Essential tax and wealth planning guide

2025 EDITION

Deloitte.

GET STARTED >

Welcome

DEAR READER,

As we approach the close of 2024, there are many tax issues on the horizon with the potential sunset of many of the individual provisions of the Tax Cut and Jobs Act of 2017 (TCJA, P.L. 115-97). While there may be an inclination to focus on what will come for tax policy, that does not mean that planning should wait. What you should be doing now to meet your tax goals is an important question that you should consider in the coming months, and Deloitte is prepared to provide perspectives for you to consider.

The **tax policy section** examines the impact of the recent federal election on the political landscape and guides you through tax legislative updates. Understanding shifting political agendas often requires frequent, timely touchpoints. Throughout the coming year, Deloitte's Tax Policy Group can deliver relevant updates to your inbox, providing you with information, news, and analysis to stay on top of the latest developments on Capitol Hill. Visit Tax News & Views for more information.

The **individual tax planning section** provides valuable insights on important tax issues related to the potential sunset of the TCJA that are likely to impact your planning goals. In these extraordinary times of change, it is vitally important to understand, analyze, and determine what steps are right for you. By breaking down complex topics and providing new perspectives, this section can help you with this in the coming weeks and months.

The **tax controversy section** provides considerations for navigating a heightened enforcement era. In today's complex and ever-evolving tax landscape, many high-net-worth individuals and their enterprises face increasing challenges that require careful navigation. This section will delve into the shifting dynamics of IRS examinations, explore the increased complexities introduced by recent legislative changes, and discuss leading practices that can help navigate these challenges.

As 2025 begins, Deloitte wants to provide you with perspectives to view what is on the horizon. To find a member of the Deloitte Private Wealth practice who specializes in your area of interest, please contact us at privatewealth@deloitte.com.

Regards,

Eric L. Johnson
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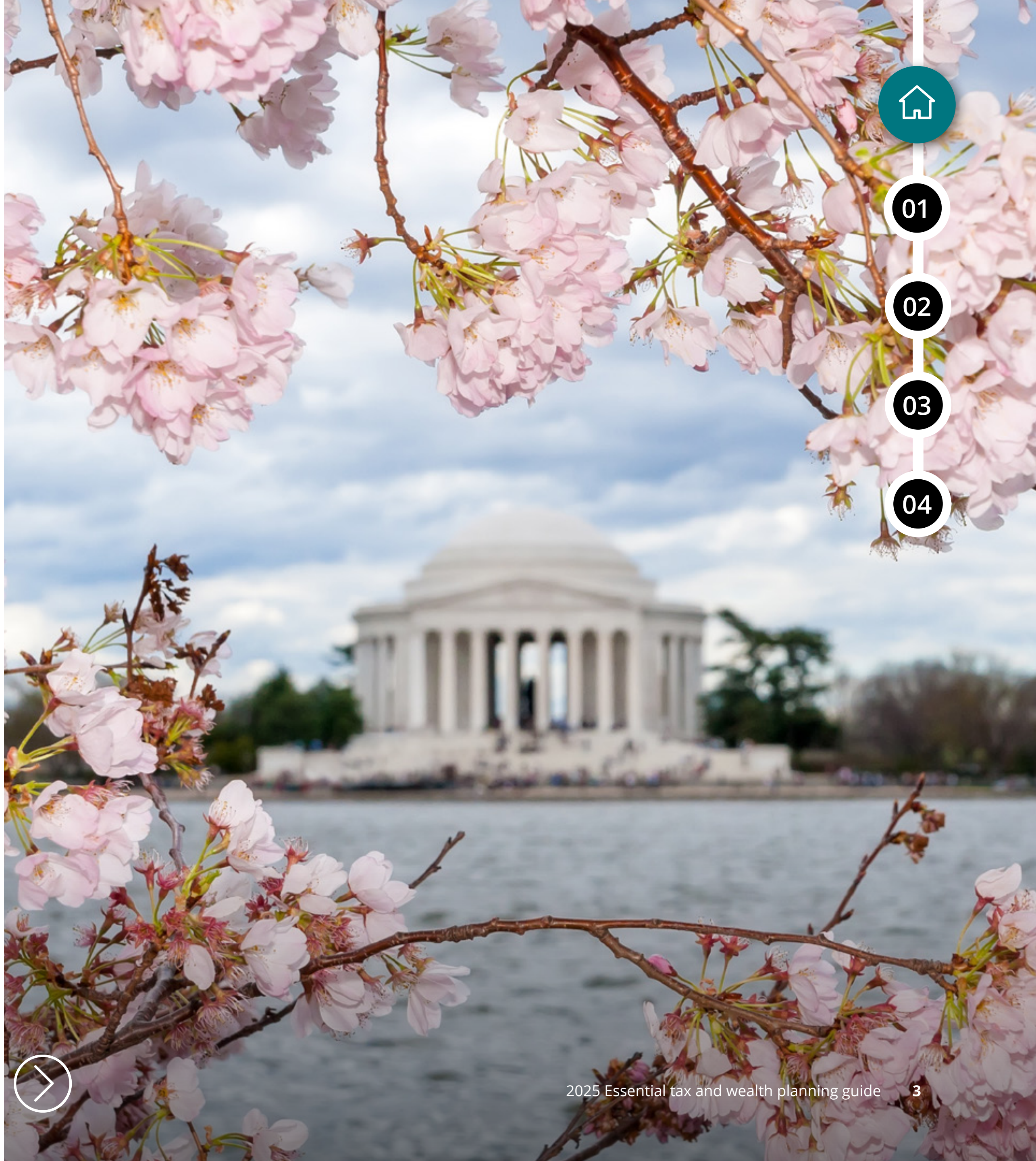
Deloitte Tax LLP

What's inside



01 Tax policy

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TAX POLICY

Implications of the 2024 election

The nation has voted and the results are now in: Donald Trump has been elected to serve as the forty-seventh president of the United States and will assume responsibility for the nation's fiscal policy beginning on January 20, 2025.

Tax policy's role in the campaign

Tax generally played a subordinate role during the election campaign, and when it did emerge as an issue, Trump and his Democratic challenger, Vice President Kamala Harris, presented their respective policy visions largely in broad strokes. One underlying component of the tax policy discussion was the future of the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97), the signature legislation of the first Trump administration that moved through a Republican-controlled Congress under fast-track budget reconciliation protections.

That law fundamentally changed the tax treatment of US-based multinationals, lowered corporate and personal tax rates, doubled the child tax credit, and broadened the tax base for both businesses and individuals.

The bulk of the TCJA's corporate changes are permanent law; however, because of long-term fiscal constraints baked into the budget reconciliation process—namely, that legislation moved under the special parliamentary procedure cannot increase the deficit in the years beyond the budget resolution that includes the underlying reconciliation instructions—Congress opted to make many of the provisions on the individual side of the tax code temporary, with sunset dates at the end of 2025.

