Current Federal Tax Developments

Week of July 5, 2021

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CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JULY 5, 2021

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SECTION: 170
IRS EXTENDS TAX FREE TREATMENT OF EMPLOYER LEAVE BASED DONATIONS FOR COVID RELIEF PROGRAMS THROUGH THE END OF 2021

Citation: Notice 2021-42, 6/30/21

A little more than one year ago the IRS released Notice 2020-46 allowing employers to establish COVID-19 related leave donation programs for employees to participate in for their leave time to be converted to a cash donation to a charitable organization offering COVID-19 relief. The program was described in an article posted to this site at the time.[1] The guidance expired on December 31, 2020.

In Notice 2021-42[2] the IRS has retroactively extended the program through the end of 2021. The Notice describes the original program as follows:

> Notice 2020-46, 2020-27 I.R.B. 7, provided guidance under the Internal Revenue Code (Code) on the federal income and employment tax treatment to employers and their employees of cash payments made before January 1, 2021, for the relief of victims of the COVID-19 pandemic in the affected geographic areas under employer sponsored leave-based donation programs. Under leave-based donation programs, employees can elect to forgo vacation, sick, or personal leave in exchange for cash payments made by their employers to charitable organizations described in section 170(c) of the Code (section 170(c) organizations).[3]

The Notice goes on to grant a formal extension of the program:

> Because of the ongoing nature of the COVID-19 pandemic, the Department of the Treasury and the Internal Revenue Service have determined that it is appropriate to extend the treatment provided in Notice 2020-46 to cash payments made to section 170(c) organizations after December 31, 2020, and before January 1, 2022.
>
> Accordingly, this notice extends the federal income and employment tax treatment provided in Notice 2020-46 to cash payments made to section 170(c) organizations after December 31, 2020, and before January 1, 2022, that otherwise would be described in Notice 2020-46.[4]

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[1] Ed Zollars, "Tax Treatment for Programs for Donation of Employee Leave Time Value to COVID-19 Charities Described in IRS Notice," *Current Federal Tax Developments* website, June 11, 2020, https://www.currentfederaltaxdevelopments.com/blog/2020/6/11/tax-treatment-for-programs-for-donation-of-employee-leave-time-value-to-covid-19-charities-described-in-irs-notice (retrieved July 1, 2021)

[2] Notice 2021-42, June 30, 2021, https://www.irs.gov/pub/irs-drop/n-21-42.pdf (retrieved July 1, 2021)

[3] Notice 2021-42, June 30, 2021

[4] Notice 2021-42, June 30, 2021

SECTION: 172
IRS PROVIDES PROCEDURES FOR MAKING ELECTIONS PROVIDED UNDER CTRA 2020 FOR FARM NET OPERATING LOSSES

Citation: Revenue Procedure 2021-14, 6/30/21

Guidance has been issued to farmers for elections related to net operating losses added by the COVID-related Tax Relief Act of 2020 (CTRA) in Revenue Procedure 2021-14.[5] The Procedure broadly described its guidance as follows:

> Specifically, this revenue procedure prescribes when and how to make an election with regard to all NOLs of the taxpayer, regardless of whether the NOL is a Farming Loss NOL. This revenue procedure also provides that a taxpayer is treated as having made a deemed election under § 2303(e)(1) of the CARES Act if the taxpayer, before December 27, 2020, filed one or more original or amended Federal income tax returns, or applications for tentative refund, that disregard the CARES Act Amendments with regard to a Farming Loss NOL. This revenue procedure further prescribes when and how to revoke an election made under § 172(b)(1)(B)(iv) or § 172(b)(3) of the Code to waive the two-year carryback period for the farming loss portion of a Farming Loss NOL incurred in a taxable year beginning in 2018 or 2019.[6]

CTRA sought to grant relief to farmers that Congress had impacted by changes meant to grant a tax benefit in the CARES Act. Under TCJA, beginning in 2018 net operating losses could no longer be carried back generally and only could offset 80% of taxable income. However, TCJA did allow a farm loss to be carried back two years.

The CARES Act suspended the TCJA changes until 2021 and provided for a five year net operating loss carryback unless a taxpayer elected to carry the loss forward for 2018-2020. However, in doing so Congress, likely without really realizing it, required farmers to choose between carrying their losses back five years *or* carrying the loss forward. The option to carry the loss back two years was part of the provisions suspended until 2021.

