Top Tax Takeaways for This Year and Next

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Learning objectives

- Provide business owners and investors with updates to current tax programs and insights into proposed tax legislation.

Polling question

If you could stay at one age for the rest of your life, what would it be?

- 10-20
- 20-30
- 30-40
- 40-50
- Over 50

Updates to Existing Tax Programs

Employee Retention Credit and Paycheck Protection Program

Employee Retention Credit (ERC)

ERC timeline

Coronavirus Aid, Relief and Economic Security (CARES) Act

Established ERC for wages paid between 3/13/20 and 12/31/20

March 27, 2020

Taxpayer Certainty and Disaster Relief Act of 2020

Extended ERC to 6/30/21

Dec 27, 2020

American Rescue Plan Act of 2021

Extended ERC past 6/30/21

March 11, 2021

ERC – Changes Retroactive to 2020

Prior law:

Employers who received a PPP loan in 2020 were not able to claim the ERC

New law:

Employers who received a PPP loan in 2020 can retroactively claim the ERC for 2020 by filing amended quarterly payroll tax returns (Form 941-X)

- An employer may not claim the ERC for the same wages that it is using to claim PPP forgiveness. If wages were previously used to claim PPP forgiveness, those wages must be excluded from the ERC calculation.
- The rules for the 2020 ERC remain in effect for retroactive claims: Credit is equal to 50% of qualified wages up to a maximum $10,000 per employee <u>for ALL quarters.</u>

ERC – Changes for 2021

Prior law:

Maximum credit was 50% of qualified wages and qualified wages were capped at $10,000 paid to any one employee for the entire year

2021 change:

Maximum credit is 70% of qualified wages and qualified wages are capped at $10,000 <u>paid to any one employee per quarter</u>

Prior law:

If under 100 FTEs, all wages paid to employees during eligible quarters were qualified wages. If over 100 FTEs, only wages paid to employees not to provide services during an eligible quarter were qualified wages.

2021 change:

Employee threshold increased to 500 FTEs

ERC – Changes for 2021

Prior law:

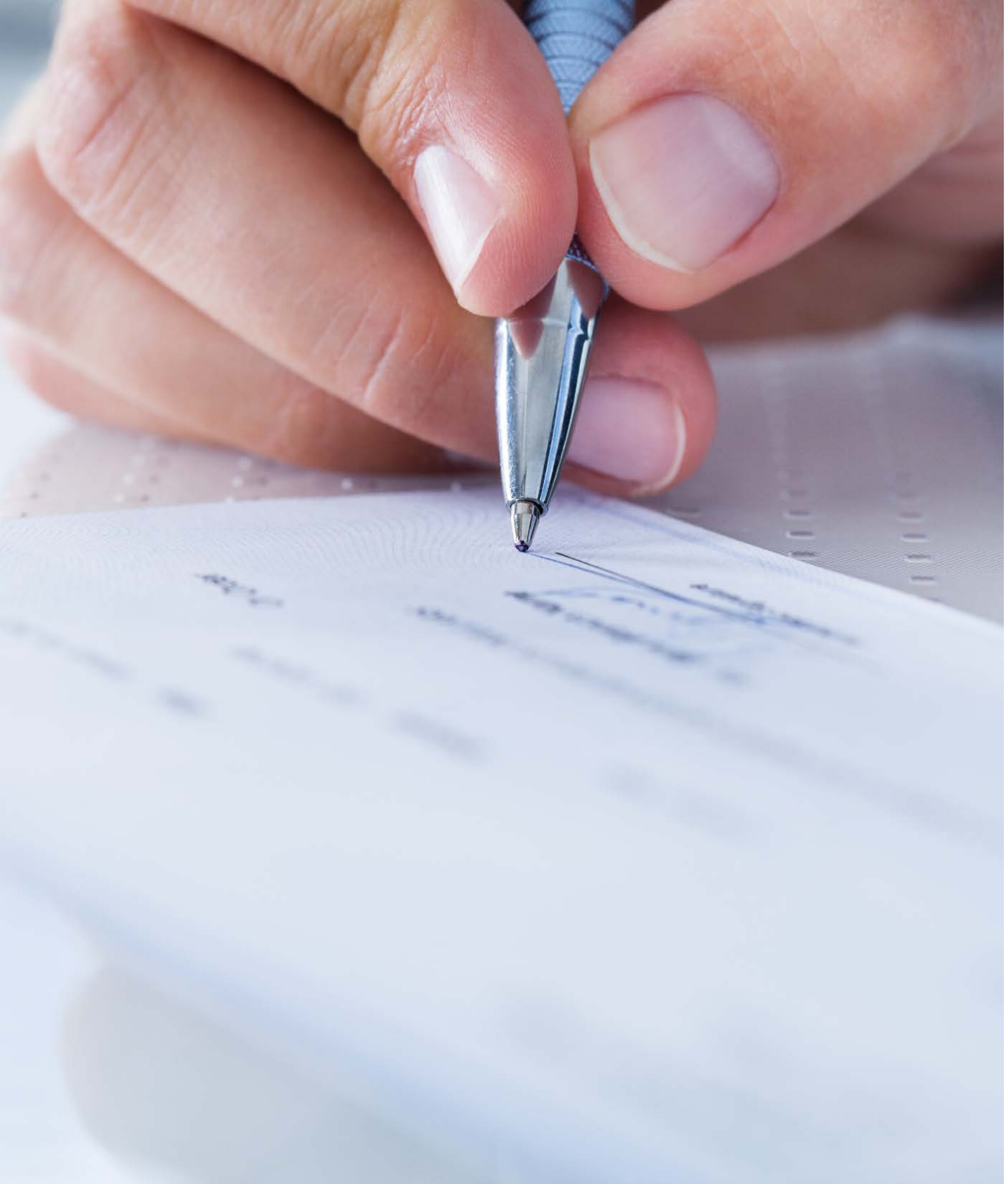
Eligibility – Employer needed to experience at least one quarter in 2020 where operations were suspended by a government order or experienced a quarter where gross receipts dropped at least 50% compared to the same quarter in 2019.