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Among the more notable provisions scheduled to lapse are the reduced income tax rates for individuals, increased exemption amounts for the individual alternative minimum tax and the estate and gift tax, the doubled child tax credit, the increased standard deduction, and the 20% deduction for permanent passthrough business income. Lawmakers also included revenue-raising provisions with delayed effective dates, some of which have since come into effect, as well as other changes that will raise further revenue from multinational corporations and are scheduled to take effect after the end of next year.

All of this sets up the prospect of a massive fiscal cliff for former—and future—President Trump and the incoming 119th Congress as they grapple with how to address the pending expiration of marquee TCJA provisions. The nonpartisan Congressional Budget Office (CBO) **estimated** in May that the 10-year cost of permanently extending all of these provisions, as Trump has proposed, will come in at $4.6 trillion (including additional debt service costs). That represents a $1.1 trillion increase from similar projections the agency issued in 2023. Adding to the magnitude of the challenge ahead for the White House and Congress is the scheduled expiration next year of some significant temporary non-TCJA tax benefits, such as the new markets tax credit, the lookthrough rules for controlled foreign corporations in section 954(c)(6), and the enhanced tax premium tax credit for certain individuals who purchase health insurance on one of the Affordable Care Act exchanges.

Implications of the 2024 election

Trump's tax agenda

Trump has proposed long-term extensions of all of the TCJA's expiring tax cuts, so if his plan becomes law, taxpayers should expect to see key items such as their income tax rates and their AMT and estate tax exemptions continue at their current levels and for the 20% passthrough deduction to remain in place.

The former—and future—president's blanket TCJA extension includes one notable exception, however. In a move that took many by surprise, he announced during the campaign that he would allow the TCJA's $10,000 cap on the deduction for state and local taxes (SALT) to expire as scheduled at the end of 2025. Thus, the unlimited SALT deduction that had been in effect under prior law would be restored—a change that, if enacted, would be particularly beneficial to taxpayers who live in jurisdictions with high local income and property taxes.

Trump also has proposed to reduce the corporate tax rate to 15% for companies that manufacture their products in the US. (The TCJA permanently set the corporate tax rate at 21%.)

Beyond preserving the expiring TCJA tax cuts, Trump has proposed a series of tax relief measures targeted largely to less affluent taxpayers, including federal tax exemptions for tip income, overtime pay, and Social Security benefits, as well as new deductions for interest on automobile loan payments and for certain expenses associated with having a newborn child.

Implications of the 2024 election

TCJA extensions likely will require revenue raisers

As already noted, the nonpartisan CBO has estimated that extending all the expiring TCJA provisions, as Trump has proposed, would cost $4.6 trillion over 10 years (including additional debt service costs). And although official estimates are not yet available, his proposals to further reduce the corporate tax rate and provide additional tax cuts are likely to raise the overall cost of his tax plan even higher.

Given that reality, plus the CBO's increasingly gloomy long-term deficit outlook, there are growing calls within Congress for fiscal discipline, and even some lawmakers who previously had been averse to raising revenue to pay for tax cuts are beginning to acknowledge that the cost of extending the TCJA and enacting other tax relief next year may need to be at least partially offset with tax increases. House Ways and Means Committee Chairman Jason Smith appeared to open that door when he stated at a legislative seminar sponsored by BakerHostetler in May that there are Republican lawmakers who believe the corporate tax rate cut in 2017 may have been too deep, and who now may be willing to buck what has been regarded historically as GOP orthodoxy and consider an increase in the rate as a viable revenue raising option for a future tax bill.[1] It's worth noting that one GOP Senate taxwriter—Thom Tillis of North Carolina[2]—and one member of the conservative House Freedom Caucus—Chip Roy of Texas[3]—have since publicly stated that they would be open to a small corporate rate increase. It is unclear whether there is an appetite among congressional Republicans for raising revenue from individuals, either through tax increases or base-broadening provisions.

1. Cady Stanton. "Some House Republicans Want to Raise Corporate Rate, Smith Says," *Tax Notes*, May 9, 2024.
2. Joseph Zeballos-Roig. "Trump's idea to lower corporate tax rate draws more Republican skepticism," *Semafor*, Aug. 1, 2024.
3. Brian Faler. "Corporations face reversal of fortune as 2025 tax debate heats up," *Politico*, June 18, 2024.

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TAX POLICY

Implications of the 2024 election

How the new Congress may shape the agenda

President-elect Trump will come into office with a tax policy agenda, but writing tax legislation is the prerogative of Congress. Trump and congressional leaders will approach the tax policy debate with their own unique priorities and their own expectations regarding what an acceptable deal should look like, which means that at least some of his proposals could be revised—perhaps significantly—as they move through the legislative process.

Watchwords for taxpayers: Evaluate, model, plan

Despite uncertainty over the exact direction that future negotiations over tax policy may take, significant tax law changes—including corporate-focused revenue increases—remain a real possibility. It is not too early to start evaluating any proposals being put forward or any options that may have surface appeal, modeling potential outcomes, and planning the appropriate actions to take if and when these proposals go from high-level plans and talking points to fully framed legislative policies with substance, effective dates, and, presumably, anti-avoidance rules. Being nimble and not getting locked into any one theory of what will happen will be critical.

Find out more

Scaling the cliff: Tax policy implications of a Donald Trump presidency, a new publication from Deloitte Tax LLP, provides additional details on President-elect Trump's tax policy goals and how they may be shaped by a Republican-controlled House and Senate in the 119th Congress.

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Individual tax planning

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INDIVIDUAL TAX PLANNING

Planning for today with your eye on tomorrow

When the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) was enacted, it overhauled significant portions of the tax landscape, particularly for individuals and the companies in which they may invest. From an income tax perspective, the change in tax rates along with the shift for some to the standard deduction, may have fundamentally changed the tax planning issues on the table. Additionally, from a transfer tax perspective, the TCJA substantially increased the amount that could be transferred during lifetime or at death (known as the basic exclusion amount (BEA)) creating a window of opportunity for estate planning. However, as many of the provisions of the TCJA are scheduled to sunset at the end of 2025, and revert to back to prior law, it is important to broaden the lens on today's planning and ask important questions to understand the interconnected nature of these potential changes.

This section of the Guide poses a few important questions that may be applicable to achieving your goals in a tax efficient manner. Don't wait for what you may see on the horizon and lose opportunities to plan for today with your eye on tomorrow.

