren't met • Wage requirements must be met for the duration of construction and entire 10-year PTC period or 5-year ITC recapture period • Apprenticeship requirements must be met during construction only	• Credit amount is subject to approximately 80% reduction if wage and apprenticeship requirements aren't met • Wage requirements must be met for the duration of construction and entire 5-year ITC recapture period • Apprenticeship requirements must be met during construction only

BONUS CREDITS	Additional 10% for PTC and 10% of basis for ITC if: • Domestic content requirements are met • Located in an energy community • For ITC only—located in a low-income community or on Tribal land and less than 5 MW, subject to 1.8 GW annual limitation	Additional 10% of basis if: • Domestic content requirements are met • Located in an energy community
DIRECT PAY	Only for taxable years 2025-2032 and only for: • Tax-exempt entities, states, or local governments • The Tennessee Valley Authority • Indian Tribal governments • Any Alaska Native Corporation • Any cooperative engaged in furnishing electric energy to persons in rural areas Reduction if domestic content requirements aren't met	Only for taxable years 2025-2032 and only for: • Tax-exempt entities, states, or local governments • The Tennessee Valley Authority • Indian Tribal governments • Any Alaska Native Corporation • Any cooperative engaged in furnishing electric energy to persons in rural areas Reduction if domestic content requirements aren't met
TRANSFERABLE	Yes	Yes

Clean Vehicles Commercial Tax Credits

- The following clean vehicle credits for businesses are new, expanded, or extended as part of the Inflation Reduction Act:
  - Section 30C alternative fuel refueling property credit.
  - NEW: Section 45W qualified commercial clean vehicles credit.

Section 30C Alternative Fuel Refueling Property Tax Credit

Previous Law

- Under the previous law, Section 30C allows a tax credit in an amount equal to 30% of the cost of any qualified alternative fuel vehicle refueling property—an electric vehicle charging station, for example—placed in service before January 1, 2022.

What's changed?

- Section 30C(b) limits the maximum credit allowable with respect to all qualified alternative fuel vehicle refueling property at a location, to $100,000 for businesses.

Section 30C Alternative Fuel Refueling Property Tax Credit

- For this purpose, only the following are treated as qualified alternative fuel:

- Any fuel at least 85% of the volume of which consists of one or more of the following:
  - Ethanol;
  - Natural gas;
  - Compressed natural gas;
  - Liquified natural gas;
  - Liquified petroleum gas; or
  - Hydrogen.
- Any mixture that consists of two or more of the following:
  - Biodiesel (at least 20% of the volume must consist of biodiesel determined without regard to any kerosene in the mixture);
  - Diesel fuel; or
  - Kerosene.

Section 30C Alternative Fuel Refueling Property Tax Credit

- The Inflation Reduction Act extends the alternative fuel refueling property credit for qualifying property placed in service before January 1, 2033.
- However, beginning after December 31, 2022, only property placed in service within a low-income or rural census tract area is considered a qualified property. The definition of qualifying property for this purpose now includes bidirectional charging equipment.
- Assuming all other requirements are satisfied, the alternative fuel refueling property credit is at a maximum rate of 30% of the cost basis if prevailing wage and registered apprenticeship requirements are met.

NEW: Section 45W Qualified Commercial Clean Vehicles Tax Credit

- The Inflation Reduction Act creates a new tax credit for qualified commercial clean vehicles, equal to the lesser of:
  - 15% of the vehicle's cost (30% for vehicles not powered by a gasoline or diesel internal combustion engine-Hybrids); or
  - The incremental (excess) cost of the vehicle relative to a comparable vehicle.
- Credit amounts can't exceed $7,500 for vehicles weighing less than 14,000 pounds, or $40,000 otherwise.
- Eligible vehicles would have a battery capacity of not less than 15 kilowatt hours (seven-kilowatt hours in the case of vehicles weighing less than 14,000 pounds) and be charged by an external source of electricity. Mobile machinery and qualified commercial fuel cell vehicles would also be eligible for this credit. Qualifying vehicles must be depreciable property.

