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Tax Talk

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Inside this issue:

Dear Clients and Friends,

As mentioned in previous issues of our newsletter, Georgia has long been the epicenter of the syndicated conservation easements industry, which has been in the IRS' crosshairs for quite some time. Accordingly, even though we always advised our clients not to participate (and, thankfully, they followed our advice), we have many clients who did invest in syndicated conservation easements before becoming our clients, and so we closely follow the developments in this area.

On May 13, the IRS announced a long-anticipated "time-limited settlement opportunity for eligible taxpayers involved in conservation easement or historic preservation easement disputes with the IRS". We will cover that in this issue, along with providing updated information on some topics we have covered in the past (the "qualified business income" deduction and the IRC 1202 gain exclusion), describe a new property tax exemption for residents of Fulton County age 65 and older, summarize recent Georgia tax legislation, and profile one of our members.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges

Kent Bridges,
Managing Partner

IRS Announces Global Settlement Offer for Conservation Easements

With more than 700 conservation easement cases docketed with the Tax Court and another 400 or so at the examination level, the IRS announced on May 13 (IR-2026-65) that it is going to try again to settle these cases en masse rather than continuing to incur the time and expense of litigating them one at a time.

The IRS notes that its prior settlement initiatives resolved 405 cases, with 32% of all offers being accepted. The IRS has been on a winning streak in Tax Court recently, with the Tax Court typically permitting only a minimal deduction and upholding the IRS' assessment of a 40% gross valuation misstatement penalty. Perhaps wary of offering better terms than offered in the past, the terms of the new offer are very similar to those offered in the past for cases docketed at the Tax Court.

Eligible partnerships will receive individualized correspondence from the IRS, to be issued on a rolling basis, which provides the partnership 90 days (from the date of the letter) to accept the following terms. The partnership forfeits the charitable deduction claimed and instead takes an "other deduction" equal to the amount of its actual out-of-pocket costs, and a penalty of 10% applies, plus accrued interest. Unlike with some of the prior settlement offers, the partnership is not required to make an upfront payment at the time it elects to accept the settlement offer.

No extension of the 90-day period will be available, but, for a period of 45 days following the close of the 90-day period, eligible partnerships can generally settle on the same terms, except that the penalty rate will be 20%. After the expiration of the 135 days, cases will be resolved before a court decision only on the basis of hazards of litigation, and the IRS anticipates that will generally result in a deduction of only 5% to 7% of the originally-claimed amount and a 40% penalty.

The settlement opportunity will not be made available in cases that have been tried and are awaiting an opinion, are on appeal to one of the Circuit Courts of Appeal, have already been settled, have agreed to be bound to another case if the test case has been tried and is awaiting final decision, have a trial date that is set to commence within 30 days of the May 13 announcement, or that are designated as test cases (unless all bound cases have settled or agree to settle under the initiative).

From a procedural standpoint, collection will depend on whether the tax year involved is 2017 or earlier or 2018 and later (as the tax law governing partnership examinations is different for those two time periods). For cases pertaining to tax years 2017 and earlier, once a settlement agreement is reached and approved by the Tax Court, taxpayers will receive IRS notices stating the amount owed by each individual investor. For cases pertaining to tax years 2018 and later, if the partnership elected to "push out" the adjustment, the individual investors will receive a statement from the partnership with the amount of adjustment they must make. If the partnership did not elect to push out the adjustment, then the partnership is responsible for the payment, unless it is unable to pay (which is typically the case) in which case the investors are responsible for payment and the IRS will notify them of the amount they owe.

Consistent with past settlement offers, the offer will be only to the partnership which claimed the conservation easement deduction. There is no mechanism by which an individual investor can accept the settlement offer directly.

Member in the Spotlight — Cameron Beverlin

The first voice you usually hear when you call our office and the first face you see when you visit our office is that of Cameron Beverlin. She is also the one who turns rough drafts of tax returns and financial statements into the nice finished package you receive, makes sure your tax returns, extensions and other documents not being filed electronically get filed by certified mail, manages our power of attorney filings with IRS, manages our incoming and outgoing mail, FedEx, UPS and couriers, scans and organizes documents we receive in physical format, gets copies of your tax returns to your bankers when requested, gets invoices out to clients, manages our file room, assists our Office Manager with our internal payroll, HR, accounting and IT, makes it possible for our professionals to work remotely, and more.

Cameron grew up in Daytona Beach, Florida and attended Western Carolina University, from which she received a Bachelors in Psychology. Outside of work she enjoys spending time with her friends and family, traveling back home to the beach, and going to baseball games. Cameron and husband Cole are expecting their first child in November of this year.