Planning for today with your eye on the horizon

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Basic overview of specific provisions of the TCJA

The TCJA ushered in several new provisions and, consequentially, new tax planning considerations. (For a more detailed background of the TCJA, please refer to the *2019 Essential Tax and Wealth Planning Guide: Individual Income Tax Planning*). You should consult your tax advisor to understand how particular changes may affect your planning. However, for purposes of the tax planning questions posed here, we will concentrate on the implication of a few specific provisions:

Lower overall rates: The TCJA maintained seven individual income tax brackets but shifted the thresholds for the upper brackets. It also reduced the highest tax bracket from the prior level of 39.6% to 37%. In 2025, the 37% tax bracket applies to single filers with taxable income over $626,350 and for married filing joint taxpayers with taxable income over $751,600. The changes to the individual income tax brackets and rates are scheduled to sunset. However, the lower corporate income tax rate of 21% under the TCJA is permanent.

The deduction for domestic qualified business income: To attempt to create parity with the lower corporate 21% corporate income tax rate, the TCJA created a new 20% deduction under Internal Revenue Code* section 199A for certain qualified income from passthrough entities for individuals, estates, and trusts. This provision is scheduled to sunset.

The business interest expense limitation: The TCJA imposed a new limitation on the deduction for business interest expense under section 163(j). Disallowed business interest deductions can be carried forward indefinitely. Certain trades or businesses are exempt from the business interest expense limitation, including those performing services as an employee, certain utility businesses, electing real property trades or businesses, and electing farming businesses. In addition, the limitation does not apply to “small businesses”—those with average gross receipts of less than $25 million over a three-year period. The new business interest expense limitation does not sunset.

* All references herein to “Code” or “section” refer to the Internal Revenue Code of 1986, as amended, unless otherwise specified.

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The excess business and net operating loss provisions: Under section 461(l), the TCJA provided that an excess business loss is not allowed in the current year and is carried forward and treated as a net operating loss (NOL) in subsequent years. While there are broader technical considerations, an excess business loss exists when a taxpayer's aggregate trade or business deductions exceeds the sum of the taxpayer's aggregate trade or business gross income and gain plus a threshold amount, which for 2025 is $313,000 (or $626,000 for a married filing joint return). This provision is eliminated for tax years beginning after December 31, 2028. Additionally, the TCJA altered the NOL ruleset such that, with limited exceptions, NOLs arising in tax years beginning after 2017 may only be carried forward (not back up to two years as under prior law) and NOLs may be carried forward indefinitely (as opposed to up to 20 years under prior law). This provision does not sunset.

The limitation on the state and local income tax deduction: One area of the TCJA that substantially altered planning from a deduction perspective was the limitation of the aggregate of nonbusiness (1) state and local property taxes, and (2) state and local income taxes (SALT) or sales taxes to only $10,000 ($5,000 for married taxpayers filing a separate return). In response to this limitation, many states adopted elective passthrough entity tax (PET) regimes where a passthrough entity elects to make state taxes a liability of the entity and thus pay, which would not be subject to the SALT cap. This limitation is scheduled to sunset.

Bonus depreciation: Under the TCJA, the 100% rate for bonus depreciation has been phasing down in annual increments of 20 percentage points since 2023. (A 60% rate is in effect for 2024, but will be reduced to 40% for 2025, 20% for 2026, and zero for property placed in service after December 31, 2026.) The TCJA also provides that research and development expenditures paid or incurred in taxable years beginning after December 31, 2021, are subject to capitalization over five years for research conducted within the US and 15 years for research conducted outside the US.

Planning for today with your eye on the horizon

A summary of these and a few other provisions relevant to our discussion is captured below:

	Current law	Upon sunset of the TCJA
Top ordinary income tax rate	37%	39.6%
Section 199A deduction	In affect	Eliminated
Bonus depreciation	Decreases 20% per year from 2023 until completely phased out for property placed in service after 12/31/2026	
Section 461(l) limitation	Applies to tax years beginning before 1/1/2029	Eliminated for tax years beginning after 12/31/2028
Charitable deduction	Cash gifts to public charity offset 60% of adjusted gross income (AGI)	Cash gifts to public charity offset 50% of adjusted gross income (AGI)
Limit on SALT deduction	$10,000	None
Mortgage limitation	$750,000 acquisition indebtedness	$1M acquisition indebtedness +$100,000 home equity
Miscellaneous deductions subject to the 2% floor	Eliminated	Reinstated
Overall limitation on itemized deductions	Eliminated	Reinstated
Standard deduction	2024 - $29,200 married filing joint/$14,600 single 2025 - $30,000 married filing joint/$15,000 single	Reverts to pre-TCJA amounts
Personal exemption	Eliminated	Reinstated

Planning for today with your eye on the horizon

Tax planning through the lens of potential change

With the potential for such broad change to the tax provisions affecting individuals and the entities in which they invest, several planning questions may arise that do not have simple answers. As you consider these questions, some of the factors may be either unknown or not within your control. For example, you may not be able to control the timing of income received, but you may be able to control the timing of a substantial charitable contribution. Regardless of the unknowns in either law or facts, it is important to remember that reviewing your personal tax situation broadly and committing to thoughtful tax planning today may provide a more tax efficient result.

Thus, as we consider the potential changes on the horizon, what are some of the questions that may be relevant to ask about planning today?

Planning for today with your eye on the horizon

Question 1:

Income from businesses that are held in a passthrough entity is passed out to the owners and thus subject to individual income tax rates. As noted above, the lower individual income tax rates under the TCJA may sunset and increase to prior rates. Therefore, the owner of a business held in a passthrough entity may ask, "Should I accelerate income before tax rates increase due to the potential sunset of the TCJA?"

Interconnectedness: Effect of accelerating ordinary income prior to sunset

Ordinary income

- Ordinary income taxed at lower rates
- More ordinary income creates less exposure for alternative minimum tax (AMT)—may be important for PET planning
- May create increased state tax liability. Although this may be helpful for PET planning, it may cause the PET deduction to possibly offset lower rate income
- May also increase net investment income (NII) or Self-Employed Contributions Act (SECA)

Deductions

- Increased income may allow for increase in the qualified business income deduction and increased adjusted taxable income (ATI), which may assist in avoiding the limitation on deducting business interest expenses
- But deductions may offset lower rate income
- Higher adjusted grow income (AGI) base provides opportunity for increased amount of charitable contributions at a 60% AGI limitation
- Be mindful of what character of income would be offset by controllable deductions
- Increased income may allow for PET planning

Other considerations

- Accelerating income may cause implications for deducting excess business losses in future years
- Cash flow implications
- Large asset acquisitions (e.g., an airplane)
- Market conditions
- Interest rate environment

Planning for today with your eye on the horizon

Question 2:

Many tax and non-tax reasons affect the decision about what type of entity should be used for a closely held business. Considering the potential for change in some of the relevant tax factors, how does that affect the overall decision regarding the choice of entity to use?

Choice of entity and addressing entity conversion considerations: Key provisions to consider

Considering the potential for many changes if the TCJA sunsets, if you have an existing buiness venture or are contemplating a new one, then you may be motivated to reconsider the structure of the business. However, it is important to think through a wide variety of consequences, including the tax consequences, before making a conversion.