In some cases a farmer found that the five year carryback resulted in a lower refund than if the loss went back two years. As well, most 2018 loss carrybacks (and even some 2019 ones) had already been filed by farmers by the time the CARES Act was passed in March of 2020—meaning those farmers now had to revise those carrybacks to either carry the loss back five years *or* elect to carry the loss forward. The farmer did not have the option to simply accept the already filed two year carryback.

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[5] Revenue Procedure 2021-14, June 30, 2021, https://www.irs.gov/pub/irs-drop/rp-21-14.pdf (retrieved June 30, 2021)

[6] Revenue Procedure 2021-14, Section 1.02

CTRA added a provision to allow farmers various options with these losses.

Election to Ignore CARES Act Changes

Section 2303(e)(1) of the CARES Act, as revised by CTRA 2020, allows a farmer to make an election for tax years beginning in 2018, 2019 or 2020 to disregard the CARES Act changes to NOLs found at CARES Act Section 2303(a) and (b) (the five year carryback).

If such an election is made, the following consequences will follow:

- Application of 80-percent limitation. The 80-percent limitation will apply to determine the NOL deduction for each taxable year beginning in 2018, 2019, or 2020 to the extent the deduction is attributable to NOLs arising in taxable years beginning after December 31, 2017. The 80-percent limitation will not apply to determine the NOL deduction for any taxable year beginning before 2018.[7]

- Application of modified taxable income rules. Section 172(b)(2)(C) of the Code, as added by the TCJA and effective prior to enactment of the CARES Act, provides a modified taxable income rule to account for the 80-percent limitation. This rule will apply with regard to each taxable year beginning in 2018, 2019, or 2020.[8]

- NOL carryback period. The NOL carryback period will be determined under § 172(b) of the Code, as amended by the TCJA and effective prior to enactment of the CARES Act, for any NOL arising in any taxable year beginning in 2018, 2019, or 2020. For example, if a taxpayer with a Farming Loss NOL in 2018 makes the election under § 2303(e)(1), only the portion of the Farming Loss NOL that consists of a farming loss can be carried back two taxable years. In addition, for taxpayers other than insurance companies, as defined in section 816(a) of the Code, that are not life insurance companies, no portion of any NOL that does not constitute a farming loss can be carried back to any taxable year beginning before January 1, 2018.[9]

Making the Election to Ignore the CARES Act Changes

The election described above must meet the following criteria outlined in Section 2303(e) of the CARES Act as revised by CTRA 2020:

> Section 2303(e)(1)(B)(i) of the CARES Act provides that, except in the case of a deemed election described in 3.02(3)(b) of this revenue procedure, an election to disregard the CARES Act amendments (Affirmative Election) under § 2303(e)(1) must be made in the manner prescribed by the Secretary. Once made, an election under § 2303(e)(1) is irrevocable. Section 2303(e)(1)(B)(ii)(I) of the CARES Act generally provides that an Affirmative Election must be made by the due date, including extensions of time, for filing the taxpayer's Federal income

[7] Revenue Procedure 2021-14, Section 2.03(2)(a)

[8] Revenue Procedure 2021-14, Section 2.03(2)(b)

[9] Revenue Procedure 2021-14, Section 2.03(2)(c)

> tax return for the taxpayer's first taxable year ending after December 27, 2020.[10]

The Revenue Procedure offers up both a deemed election and an affirmative election.

Deemed Election

The simplest option for returns filed before December 27, 2020 that disregarded the CARES Act revisions is to use the deemed election which requires doing nothing additional. The Procedure provides:

> In the case of any taxpayer with a Farming Loss NOL that files a Federal income tax return before December 27, 2020, that disregards the CARES Act Amendments, the taxpayer is treated as having made a deemed election (Deemed Election) under § 2303(e)(1) unless the taxpayer amends such return to reflect such amendments by the due date (including extensions of time) for filing the taxpayer's Federal income tax return for the first taxable year ending after December 27, 2020.[11]

Affirmative Election

Other than taxpayers making the deemed election just described, a taxpayer with a Farming Loss NOL may make an affirmative election to disregard the provisions related to NOLs under the original CARES Act if

- The Farming Loss NOL arose in any taxable year of the taxpayer beginning in 2018, 2019, or 2020; and
- The taxpayer satisfies all of the following conditions:
  - The taxpayer must make the Affirmative Election on a statement described next by the due date, including extensions of time, for filing the taxpayer's Federal income tax return for the taxpayer's first taxable year ending after December 27, 2020.
  - The taxpayer must attach a statement to the taxpayer's Federal income tax return for the taxpayer's first taxable year ending after December 27, 2020. The statement must provide in type or legible writing at the top of the statement the following:

> *The taxpayer elects under § 2303(e)(1) of the CARES Act and Revenue Procedure 2021-14 to disregard the amendments made by § 2303(a) of the CARES Act for taxable years beginning in 2018, 2019, and 2020, and the amendments made by § 2303(b) of the CARES Act that would otherwise apply to any net operating loss arising in any taxable year beginning in 2018, 2019, or 2020. The taxpayer incurred a Farming Loss NOL, as defined in section 1.01 of*

[10] Revenue Procedure 2021-14, Section 2.03(3)(a)

[11] Revenue Procedure 2021-14, Section 2.03(3)(b)

Revenue Procedure 2021- 14, in [list each applicable taxable year beginning in 2018, 2019, or 2020].

The taxpayer should also attach a copy of the statement to any original or amended Federal income tax return or application for tentative refund on which the taxpayer claims a deduction attributable to a two-year NOL carryback pursuant to the Affirmative Election.[12]

Revoking an Election to Waive the Two-Year Carryback Period

The law allows a taxpayer to revoke an election made to waive the two-year carryback period under the following conditions:

> Section 2303(e)(2) of the CARES Act provides taxpayers with the ability to revoke an election made under § 172(b)(1)(B)(iv) or § 172(b)(3) of the Code to waive the two-year carryback period if the election—
>
> (i) was made by the taxpayer before December 27, 2020; and
>
> (ii) relates to the two-year carryback period for the portion of any Farming Loss NOL that is a farming loss arising in taxable years beginning in 2018 or 2019.[13]

Special Rules for Taxpayers With Pre-December 27, 2020 Two Year Carrybacks That Were Rejected

The Procedure notes that certain taxpayers who filed for a two-year carryback prior to December 27, 2020 may have had those claims rejected by the IRS. The Procedure provides:

> If such a taxpayer wants to continue to pursue those claims, the taxpayer should submit complete copies of their rejected applications or claims, including the original or amended Federal income tax returns for the taxable years in which the NOLs arose, in the manner set forth in this section 3.02(2), which will enable the IRS to review their cases as expeditiously as possible.
>
> (a) The taxpayer should submit a complete copy of each rejected application for tentative refund or claim for refund based on a two-year carryback period, including the original or amended Federal income tax return for the taxable year in which the NOL arose, to the IRS Service Center at which the taxpayer previously filed the application or claim and return.
>
> (b) The taxpayer should provide in type or legible writing at the top of the first page of a complete copy of each

[12] Revenue Procedure 2021-14, Section 3.01(2)

[13] Revenue Procedure 2021-14, Section 2.03(4)

> application or claim the following: "Deemed Election under section 3.02(2) of Revenue Procedure 2021-14."
>
> (c) The complete copy of each application or claim and return should be submitted on or before the due date, including extensions of time, for filing the taxpayer's Federal income tax return for the taxpayer's first taxable year ending after December 27, 2020.[14]

Exception to a Deemed Election

Since obtaining a deemed election simply requires doing nothing by a qualified taxpayer, the Procedure provides a method for such qualified taxpayers to escape deemed election treatment. The Procedure provides:

> A taxpayer will not be treated as having made a Deemed Election if, for each taxable year for which the taxpayer filed an original or amended Federal income tax return or an application for tentative refund that treated a Farming Loss NOL in a manner that disregards the CARES Act Amendments, the taxpayer subsequently files either an amended return by the due date, including extensions of time, for filing the taxpayer's Federal income tax return for the taxpayer's first taxable year ending after December 27, 2020, or an application for tentative refund within the required time for filing such an application and also by the due date, including extensions of time, for filing the taxpayer's Federal income tax return for the taxpayer's first taxable year ending after December 27, 2020, that properly reflects the treatment of each Farming Loss NOL under the CARES Act Amendments.[15]

[14] Revenue Procedure 2021-14, Section 3.02(2)

[15] Revenue Procedure 2021-14, Section 3.02(3)

The Procedure provides the following examples of applying this provision:

EXAMPLES, SECTION 3.02(3), REVENUE PROCEDURE 2021-14

A taxpayer who disregarded the CARES Act Amendments by using a 2-year carryback for the farming loss portion of the taxpayer's only Farming Loss NOL and filed Forms 1120X for the two carryback years, and who subsequently timely files a Form 1139 with a 5-year carryback that accounts for that Farming Loss NOL in a manner consistent with the CARES Act Amendments for each of the five carryback years, will not be treated as having made a Deemed Election.