Bridges & Dunn-Rankin is proud to have Cameron Beverlin as a member of our firm.

Cameron P. Beverlin

The 20% Qualified Business Income Deduction

Included in *The Tax Cuts and Jobs Act of 2017* ("TCJA") was a new deduction for owners of pass-thru entities and sole proprietorships, the 20% "qualified business income" deduction (also referred to as the QBI deduction or IRC 199A deduction). This deduction was originally scheduled to expire at the end of 2025, but July 2025 legislation made the deduction permanent. Assuming you can qualify, the deduction can be up to as much as 20% of your profit from the business, which means shaving up to 7.4 percentage points off of your marginal tax rate.

The general rules - The deduction is computed at the individual owner level and is a unique type of deduction in that it does not reduce adjusted gross income but can be claimed without regard to whether you itemize. In general, the deduction is equal to 20% of K-1 or Schedule C "qualified business income", which does not include interest, dividends and capital gains (so you cannot double dip and get the lower rate on qualified dividends and capital gains while claiming this deduction on the same income). In order to qualify for this special deduction, you have to meet one of two tests.

1) If your taxable income on married joint return is less than $403,500 (or up to $553,500 with partial deduction; and 1/2 of these amounts for single persons), then you will automatically qualify almost regardless of the type of business, and regardless of the amount of W-2 wages (if any) paid by the business; or

2) Alternatively, if your taxable income on married joint return will exceed $403,500 (or up to $553,500 for partial deduction; and 1/2 of these amounts for single persons), then the business cannot be a "specified service business" (defined further below), and your deduction is limited to the lesser of 20% of your profit from the business or 50% of your proportionate share of the W-2 wages paid by the business (or 25% of the W-2 wages plus 2.5% of the original cost of depreciable assets).

The $403,500 and $553,500 are 2026 amounts. The amounts are increased each year for inflation.

The more detailed rules - The regulations are divided into six sections: (1) operational rules; (2) determination of W-2 wages and basis of depreciable property; (3) qualified business income; (4) aggregation of businesses; (5) specified service businesses and the business of being an employee; and (6) relevant passthrough entities. Each of these is discussed further below.

Operational rules - As noted above, there are essentially two sets of rules; one for individuals with income below $201,750 (or $403,500 for couples filing a joint return), and one for individuals or couples with taxable income above these threshold amounts. If your income is below the threshold level, then almost any type of ordinary business income (other than W-2 income or K-1 guaranteed payments) will qualify for the 20% deduction (i.e. 1099-NEC income, Schedule C profit and K-1 income normally qualify). Once your taxable income (as computed after all of your personal deductions other than the 20% QBI deduction) goes above the threshold amount, then the rules get much more complicated and a number of potential limitations kick in (e.g. the income cannot be from a specified service business and your deduction cannot exceed your share of 50% of the W-2 wages paid by the business or 25% of the W-2 wages plus 2.5% of the original cost of depreciable assets). The deduction, while computed separately with respect to each flow-through business (unless you qualify under the "aggregation" rules), cannot exceed your net combined qualified business income from all flow-through entities nor 20% of your taxable income in excess of net capital gain. The income must be effectively connected to a business conducted within the U.S., and losses carry forward to reduce such income in the following year. "Reasonable compensation" (including K-1 guaranteed payments) is excluded from qualified business income. The deduction is for income tax purposes only, not for computing self-employment tax or the 3.8% Medicare tax on net investment income. Qualified REIT dividends and K-1 income from publicly traded partnerships are eligible for the deduction, and estates and trusts are eligible to claim the deduction.

Determination of W-2 wages and basis of depreciable property - The deduction is designed to encourage jobs creation, so (once your income goes over the threshold amounts discussed above) your deduction is generally limited to the lesser of 20% of your profit or 50% of your share of the W-2 wages paid by the business. In a concession to asset-intensive businesses (e.g. real estate), an alternative is provided to the 50% of wages paid limitation, whereby you can instead use 25% of the W-2 wages paid plus 2.5% of the original cost of the depreciable assets of the business (which have been held for less than the longer of 10 years or the specified depreciable lives of the assets). W-2 wages paid to a company's common law employees by a third party (e.g. a PEO or an affiliated company) can qualify.