Consider, for example:

- the entity's likely future distributions policy,
- the likelihood and potential timing of a sales transaction as the exit strategy, and
- whether such a sale is likely to be an asset sale or a sale of an equity interest

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Sample considerations for analyzing a conversion from passthrough to C corporation:

- Annual distributions—now and into the future
- Qualification for section 199A deduction
  - o US-sourced vs. non-US sourced income
  - o Qualified Business Income (QBI)
- Character of income recognized
  - o Long term capital gains and qualified dividends
  - o Section 212 portfolio deductions
- Owners of the company
- Growth of the business assets vs. growth of cash distributed
- Section 351 considerations
- International considerations
  - o Structure
  - o Foreign tax credit planning
  - o Certain gain recognition provisions such as overall foreign loss recapture and section 367
  - o Impact on dual consolidated loss rules
- Potential future changes in tax law
- Carryforward attributes of partners
- Accumulated adjustments account distribution planning for terminated S corporations
- Estate planning
- Implications of section 7519 payments for fiscal year filers
- Exit strategy considerations
  - o Sale of partnership interest
  - o Stock vs. asset deal of coproration
  - o Holding period upon exit
  - o Purchase price considerations
- State tax implications
  - o State sourcing and income tax rates
  - o Investment partnership rules
  - o Compliance costs
  - o State tax footprint of the entity
  - o State tax footprint of the owners

Planning for today with your eye on the horizon

Question 3:

Similarly, when a closely held business considers the purchase of a large asset, there are also significant tax and non-tax aspects that may affect the decision. For example, from a tax perspective, part of the TCJA includes a phaseout of bonus depreciation. What are some other factors that could be considered?

Planning considerations around timing for large asset acquisitions

When planning for a large asset acquisition, consider:

- Which taxpayer could acquire the asset
- Implications of placed-in-service date on bonus depreciation
- Whether the deduction will offset higher or lower rate income
- Timing of the expense may create issues. For example:
  - Whether a section 461(l) limitation is created due to the expensing of a large asset acquisition
  - Understanding when the loss will be allowed and what income it will offset
  - Impact on the section 199A deduction
  - If planning to finance the acquisition, recognize impact of higher interest rate environment
  - Whether the additional expense will cause section 163(j) limitations
  - Reducing taxable income with a large asset acquisition could negatively impact PET planning

Planning for today with your eye on the horizon

Question 4:

The TCJA affected individual taxpayers in ways that went beyond just tax rates. It also affected various deductions, including the substantial increase of the standard deduction. For those who still itemize, charitable donations may be the largest controllable deduction. Given that tax rates might increase in the future, should individuals consider delaying their charitable contributions to potentially offset higher rate income?

Interconnectedness: Effect of delaying a large charitable contribution

Offsetting income

- Even if tax rates increase, it is possible that a deduction prior to the increase could be more valuable than a deduction after rates increase
- What type of income will be offset and at what rate?
- Does this negatively affect a qualified business income deduction due to the "overall limitation?"

Issues affecting deduction

- Sunset of 60% AGI limitation
- Type of entity (public charity, private foundation, other) to which the type of asset (cash, long term capital gains, short term capital gains, tangible personal property, etc.) is donated
- Giving during lifetime versus through estate
- Charitable contribution carryover

Other

- Phaseout of itemized deductions
- Effect of market conditions for asset being donated
- Model the tax implications of the donation

Planning for today with your eye on the horizon

Question 5:

For those individuals who own a passthrough entity that previously elected to participate in state PET planning, the sunset of the limitation on the SALT deduction could affect both individual owners and the entities. Therefore, one may ask, "If the SALT cap is repealed, then would PET planning still be relevant?"

Interconnectedness: Planning for the PET

Tax effect

- Even with an environment where SALT would be deductible in full, PET may be more beneficial since it is effective at mitigating AMT tax implications
- Recall the AMT exposure that existed prior to the TCJA

Future of PET

- State SALT regimes differ: some sunset with the TCJA and some do not
- What changes to PET environment could occur as Congress addresses SALT legislation

Other

- Will regulations be issued, as stated in Notice 2020-75?
- Will we see an enviroment that allows for an increased SALT deduction as well as PET—or would an increased SALT deduction cause re-evaluation of the PET regime?

INDIVIDUAL TAX PLANNING

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Question 6:

Finally, in *Accessing your wealth transfer legacy in 2024*, we addressed that, for estate and gift tax planning purposes, the excess of the individual's assets owned or controlled at death over the BEA in effect at the individual's date of death (currently $13.61 million in 2024 and increasing to $13.99 million in 2025) will be subject to a 40-percent tax. Absent legislative action, this enhanced BEA reverts to $5 million (adjusted for inflation) in tax year 2026. Therefore, planning strategies may be identified to utilize the temporarily enhanced exemption. What are some of the factors that you could consider when contemplating a wealth transfer?

Interconnectedness: Effect of TCJA sunset on transfer tax planning

Step 1

- Consider what your goals are for making the transfer. Concern that the basic exclusion amount will later be diminished is an insufficient reason, by itself, for engaging in tax planning
- In order to make a completed gift for tax purposes, the donor must relinquish dominion and control over the transferred property

Step 2

- The enhanced BEA for 2025 is $13,990,000 per taxpayer, or $27,980,000 for a married couple
- Begin by calculating the remaining enhanced BEA available to make gifts prior to sunset. Any excess enhanced BEA that is not utilized by the end of 2025 may be lost

Other

- Consider other options for transfer tax planning in addition to utilizing the enhanced BEA
- Consider planning with trusts

Planning for today with your eye on the horizon

Question 7:

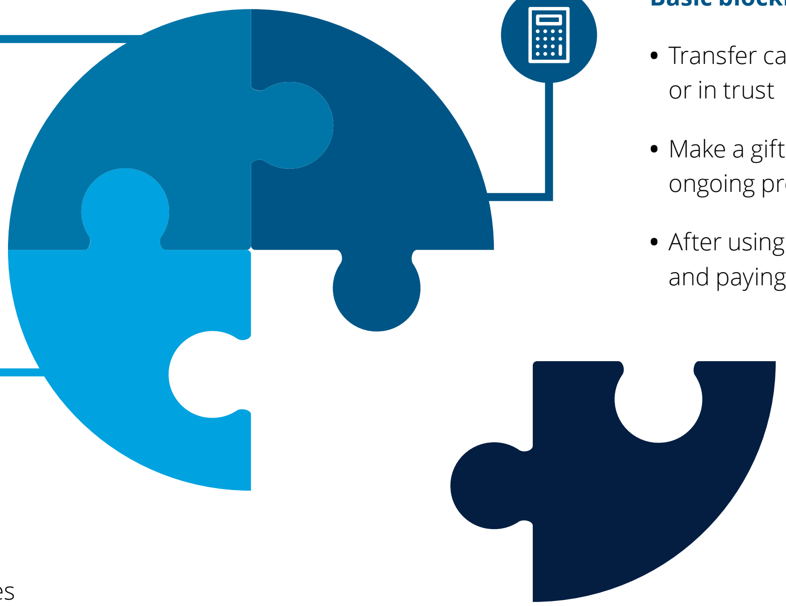
For those who may be interested in transfer tax planning, one question may be, "What transfer tax strategies can I employ to utilize my enhanced BEA prior to the expected sunset?"