Section 30C Alternative Fuel Refueling Property Tax Credit

- Only vehicles made by qualified manufacturers that have written agreements with and provide periodic reports to the Treasury could qualify. Taxpayers are required to include the vehicle identification number (VIN) on their tax return to claim a tax credit.
- The credit applies to any vehicles placed in service after December 31, 2022, and before January 1, 2033.

Nonbusiness Energy Property Tax Credit – Sections 25C, 25D, and 45L

- The Section 25C Nonbusiness Energy Property Credit is extended through 2032 and is renamed the Energy-Efficient Home Improvement Credit.
- The credit now equals 30% of the sum of the amount paid or incurred by the taxpayer for 1) energy-efficient improvements installed during the tax year, 2) the amount of residential energy property expenditures paid or incurred by the taxpayer during the tax year, and 3) the amount paid by the taxpayer for home energy audits.
- Previously, the credit equaled 10% of the amount paid or incurred for qualified energy-efficiency improvements plus the amount of residential energy property expenditures paid or incurred by the taxpayer during the tax year.

Nonbusiness Energy Property Tax Credit – Sections 25C, 25D, and 45L

- The amount of the 25C credit is changed from a $500 maximum lifetime credit to a credit of up to $1,200 per year. Certain limits also apply to the credit for purchases of certain types of qualifying property and home audits.
  - The annual limits for specific types of qualifying improvements will be:
    - $250 for any exterior door ($500 total for all exterior doors) that meet applicable Energy Star requirements;
    - $600 for exterior windows and skylights that meet Energy Star most efficient certification requirements;
    - $600 for other qualified energy property, including central air conditioners; electric panels and certain related equipment; natural gas, propane, or oil water heaters; oil furnaces; water boilers; or
    - $2,000 for heat pump and heat pump water heaters; biomass stoves and boilers. This category of improvement isn't limited by the $1,200 annual limit on total credits.

Nonbusiness Energy Property Tax Credit – Sections 25C, 25D, and 45L

- The modified Section 25C credit is available for property placed in service after December 31, 2022.
- The Act extended the Section 25D Residential Energy-Efficient Property Credit through 2034 and renamed it the Residential Clean Energy Credit. Qualified battery storage technology expenditures are added to the list of qualifying expenses.
- However, the credit no longer applies to biomass furnaces nor water heaters, those are covered by the Energy Efficient Home Improvement Credit (Section 25C).

Nonbusiness Energy Property Tax Credit – Sections 25C, 25D, and 45L

- The act also extended the Section 45L New Energy-Efficient Home Credit through 2032. The amount of the credit is increased, and various modifications are made to the energy savings requirements. The changes apply to dwelling units acquired after December 31, 2022.
- The Section 45L Tax Credit is a one-time Federal tax credit that promotes the construction of energy-efficient residential dwellings. The credit is available to builders, developers and others who build homes for sale or lease, and credit is allocated per "dwelling unit."

Projects Placed in Service in 2022

- The IRA retroactively extended the Section 45L Tax Credit for properties placed-in-service through 2022. For projects placed in service in 2022, the $2,000 credit per dwelling unit and the existing qualification criteria will remain unchanged.

Projects Placed in Service in 2023-2032

- The IRA also extends the Section 45L Tax Credit moving forward for projects placed in service from January 1, 2023-December 31, 2032. For projects placed in service in 2023 and beyond, several major changes will go into effect:
  - The energy efficiency requirements for the Section 45L tax credit will change from 50% better than the 2006 IECC energy code to Energy Star and Zero Energy Ready (ZER) Home standards.
  - Energy Star and Zero Energy Ready Home programs don't include a height requirement for qualification. Residential projects of any size may be eligible for the 45L Tax Credit under the IRA.
  - The maximum tax credit will increase to up to $5,000/dwelling unit.
  - The maximum tax credit for single-family Energy Star homes will be $2,500.

Projects Placed in Service in 2023-2032

- The maximum tax credit for single-family ZER homes will be $5,000.
- For the Energy Star Multifamily program (5 units or more) the credit will be $2,500 per unit, subject to prevailing wage provisions.* If these provisions are not followed, the credit is reduced to $500 per unit.
- Section 42 Low Income Housing Tax Credit (LIHTC) projects will NOT need to take the Section 45L credit into account when determining the adjusted basis of a property for LIHTC Credits.