Qualified business income - Qualified business income (QBI) is ordinary business income (not interest, dividends or capital gain) from 1099-NEC, Schedule C or K-1, plus qualified REIT

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The 20% Qualified Business Income Deduction — continued

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dividends and qualified publicly-traded partnership income. It does not include the W-2 compensation of an S-corp shareholder, nor the K-1 "guaranteed payments" paid to a partner. Notably, while the IRS may assert that an S-corp shareholder's W-2 compensation has been understated (thus potentially overstating the 20% deduction), the IRS has indicated that it will not make this assertion with respect to partner guaranteed payments (creating the potential opportunity for partners to maximize the QBI deduction by favoring "distributive share" allocations over "guaranteed payments"). Ordinary income from the sale of a partnership interest (IRC 751 income) and income from the change of an accounting method (IRC 481 income) qualify as QBI. Your QBI for the year will be reduced by losses suspended in previous years under the passive loss rules, basis limitation rules and at-risk rules only if the losses were suspended in a tax year after 2017. Finally, only income from business conducted in the U.S. will qualify.

Aggregation of businesses - So what if you have structured your business through multiple entities, with most of the profit concentrated in one entity while most of the payroll is concentrated in another entity? When the legislation was first enacted, there was some concern that many businesses might have to restructure in order to maximize the owners' QBI deduction. The regulations, however, provide some relief here, by permitting individuals to elect to aggregate businesses in computing the QBI deduction limitations, so long as the same group of persons, directly or indirectly, owns at least 50% of each business being aggregated, and each of the businesses meet at least two of three other factors: (1) products or services which are the same or customarily offered together; (2) shared facilities or centralized business elements like accounting and HR; and (3) operated in coordination with or reliance upon one or more of the businesses in the group. Note that you cannot include a specified service business in your aggregated group.

Specified service businesses and the business of being an employee - Once your personal taxable income goes over the threshold amount, you are denied the deduction with respect to profit from a "specified service trade or business" (SSTB). Also, income received as an employee is ineligible for the deduction, regardless of your income level. An SSTB is defined for these purposes as "any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners". Engineering and architectural firms (which were originally included in the list of bad businesses), were specifically carved out by Congress (and thus enjoy the favorable benefit). With respect to the "reputation or skill" exclusion, the IRS has essentially limited this to those situations where someone lends their name to a business in exchange for a royalty or receives an endorsement fee or an appearance fee. With respect to the term "consulting", the regulations define such for these purposes as "the provision of professional advice and counsel to clients to assist the client in achieving goals and solving problems". The regulations go on to say "consulting does not include the performance of services other than advice and counsel, such as sales or economically similar services or the provision of training and educational courses". Real estate agents and brokers and insurance agents and brokers are specifically carved out from the definition of "brokerage services", and thus may enjoy the benefit (unless limited by another provision such as the "financial services" exclusion or the lack of W-2 wages paid). "Statutory employee" income (which is reported on Schedule C) can potentially qualify for the QBI deduction.

Relevant passthrough entities - While the QBI deduction is ultimately computed and claimed on individual returns, many of the determinations (e.g. whether or not the business is an SSTB) and computations (e.g. the individual owner's share of W-2 wages paid and original cost basis of depreciable property) must be made at the "relevant passthrough entity" (RPE; e.g. S-corp or partnership) level and reported to the owners on their Schedule K-1s. If the RPE fails to properly report these items to the owner, then the amounts are presumed to be zero. Accordingly, it is very important that passthrough entities get this reporting right.

Planning to maximize the QBI deduction - Much of our planning in order to maximize the QBI deduction for our clients includes (1) avoiding SSTB classification (e.g. taking great care with how the business is described on tax returns, at website, in marketing materials, etc.); (2) keeping taxable income below the threshold amounts in order to avoid the SSTB rules and 50% of W-2 wages paid limitation; (3) electing S status where necessary in order to get sufficient W-2 wages paid; (4) optimizing the mix of S-corp shareholder W-2 compensation and K-1 flow through income; (5) restructuring partnership agreements to favor "distributive share" over "guaranteed payments"; and (6) taking advantage of the "aggregation" rules.

IRC 1202 Capital Gains Exclusion — Almost too Good to be True

Generally, when something sounds too good to be true, that's because, in fact, it is not true. An exception to that general rule is the IRC 1202 capital gains exclusion.

IRC 1202 was first enacted in 1993. However, as first enacted, it was of fairly limited benefit, due in large part to an alternative minimum tax adjustment that tended to claw back much of the otherwise tax savings. Over the years since then, legislation has been enacted which has steadily increased the potential benefit.