Tune up prior planning

- Evaluate intrafamily debt
- Analyze family limited partnerships (FLPs)
- Evaluate potential opportunities for late allocation of GST tax exemption

Enhance generational wealth

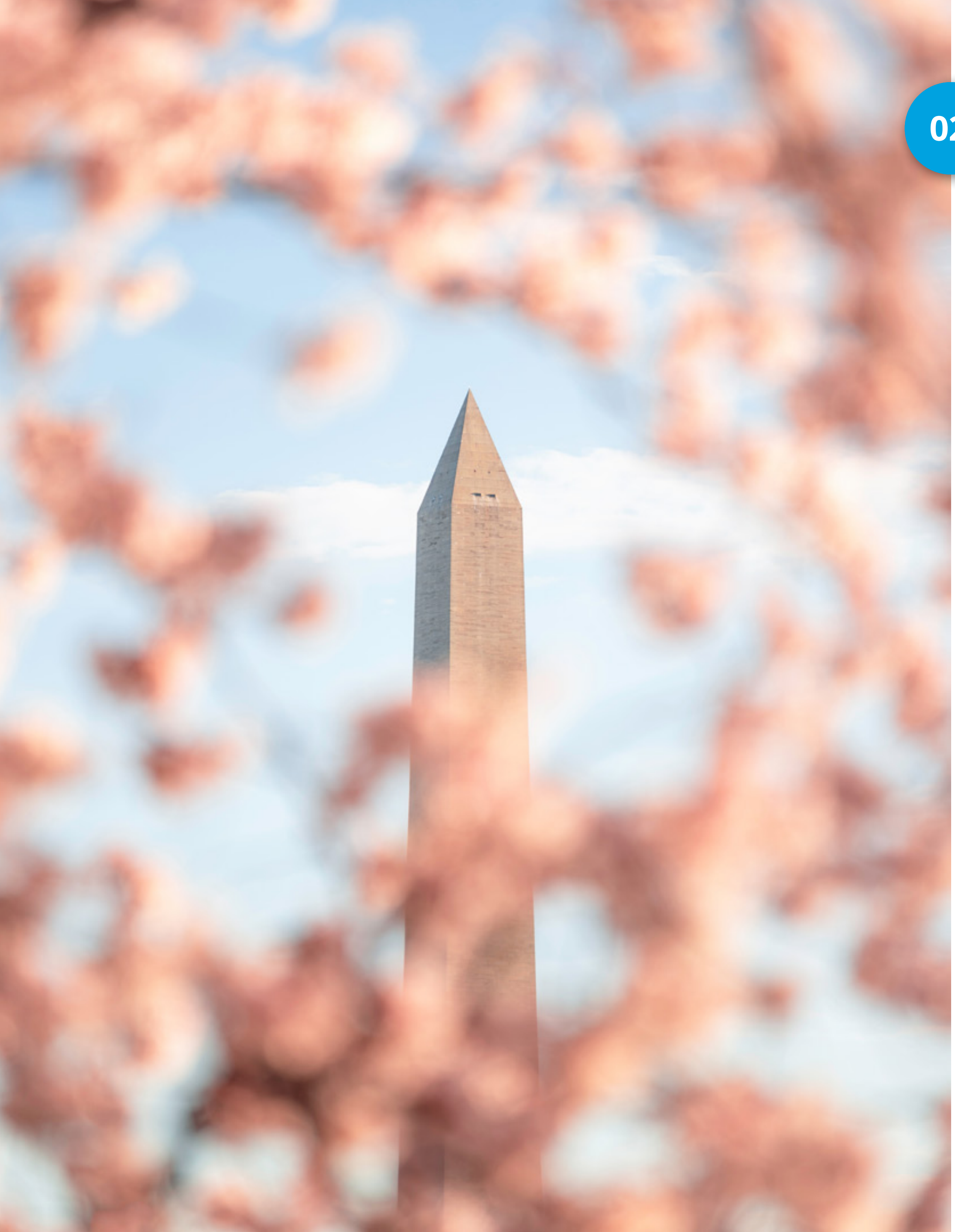
- Use dynasty trusts to transfer assets to children and more remote descendants
- Combine gifts to these trusts with leveraged sales
- Grantor type trusts are efficient estate planning vehicles



Basic blocking and tackling

- Transfer cash or marketable securities outright or in trust
- Make a gift to a life insurance trust to fund ongoing premiums
- After using the BEA, consider making taxable gifts and paying gift tax

Caution: Know the citizenship and domicile status of individual donors, trustees and trust beneficiaries. Additional planning considerations apply for non-US persons.



INDIVIDUAL TAX PLANNING

Planning for today with your eye on the horizon

Keeping your goals front and center

Hopefully the examination of these questions has painted a broader vision for you of why planning for your income and transfer tax planning goals is so important. Your peripheral view may include glimpses of change in areas such as tax rates or applicable deductions, but don’t let that cloud your vision of what should be considered relevant today. Your current goals and objectives need to be front and center. Consider what is in plain view, because those distractions may turn out to be very costly. By concentrating your view on planning opportunities that are available to you today with an eye towards tomorrow, you may realize a more tax-efficient result for you and your family.

03 Tax controversy

TAX CONTROVERSY

Navigating a heightened enforcement era

In today's complex and ever-evolving tax landscape, many high-net-worth individuals and their enterprises face increasing challenges that require careful navigation. With an increasing budget, the Internal Revenue Service (IRS) has significantly expanded its hiring and enforcement efforts.

The IRS's evolving audit approach involves larger teams of revenue agents and specialists, more expansive document requests, and analysis from artificial intelligence, machine learning and data analytics. The stakes can be high for those unprepared to meet intensified scrutiny from both the IRS and state tax authorities.

Historically, some taxpayers may have approached controversy with a reactive mindset, addressing issues only as they arose during an audit. Today, proactive planning from the onset is not just advisable but essential. Proactive planning can place taxpayers in a stronger position should an examination occur, mitigating risks and potentially avoiding disputes altogether.