Credits Available Under Section 45L

Single Family Unit Type	Leased or Sold in	Requirement Criteria	Maximum Tax Credit Per Unit
Energy Star Home	2023	Energy Star Single-Family New Homes National Program Requirement 3.1	$2,500
Energy Star Home	2024	Energy Star Single-Family New Homes National Program Requirement 3.1	$2,500
Energy Star Home	2025-2032	Energy Star Single-Family New Homes National Program Requirement 3.2 **AND** must meet most recent set of *local* Energy Star Single-Family New Homes Requirements (published within two years of dwelling unit acquisition)	$2,500
Mobile Home	2023-2032	Energy Star Manufactured Home National Program Requirements (most recent version published within two years of dwelling unit's acquisition)	$2,500
Zero Energy Ready Home	2023-2032	Zero Energy Ready Home Program of the Department of Energy in effect on January 1st, 2023 (or the successor program)	$5,000

Clean Vehicle Credits – Sections 30D and 25E

- The act modified the $7,500 Section 30D credit for electric vehicles in several ways.
- First, it changes the name of the credit to the Clean Vehicle Credit. It also imposes a requirement that the final assembly of the vehicle must occur in North America (effective August 16, 2022).
- The act also removes the limitation on the number of vehicles eligible for the credit, so electric vehicles purchased from manufacturers that had formerly reached their cap will now be eligible for the credit.
- However, there are price caps, so the credit is not allowed for cars with a manufacturer's suggested retail price over $55,000 or for vans, SUVs, or pickup trucks with a manufacturer's suggested retail price over $80,000.
- However, the act imposes a new requirement that a percentage of critical minerals used in the car must have been extracted or processed in the United States or in a country with which the United States has a free trade agreement or recycled in North America.

Clean Vehicle Credits – Sections 30D and 25E

- This requirement phases in and applies to 40% of such minerals before 2024 and to 80% after 2026.
- A percentage of the battery components for the vehicle must also be manufactured or assembled in North America. This requirement applies to 50% of a battery's components before 2024 and phases in until it applies to 100% of a battery's components after 2028. The manufacturer of the vehicle will attest to meeting these limitations.
- The credit is allowed once per vehicle (and includes a requirement that the taxpayer include the vehicle identification number on the return). Also, the credit is not allowed for taxpayers whose modified adjusted gross income (MAGI) exceeds certain thresholds ($300,000 on joint returns, $225,000 for heads of household, and $150,000 for single taxpayers).

Clean Vehicle Credits – Sections 30D and 25E

- The changes to Section 30D are generally effective for vehicles placed in service after December 31, 2022 (the final assembly requirement, as noted, was effective when the law was enacted).
- The credit will expire after 2032. Taxpayers who purchased a clean vehicle or entered into a written binding contract to purchase a clean vehicle between January 1 and August 15, 2022, but placed it in service on or after August 16, can elect to have the former Section 30D credit rules apply to that vehicle.
- The act also creates a new credit for used clean vehicles (new Section 25E). Qualified buyers can claim a credit of up to $4,000. Their MAGI must be under $150,000 on joint returns, $112,500 for heads of household, and $75,000 for single taxpayers. The sales price for the used vehicle must be $25,000 or less. The used clean vehicle credit applies to vehicles acquired after December 31, 2022.

High Efficiency Electric Home Rebates

- Although not a tax credit, the High-Efficiency Electric Home Rebate Program will also help American families go green. The program, which was added by the Inflation Reduction Act, will provide rebates to low- and middle-income families who purchase energy-efficient electric appliances. To qualify for a rebate, your family's total annual income must be less than 150% of the median income where you live (Syracuse Area $91,100 x 150% = $136,650 to qualify).

High Efficiency Electric Home Rebates

- Qualifying homeowners can get rebates as high as:
  - $840 for a stove, cooktop, range, oven, or heat pump clothes dryer;
  - $1,750 for a heat pump water heater; and
  - $8,000 for a heat pump for space heating or cooling.
- Rebate for non-appliance upgrades will also be available up to the following amounts:
  - $1,600 for insulation, air sealing, and ventilation;
  - $2,500 for electric wiring; and
  - $4,000 for an electric load service center upgrade.