Similarly, a taxpayer who filed a Form 1139 prior to December 27, 2020, and disregarded the CARES Act Amendments by using a 2-year carryback for the farming loss portion of the taxpayer's only Farming Loss NOL and subsequently timely files a Form 1139 with a 5-year carryback that accounts for that Farming Loss NOL in a manner consistent with the CARES Act for each of the five carryback years, will not be treated as having made a Deemed Election.

Waivers of Carryback Periods

Some taxpayers may now wish to revoke their original election to not apply the two-year carryback period for farm losses. The Procedure allows for that as well.

A taxpayer that elected not to have the two-year carryback period apply to the farming loss portion of a Farming Loss NOL incurred in a taxable year beginning in 2018 or 2019 may revoke that election if the taxpayer—

- Made that election before December 27, 2020; and
- Satisfies all of the following conditions:
  - Revocation deadline. A taxpayer must make the revocation under this provision by the date that is 3 years after the due date, including extensions of time, for filing the return for the taxable year the Farming Loss NOL was incurred and
  - Required statement. The taxpayer must attach a statement to an amended return for the loss year. The statement must provide in type or legible writing at the top of the statement the following:

> *Pursuant to section 4.01 of Rev. Proc. 2021-14 the taxpayer is revoking a prior §172(b)(1)(B)(iv) or § 172(b)(3) election not to have the two-year carryback period provided by § 172(b)(1)(B)(i) apply to the Farming Loss NOL, as defined in section 1.01 of Rev. Proc. 2021-14, incurred in the taxable year.*[16]

Consolidated Groups

The procedure also gives guidance for consolidated groups regarding these elections.

[16] Revenue Procedure 2021-14, Section 4.01

Manner of Making Elections for Consolidated Groups

The Procedure outlines the following manner for making an election for a consolidated group:

> An Affirmative Election under section 3.01 of this revenue procedure and a revocation described in section 4.01 of this revenue procedure are made by the agent for the consolidated group. An amended return described in section 3.02(3) of this revenue procedure is filed, and a Deemed Election under section 3.02 of this revenue procedure is deemed made, by the agent for the consolidated group. See § 1.1502-77(a) and (c).[17]

Consequences of Affirmative and Deemed Elections for a Consolidated Group

The Procedure describes the consequences of the various elections for a consolidated group:

> If the agent for the consolidated group makes an Affirmative Election or a Deemed Election, the consequences described in section 2.03(2) of this revenue procedure apply to the consolidated group. Therefore, for example, if a consolidated group has a CNOL a portion of which is a farming loss, and if the agent for the consolidated group makes an Affirmative Election or a Deemed Election, then the portion of the CNOL that is a farming loss can be carried back two taxable years, and the 80-percent limitation will apply to determine the deduction for the entire CNOL for each taxable year beginning in 2018, 2019, or 2020.[18]

The Procedure also provides:

> Reliance on rules in § 1.1502-21 regarding application of the 80-percent limitation. If a consolidated group makes an Affirmative Election or a Deemed Election, the consolidated group may choose to apply § 1.1502-21(a), (b)(1), (b)(2)(iv), and (c)(1)(i)(E), as revised by TD 9927 (85 FR 67966, Oct. 27, 2020), for its taxable years beginning in 2018, 2019, or 2020.[19]

[17] Revenue Procedure 2021-14, Section 5.01(2)

[18] Revenue Procedure 2021-14, Section 5.02

[19] Revenue Procedure 2021-14, Section 5.03

SECTION: 6031
PENALTY RELIEF GRANTED IN CERTAIN CASES RELATED TO FILING NEW SCHEDULES K-2 AND 3 ON 2021 RETURNS

Citation: Notice 2021-39, 6/30/21

In Notice 2021-39,[20] issued at the same time as draft versions of the 2021 instructions for new Forms K-2 and K-3 for partnerships and S corporations, the IRS provided limited relief from penalties related to issues properly preparing those forms on 2021 tax returns.

The Notice describes the new forms as follows:

> Form 1065, Schedules K-2, Partners' Distributive Share Items — International, and K-3, Partner's Share of Income, Deductions, Credits, etc. — International, are new for taxable years beginning in 2021. These schedules replace, supplement, and clarify the reporting of certain amounts formerly reported on Form 1065, Schedule K, Partners' Distributive Share Items, line 16, Foreign Transactions, and Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., Part III, Partner's Share of Current Year Income, Deductions, Credits, and Other Items, line 16, Foreign Transactions. Schedules K-2 and K-3 also replace, supplement, and clarify reporting of certain amounts formerly reported on Form 1065, Schedule K, line 20c, Other items and amounts, and Schedule K-1 (Form 1065), Part III, line 20, Other information. The new standardized format assists partnerships in providing partners with the information necessary to complete their returns with respect to the international tax aspects of the Code and allows the IRS to more efficiently verify tax compliance.
>
> For the same reasons, for taxable years beginning in 2021, Form 1120-S includes new Schedules K-2, Shareholders' Pro Rata Share Items — International, and K-3, Shareholder's Share of Income, Deductions, Credits, etc. — International. These schedules replace, supplement, and clarify the reporting of certain amounts formerly reported on line 14, Foreign Transactions, of both Form 1120-S, Schedule K, Shareholders' Pro Rata Share Items, and Schedule K-1 (Form 1120-S), Shareholder's Share of Income, Deductions, Credits, etc. Part III, Shareholder's Share of Current Year Income, Deductions, Credits, etc. Schedules K-2 and K-3 also replace, supplement, and clarify the reporting of certain amounts formerly reported on Form 1120-S, Schedule K, line 17d, Other items and amounts, and Schedule K-1 (Form 1120-S), Part III, line 17, Other Information.
>
> Finally, for the same reasons, for taxable years beginning in 2021, Form 8865 includes new Schedules K-2, Partners' Distributive Share Items — International, and K-3, Partner's Share of Income,

[20] Notice 2021-39, June 30, 2021, https://www.irs.gov/pub/irs-drop/n-21-39.pdf (retrieved July 1, 2021)

> Deductions, Credits, etc. — International. These schedules replace, supplement, and clarify the reporting of certain amounts formerly reported on line 16, Foreign Transactions, of both Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, Schedule K, Partners' Distributive Share Items, and Schedule K-1 (Form 8865), Partner's Share of Income, Deductions, Credits, etc., Part III, Partner's Share of Current Year Income, Deductions, Credits, and Other Items. Schedules K-2 and K-3 also replace, supplement, and clarify the reporting of certain amounts formerly reported on Form 8865, Schedule K, line 20c, Other items and amounts, and Schedule K-1 (Form 8865), Part III, line 20, Other information.[21]

Penalties Covered by the Relief

As the Notice describes, a failure to properly prepare and issue these forms for the applicable 2021 tax returns would subject the issuing entity to a number of penalties. The penalties discussed are:

- Failure to File or Show Information on Partnership Return (IRC §6698);
- Failure to File or Show Information on an S Corporation Return (IRC §6699);
- Failure to File Correct Information Returns (IRC §6721);
- Failure to Furnish Correct Payee Statements (IRC §6722); and
- Failure to furnish information required by IRC §6038 related to Form 8865 (IRC §§6038(b) and (c))[22]

In most cases a failure would trigger more than one of these penalties absent a showing of reasonable cause for the failures. The Notice provides transition penalty relief to entities that will have to file the Schedules K-2 and K-3 on 2021 returns.

Relief and Conditions to Obtain Relief

The Notice describes the relief broadly as follows:

> This section provides transition relief for taxable years that begin in 2021 (processing year 2022) with respect to Schedules K-2 and K-3 to Forms 1065, 1120-S, and 8865. During this transition period, a partnership required to file Form 1065, an S corporation required to file Form 1120-S, or a U.S. partner required to file Form 8865 (a "Schedule K-2/K-3 filer") will not be subject to the relevant penalties described in section 2 for any incorrect or incomplete reporting on the Schedules K-2 and K-3 if the filer establishes to the satisfaction of the Commissioner that it made a good faith effort to comply with the Schedules K-2 and K-3 filing requirements (and the Schedule K-3 furnishing requirements) per the instructions. A Schedule K-2/K-3

[21] Notice 2021-39, Section 2.02

[22] Notice 2021-39, Section 2.03

> filer that does not establish that it made a good faith effort to comply with the new requirements will not be eligible for penalty relief under this notice.[23]

The Notice outlines criteria the IRS will consider in determining if the filer made a good faith effort to comply for purposes of this relief:

> For purposes of determining whether a Schedule K-2/K-3 filer makes a good faith effort to complete Schedules K-2 and K-3, the IRS will take into account the extent to which a Schedule K-2/K-3 filer has made changes to its systems, processes, and procedures for collecting and processing information relevant to filing the Schedules K-2 and K-3 and the extent to which a Schedule K-2/K-3 filer has obtained information from partners, shareholders, or the CFP, or applied reasonable assumptions when information is not obtained. The IRS will also take into account the steps taken by the Schedule K-2/K-3 filer to modify the partnership or S corporation agreement or governing instrument to facilitate the sharing of information with partners and shareholders that is relevant to determining whether and how to file Schedules K-2 and K-3.[24]

