



**Lally & Co.**

CPAs and Business Advisors

# The EVERGREEN

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## Fall 2022 – Volume XXXVIII

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### The Evergreen. Always Growing.

Like the evergreen tree, Lally & Co. is always growing. With the support and loyalty of our clients and friends we have grown into a firm of 51 individuals serving clients in many diverse fields. Our growth gives us the ability to better serve our clients and provide effective solutions to their needs. If you have questions about your business or personal tax situation, please contact us. We welcome your call and are always looking for ways to better serve you.

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Contact our office or visit our website for more information.

**412.367.8190**

## Dear Clients and Friends,

We are excited to share with you that this summer we extended our office lease and will continue to be a part of the McCandless community for at least seven more years. As a growing firm, we have not only kept our current space, but expanded our footprint at 5700 Corporate Drive and completely refreshed the existing office. We are excited for the next seven years and encourage you to stop in for a visit; we'll be more than happy to give you a grand tour!

As you read through *The Evergreen*, please do not hesitate to contact us if you have questions regarding an article or regarding your business or personal tax situation. We would be happy to hear from you! This and past issues of *The Evergreen* are available on our website at <http://lallycpas.com/newsletters/>.

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### IRS Completing Processing on Original Tax Returns Filed in 2021, IR-2022-128

The IRS announced that is completing the processing on a key group of individual tax returns filed during 2021. Business paper returns filed in 2021 will follow shortly afterwards. The Service began 2022 with a larger than usual inventory of paper tax returns and correspondence filed during 2021 due to the pandemic. The IRS will continue to work on the few remaining 2021 individual tax returns that have processing issues or require additional information from the taxpayer. As of June 2022, the IRS had processed over 4.5 million individual paper tax returns received in 2021.

To date, more than twice as many returns await processing compared to a typical year at this point in the calendar year.

A greater percentage of this year's inventory awaiting processing is comprised of original returns that, generally, take less time to process than amended returns. To address the unprocessed inventory by the end of this year, the IRS has taken aggressive steps including significant, ongoing overtime for staff throughout 2022, creating special teams of employees focused solely on processing aged inventory and expediting hiring of thousands of new workers and contractors. Additionally, the IRS has improved the process for taxpayers whose paper and electronically filed returns were suspended during processing for manual review and correction.

Filing sooner avoids potential delays for taxpayers and assists the larger ongoing IRS efforts to complete processing tax returns this year.

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## **IRS Urges Business Owners to Take Advantage of Tax Benefits for 2022**

During the National Small Business Week, May 1 to 7, the IRS highlighted tax benefits and resources tied to the theme for this year's celebration: "Building a Better America through Entrepreneurship." The IRS urged business taxpayers to take advantage of tax benefits for 2022, make estimated tax payments electronically, e-file payroll tax returns, and check out the Work Opportunity Credit.

### **Tax Benefits**

The IRS urged business taxpayers to begin planning now to take advantage of the enhanced 100 percent deduction for business meals and other tax benefits available to them when filing their 2022 income tax return. For 2021 and 2022 only, businesses can generally deduct the full cost of business-related food and beverages purchased from a restaurant. Further, more information about this provision is provided in IRS Publication 463, Travel, Gift, and Car Expenses.

Additionally, many business owners may qualify for the home office deduction, also known as the deduction for business use of a home. Usually, a business owner must use a room or other identifiable portion of the home exclusively for business on a regular basis. Those eligible can figure the

deduction using either the regular method or the simplified method. To choose the regular method, taxpayers can fill out and attach Form 8829, Expenses for Business Use of Your Home. Alternatively, business owners can choose the simplified method, based on a six-line worksheet found in the instructions to Schedule C, Profit or Loss from Business. Under both the regular and simplified methods, business expenses in excess of the gross income limitation are not deductible.

Further, the IRS informed taxpayers about a variety of other tax benefits often available to business owners. This includes business start-up expenses, qualified business income deduction and the health insurance deduction for self-employed individuals. Information about these, and other tax benefits, is provided in Publication 535, Business Expenses.

### **Making Estimated Tax Payments Electronically**

The IRS reminded all businesses to make estimated tax payments quarterly and that making them electronically is fast, easy and safe. Estimated tax is used to pay income tax and other taxes including self-employment tax and alternative minimum tax. If a taxpayer doesn't pay enough tax through withholding and estimated tax payments, they may be charged a penalty. However, generally, paying quarterly estimated taxes will lessen or even eliminate any penalties.