High Efficiency Electric Home Rebates

- There are limits on the amount certain families can get, though. For instance, a rebate can't exceed 50% of the cost of a qualified electrification project if the family's annual income is between 80% and 150% of the area median income. Each qualifying family will also be limited to no more than $14,000 in total rebates under the program.
- The limits for families under the 80% test of the median income (Syracuse Area $91,100 x 80% = $72,880) is 100% of the cost of the project, again limited to $14,000 total.

The IRS – Dealing with the Service and New Funding Objectives

- The IRS is in crisis, and it is not getting better; and
- Additional funding to IRS and how they will be spending it.

The IRS – Dealing with the Service and New Funding Objectives

- On June 22, 2022, National Taxpayer Advocate Erin M. Collins released her statutorily mandated mid-year report to Congress on how the IRS was performing. It did not go well.
- The report expresses extreme concern about continuing delays in the processing of paper-filed tax returns and the consequent impact on taxpayer refunds. The Advocate stated in direct language that the Service was failing in their basic mission.
- At the end of May, the agency had a backlog of 21.3 million unprocessed paper tax returns, an increase of 1.3 million over the same time last year. – Note normal amount is between 900,000 and 1.5 million.
- Several items are especially troubling in these figures. First, the sheer size of the backlog is incredible and the time to "fix" this issue and reduce the backlog to pre-pandemic numbers is equally astonishing. Secondly, the fact that the backlog has INCREASED during the past year is beyond belief.

The IRS – Dealing with the Service and New Funding Objectives

- Advocate Collins commented: "The IRS has said it is aiming to crush the backlogged inventory this year, and I hope it succeeds. Unfortunately, at this point, the backlog is still crushing the IRS, its employees, and most importantly, taxpayers. As such, the agency is continuing to explore additional processing strategies."
- The report points out that the significant majority of individual taxpayers receive refunds. "At the end of the day, a typical taxpayer cares most about receiving his or her refund timely," Collins wrote. "Particularly for lower-income taxpayers who receive Earned Income Tax Credit benefits, tax refunds may constitute a significant percentage of their household income for the year. Thus, these processing delays are creating unprecedented financial difficulties for millions of taxpayers and outright hardships for many."

The IRS – Dealing with the Service and New Funding Objectives

- Among business taxpayers, many have been waiting extended periods to receive Employee Tax Retention Credits for which they are eligible, in addition to their regular refunds. I have several clients who filed amended payroll returns back in November, or before, and who are still waiting on the "Expedited" refund claims.
- Additionally, carryback returns, for NOL's filed more than a year ago, and amended returns, are lying unopened in a pile at a processing center. Numerous 'normal' returns, which were paper filed, are now flagged as late and penalties being automatically assessed, due to the return not being processed.

The IRS – Dealing with the Service and New Funding Objectives

- All this points to the IRS's antiquated systems. Of course, once you get an automated notice you can respond, in writing, via letter, disputing this, and that letter will be opened perhaps sometime in 2024, after the issue has gone to collections.
- The Advocate certainly identified key taxpayer challenges this year, which have included dramatic return processing delays, correspondence processing delays, and difficulty reaching the IRS by phone.
- Attempts to reach the IRS via phone are almost futile. Often being on hold for 4 hours only to be disconnected after that time with nothing more than a prerecorded. Thank you, goodbye.

Backlog of Unprocessed Paper Tax Returns

- More than 90 percent of individual income taxpayers e-file their returns, yet last year, about 17 million taxpayers filed their returns on paper.
- Some choose to file on paper. Some have no choice because they encounter e-filing barriers, such as when they are required to file a tax form or schedule the IRS cannot accept electronically.
- Before the pandemic, the IRS typically delivered refunds to paper filers within four to six weeks. Over the past year, refund delays on paper-filed returns have generally exceeded six months, with delays of 10 months or more common for many taxpayers.
- Again, many of the paper filing taxpayers are receiving tax notices, with penalties and large assessments, due to the IRS not processing the returns timely. This is causing a lot of stress and unhappy taxpayers (not to mention tax accountants).