2021 change:

Employer whose gross receipts dropped at least 20% compared to the same quarter in 2019 are eligible to claim the ERC. The comparison can be made to a quarter in 2020 if the business did not exist during the same quarter in 2019.

2021 change:

The employer can also go back to the previous quarter and compare to 2019. Ex: If Q1 2021 does not satisfy the gross receipts test, the employer can compare Q4 2020 vs Q4 2019 for comparison to qualify Q1 2021 for the ERC.



Paycheck Protection Program

- The last day for PPP loan applications was March 31, 2021
- Rev. Proc. 2021-20 provides two remedies for taxpayers who filed a 2020 return reflecting disallowed deductions attributable to PPP proceeds
  - Amend the original return or if a partnership file an Administrative Adjustment Request
  - Safe Harbor Election, which requires attaching a statement titled “Revenue Procedure 2021-20 Statement”
- Additionally for accrual basis taxpayers, interest expense forgiven can be a deduction for tax purposes

Proposed Tax Rate Changes

What you need to know as a business owner and investor

Individual Tax Rates

Current law

The top individual tax rate is 37%. For 2021, this rate begins at $523,601 of taxable income (TI) for single taxpayers and $628,301 of TI for married couples.

Proposed law

Increase the top rate to 39.6% beginning at $452,700 of TI for individuals and $509,300 of TI for married couples.

Effect on business owners

S-Corporation shareholders and partners in a partnership or LLC may be paying higher taxes on the income that flows through from their businesses. This rate increase may be mitigated if Congress repeals the $10,000 SALT limitation.

Capital Gains Tax Rates

Current law

The top tax rate for long-term capital gains (LTCG) is 20% + the 3.8 net investment income tax (NIIT) for a total combined rate of 23.8%. The 20% rate begins at $445,850 of TI for single taxpayers and $501,600 of TI for married couples.

Proposed law

LTGCs and qualified dividends will be taxed at the top individual tax rate (proposed at 39.6%) for gains over $1 million ($500,000 for married individuals filing separately). The 3.8% NIIT would still apply making the top combined rate 43.4%. <u>This change is proposed to be retroactive to the “date of announcement” (presumably April 28, 2021).</u>

Effect on business owners

Any owner of investment assets, including business interests, securities and real estate, may face higher taxes when those assets are sold. Separate tax rates for different income thresholds may make tax distributions from partnerships and S-Corporations more difficult. Tax-free mergers may become a more viable option for business owners.

Self-Employment (SE) tax

Current law

The SE tax is a combined 15.3% tax. Social security tax of 12.4% is assessed on SE income up to $142,800 (2021 limit) and the Medicare tax of 2.9% is assessed on all SE income. Limited partners, S-Corporation shareholders and passive LLC members are not subject to the SE tax.

Proposed law

Limited partners, S-Corporation shareholders and LLC members will be subject to the SE tax on their income if their adjusted gross income is over $400,000.

Effect on business owners

Limited partners, S-Corporation shareholders and passive LLC members who provide services may now be subject to the SE tax on those earnings. It is unlikely that rental income will be subject to the SE tax.

Net Investment Income Tax (NIIT)

Current law

The 3.8% NIIT is assessed on net investment income over $200,000 for single individuals and $250,000 for married couples. The NIIT is not assessed on passthrough business income of individuals who materially participate in their business.

Proposed law

NIIT will apply to passthrough income that is not subject to the SE tax and it will apply to taxpayers with adjusted gross income over $400,000.

Effect on business owners

Depending on the changes to the SE tax discussed on the previous slide, this may affect S-Corporation shareholders, limited partners and passive LLC members. The proposed SE tax and NIIT changes will ensure that most pass-through earnings of high-income taxpayers will be subject to either SE tax or the NIIT.

Polling question

What is your favorite vacation spot?