The Notice explains that the IRS is aware that some of the items requested on these forms will require obtaining information about the interest holder:

> In several instances, certain information about partners, shareholders, or the CFP is relevant for determining the applicability of a part of Schedules K-2 and K-3. For example, if a partnership has a direct or indirect partner that is a nonresident alien individual or a foreign corporation, the partnership must complete Form 1065, Part X of Schedules K-2 and K-3. Information about the partners, shareholders, or the CFP is also relevant for determining how to report some amounts. For example, for taxable years beginning in 2021, the instructions for Form 1065, Part IX of Schedule K-2 and K-3 state that a partnership is expected to collaborate with its partners to identify the foreign related parties of each partner.
>
> The Treasury Department and the IRS are aware that a Schedule K-2/K-3 filer may not currently have systems or procedures in place to obtain information about its partners, shareholders, or the CFP to determine whether it must file a part of Schedules K-2 and K-3 or how to complete a part that must be filed.[25]

The Notice goes on to explain what the filer must do to qualify for relief for issues arising related to these items:

> In general, in the taxable year 2021 instructions, unless the Schedule K-2/K-3 filer has knowledge to the contrary, it must file or complete

[23] Notice 2021-39, Section 3

[24] Notice 2021-39, Section 3

[25] Notice 2021-39, Section 3

> certain parts assuming that the information would be relevant to the partner or shareholder. Under this notice, during the transition period, a Schedule K-2/K-3 filer will not be subject to the relevant penalties described in section 2 for any incorrect or incomplete reporting on Schedules K-2 or K-3 if it establishes to the satisfaction of the Commissioner that it made a good faith effort to determine whether it must file a part and how to complete a part that it files.
>
> With respect to information about partners, shareholders, or the CFP that is relevant to determine whether to file and how to complete a part, the IRS will assess the effort the Schedule K-2/K-3 filer made to obtain this information and the reasonableness of any assumptions, taking into account the relationship between the Schedule K-2/K-3 filer and its partners, shareholders or the CFP. For example, the appropriate level of diligence and/or the reasonableness of an assumption may differ with respect to a partner that manages or controls the partnership, or a partnership with a partner with a significant interest in the partnership, such as a partner with a 10-percent interest, as compared to partners holding small interests for which there may not be the same ease of access to information. Nevertheless, a Schedule K-2/K-3 filer may have made a good faith effort despite being unsuccessful in obtaining information from its partners, shareholders, or the CFP.[26]

The important thing to note about this relief is that it is very much *conditional* relief—if the filer makes no effort to compile and obtain relevant information, the filer would not meet the conditions to obtain this relief. For this reason, filers should begin studying the draft instructions and the forms, determining how the filer would be able to compile or obtain the necessary information, and begin documenting the steps being taken as well as the problems that arise in attempting to fully comply with the requirements.

Comments Being Requested

The Notice ends by requesting comments on the draft instructions to the various Schedules that were released at the same time as the Notice. The nature of the comments requested is described as follows:

> The IRS solicits comments on the draft instructions to Schedules K-2 and K-3 for taxable years beginning in 2021 being released the same date as this Notice, particularly any instances where the instructions do not provide sufficient guidance on how to complete the returns or where additional clarity is needed. The IRS is specifically interested in suggestions for addressing structures and situations that make it difficult to determine certain information (for example, tiered partnership structures or publicly-traded partnerships).
>
> As discussed in section 3, in general, the instructions for taxable years beginning in 2021 for certain parts of the Schedules K-2 and K-3

[26] Notice 2021-39, Section 3

> require the partnership and the S corporation to report information unless the partnership and S corporation know that the information is not relevant to partners, shareholders, or indirect partners. The IRS solicits comments concerning reasonable assumptions Schedule K-2/K-3 filers could make in determining whether and how to complete Schedules K-2 and K-3 for years after the transition period and whether these assumptions may differ between various parts of the Schedules K-2 and K-3.[27]

The Notice describes the method for submitting comments as follows:

> Comments should be submitted in writing and should include a reference to Notice 2021-39. Comments may be submitted in one of two ways:
>
> > (1) Electronically via the Federal eRulemaking Portal at www.regulations.gov (type IRS-2021-0006 in the search field on the regulations.gov homepage to find this notice and submit comments).
> >
> > (2) Alternatively, by mail to: Internal Revenue Service, Attn: CC:PA:LPD:PR (Notice 2021-39), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.
>
> All commenters are strongly encouraged to submit public comments electronically. The IRS expects to have limited personnel available to process public comments that are submitted on paper through the mail and these comments, submitted through the mail, may not be processed with enough time before revisions to the instructions need to be prepared. Until further notice, any comments submitted on paper will be considered to the extent practicable. The Treasury Department and the IRS will publish for public availability any comment submitted electronically, and to the extent practicable on paper, to its public docket.[28]

