GBQuarterly: Year-End Business Tax Update

December 7, 2022

Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.

2. Information presented herein is not intended to be tax advice.

3. Please consult with a qualified practitioner for tax advice related to specific transactions.

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Agenda

- Research and Development Capitalization
- Other Tax Changes
- Tax Provisions in the "CHIPS" Act and the Inflation Reduction Act "IRA"
- Tax Planning Strategies

Research & Development – Tax Law Change

- 2017 Tax Reform Act – Revenue Raiser
  - For tax years beginning BEFORE January 1, 2022, taxpayers may deduct expenditures made for research activities.
  - However, for tax years beginning AFTER December 31, 2021, research expenditures must be capitalized and amortized over a five-year period (15 years for research conducted outside of the United States).
    - Amortization begins with the midpoint of the taxable year for the first year

- Legislative fix?

Research & Development – Section 174

- All costs incidental to the development or improvement of a product
- Activities intended to discover information that would eliminate uncertainty
- Examples of potential Section 174 costs include the following:
  - Compensation of employees conducting research
  - Supplies consumed during research activities
  - Costs associated with research facilities:
    - Rent
    - Utilities
    - Depreciation
  - Attorney fees related to patent applications
  - Computer software development costs

Research & Development – Impact Example

Assume taxpayer incurs $5,000,000 of Section 174 costs annually and all research activity is conducted within the U.S.

Tax Year	2022	2023	2024	2025	2026	2027
R&D Costs, Annually	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000	5,000,000
Tax Amortization	500,000	1,500,000	2,500,000	3,500,000	4,500,000	5,000,000
Book/Tax Difference	4,500,000	3,500,000	2,500,000	1,500,000	500,000	0
Fed Corp Rate	21%	21%	21%	21%	21%	21%
Current Tax Impact	**945,000**	**735,000**	**525,000**	**315,000**	**105,000**	**0**

Research & Development – Considerations

- Tracking – How do I start to analyze?
  - Financial Statement R&D footnote disclosure
  - IRC §41 R&D tax credit
  - UNICAP §263A R&D costs
  - *None of the above will be an all-inclusive remedy

- Estimated tax payments 2022

- Legislative fix – subsequent event financial statement footnote

- R&D credit study opportunity?

Other Tax Changes

Deferral of employment tax deposits and payments

- Employers were allowed to defer the deposit and payment of the employer's portion of FICA taxes from March 27, 2020, through December 31, 2020
- 50% repaid by December 31, 2021, and final 50% repaid by December 31, 2022

Meal Expenses

- Temporary exception to the 50% disallowance of meal expenses incurred in 2021 and 2022
- IRS has issued two notices providing guidance on the application of this rule change
    - Notice 2021-25: Provides a definition of "restaurant" as a business that prepares and sells food and beverages
    - Notice 2021-63: Allows the meal portion of per-diem rate to qualify for 100% deduction
- Back to 50% limitation for 2023

Other Tax Changes – Interest Limitation

Section 163(j) – Interest Deduction Limitation

- Section §163(j) generally limits the deduction for net business interest expense to 30% of a taxpayer's adjusted taxable income

- Adjusted taxable income (ATI) – in general:
    - For tax years beginning in 2018 through 2021 – EBITDA
    - For tax years beginning in 2022 – EBIT
        - Major impact on entities with material depreciation and amortization

- Any business interest expense disallowed is carried forward and treated as business interest expense in the following year
    - Indefinite carryforward period

Other Tax Changes - Net Operating Loss (NOL)

- Prior to the Tax Cuts and Jobs Act ("TCJA") of 2017, NOLs incurred were eligible for a 2-year carryback and 20-year carryforward
- TCJA eliminated NOL carrybacks for tax years ending after December 31, 2017
- Post TCJA there were effectively two groups of NOL carryforwards:
  - Group 1 – NOLs generated in tax years beginning BEFORE December 31, 2017 (Pre TCJA NOLs)
    - 20-year carryforward and available to offset 100% of taxable income
  - Group 2 – NOLs generated in tax years beginning AFTER December 31, 2017 (Post TCJA NOLs)
    - Unlimited carryforward and available to offset 80% of taxable income
- CARES Act provided temporary relief from 80% limitation and allowed NOL carry backs for 2019 and 2020 tax years

Other Tax Changes - Foreign Reporting

Sample of reporting penalties (in general):

- Foreign Bank Account Report (FBAR) - *non-willful $10,000****
  - Supreme Court – Bittner case (oral arguments 11/2/22)
- Specified Foreign Financial Assets (Form 8938) - *$10,000*
- Information Return of U.S. Persons With Respect to Certain Foreign Corporations (Form 5471) - *$10,000/per*
- Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Form 5472) - *$25,000/per*

Forms K-2 and K-3 (new 2021)

- Requires partnerships and S-corporations with international operations to provide additional information
- 2022 Instructions (Form 1065 K-2/K-3) – 45 pages long

CHIPS Act – Semiconductor Manufacturing

- Creating Helpful Incentives to Produce Semiconductors for America (CHIPS) was created to promote semiconductor manufacturing in America

