Tax Update: Capitalizing on Credits and Planning Considerations for the Year Ahead

Meet Today’s Panel

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Today's Agenda

- Inflation Reduction Act
- State and International Tax Update
- Federal Tax Update
- SECURE Act 2.0


Inflation Reduction Act

Inflation Reduction Act

- 15% corporate minimum tax on adjusted financial statement income for corporations with more than $1B financial statement income
- 1% excise tax on corporate stock buybacks for publicly traded corporations
- Extension of the excess business loss limitation rules until Dec. 31, 2028
- Approximately $80B increase in IRS funding
- Energy- related credits and incentives

Electric Vehicle Credits

Clean Vehicle Credit

Introduced several changes that will phase in over time

- Placed in service from 8/17/22 - 12/31/22
  - Follows original law, BUT also must have had final assembly in North America (requirement carries thru 2023)
  - Base credit is $2,500 and goes up by $417 for each KWh of battery over 5KWh; max credit is $7,500

- Placed in service after 12/31/22
  - Adds more requirements, including vehicle wight, MSRP limits, etc.
  - $3,750 “critical mineral” requirement, $3,750 “battery component” requirement; max credit is $7,500.

Electric Vehicle Credits

NEW: Previously Owned Vehicle Credit

Credit

- For individuals only
- 30% of the purchase price, up to a maximum of $4,000

- **Vehicle Requirements**
  - Placed in service after 12/31/22
  - Qualified fuel cell or clean electric vehicle at least 2 years old
  - Price and weight limits apply.

&

NEW: Commercial Clean Vehicle Credit

Credit

- Lesser of 1) 15% of the cost of the vehicle (30% if not powered by gas or diesel) or 2) the incremental cost of the vehicle
- Limited to $7,500 for vehicles with gross weight less than 14,000 pounds; $40k for heavier vehicles

- **Vehicle Requirements**
  - Placed in service after 12/31/22
  - Primarily used on public streets, roads, highways; can also be mobile machinery
  - Propelled significantly by an electric motor or fuel cell motor

Charging Station Credits

Alternative Fuel Vehicle Refueling Property Credit

Placed in service before 1/1/23

- Follows original law
- Credit is the lesser of 1) 30% of the cost of the station or 2) $30,000
    - Lesser of 1) 30% of the cost of the station or 2) $1,000 for residential property
- Applies to all property at a single location