[27] Notice 2021-39, Section 4

[28] Notice 2021-39, Section 4

SECTION: STATE TAX
SUPREME COURT DECLINES TO HEAR CHALLENGE ON TAXING EMPLOYEES WHO WORKED REMOTELY OUT OF STATE DURING COVID-19 EMERGENCY

Citation: Supreme Court Order List: 594 US, Monday, June 28, 2021, New Hampshire v. Massachusetts, 7/28/21

The U.S. Supreme decided not to hear the challenge by the state of New Hampshire to Massachusetts' taxation of workers who worked remotely in other states.[29]

The state of Massachusetts issued emergency regulations on nonresident income sourcing due to the closing of offices in the state during the COVID-19 epidemic.[30] The key provision the state of New Hampshire objected to reads as follows:

> Under M.G.L. c. 62, § 5A(a), income of a nonresident derived from a trade or business, including any employment, carried on in the Commonwealth is sourced to Massachusetts. Pursuant to this rule, all compensation received for services performed by a nonresident who, immediately prior to the Massachusetts COVID-19 state of emergency was an employee engaged in performing such services in Massachusetts, and who is performing services from a location outside Massachusetts due to a Pandemic-related Circumstance will continue to be treated as Massachusetts source income subject to personal income tax under M.G.L. c. 62, § 5A and personal income tax withholding pursuant to M.G.L. c. 62B, § 2.[31]

In this case, this rule applied during the following time period:

> 830 CMR 62.5A.3 applies to the sourcing of wage income attributable to employee services performed commencing March 10, 2020 through 90 days after the date on which the Governor of the Commonwealth gives notice that the Massachusetts COVID-19 state of emergency is no longer in effect.[32]

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[29] Supreme Court Order List: 594 US, Monday, June 28, 2021, *New Hampshire v. Massachusetts*, p. 2, https://www.supremecourt.gov/orders/courtorders/062821zor_6j37.pdf (retrieved June 29, 2021)

[30] Massachusetts 830 CMR 62.5A.3, December 8, 2020, https://www.taxnotes.com/research/state/massachusetts/regulation/ma-admin-department0830%20cmr/massachusetts-830-cmr-830-cmr-62.00-v-1-62.5a.3-v-1 (retrieved June 29, 2021)

[31] Massachusetts 830 CMR 62.5A.3(3)(a)

[32] Massachusetts 830 CMR 62.5A.3(1)(d)

By the time the Supreme Court issued its ruling passing on hearing the case, the regulation was already on the path to expiring. As the State of Massachusetts noted in a supplemental brief filed on June 15:

> This supplemental brief, filed pursuant to Rule 15.8, brings to the Court's attention that on June 15, 2021, the Commonwealth of Massachusetts's COVID-19 state of emergency ended. See Governor Charles D. Baker, COVID-19 Order No. 69 (May 28, 2021), https://tinyurl.com/5ddx42bn (ending emergency effective June 15, 2021); see also Office of Governor Charlie Baker & Lt. Governor Karyn Polito, COVID-19 State of Emergency, https://tinyurl.com/fwwsbvkt (acknowledging emergency's end on June 15, 2021). The Governor's declaration of an end to the emergency triggers the sunset of the pandemic-related tax regulation New Hampshire seeks to challenge in this Court in the first instance. See 830 Code Mass. Regs. 62.5A.3(1)(d) (governing "the sourcing of wage income attributable to employee services performed commencing March 10, 2020 through 90 days after the date on which the Governor of the Commonwealth gives notice that the Massachusetts COVID-19 state of emergency is no longer in effect"); see also *id.* at 62.5A.1(5), 62.5A.2 (setting forth Massachusetts's pre-existing wage-income sourcing rules — not challenged by New Hampshire here — that will apply following the pandemic-related regulation's sunset).
>
> The regulation's sunset, while not unexpected in that it is contemplated by the regulation's very terms, underscores the arguments why this dispute fails to rise to the level of grave importance warranting exercise of the Court's original jurisdiction, see Br. in Opp. 11-21; U.S. Br. 4-11, and why any disputes over application of the temporary regulation to taxpayers should be addressed through the ordinary course of state proceedings in the first instance, see Br. in Opp. 22-25; U.S. Br. 11-16. Above all, the development belies New Hampshire's contention that this expressly time-limited measure will endure "indefinitely," N.H. Reply Br. 2.[33]

Although the order did not contain any explanation of why the court decided 7-2 not to hear this case, a number of factors may have influenced the court's decision to pass on this case.