Backlog of Unprocessed Paper Tax Returns

- The report says the IRS has failed to make progress in eliminating its paper backlog because "it’s pace of processing paper tax returns has not kept up with new receipts."
- During the month of May, the IRS processed an average of about 205,000 individual income tax returns (Forms 1040) per week. Its Form 1040 backlog at the end of May stood at 8.2 million, with millions more paper tax returns not yet classified or expected to arrive before the extended filing deadline of October 15th.

Figure 1: Status of Unprocessed Paper Tax Returns Comparing Weeks Ended May 22, 2021 and May 27, 2022

Paper Returns Awaiting Processing – 2021	Individual	Business	Not Specified	Total
Original Returns	6,100,000	5,600,000	5,100,000	16,800,000
Amended Returns	2,700,000	500,000	—	3,200,000
Total Paper Returns Awaiting Processing	8,800,000	6,100,000	5,100,000	20,000,000
Paper Returns Awaiting Processing – 2022	Individual	Business	Not Specified	Total
Original Returns	8,200,000	6,500,000	3,400,000	18,200,000
Amended Returns	2,300,000	900,000	—	3,200,000
Total Paper Returns Awaiting Processing	10,500,000	7,400,000	3,400,000	21,300,000

Backlog of Unprocessed Paper Tax Returns

- Let's do some math – at 205,000 per week, it will take another 40 weeks to catch up on the filed paper returns currently sitting in warehouses. This of course does not address the millions of returns on extension that will come in by October 15th.
- In fact, if we compute an entire year's processing of 52 weeks times 205,000 per week, we see the total capacity for the Service is at 10.7 million returns a year. Well short of the 17.0 million that are coming in.
- The report says the IRS would have to process well over 500,000 Forms 1040 per week – more than double its current pace to eliminate the backlog this year. "The math is daunting," the report says.
- Forms 1040 are just one component of the paper tax returns processing backlog. Millions of business tax returns and amended tax returns (both individual and business) are also filed on paper. The overall backlog has increased by 7 percent over the past year as shown in the Figure 1.

Backlog of Unprocessed Paper Tax Returns

- The IRS has publicly committed to reducing its paper tax return backlog to a "healthy" level by the end of the year, but it has not provided a definition of "healthy.“
- "Historically, the IRS has paid refunds resulting from paper filed returns within four-to-six weeks," Collins wrote. "From a taxpayer perspective, returning to a four-to-six-week refund delivery period is a reasonable definition of 'healthy.'”
- More importantly they have given no indication as to how they propose to achieve this desired outcome. The Service was provided funding to hire additional personnel to assist in the processing back in August of 2021. They committed to hiring up to 22,000 new agents. To date they have hired less than 3,000.

Backlog of Unprocessed Paper Tax Returns

- Largely because of the likelihood that the IRS will carry a large inventory of unprocessed paper tax returns into the 2023 filing season, Collins issued a Taxpayer Advocate Directive (TAD) in March directing the IRS to implement 2-D barcoding or other scanning technology to automate the transcription of paper tax returns.
  - "Today, the digits on every paper return must be manually keystroked into IRS systems by an employee," Collins wrote. "In the year 2022, that doesn't just *seem* crazy. It *is* crazy."
- The IRS's response to the TAD's report was issued on June 27, 2022, and is covered below.
- The Advocate's report credits the IRS with taking recent steps to address the backlog but notes "missed opportunities" to have acted earlier.
  - "The IRS's paper processing delays were evident more than a year ago, and the IRS could have addressed them more aggressively at that time."

Backlog of Unprocessed Paper Tax Returns

- Additionally, Collins noted:
    - "Had the IRS taken steps a year ago to reassign current employees to processing functions, it could have reduced the inventory backlog carried into this filing season and accelerated the payment of refunds to millions of taxpayers. Had the IRS implemented 2-D barcoding, optical character recognition, or similar technology in time for the 2022 filing season, it could have reduced the need for employees to engage in the highly manual task of transcribing paper tax returns. Had the IRS quickly used some of the $1.5 billion of additional funds provided by the American Rescue Plan Act of 2021 (ARPA), which was enacted 15 months ago, to hire and train additional employees, it could have worked through the backlog, answered more taxpayer telephone calls, and otherwise improved taxpayer service."