- Taxpayers who invest in the manufacturing of semiconductors or the manufacturing of equipment required in the semiconductor manufacturing process may be eligible for a 25% advanced manufacturing investment credit in 2023

    - Generally applies to qualified property placed in service after December 31, 2022

    - Construction must start before January 1, 2027

- Application process should open by February 2023

Inflation Reduction Act (IRA)

Large or Public Company Provisions:

- An applicable corporation will have a 15% alternative minimum tax (AMT) on the adjusted financial statement income
  - Effective for tax years beginning after December 31, 2022
  - If subject to AMT in 2023, corporations are required to estimate their adjusted financial statement income for tax years 2020, 2021, and 2022
- Repurchases made by public companies after December 31, 2022 will have a 1% excise tax on corporate stock buybacks
  Exceptions:
  - Repurchased amount < $1 million
  - Repurchased amount is treated as a dividend

IRA - Green Energy Incentives

The IRA is the largest-ever U.S. investment committed to combat climate change, allocating $370 billion in tax incentives to energy security and clean energy programs over the next 10-years

- Goal: Reduce greenhouse gas emissions by 40% in 10 years
- Introduces new credits and structures
  - New requirements to maximum certain green energy tax credits:
    - Prevailing wage requirements
    - Domestic content requirements
- Adds additional monetization options
- Provides tax-exempt entities the ability to claim credits
- Extends and enhances many of the current energy-related tax credits

IRA – Excess Business Loss Limitation

2017 Tax Reform Act introduced a new limitation on the deductibility of excess business losses for noncorporate taxpayers

- Limitation is applied at the owner level for each owner's allocable share of income, gain, deduction or loss
- The loss limitation is $250,000 ($500,000 for joint filers), indexed for inflation
- 2022 limitation is indexed to $270,000 ($540,000 for joint filers)
- Provision originated for the 2018 tax year and was set to expire after 2026
- As part of COVID relief legislation – these rules were temporarily suspended for 2019 and 2020 tax years
- The IRA extends these limitation rules for noncorporate taxpayers
    - Now set to expire for tax years beginning after December 31, 2028

Tax Planning Strategies - State PTE Election

- 2017 Tax Reform introduced $10,000 state and local tax limitation “SALT Cap” on Federal individual return
- More than 30 states have enacted or are considering legislation to allow Partnerships and S-Corporations (pass-through entities “PTE”) to elect to pay tax at the entity level for state income tax purposes
  - *Ohio starting 2022
- Basic mechanics of Ohio pass-through entity tax election:
  - Ohio tax paid by PTE and taken as a deduction on PTE’s Federal tax return (SALT Cap workaround)
  - The owners add-back the Ohio tax on their individual Ohio return, but then claim a credit against their personal tax liability and any excess is refunded to the individual
- Limited guidance exists within ASC 740, however examples under ASC 740-10-55-226 through 228 provide FASB insight

Tax Planning Strategies – Tax Methods

Accounting Method Changes

Income Deferral

- Look at the possibility of deferring the recognition of advanced payments
    - IRS and Treasury released final regulations on December 21, 2020
    - IRS released Revenue Procedure 2021-34 for procedures on obtaining automatic consent for the method change
- Changing from the overall accrual method to cash method of accounting

Prepaid Expenses - "12-month rule"

LIFO – Beneficial in inflationary environment

UNICAP – Modified Simplified Production Method

Tax Planning Strategies – Fixed Assets

Capitalization vs Expense?

- **De Minimis Safe Harbor**
  - Election to deduct amounts paid to acquire or produce tangible property to extent deducted for book purposes (book-tax conformity)
  - Limited to $2,500 per invoice or item ($5,000 for taxpayers with applicable financial statements)
- **Tangible Property Regulations**
  - Regulatory framework to help taxpayers determine whether certain costs are currently deductible or must be capitalized

Depreciation Optimization

- **Bonus Provisions**
  - Evaluate capital expenditures in the current year to maximize bonus depreciation (100%) before percentage begins to phase down in 2023 (80%) and future years
- **Cost Segregation Studies**
  - Ability to break out costs of major constructions projects into its components to optimize amounts eligible for bonus depreciation
- **Qualified Improvement Property**
  - CARES Act technical correction to define qualified improvement property as 15-year property
  - Since 15-year property, eligible for bonus depreciation

Tax Planning Strategies - ERC

Employee Retention Credit (ERC)

What is the Employee Retention Credit?

- The Employee Retention Credit is a federal payroll tax credit that encourages businesses financially impacted by COVID-19 to keep employees on their payroll.
- For 2020, the refundable tax credit is 50% of qualified wages up to $10,000 for the year. For 2020, the maximum credit is $5,000 per employee for the year.
- For 2021, the refundable tax credit is 70% of qualified wages up to $10,000 *per quarter*. For 2021, the maximum credit is $7,000 per employee *per quarter* (so $28,000 total for all quarters).
- For 2020, for businesses with 100 or fewer full-time employees, qualified wages include wages and health plan expenses paid to ***all*** employees, whether they provided services or not. For 2021, the 100-person threshold was increased to 500 or fewer full-time employees.