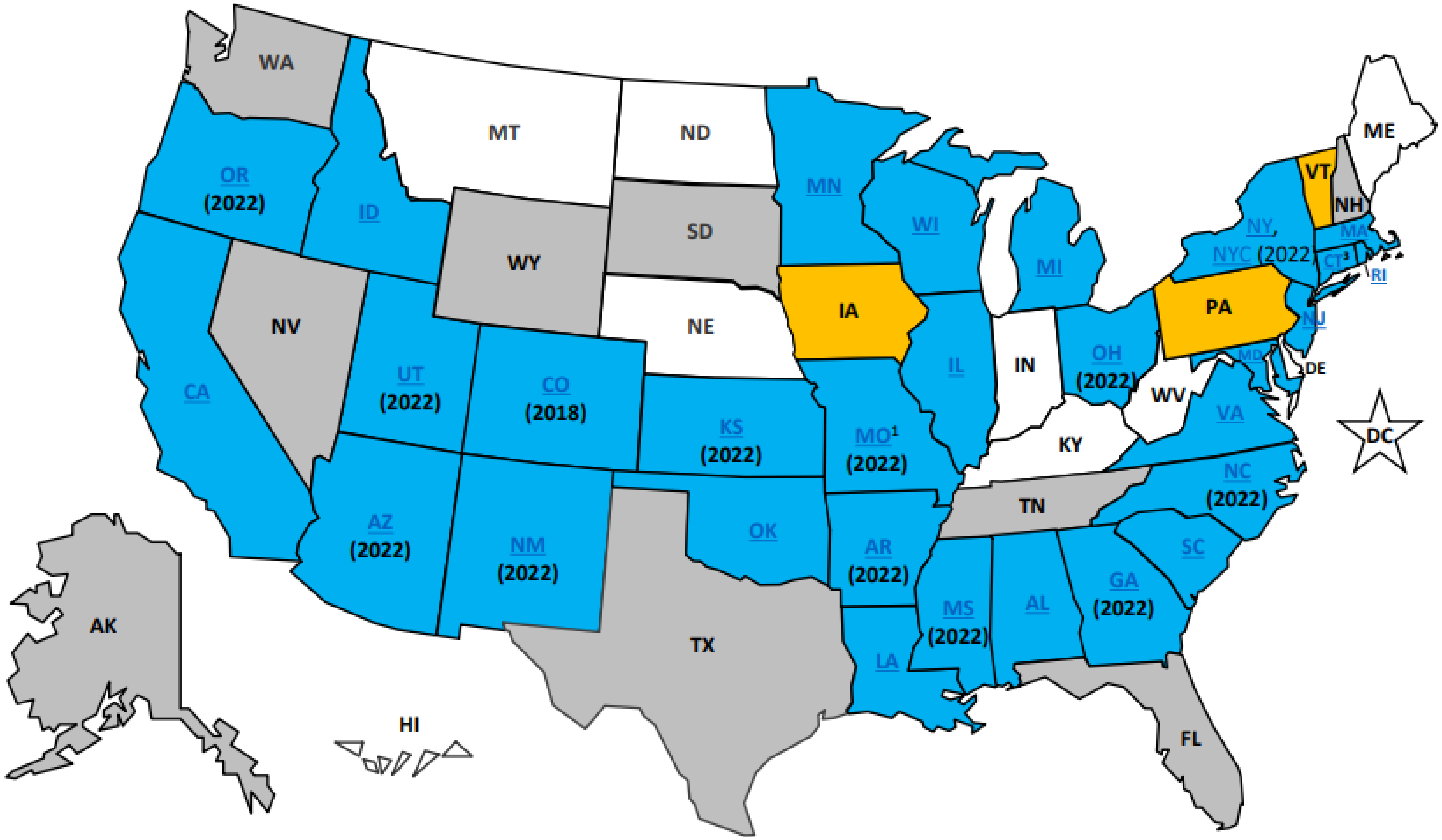
Placed in service after 12/31/22

- Credit is the lesser of 1) 30% of the cost of the station or 2) $100,000
    - Same rules for residential property
- Applies to any single item of qualified property
- Must be located in an eligible census tract
- The 30% is reduced to 6% if wage and apprenticeship requirements not met

State and Local & International Tax Updates

States with Enacted or Proposed Pass-Through Entity (PTE) Level Tax

As of August 31, 2022



29 states (& 1 locality) that enacted a PTE tax since TCJA SALT deduction limitation, effective for 2021 (or earlier) unless noted:

AL, AR[1], AZ[1], CA, CO[2], CT[3], GA[1], ID, IL, KS[1], LA, MA, MI, MD, MN, MO[1], MS[1], NC[1], NJ, NM[1], NY, OH[1], OK, OR[1], RI, SC, UT[1], VA, WI, and NYC[1]

[1] Effective in 2022 or later – on map (2022) or (2023)

[2] Retroactive to 2018

[3] Mandatory

3 states with proposed PTE tax bills:

IA - HF 2087, session over, not enacted

PA – HB 1709, in committee

VT - H 0527 , session over, not enacted

9 states with no owner-level personal income tax on PTE income:

AK, FL, NH, NV, SD, TN, TX, WA, WY

10 states with an owner-level personal income tax on PTE income that have not yet proposed or enacted PTE taxes:

DE, HI, IN, KY, ME, MT, NE, ND, VT, WV

AICPA

Entity-Level Taxes on Pass-Throughs

- Designed to avoid TCJA's $10k SALT deduction cap
- Converts individual-level taxes (even if paid via nonresident withholding or composite) into entity-level taxes, thus eligible for full deduction from entity's taxable income on Schedule E
- IRS Notice 2020-75 issued November 9 announces forthcoming proposed regulations that will bless this workaround as a viable way to avoid the SALT cap
  - Whether the entity-level tax is mandatory or elective
  - Whether the individual owners then get a deduction, exclusion, or credit on their personal returns to account for the tax paid by the entity

Entity-Level Taxes on Pass-Throughs

- Structure varies state to state
- Owners generally claim a credit against their personal income tax liability or an exclusion on the portion of the owner's pass-through income subject to the entity tax
- Timing of election varies state to state
- Relief from nonresident withholding varies state to state
- Relief from filing individual income tax return varies state to state

Entity-Level Taxes on Pass-Throughs

Considerations

- Reduce federal taxable income and could impact federal credits
- Impact on corporate owners
- Ability for owners to utilize credit for taxes paid to other states in their state of residency
- Cost of any additional compliance (Michigan)


Nexus/Doing Business

Nexus: What is it and Why Does It Matter

Nexus, what is it?

- Nexus is a fancy word for "connection."
- In order for a state to impose income, franchise or sales taxes on an out-of-state business, there must be a requisite level of connection between the state and the business.