Further, the IRS reminded individuals, including sole proprietors, partners and S corporation shareholders, that they must generally make estimated tax payments if they expect to owe tax of \$1,000 or more when their return is filed (for corporations, the threshold is \$500 or more). Self-employed individuals and gig workers who also receive salaries and wages from an employer can avoid paying estimated tax by asking their employer to withhold more tax from their paycheck. They can check the Tax Withholding Estimator on the IRS website for more help. Individuals generally use Form 1040-ES to figure estimated tax while corporations generally use Form 1120-W.

Taxpayers can use the Electronic Federal Tax Payment System for all their federal tax payments. Individual Taxpayers can also create an IRS Online Account or use Direct Pay, a debit, credit card or digital wallet to make their estimated tax payments. Finally, taxpayers may also send estimated tax payments with Form 1040-ES by mail.

### **E-File Payroll Tax Returns**

The IRS has urged small businesses to take advantage of filing their payroll tax returns and making tax payments electronically. Payroll taxes include federal income tax withheld from employee wages, as well as both the employer and employee portions of Social Security and Medicare taxes, and Federal Unemployment





**Firm Announcements**

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**Joshua Wilson** joined the Firm’s Audit Department in June as an Associate

**Jennifer Shannon** joined the Firm’s Processing Department in August

**Amanda M. Lynch, CPA** has been promoted to Manager in the Audit Department

**Zach S. Bussard, CPA** has been promoted to Manager in the Tax Audit Department

**Tom S. Lutz** has been promoted to Supervisor in the Tax Department

**Elizabeth J. Perich** has been promoted to Senior in the Audit Department

**Sharon A. Welfer** has been promoted to Senior in the Tax Department

**Natalie Rhoades** joined the Firm’s Tax Department in September as an Associate

**Tony DiNardo** joined the Firm’s Tax Department in October as an Associate

**UDGR□□□□** and his wife, Brooke, welcomed baby girl, Helena Kathryn Niznik, on October 5th, 2022

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**Important Dates**

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**November 15, 2022** – Extended 2021 990 and 990-PF Tax Returns Due

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**Tax.**

Additionally, the IRS reminded taxpayers that taxpayers who file on paper miss out on all the advantages of e-filing. E-filing saves time, is secure, and is accurate. The IRS acknowledges receipt of an electronically filed return within 24 hours. With electronic filing, any mistake is often discovered and fixed quickly. Employers choosing to e-file themselves will need to purchase IRS-approved software. Alternatively, the Authorized IRS e-file Providers Locator Service can help employers find a suitable tax professional to file for them.

Finally, the IRS reminds businesses, while some employers can choose to pay their taxes when they file their payroll tax returns, most need to deposit them regularly with the Treasury Department instead. Federal tax deposits must be made by electronic funds transfer (EFT). A fast, easy and free way to do that is through the Electronic Federal Tax Payments System (EFTPS). Payments can be made either online or by phone. To enroll or for more information, taxpayers can visit EFTPS.gov or call 800 -555-4477.

**Work Opportunity Tax Credit**

The IRS reminded employers to check out the Work Opportunity Tax Credit (WOTC) for hiring long-term unemployment recipients and other group of workers facing significant barriers to employment. The

WOTC encourages employers to hire workers certified as members of any of ten targeted groups facing barriers to employment. The WOTC is available for wages paid to certain individuals who begin work on or before December 31, 2025.

Additionally, the IRS announced that to qualify for the credit, an employer must first request certification by submitting IRS Form 8850, Pre-screening Notice and Certification Request for the Work Opportunity Credit, to their state workforce agency (SWA). It must be submitted to the SWA within 28 days after the eligible worker begins work.

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**New Pennsylvania Law to Recognize 1031 State Tax Deferral**

On July 8, 2022, Governor Tom Wolf signed House Bill 1342 into law. Included in this bill is a provision that will conform Pennsylvania’s state tax treatment of like-kind exchanges with Section 1031 of the Federal Internal Revenue Code for tax years beginning after December 31, 2022.

**What is a Section 1031 Exchange?**

A 1031 exchange allows Taxpayers to defer paying capital gains taxes when selling or exchanging real property. Essentially, taxpayers exchange one or more pieces of property for one or more new pieces of



real property. The newly acquired real property carries over the basis of the exchanged property and allows the Taxpayer to defer the gain to a future point in time. Previously, for PA residents, this tax break was only available for Federal Income Tax purposes.

### **Who Qualifies for a Section 1031 Exchange?**

Individuals, C Corporations, S corporations, partnerships (general or limited), limited liability companies, trusts and any other taxpaying entity may set up an exchange of real property under Section 1031.

To qualify as a Section 1031 exchange the transaction must be a “deferred exchange.” Differed exchanges are distinguished from the situation in which a Taxpayer simply sells one property and uses the sale proceeds to purchase another property – that would be considered a taxable transaction. In a deferred exchange, the disposition of the relinquished property and acquisition of the replacement property must be mutually dependent parts of an integrated transaction constituting an exchange of property.