By adopting a strategic approach to tax controversy, taxpayers can effectively manage their obligations and protect their interests. In this chapter, we will delve into the shifting dynamics of IRS examinations, explore the increased complexities introduced by recent legislative changes, and discuss leading practices that can help navigate these challenges.

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Navigating a heightened enforcement era

The IRS's focus on high-net-worth individuals and their related enterprises

The IRS has had a long-standing focus on high-net-worth individuals and their related enterprises, going back at least to the creation of the Global High Wealth (GHW) Audit Program in 2009. Tax gap studies (the estimated difference between taxes paid and taxes owed) show that high-net-worth individuals are the largest contributors to the tax gap.

Several additional factors have contributed to a heightened focus, including the increased budget from the Inflation Reduction Act, which enabled the IRS to hire and allocate more resources to this effort. Notably, the IRS has announced a plan to increase the size of the GHW program.

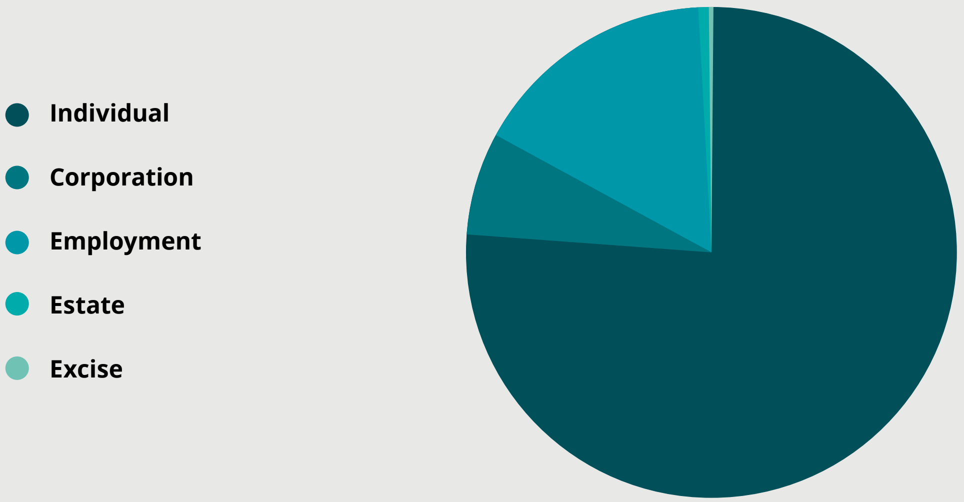
Public awareness of tax equity issues has also grown, and the Bipartisan Budget Act of 2015 (BBA) audit regime has impacted the examination process for related enterprises, making it easier for the IRS to conduct audits of an individual's broader enterprise. These elements collectively underscore the IRS's strategic emphasis on ensuring high-net-worth individuals meet their tax obligations.

These strategic priorities are supported by significant funding increases, as detailed in the following section.

"The IRS will increase audit rates by more than 50% on wealthy individual taxpayers with total positive income over $10 million."

IR-2024-130, May 2, 2024

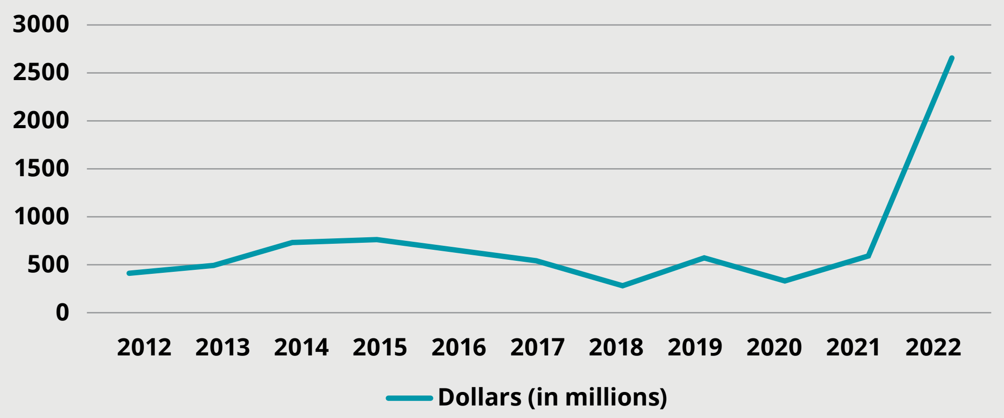
Share of gross tax gap (2021)



Source: Publication 5869 (10-2023) (irs.gov)

Navigating a heightened enforcement era

IRS total assessed additional tax (in millions) for audits of taxpayers w/ $10 million+ of total positive income (as of June 2023)



[GAO-24-106112, TAX COMPLIANCE: Opportunities Exist to Improve IRS High-Income/High-Wealth Audits]

IRS enforcement funding: Boosted by the Inflation Reduction Act and poised to surge

The Inflation Reduction Act (IRA) allocated nearly $80 billion in supplemental funding to the IRS, with $45.6 billion earmarked for enforcement activities aimed at curbing tax evasion among high-net-worth individuals and their enterprises.[4]

As of the IRS's 2023 fiscal year-end, the IRS spent $299 million of this enforcement allocation (less than 1% of the total earmark).[5] However, there was approximately a six-fold increase (from $619 million to $2.6706 billion) to total collections for the highest-income taxpayers (see chart).

The Fiscal Responsibility Act of 2023 reduced the amounts earmarked for enforcement, but despite this, the IRS projects that increased enforcement funding could boost revenue significantly over the next decade.[6]

"[A] sweeping, historic effort to restore fairness in tax compliance by shifting more attention onto high-income earners, partnerships, large corporations…"

IR-2023-186, Sept. 8, 2023

4. Brendan McDermott. "IRS-Related Funding in the Inflation Reduction Act," Congressional Research Service, October 20, 2022.
5. "Quarterly Snapshot: The IRS's Inflation Reduction Act Spending Through September 30, 2023," Treasury Inspector General for Tax Administration, January 29, 2024.
6. Department of the Treasury. "Return on Investment: Re-Examining Revenue Estimates for IRS Funding," International Revenue Service, February 2024.

TAX CONTROVERSY

Navigating a heightened enforcement era

To date, the IRS has primarily used Inflation Reduction Act (IRA) funds to enhance taxpayer services (e.g., call centers, tax return processing). However, according to the strategic operating plan, a significant shift towards increased enforcement activity is planned.[7] This shift will see a substantial acceleration in the increasing of resources allocated to hiring enforcement personnel in the coming years; see the chart for planned full-time equivalents in enforcement.