Fundamental requirement of both the Due Process and Commerce Clauses of the U.S. Constitution that there be:

> "Some definite link, some minimum connection between a state and the person, property, or transaction it seeks to tax"
>
> *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768, 777, 112 S. Ct. 2251 (1992)

Remote Workers

Can create nexus for

- Employer –
  - Corporate income/franchise taxes;
  - Gross receipts taxes;
  - Employer withholding taxes
  - Unemployment taxes; and
  - Sales and use taxes

- Employee – Personal income tax
  - Resident subject to tax on all income in resident state
  - Nonresident subject to tax only on income derived from sources in state

What is Enough of a Connection for Nexus

- Most states indicate that the presence of 1 – 6 remote workers in the state will create nexus for a company (*See Bloomberg Tax, 2021 Survey of State Tax Departments*)

- 30+ jurisdictions report nexus would arise from a single remote worker who performed back-office administrative business functions

- Any COVID exception have expired

- Some states have time thresholds for withholding

What is Enough of a Connection for Nexus

Contrast with

Inventory - case of first impression, *Guild v Hassel,* No. 179 MD 20212 (September 9, 2022) Commonwealth Court of Pennsylvania held that mere fact that non-resident had inventory in Commonwealth as participation in fulfillment by Amazon program did not establish nexus as the taxpayer did not have control over where Amazon chose to store the inventory.

Contrast with

Multistate Tax Compact revised statement on Public Law 86-272. The revised statement tends to narrow the protection from the imposition of income tax by specifically addressing activities conducted on interactive websites as unprotected activities.


K2/K3 & FTC

International Tax Update
Shifting Sands

Forms K2/K3 | Latest Developments
- Draft → Revised Draft → Final?

Foreign Tax Credit Regulations
- Proposed → Corrected → Final
- Wash. Rinse. Repeat.

K-2 / K-3 Update
Background | Who has to file?

- Any partnership or S- Corp with items relevant to the determination of the U.S. tax or certain withholding tax or reporting obligations of its partners under the international provisions of the Internal Revenue Code
- Certain owners of foreign partnerships
- Items of international relevance are defined broadly
- The forms are required, unless one of the exceptions applies

New: Domestic filing exception for 2022

Domestic partnership is **not required** to file forms K-2/K-3 if **all of the following** are met:

1. no foreign activity, or limited passive foreign activity with no more than $300 in allowable income tax credits and such income and taxes are shown on a payee statement that is furnished to the partnership

2. all direct partners are either (a) US citizens, (b) resident aliens, (c)domestic decedent's estates, (d) domestic grantor, (e) domestic non-grantor trusts, (f) S- corps with a sole shareholder, (g)SMLLC, where the member is one of the persons described above in a-f and the LLC is a disregarded entity.

3. **Updated:** Partner notification. A partnership that meets criteria 1 and 2, must notify the partners that they will not receive Sch K-3 unless they request them. Notification must be received **at the latest when the partnership provides Schedules K-1 to partners.** (it can be an attachment to Sch K-1)

4. No 2022 Schedule K-3 requests from the partners by the 1-month date. The "1-month date" is 1 month before the date the partnership **files the Form 1065.** For tax year 2022 calendar year partnerships, **the latest 1-month date is August 15, 2023, if the partnership files an extension**

Foreign Tax Credits
In General

The foreign tax credit intends to reduce the double tax burden that would otherwise arise when foreign source income is taxed by both the United States and the foreign country from which the income is derived.

Qualifying Tests for the Credit

The tax must meet four tests to qualify for the credit:

1. The tax must be a legal and actual foreign tax liability
2. The tax must be imposed on you
3. You must have paid or accrued the tax, and
4. The tax must be an income tax (or a tax in lieu of an income tax)

Evolving Regulations
Some Key Issues

- **Attribution requirement**
  - Sufficient nexus required
- **Cost recovery requirement**
  - Recovery of significant costs and expenses required
- **Source based attribution for royalty payments**
  - US vs foreign country sourcing rules
- **Allocation and apportionment of foreign income taxes**
  - Disregarded payments and reattribution


Federal Tax Update

Research & Development

- **Tax law for tax years that began before Jan. 1, 2022**
  - Expense research & development costs in the year incurred; or
  - Amortize research & development costs over no less than 60 months.

- **Tax law for tax years that begin after Dec. 31, 2021**
  - Required to amortize research & development costs over no less than 60 months (half-year convention);
  - 15-year amortization period in the case of any specified research & development costs that are attributable to foreign research;
  - This is regardless if a taxpayer currently uses the research & development tax credit to reduce its tax liabilities.

- **Start-up companies – payroll credits up to $500,000**
  - Less than five years of existence, include the year applying for the R&D credits; and
  - Less than $5million in gross receipts yearly.