The rules surrounding Section 1031 can be complex and it is recommended that such transactions not be undertaken without the advice and direction of an accounting or legal professional.

### **Staffing Shortages Hampering IRS Processing of Current and Backlog Returns**

The Internal Revenue Service continues to struggle with issues related to staff shortages, the Treasury Inspector General for Tax Administration (“IG”) said.

In a May 2, 2022, interim report on the 2022 filing season, the IG stated that "significant staffing shortages continue to hamper the IRS’s efforts to address backlog inventories and continue to affect the IRS’s ability to ensure that current year tax returns are processed timely."

The data in the report comes from March and predates a number of appearances of IRS Commissioner Charles Rettig before Congress where he has pledged that, barring another significant spike in the pandemic or some other unforeseen issue, the backlogged inventories will be back to "healthy" by the end of the year.

The report highlights the agency’s overall "IRS Get Healthy Initiatives" and states the IG will be performing separate reviews on how the agency is addressing the backlog as well as hiring shortfalls.

The IG reported that as of March 15, 2022, the IRS onboarded 521 submission processing employees, or 9.5

percent of the hiring goal of 5,437, although Rettig has testified before Congress that in-person and virtual job fairs have yielded higher numbers since then and those hired should be onboarded and complete their training in June. The IG also reported that as of March 17, 2022, the agency onboarded 3,827 accounts management employees, or 76.5 percent of the hiring goal of 5,000 for the 2022 tax season.

IG estimates that as of the week ending March 12, 2022, there are nearly 5 million paper tax returns that still need to be processed. Through March 4, for the 2022 filing season, the IRS received nearly 55 million returns, including 1.5 million paper returns, which is 15 percent lower than the paper returns received in roughly the same window (March 5, 2021) during the previous year’s tax filing season.

As of March 4, the IRS has issued about 38 million refunds totaling \$129.2 billion. Both represent increases from the same time in the previous tax filing season through March 5 that had about 36 million refunds issued totaling \$107.8 billion.

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### **AICPA Calls On Congress To Meet IRS Budget Request; Recommends Sec. 174 Modifications**

#### **IRS Funding**

The American Institute of CPAs



is calling on Congress to fund the Internal Revenue Service at the level requested by the White House in its fiscal year 2021 budget request.

In a May 25, 2022, letter to Democratic and Republican leadership in both the House and Senate Appropriations Committees, the AICPA said, "In advance of the Fiscal Year 2023 appropriations cycle, we request that you fund the Internal Revenue Service (IRS) at necessary levels to allow it to handle all the duties required of it by Congress, including properly administering and enforcing our nation's tax laws as well as providing needed assistance to taxpayers and their advisers in a timely and professional manner."

Additionally, the AICPA expressed concern that "service challenges will persist long after the pandemic has ended unless sufficient, targeted funding for technology improvements, human talent and training, and taxpayer services are appropriated."

The organization also noted that "funding alone will not solve the IRS's problems." "Structural reforms and organizational alignment from Congress, the President, the Secretary, and the Commissioner are necessary to delivering the promised goals."

### Priority Guidance Recommendations

In a letter sent to the IRS May 24, 2022, AICPA outlined its suggestions for the guidance

that the agency should be prioritizing. The guidance recommendations cut across a range of programs and legislation, such as the Tax Cuts and Jobs Act, the SECURE Act, and the CARES Act and covering several areas such as corporation and shareholder taxation, employee benefits taxation, individual taxation, and international taxation.

### R&E Recommendations

AICPA is also recommending the Internal Revenue Service issue specific regulations related to the treatment of research and experimental (R&E) expenditures under Sec. 174.

In a May 26, 2022 letter to the IRS, AICPA said that the Department of the Treasury and the IRS should "issue regulations providing that section 174(a) expenditures include direct costs, including employee compensation, contract labor, and materials, and at the taxpayer's election, allocable indirect and overhead costs."

AICPA also said that Treasury and the IRS "should issue regulations that illustrate, using detailed examples, which costs are 'incident to' the development or improvement of a product as per Reg. §1.174-2."

If the agency doesn't issue new regulations, AICPA recommended guidance to cover these requests.

Additionally, AICPA identified issues that have arisen

with Rev. Proc. 2000-50, which covers the treatment of costs paid or incurred to develop, purchase, or lease computer software.

"IRS should modify the scope limitation under section 4 of Rev. Proc. 2000-50 to clarify that the limitation on costs that a taxpayer has treated as R&E expenditures under section 174 only applies to costs previously subject to an irrevocable election under section 174, including 174(b) or charging the expenses to capital account."