Tax Planning Strategies – ERC Continued

Who qualifies?

Employers in the private-sector and tax-exempt organizations that carry on a trade or business, and either:

- Have operations that were fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; **OR**
- Experienced a significant decline in gross receipts during the calendar quarter. A significant decline means gross receipts for a calendar quarter in 2020 are less than 50% of gross receipts for the same calendar quarter in 2019. For 2021, a significant decline means gross receipts for a calendar quarter in 2021 are less than 80% of gross receipts for the same calendar quarter in 2019.

Refund timing – Amended payroll tax returns, statutes open for 2020/2021

IRS audit ramp up – additional IRS funding and targeted enforcement

Tax Planning Strategies – Future?

What is coming down the road?

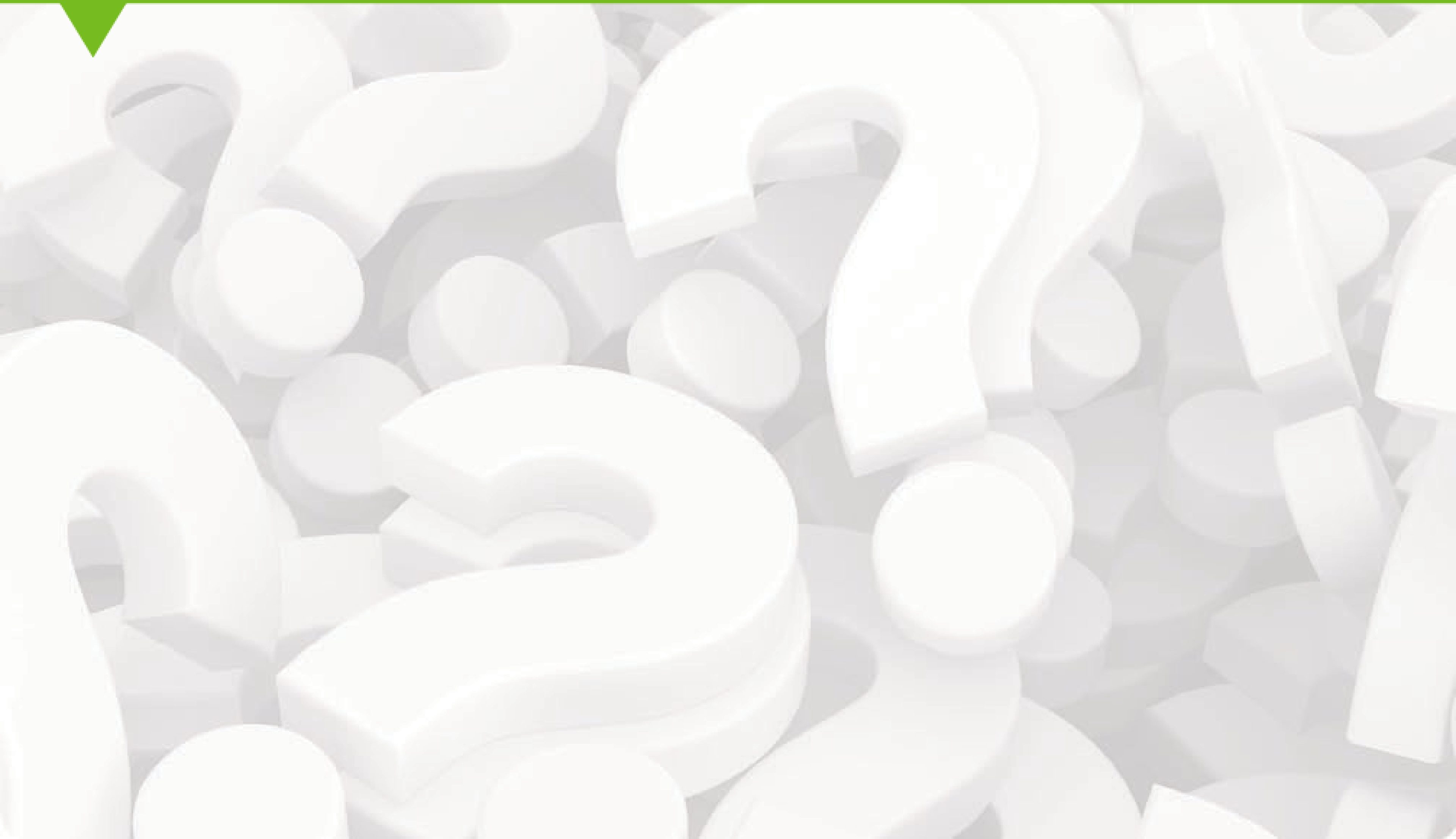
- Political climate
  - Lame duck session – government funding
  - Divided Congress 2023/2024
  - What happens in 2024 election cycle?

- Various temporary tax provisions set to expire

- Post COVID relief tax policy and impact on Federal deficit

- IRS funding and increased audit activity

Questions



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