Business Interest Expense Deduction Limitation

- Limits the interest expense deduction to 30% of adjusted taxable income with any excess carried forward
- For tax years beginning after **Dec. 31, 2021**, the addback for depreciation, depletion, & amortization will no longer be allowed when calculating adjusted taxable income
- Overall small business exception for businesses with average gross receipts of $27M or less
- Businesses who have not been subject to limitations in the past may be going forward

Bonus Depreciation

Starting in 2023 100% bonus depreciation will begin to phaseout from 2023-2026

Phaseout Schedule

- 2022 – 100% bonus depreciation
- 2023 – 80% bonus depreciation
- 2024 – 60% bonus depreciation
- 2025 – 40% bonus depreciation
- 2026 – 20% bonus depreciation
- 2027 – 0% bonus depreciation

Other Expiring TCJA Provisions

Provisions expiring Dec. 31, 2025

- Individual tax rates, brackets and deductions
- Increased estate and gift tax exemption
- Pass-through business deduction
- SALT deduction cap

Provisions expiring Dec. 31, 2028

- Excess business loss limitation

Employee Retention Credit (ERC)

Refundable payroll tax credit up to:

2020

- $5,000 per employee
- 50% of $10,000 of eligible wages paid from March 13, 2020, to Dec. 31, 2020, by an eligible employer

2021

- $21,000 per employee ($7,000 per quarter)
- 70% of $10,000 of eligible wages paid during an eligible 2021 quarter by an eligible employer

Eligible Employer

2020

- Carrying on a trade or business during 2020
- Partial of full suspension of operations due to COVID-19 government orders or have to have a greater than 50% reduction in quarterly gross receipts compared to same quarter in 2019

2021

- Carrying on a trade or business during 2021
- Partial of full suspension of operations due to COVID-19 government orders or have to have a greater than 20% reduction in quarterly gross receipts (or prior quarter) compared to same quarter in 2019

Steps to analyzing ERC

1

Determine and document eligibility

Government order test (full or partial suspension of operations) or gross receipts test

2

Determine employee count (FTE)

Separate rules when over 100 employees (2020) or 500 employees (2021)

3

Calculate qualified wages per employee

- Factor in wage caps - $10,000 per year (2020) or $10,00 per quarter (2021)
- Remember cannot use same wages for PPP forgiveness

4

CLAIM THE CREDIT

Other Credits and Incentives

Cost Segregation Study

- Accelerates depreciation by categorizing real property building components into assets classes with shorter recovery periods

- Can be taken on real property placed in-service in prior years as well

State and Local Credits and Incentives

- Governments and municipalities offer various credits and incentive programs to drive economic growth in their areas

- Some examples include:
  - Refundable tax credits for job creation
  - Investment tax credits
  - Property tax abatements

- Requires upfront negotiations

Corporate Transparency Act (CTA)

Overview

- Enacted in January of 2021 to combat money laundering
- Requires closely held businesses to disclose their beneficial owners to the Financial Crimes Enforcement Network (FinCEN)
- Large operating company exception

Key Dates

- Entities created before Jan. 1, 2024 must file a report by Jan. 1, 2025
- Entities created on or after Jan. 1, 2024 must file a report within 30 days of the entity receiving confirmation that the entity formation was effective
- If there's a change in the information previously reported concerning the reporting company or its beneficial owners, the entity must file an updated report within 30 days after the change occurs

SECURE ACT 2.0

Passed by the House March 29, comparable bills passed by the Senate, now in reconciliation.

Due to the bipartisan support this legislation has received, we are expecting this to become law in some form.

Key Benefits:

- Expanding Automatic Enrollment in Retirement Plans
- Increase in Age for Required Beginning Date for RMDs
- Higher Catch-Up Limit for Participants Ages 62, 63 and 64
- Treatment of Student Loan Payments as Elective Deferrals for Purposes of Matching Contributions
- Small Immediate Financial Incentives for Contributing to a Plan
- Safe Harbor for Corrections of Employee Deferrals
- One-Year Reduction in Period of Service Requirements for Long-Term Part-time Workers
- Recovery of Retirement plan Overpayments
- Reduction in Excise Tax on Certain Accumulations
- Special One-Time IRA Distribution
- Annuities as QDIAs
- Expands Startup Credits for Small Employer Plans
- Provisions for Pooled Employer and Open Multiple Employer Plans
- Expansion of Savers Credit
- Indexing of IRA Catch-up Limit
- Dollar Limit on Mandatory Distributions
- Modification to Top Heavy Testing
- Reform of Family Attribution Rules
- Catch Up Contributions
- Solo 401(k) Plans
- Roth Treatment for Employer Contributions


QUESTIONS

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