Backlog of Unprocessed Paper Tax Returns

- But wait – there's more.
  - In addition to the returns that are awaiting processing, there are other returns still tied up in the system. At the end of May 2021, the IRS had an additional 15.8 million returns (mostly electronically filed ones) that had been suspended during processing and required manual review by IRS employees.
  - The suspended returns consisted largely of e-filed returns on which taxpayers claimed Recovery Rebate Credit amounts that differed from the allowable amounts shown on IRS records. As of May 2022, the IRS had reduced the number of suspended returns to 5.4 million. The report credits the IRS with developing procedures to reduce delays among suspended returns, in part by automating the review process. However, e-filed returns suspended during processing did not generally result in extended refund delays. By contrast, unprocessed paper-filed tax returns have resulted in refund delays of six-to-10 months or longer.
  - While these suspended returns were not delayed significantly, they too require a large amount of manual processing and further reduced the Service's ability to deal with taxpayers. Additionally, many of the returns were processed and refunds paid without the normal level of scrutiny and resulted in refunds that were not proper.

Correspondence Processing Delays

- When a taxpayer receives a notice and is requested to respond or chooses to respond, the taxpayer must generally do so by mail. Through May 21, 2022, the IRS processed 5 million taxpayer responses to proposed adjustments. It took an average of 251 days to do so – more than eight months. That is more than triple the processing time of 74 days in the fiscal year 2019, the most recent pre-pandemic year.
  - "When a math error or similar notice is generated in connection with a paper filed tax return," the report says, "the combination of the return processing delay and the correspondence processing delay may mean that the taxpayer must wait well over a year to get the issue resolved and receive the refund due."

Correspondence Processing Delays

- Finally
  - There are currently over 336,000 taxpayers who could not file their returns or receive their refunds because identity thieves had already filed a return using their identifying information. These taxpayers must submit affidavits and other documentation to substantiate their identities. They now generally must wait at least a year to receive their refunds. The IRS website states: "Due to extenuating circumstances caused by the pandemic, our identity theft inventories have increased and on average it is taking about 360 days to resolve identity theft cases."

Telephone Challenges

- During the 2022 filing season, the IRS received about 73 million telephone calls. Only one out of 10 calls reached an IRS employee. Compared with the 2021 filing season, IRS employees answered less than half as many calls, but the percentage of calls answered remained about the same because they also received less than half as many calls. Many tax preparers and taxpayers simply did not attempt to contact the service knowing it was futile.
- The time the average taxpayer spent waiting on hold rose from 20 minutes to 29 minutes. Again, please note that 90 percent of the callers never spoke with an agent.
- A comparison of telephone service during the 2021 and 2022 filing seasons is shown in Figure 2.

Figure 2: IRS Enterprise Telephone Results Comparing Weeks Ended May 21, 2021 and April 23, 2022

Filing Season	Calles Received	Number of Calls Answered by an IRS Employee	Percentage of Calls Answered by an IRS Employee	Time on Hold
2021	167 million	15.7 million	9%	20 minutes
2022	73 million	7.5 million	10%	29 minutes

"The combination of more than 21 million unprocessed paper tax returns, more than 14 million math error notices, eight-month backlogs in processing taxpayer correspondence, and extraordinary difficulty reaching the IRS by phone made this filing season particularly challenging," Collins wrote.

TAS Objectives for TY 2023

- As required by law, the Advocate's report identifies TAS's key objectives for the upcoming fiscal year. The report describes 14 systemic advocacy objectives, six case advocacy and other business objectives, and three research objectives. In light of the challenges taxpayers have been facing over the last two years, Collins wrote that TAS will be placing heavy emphasis on working with the IRS to improve the processing of tax returns and taxpayer service generally. Among the objectives, the report identifies the following:
  - **Automating the processing of paper tax returns.** On March 29, as noted above, Collins issued a Taxpayer Advocate Directive (TAD) directing the IRS to implement scanning technology by the start of the 2023 filing season so that paper tax returns can be machine-read, and employees will not have to keystroke each digit on the return into IRS systems. After obtaining an extension for responding, the IRS leaders have indicated they are not likely to implement 2-D barcoding, but Collins has strongly urged them to implement a plan to achieve automation of paper processing in time for the next filing season.
  - "Doing so is critical," Collins wrote. "It is unacceptable that the agency is still paying thousands of employees to keystroke the data from millions of tax returns, digit-by-digit, into IRS systems – creating the current processing backlog and producing an error rate in transcribing individual returns last year of 22 percent.“