Legislation enacted in 2010 provides that for C-corp stock in a qualifying business received after September 27, 2010 and held for at least 5 years, the selling shareholders can enjoy a 100% capital gains exclusion on up to the greater of $10,000,000 (per shareholder limit at individual shareholder level with spouses treated as a single shareholder) or 10 times the amount invested in the stock. Legislation enacted in 2025 increased (for stock acquired after July 4, 2025) the potential gain exclusion to $15,000,000 and provides for a new partial gain exclusion for qualifying shares held for less than 5 years (50% exclusion for stock held at least 3 years and 75% for stock held at least 4 years).

In order for the C-corp stock to qualify, the corporation must be conducting an

Kyle K. Bartleson, CPA

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IRC 1202 Capital Gains Exclusion — Almost too Good to be True — continued

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active business and cannot be in a disqualified industry (performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services, or in banking, insurance, financing, leasing, investing, farming, natural resources, hotels and restaurants). Also, the company must not have had (at the time of issuance of the stock and essentially at all times before that) assets in excess of $50,000,000 ($75,000,000 for stock acquired after July 4, 2025), and the company must be a domestic (i.e. U.S., not foreign) corporation.

For C-corp stock acquired between August 10, 1993 and September 26, 2010, a 50% or 75% exclusion may apply, in lieu of the 100% exclusion.

A partnership can convert to C-corp status in order to become eligible for the IRC 1202 exclusion, but the holding period for the required 3, 4 or 5 year period begins on the date of conversion, any pre-conversion appreciation in value is not eligible for the exclusion, and the value of the business on the date of conversion must not exceed $75,000,000 (or $50,000,000 for conversions occurring before July 5, 2025). On the plus side, however, the 10x limit is also based on value as of the date of conversion.

It should be noted that one downside of converting to C-corp status is that any gain not covered by the exclusion is subject not only to income tax, but also the 3.8% Medicare tax on net investment income (which does not apply to gain on the sale of a flowthrough entity by an active participant in the business). Accordingly, if the gain is high enough, the 3.8% Medicare tax can actually exceed the income tax savings of the IRC 1202 exclusion.

As a general rule, a partnership can convert to C-corp status tax-free. However, there are important exceptions. Under IRC 357 (c), if the company has liabilities in excess of basis, then a taxable gain is recognized to the extent of the excess. Also, under IRC 465(e), previously deducted losses may have to be recaptured if the partner/shareholder's "amount at risk" drops as a result of the conversion. Further, pursuant to Treasury Regulation 1.451-8(c)(4), a partnership with a deferred revenue liability may be required to accelerate the recognition of the deferred income upon conversion to C-corp status.

New Property Tax Exemption for Fulton County Residents 65 or Older

For many years, Cobb County, Georgia has provided its residents age 62 or older an exemption from the school portion of property tax; a very lucrative benefit which has made Cobb County an attractive place to live for those 62 and older. Recently, neighboring Fulton County has decided to get in on the act with a similar, although more restrictive and less lucrative benefit for its residents age 65 and older.

The amount of the new Fulton County exemption depends on your age and whether you are inside or outside the Atlanta Public School District (APSD).

For those inside APSD, the exemption is limited to $50,000, which means an annual tax savings of approximately $1,000. For those in Fulton County, but outside APSD, those age 65 – 69 get an exemption from the school portion of the tax against taxable assessed value of 25%, while those age 70 and above get an exemption of 50%. To be eligible for the 25% or 50% exemption, you must have had a basic homestead exemption in place for 5 of the past 6 years.

Georgia's income Tax Rate to Continue to Decline

For 49 years (from 1969 until 2018), Georgia's income tax rate was 6%. In 2018, the rate was reduced to 5.75%, and the state continues to reduce the rate.

Pursuant to recent legislation, the rate for 2026 will be 4.99% and (assuming certain contingencies are met) the rate will be reduced by 0.125% each year going forward until it is reduced down to 3.99%.

Georgia's retirement income exclusion (which applies not only to pension and IRA distributions, but also investment income) for taxpayers 65 and older is increased from $65,000 to $70,000 for 2027 and subsequent years. For those ages 62, 63 or 64, it remains at $35,000. The exclusion is computed separately for each individual, so a married couple can potentially double these amounts (if each is old enough to qualify and has enough qualifying income in their name).

Georgia's standard deduction has been increased to $30,000 for married couples filing jointly and $15,000 for other filers.

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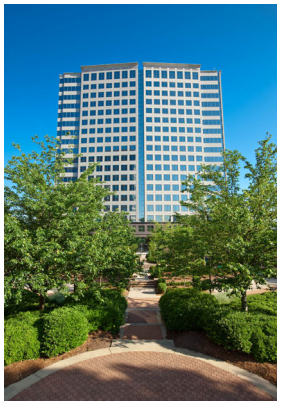

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