Average recommended tax per audit hour, fiscal year 2022, for taxpayers with total positive income of $10 million or more:

$13,011

Table 12 - [GAO-24-106112, TAX COMPLIANCE: Opportunities Exist to Improve IRS High-Income/High-Wealth Audits]

Table 4: Estimated FTE funded with IRA through FY 2031

Appropriation	FY22 Actual	FY23 Actual	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31
Taxpayer Services		10,518	7,279	12,562						
Enforcement		495	4,088	7,239	17,300	24,100	31,900	33,000		
Operations Support		2,317	2,944	3,808	5,000	4,900	5,300	5,500	3,600	
BSM		327	193	300						
Energy Security			1,810	1,810	1,400					
Direct File Study		4								
IRA Funded FTE	**0**	**13,661**	**16,314**	**25,719**	**23,700**	**29,000**	**37,200**	**38,500**	**3,600**	
Discretionary/Other FTE	**79,070**	**69,329**	**72,097**	**64,008**	**64,000**	**64,000**	**64,000**	**64,000**	**64,000**	**64,000**
Total FTE	**79,070**	**82,990**	**88,411**	**89,727**	**87,700**	**93,000**	**101,200**	**102,500**	**67,600**	**64,000**

[Publication 3744-A (Rev.4-2024) (irs.gov)]

7. "Quarterly Snapshot: The IRS's Inflation Reduction Act Spending Through September 30, 2023," Treasury Inspector General for Tax Administration, January 29, 2024.

Navigating a heightened enforcement era

IRS service center operations

The IRS's service centers continue to play a crucial role in its operations. In recent years, their operations have seen both significant improvements and ongoing challenges. The Government Accountability Office (GAO) reported that the backlog of unprocessed correspondence, including amended returns, reached high levels by the end of the 2023 filing season.[8]

However, the IRS has made strides in reducing call wait times, achieving an average of three minutes for the 2024 filing season.[9] The agency also reported an 88 percent level of phone service, a substantial improvement from previous years.[9] The IRS has also hired 5,000 additional employees to enhance customer service,[10] though this rapid hiring has coincided with an increase in return processing errors.[11] The identity theft resolution service remains backlogged, with an average resolution time of 19 months and approximately 484,000 cases awaiting processing by the end of fiscal 2023.[12]

Leading practices:

- Retain proof of mailing for extensions, payments, returns
- E-file & electronically pay where possible
- Monitor tax accounts with transcripts
- Consider responding to notices with a written & phone response
- Review interest computations
- Understand electronic signature rules

8. Jessica Lucas-Judy. "IRS Improved Customer Service, but Could Further Improve Processing and Evaluate Expedited Hiring," United States Government Accountability Office, January 2024.
9. "IRS delivers strong 2024 tax filing season; expands services for millions of people on phones, in-person and online with expanded funding," IRS, April 15, 2024.
10. "IRS sets January 23 as official start to 2023 tax filing season; more help available for taxpayers this year," IRS, January 12, 2023.
11. "National Taxpayer Advocate issues mid-year report to Congress; highlights filing season challenges and focuses on strategic priorities," Taxpayer Advocate Service, June 26, 2024.
12. Department of the Treasury. "IRA Strategic Operating Plan: Annual Update Supplement," IRS, 2024.

Navigating a heightened enforcement era

Despite these challenges, the IRS has reduced the average processing time for Form 1040 paper returns from 51 days in 2022 to just eight days in 2023.[13] Initiatives like the Paperless Processing Initiative and updates to the "Where's My Refund?" tool have further improved taxpayer services. Digital services have also expanded, allowing more types of notices to be responded to online, streamlining processes and reducing administrative burdens.[14]

In addition to these operational improvements, the IRS is leveraging advanced technologies like artificial intelligence to enhance its enforcement capabilities.

Enforcement of related passthrough entities

The IRS has significantly increased its focus on the enforcement of passthrough entities, particularly through the Bipartisan Budget Act of 2015 (BBA) audit regime. This regime streamlines the audit process for partnerships and other passthrough entities. The IRS is intensifying its focus on passthrough entities through new initiatives, campaigns, and increased hiring. For example, the IRS introduced a large partnership compliance program and stood up a special work unit to focus on large or complex pass-through entities. The IRS has ongoing campaigns including SECA taxes for LPs, sales of partnership interests, and non-filing partnerships.

Areas of focus

- sales of partnership interest,
- syndicated conservation easements,
- noncash charitable contribution arrangements,
- negative tax basis capital account reporting issues,
- disguised sales,
- SECA taxes for LPs,
- special allocations (e.g., stuffing allocations) and targeted allocations, and
- related party basis shifting transactions.

Global high-wealth audits start with an individual taxpayer and can expand out to any connected tax return, even if the taxpayer doesn't have a direct ownership interest.

13. Jessica Lucas-Judy. "IRS Improved Customer Service, but Could Further Improve Processing and Evaluate Expedited Hiring," United States Government Accountability Office, January 2024.
14. Department of the Treasury. "IRA Strategic Operating Plan: Annual Update Supplement," IRS, 2024.

Navigating a heightened enforcement era

Furthermore, partnership audits may intersect with gift and estate issues in areas such as:

- gifting being taxable to an extent when partnerships have liabilities,
- section 2036, and
- partnership asset basis adjustments upon death.

Other considerations of the BBA audit regime?

Bipartisan Budget Act of 2015 (BBA) partnerships are now required to address adjustments at the partnership level unless they choose to push these adjustments out to their partners. This change means that partnerships can no longer amend prior year tax returns but must file adjustments within a specified timeframe. These adjustments, once pushed out, affect partners' tax liabilities and attributes, requiring recalculations for reviewed and intervening years.

TAX CONTROVERSY

Navigating a heightened enforcement era

Form 8978 serves as a crucial tool in this process, functioning like a pro forma amended return included within the partner's income tax return. It requires detailed recalculations and adjustments, with potential penalties and interest implications for partners. Similarly, Form 8986 must be meticulously managed, with strict deadlines and potential penalties for non-compliance.

Strategic planning and coordination is important to mitigate risks such as stranded overpayments and imputed underpayments. By adopting leading practices, partnerships and their partners can effectively navigate the complexities introduced by the BBA, enabling partnerships and their partners to be well-prepared to meet intensified scrutiny from the IRS and state tax authorities.

Upon receipt of Form 8986

- **Is the Form 8986 completed correctly?**
- **Has partner already accounted for adjustment?**
- **Calendar when need to push out**
- **Evaluate the ultimate taxpaying partner**

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TAX CONTROVERSY

Audit readiness

As we've discussed, taxpayers are facing heightened scrutiny from revenue authorities around the world. Authorities seek greater transparency and what they believe to be their jurisdiction's fair share of the tax pie, and they are using increasingly sophisticated technology and techniques to enforce tax laws and regulations.

In such an environment, a prudent step for taxpayers is to identify and prepare for potential examination risks, understand changing examination procedures and navigate dispute resolution alternatives available to them, if needed. Taxpayers should proactively incorporate such practices into their tax planning and compliance processes. For example, many financial decisions, transactions and events can trigger revenue authority scrutiny. Proactive planning is important both to document the related tax positions and a strategy for defending them.