TAS Objectives for TY 2023

– **Reducing barriers to e-filing tax returns.** Some taxpayers still prefer to file paper tax returns. However, many paper filers, perhaps the majority, would prefer to e-file their returns but are not able to do so. Among the barriers: some taxpayers must file IRS forms or schedules that the IRS does not accept through its e-file system; some taxpayers must include attachments (*e.g.*, appraisals or disclosure statements) that cannot be filed by their tax software packages; some software packages block returns from e-file if the taxpayer overrides certain entries; IRS systems reject certain returns during the e-file process and require affected taxpayers to mail their returns instead. The report says the IRS must reduce e-filing barriers, so more taxpayers can e-file and there will be fewer paper tax returns to transcribe or scan.

– **Improving the IRS's hiring and training processes.** In FY 2022, Congress increased the IRS's overall budget by almost 6 percent and the taxpayer services portion of the budget by nearly 9 percent. Many of the IRS's challenges stem from inadequate staffing, including limited staffing in Submission Processing and telephone call centers. The report says that hiring and adequately training new employees will enhance the taxpayer experience.

TAS Objectives for TY 2023

- **Improving telephone service.** Some taxpayer issues may be resolved through technology channels and enhancing those channels must be a priority. But some issues are best resolved through a conversation, and some taxpayers are not comfortable with technology. The report says it is critical that taxpayers be able to reach the IRS by phone. As discussed above, IRS employees were only able to answer 10 percent of taxpayer telephone calls this filing season.
- "If a private company failed to answer 9 out of 10 customer calls, customers would go elsewhere," Collins wrote. "That, of course, is not an option for U.S. taxpayers, so it is critical that the IRS increase staffing in its telephone call centers to handle the volume of calls it receives."

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- $79.6 Billion in funding to the IRS to supplement, not replace, the normal annual appropriations.
- The money will be allocated to various aspects of the IRS, as follows, through December 31, 2031:

Taxpayer Services	$ 3,181,500,000
Enforcement	45,637,400,000
Operations Support	25,326,400,000
Business Systems Modernization	4,750,700,000
Other	557,500,000
	$ 79,453,500,000

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- Breakdown of each allotted area and where the funds are going to and for:
- Taxpayer Services.
  - According to the Congressional Research Service (CRS), the number of unprocessed tax returns at the end of the 2022 filing season rose from 7.4 million in 2019 to 35.8 million in 2021 and 13.3 million in 2022.
  - The money dedicated to taxpayer services will help the IRS improve pre-filing assistance and education, filing and account services, and taxpayer advocacy services.
  - In addition, the IRS will use $15 million of this money to fund a task force that will study the cost and feasibility of creating a free direct e-file program. Previously, the IRS partnered with private tax filing software companies to provide free services to low- and moderate-income taxpayers.

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- Enforcement
  - According to the CRS, these funds will cover hiring more enforcement agents, litigation and criminal investigation expenses, and investing in investigative technology.
  - Clearly, the question from clients is, “Will I be audited?” When we look at projections on audit rates, it appears, at least from the taxpayer’s perspective, that the focus will be on the $400,000 taxable income threshold and up. While enforcement activities are squarely aimed at super-high wealth taxpayers, large corporations, and sophisticated partnerships, it will take the IRS some time to hire and train additional agents, so don’t expect audits to rise overnight.

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- According to the CRS, the overall goal of this significant investment in tax enforcement is to reduce the tax gap which is the difference between total taxes owed and taxes paid on time. The IRS estimates that **the tax gap averaged $381 billion** after accounting for enforcement between 2011 and 2013, the most recent years available. The Congressional Budget Office (CBO) estimates that the additional enforcement measures funded by this bill would generate $204 billion in revenues through 2031.
- Another interesting piece of enforcement activity involves cryptocurrency and digital asset monitoring. With more than 15,000 different types of digital assets, these transactions have largely flown under the radar in terms of reporting. Under the new legislation, cryptocurrency brokers will be required to report more information on their clients' trading activity to the IRS starting in 2023.