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### IRS Independent Office of Appeals Working to Reduce Cycle Times

The Internal Revenue Service's Independent Office Of Appeals has seen its cycle times for handling appeals cases stretch to more than a year during the COVID-19 pandemic, but the office is working to get it back to pre-pandemic levels.

Speaking May 13, 2022, at the American Bar Association's May Tax Meeting, office Chief Andy Keyso provided an update on where the agency stands as it, and the IRS as a whole, prepare for all offices to open for employees, as the end of June.

The cycle time for closed cases in fiscal year 2021 reached 372 days, up from 194 days in fiscal year 2018. Keyso noted that the upward trend started in FY





2019 due to the government shutdown, and then increased again in FY 2020 during the first year of the pandemic.

Despite the increase, Keyso is optimistic that change can happen. "I'm troubled by the increase in cycle time but I am not defeated by it," Keyso said. "I believe that it is reversible, and we will reverse it as we get people back in the office."

His optimism stems from the fact that while cycle times have gone up, it is not because more time is being spent on cases by appeals officers. That time hasn't changed, he said. The problems are more a function of issues that are plaguing the agency as a whole since the start of the pandemic, including the backlog of processing written correspondence. Getting that cycle time back down is one of the office's priorities once people are back in their offices full time, Keyso said.

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## IRS Destroys Documents Amid Backlog as IG Calls For More E-Filing

A recent report by the Treasury Inspector General for Tax Administration primarily focused on the need for the Internal Revenue Service to expand its electronic filing capabilities also noted that the agency has destroyed some 30 million paper-filed documents in 2021.

"The continued inability to process backlogs of paper-filed tax returns contributed to management's decision to destroy an estimated 30 million paper-filed information return documents in March 2021," the report, dated May 4, 2022, states. "The IRS uses these documents to conduct post-processing compliance matches such as the IRS's Automated Underreporter Program to identify taxpayers not accurately reporting their income."

The IRS said in a May 13th statement that the documents destroyed were documents "submitted to the IRS by third-party payors, not taxpayers. 99 percent of the information returns we used were matched to corresponding tax returns and processed. The remaining 1 percent of those documents were destroyed due to a software limitation and to make room for new documents relevant to the pending 2021 filing season."

The agency added that there were "no negative taxpayer consequences as a result of this action. Taxpayers or payers have not been and will not be subject to penalties resulting from this action."

The IG report adds that agency management "advised us that once the tax year concludes, the information returns, e.g. Forms 1099-Miscellaneous Information, can no longer be processed due to system limitations. This is because the system used to process these

information returns is taken offline for programming updates in preparation for the next filing season."

### More E-Filing Needed

The revelation comes as the IG calls for more documents to be able to be electronically filed.

Indeed, the first recommendation of the report was that the IRS "develop a Service-wide strategy to prioritize and incorporate all forms for e-filing," a recommendation the IRS agreed with.

To put the need in context, the IG report highlights the cost of processing a paper return compared to an electronically filed return in 2020. For example, an individual Form 1040 costs 36 cents to process if the form was filed electronically, but increases to \$15.21 if the Form 1040 was filed in paper form. A Form 1041 costs 37 cents to process electronically and \$14.02 to process a paper return.

E-filed returns also allow for "a number of upfront validations that check for more than 1,000 possible errors before the IRS accepts an e-filed tax return for processing" giving e-filed returns a greater degree of accuracy, compared to a paper return that requires an individual to keypunch all the details, a key contributor to the backlog of processing during the COVID-19 pandemic.



And while the agency has been relatively successful in getting individuals to electronically file their returns (a 93.4 percent e-file rate in 2020), it is not having the same success in getting businesses to do the same (63.3 percent e-file rate in 2020). That number goes down to 49 percent when looking at employment tax returns.

IG noted that the agency has not taken previously recommended actions, including:

- Developing a business tax return e-filing Service-wide strategy;
- Developing a less burdensome electronic signature process for employment tax returns; and

- Working with the Department of the Treasury to consider revising current requirements and/or creating new requirements for e-filing business returns.

IG also called upon the IRS to be more active in identifying businesses who are non-compliant with e-filing mandates and assessing the noncompliance penalties.

The report noted that in 2018, there were 897 corporate taxpayers that were mandated to e-file but still filed paper returns. The agency could have assessed more than \$2.4 million in penalties that were not assessed on these corporate filers.

The report notes that IRS did not take actions to assess penalties "because of potential implementation issues," an excuse the IG Office of Audit called "insufficient. The IRS could develop processes and procedures to identify these filers post-filing. In view of the paper backlogs of paper tax returns, the IRS should take additional steps in an effort to continue to reduce paper filings."