By conducting a periodic risk assessment, taxpayers can be effectively prepared for a tax examination if one takes place. Such risk assessments can range from a simple discussion with internal advisors to a detailed examination readiness assessment that includes document analysis, interviews, and other data gathering.

The assessment can help taxpayers identify and quantify potential issues that may be a focus of an examination. In addition, it can help taxpayers develop and maintain a system for handling information requests that may be received from revenue authorities.

In this section, we will identify issues which may become a focus on examination, discuss what risk assessments could look like and recommend how taxpayers can prepare for examination of these issues.

TAX CONTROVERSY
Audit readiness

Important considerations

Recognizing and identifying issues that can become the focus of examinations is critical, as is preparing for examination of these issues. Accordingly, there are specific areas of interest that revenue authorities tend to target more commonly. Some topics of interest include:

IRC § 183 hobby

The IRS frequently investigates hobby potential for Schedule C businesses (sole proprietorships) that generate consistent losses. Examinations related to hobby loss focus on the setup of the entity in question. Taxpayers should operate the business with the intention to make a profit. Evidence of that may include having a business plan in place, consulting experts, separate books and records for the activity, and a business bank account to name a few. It's important that the taxpayer treats the activity like a business in all facets, with a clear intent to make a profit.

Sports teams

Sports teams are often examined by revenue authorities, with a particular emphasis on basis. The IRS has a campaign specifically to identity partnerships within the sports industry that report large losses. The purpose of the campaign is to ensure that the income and deductions creating the losses are properly reported per the Internal Revenue Code. Additional topics that are commonly examined are deferred compensation and fringe benefits, amortization of player contracts, depreciation, broadcasting rights and revenue, as well as multistate tax issues.

TAX CONTROVERSY

Audit readiness

Artwork

In anticipation of an examination which focuses on art valuation, it is prudent to have a system in place to manage artwork inventory, specifically if the art is part of an estate plan or if it is to be gifted. Important documentation to retain includes appraisals, condition reports, provenance, insurance policies and high-definition photographs. This documentation may be requested by the IRS's Art Appraisal Services and the Art Advisory Panel.

Charitable contributions

Taxpayers should retain contemporaneous written acknowledgement letters for all charitable contributions made, including the "no goods or services" language if applicable. Also important is maintaining qualified appraisals and working with an appraiser who is knowledgeable of the rules. If a taxpayer has charitable contribution carryovers, the IRS may ask for support of contributions made in prior years. Another leading practice is to be mindful of charitable contributions made prior to realization events, which could be viewed by revenue authorities as subject to claw back under the assignment of income doctrine.

TAX CONTROVERSY

Audit readiness

Basis

Basis is a key issue for many of the IRS's campaigns, like sales of partnership interests, losses in excess of basis, and distributions in excess of basis. However, basis can be difficult to substantiate when the relevant interest was acquired years or even decades in the past. A leading practice is to maintain an updated basis schedule as well as to retain underlying support for the schedule, such as Schedules K-1 from partnership interests as well as wire transfers, cancelled checks, or bank confirmations for any capital contributions. If the entity has document retention policies in place, basis records often necessitate a separate retention policy, until a number of years after the interest is disposed of.

Aircraft

The IRS introduced a Business Aircraft Campaign in February 2024, but aircraft has been a significant focus for an extended period. A leading practice is to keep detailed flight logs of all business flights, including classification of the passengers on board, the purpose of each person's travel, the location(s) of travel, and what events took place at each destination, along with support.

Real estate professional

Taxpayers should be aware that claiming status as a real estate professional on a tax return may be reviewed by the IRS. A leading practice is to keep detailed records of hours spent as a real estate professional, including a calendar of all related work, a mileage log, and travel records if applicable. If the taxpayer has any professional licenses in the field or attends any professional conferences related to their work as a real estate professional, those items should be documented as well.

TAX CONTROVERSY

Audit readiness

Investment interest expense

It is essential to establish systems that trace loan proceeds directly to individual investments. Given the fungibility of cash, tracing funds from a loan into a central bank account and subsequently to specific investments can be challenging.

Passive/non-passive determinations

If an individual is considered non-passive under one of the hours-based tests of IRC 469, then a leading practice is to proactively keep a calendar or other log of working hours should an examination arise. Other tracking methods may be instituted, such as keeping track of badge swipe data or other location data. Reconstructing these records during an examination can be exceedingly time-consuming and challenging.

Residency

In recent years, as high-net-worth individuals have relocated more frequently, state tax authorities have intensified their enforcement of residency examinations, which can be fact-intensive and intrusive. A leading practice for those who are considering a move is to keep robust records of their change of residency. This can include keeping a detailed calendar of their whereabouts during the year of re-location. This is particularly important if the individual split time between two states throughout the year.

Audit readiness

Family office

A taxing authority's examination and challenge of a high-net-worth individual's or entity's tax position could affect a family office in several ways. The family office, itself, could come under exam, or an individual or entity whose affairs the family office manages could be subject to such a review. As previously discussed, IRS examinations have the potential to initiate audits in one area, which may subsequently lead to the examination of other related entities and/or individuals.

As a result, family offices not only may face a higher probability of involvement in a tax controversy, they may encounter a lengthier and more complex examination process, as well. Regardless of whether the involvement pertains to a simple inquiry or an extended examination, responses must be timely and executed with meticulous care.

While virtually any issue could prompt a tax controversy, the IRS does enhance its focus on certain issues from time to time. Recent areas of focus that may impact the operations of a family office include foreign tax credits, reasonable compensation, transfer pricing issues, research credits, and information reporting, particularly concerning foreign accounts and interests.

Some important considerations to contemplate in preparing for the possibility of an examination are:

- if the family office receives management fees, how are the fees determined and are they supported by legal contracts,
- understanding recent case law and analyzing the potential impact for your family office structure, and
- if the family office provides centralized employees for a number of legal entities, are there contracts between the entities setting forth the reimbursement computation and are invoices being issued.

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TAX CONTROVERSY

Audit readiness

Final thoughts

High-net-worth individuals and their related enterprises face increasing challenges in today's tax landscape. The IRS has expanded its capabilities, using advanced technologies for more rigorous examinations, making proactive planning essential.

The heightened enforcement era underscores the importance of adopting leading practices in tax planning and compliance. Implementing robust internal controls, meticulous document retention, and periodic risk assessments are crucial for mitigating risks. Staying informed about IRS examination dynamics and recent legislative changes is vital.

A strategic approach to tax controversy is necessary. By equipping themselves with the right knowledge and strategies, high-net-worth individuals and their related enterprises can effectively manage tax obligations and safeguard their financial interests.

For more information on Deloitte's tax controversy services, visit
[Tax Controversy Services | Deloitte US]

04 Resources

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05

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