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- Operations Support
  - To support the investment in taxpayer services and enforcement, the IRS is also focused on enhancing operations. This includes routine costs such as rent payments, facilities services, postage, security, research, telecommunications, maintenance, and information technology development.
  - These funds may also go toward research and the IRS Oversight Board, an independent body charged with providing the IRS with long-term guidance and direction.

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- Business Systems Modernization
  - In 2019, IRS customer service representatives answered 59% of phone calls they received, but in 2021 and 2022, they answered only 19% and 18% respectively. According to the **June 2020 National Taxpayer Advocate Annual Report to Congress**, it was recommended that the IRS prioritize the expansion of customer callback technology and give taxpayers the option of receiving face-to-face service through videoconferencing.
  - The business systems modernization piece of the overall funding will include the development of callback and other technology designed to provide a more personalized customer service experience. It does not include, however, the operation and maintenance of legacy systems.
  - In 2019, the IRS released a plan to upgrade its business systems that administer taxpayer services, operations, and cybersecurity. These new funds could be invested in these areas and may include upgraded technology like online secure portals, the ability to view client tax payments, and secure email correspondence with tax practitioners.

Background on the Inflation Reduction Act and Benefits to the Internal Revenue Service

- Other
    - The Inflation Reduction Act also gives other Treasury offices $557.5 million to oversee the administration of these new IRS funds. Of that amount, $403 million goes to the independent IRS watchdog agency known as Treasury Inspector General for Tax Administration (TIGTA), $104.5 million goes to the Office of Tax Policy, and $50 million goes to the Treasury Departmental Offices.

2023 Tax Changes: IRS Issues Inflation Adjustments

- Here's a rundown of changes to limits and thresholds on some well-known tax provisions for the 2023 tax year.
- On October 18, 2022, the IRS announced the annual inflation adjustments for the 2023 tax year.
- As a result, many key tax provisions – including the income thresholds for Federal tax brackets – will increase <u>by roughly 7%</u> to account for the high inflation Americans have seen throughout 2022.
- This larger-than-usual adjustment could mean many folks may stay in a lower tax bracket; some may even see a smaller tax bill in 2024.
- Here's a look at how certain tax thresholds and credits will shift for the 2023 tax year, plus a comparison to 2022.

Federal Tax Brackets and Tax Rates

- In the U.S., there are seven Federal tax brackets. The marginal rates – 10%, 12%, 22%, 24%, 32%, 35%, and 37% - remain unchanged from 2022.

Standard Deduction

- Each year, taxpayers can either itemize their tax return or take the standard deduction to lower their taxable income.
- For the 2023 tax year, the standard deduction will increase by $900 for single filers and those married filing separately, $1,800 for married couples, and $1,400 for head of household.
- The standard deduction is also $1,500 higher for those over 65 or blind (up from $1,400 in 2022) and $1,850 higher if also unmarried and not a surviving spouse (up from $1,750 in 2022).

Filing Status	2022 Tax Year	2023 Tax Year
Single	$ 12,950	$ 13,850
Married Filing Jointly	$ 25,900	$ 27,700
Married Filing Separately	$ 12,950	$ 13,850
Head of Household	$ 19,400	$ 20,800

Other Changes for 2023

- Also included in the IRS' 28-page inflation release are various changes to sever tax provisions beyond the Federal tax brackets:
  - The annual exclusion for gifts, which limits how much taxpayers can give an individual without filing a gift tax return on certain gifts, will increase to $17,000 per person in 2023, up $1,000 from 2022.
  - The lifetime estate tax exclusion establishes a threshold for the taxation of estates upon a wealthy person's death. In 2023, estates valued at or below $12.92 million will not be subject to estate tax, up from $12.06 million in 2022.
  - Starting in 2023, taxpayers who contribute to a health flexible spending account, or FSA, can contribute up to $3,050 and, if permissible by their plan, will be able to carry over up to $610 into the next tax year.

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Questions

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