First, the Supreme Court rarely hears these cases between the states where it has original jurisdiction, even though two Justices (Justices Thomas and Alito) have argued the court is required to take up these cases. While those two Justices again wanted the Court to hear this case, the other Justices do not appear to share this view.

Second, as Massachusetts noted, the regulation in question would not be in force by the time that any decision would be rendered. Of course, that overlooks the fact that those who were working outside the state and were covered by this rule would have had a claim for refund on amounts the Commonwealth taxed during the time this regulations

[33] Supplemental Brief in Opposition, Commonwealth of Massachusetts, June 15, 2021

was in place. As well, the lifting of the state of emergency occurred just days before this order was issued, so it doesn't appear likely that this was the key reason the Court passed on this case.

To this author, a reason suggested by Don Williamson, professor at the Kogod School of Business at American University and executive director of the Kogod Tax Policy Center in an article on the denial published in *Tax Notes Today Federal*[34] on June 29 that the court saw this as a case that individuals (not the state) should first litigate before SCOTUS would consider looking at the issue seems a more likely reason for the Court to pass on taking on the case:

> Williamson said requiring the affected taxpayers to sue in the Massachusetts courts would provide a record, and the Court could more easily make a decision instead of exercising original jurisdiction and having to start from scratch.
>
> …
>
> "As the Supreme Court does, and probably should, they'll only take up an issue when they have to, and they didn't have to take this issue up today," Williamson said, suggesting that there may eventually be a better case for the Court to take up and address those issues.[35]

Certainly, the failure of the Court to take up this case doesn't mean they necessarily agree with Massachusetts on the merits of their position.

However, some advisors had hoped the Court might take up this case and deal with the broader concept of states that have "convenience of the employer" sourcing rules, such as the state of New York. Such rules generally source income to the state if the employee is providing services to an employer's location in the state and there is no reason an employer would require the employee to be in that other state had the employee not already been there.

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[34] Andrea Muse, "SCOTUS Won't Hear New Hampshire Remote Worker Tax Fight," *Tax Notes Today Federal*, June 29, 2021, https://www.taxnotes.com/tax-notes-today-federal/nonresident-taxation/scotus-wont-hear-new-hampshire-remote-worker-tax-fight/2021/06/29/76pwf (subscription required, retrieved June 29, 2021)

[35] Andrea Muse, "SCOTUS Won't Hear New Hampshire Remote Worker Tax Fight," *Tax Notes Today Federal*, June 29, 2021

EXAMPLE – LOCATED OUT OF STATE FOR THE CONVENIENCE OF THE EMPLOYER

Mary has taken a job with Employer Co, located in State B to sell product for the company in State C, a state located on the opposite coast of the country from State B. State B sources wage income based on a convenience of the employer rule. Mary's job includes meeting with customers at their location, providing in-person training and being available to provide in-person assistance should the customers run into problems with Employer Co.'s products.

The nature of the position Employer Co. has hired Mary to fill requires Mary to be located in State C. Thus, she is located in State C for the convenience of Employer Co. and her wages are not considered by State B to be sourced to State B, therefore she owes no tax to State B.

EXAMPLE – NOT LOCATED OUT OF STATE FOR THE CONVENIENCE OF THE EMPLOYER

Let us assume Employer Co. is in the business of preparing tax returns in State B and Mary, again located in State C, is hired to perform tax preparation services. Employer Co.'s clients are primarily located in State B. Mary's job is solely to initially prepare returns based on information provided to her electronically by Employer Co. and Employer Co.'s clients. While Mary does phone these clients to ask questions, she does not meet with the clients in person, nor do others performing a similar job for Employer Co. who work out of the company's offices in State B.

In this case, Employer Co. has no requirement that Mary be located in State C, and her job could just as easily be done in State B where Employer Co. is located. In this case, Mary performing services in State C is not for the convenience of the employer, but rather for her own convenience.

While only a minority of states have a variant of the convenience of the employer rule (with most located in the Northeast), the COVID-19 pandemic and the rethinking of tax nexus brought about by the *Wayfair* decision may see more states looking at using this option, especially if remote work continues to grow and employees locate in lower-tax jurisdictions.