- Beach resort
- Lakeside cabin
- Mountainside cottage
- I would rather work

Business Tax Changes

Proposed changes to tax rates, 1031 Exchanges and Carried Interest

Corporate Tax Rates

Current law

TCJA replaced a graduated tax schedule with a flat tax of 21 percent applied to all C Corporations.

Proposed law

Increase tax rate for C Corporations to 28% for tax years after December 31, 2021 for calendar year taxpayers. Taxpayers with a fiscal year during 2021-2022, the tax rate would be equal to 21% + 7% for the portion of the year in 2022.

Effect on business owners

Corporate tax expense will increase.

Corporate Tax Rates

Current law

Corporations pay tax based on taxable income rather than book income reported on financial statements.

Proposed law

Impose a 15 percent minimum tax on worldwide book income for corporations with income in excess of $2 billion.

Effect on business owners

Corporations would pay tax on book income if higher than taxable income curtailing the benefit of some favorable tax incentives such as accelerated depreciation.

Like-Kind Exchanges (1031 Exchanges)

Current law

Taxpayers who exchange real estate for other real estate can defer the capital gains on the appreciation of the relinquished property.

Proposed law

The gain deferral on these exchanges will be limited to $500,000/year for single individuals and $1 million/year for married couples.

Effect on business owners

Real estate investors will be limited in the amount of gain that can be deferred by a like-kind exchange.

Carried Interest

Current law

Partners who receive profits interests in exchange for their services can receive LTCG treatment on their labor if the holding period of the partnership asset is at least three years.

Holding periods less than three years is STCG and is not subject to SE tax.

Proposed law

The income will be subject to ordinary income tax and SE tax if their taxable income from all sources exceeds $400,000.

Effect on business owners

Partners with a carried interest in a private equity or hedge fund will face higher taxes.

Excess Business Loss Limitations

Current law

An individual taxpayer may not deduct a loss from their business in excess of $262,000 (single individuals) and $524,000 (married couples) in a single year. The excess losses carry forward as a net operating loss. This provision is set to expire on 12/31/26.

Proposed law

This provision will become permanent.

Effect on business owners

Sole-proprietors and owners of pass-through entities will continue to be subject to these loss limitations.

Global Intangible Low Tax Income (GILTI)

Current law

Effective 10.5% tax on GILTI of U.S. shareholders and corporations.

Proposed law

Raise the minimum GILTI rate to 21%, calculate on a per country basis, and eliminate the exemption of the first 10% of return when they locate investments in foreign countries.

Effect on business owners

Increases taxes for U.S. businesses and shareholders doing business overseas.

Gifts and Inherited Property

Potential impacts to transferring your assets

Gifted Property

Current law

Transfers by gift are not taxable and the recipient receives basis equal to the donor’s basis.

Proposed law

Donor will recognize a capital gain on the gift if the asset has appreciated over $1 million.

Effect on business owners

Business owners who gift their ownership interests to family members or trusts may trigger a tax on those gifts.

Inherited Property

Current law

A beneficiary of a decedent's estate receives a stepped-up basis in an asset to the date of death value. The beneficiary only recognizes gain on appreciation after the date of death.

Proposed law

The decedent would recognize a capital gain at the date of death if the asset has appreciated over $1 million. The gain will be reported on a separate estate or special capital gains tax return. Relief will be available for family owned and operated businesses, bequests of personal property and gifts to charity.

Effect on business owners

Anyone who owns highly appreciated assets or business interests may need to update their estate plan, especially those who are planning on passing their assets down to the next generation. It is unclear how a tax on inherited property will be affected by the current estate tax in place. The Green Book does not address changes to the estate/gift tax rates or exemptions.

Appreciated Assets

Current law

Appreciated assets held by non-corporate entities (e.g. trusts and partnerships) do not recognize gain on the unrealized appreciation of those assets.

Proposed law

Gain on unrealized appreciation of assets will occur if no gain recognition has occurred since 1/1/1940. The first recognition event date will be 12/31/2030.

Effect on business owners

Business owners and families who hold assets in long-standing trusts will potentially face a gain recognition event.

Renewable Energy Incentives

Tax Credits Today and Proposed Changes for the Future

Energy Incentives

Current law

Production Tax Credit –
1.5 cents per kilowatt hour of electricity. No credit for facilities that started construction after 2021.

Investment Tax Credit –
Generally, 26% for projects where construction began after 12/31/2019 & before 1/1/2023. Going down to 22% for projects constructed after 12/31/2022. In 2024 the ITC is 10%.

Proposed law

Production Tax Credit –
Expand the full PTC for construction after 12/31/2021 and before 1/1/2027. Phase down to zero over 5 years

Investment Tax Credit –
Expand to the full ITC to 30% for construction after 12/31/2021 and before 1/1/2027.

Effect on business owners

Expanding the PTC and ITC increases the attraction of investing in renewable energy projects. As well as creating good paying jobs for all stages of project construction. Per the International Renewable Energy Agency (IRENA) each MW of renewable energy power supports 3.8 jobs.

The Renewable Energy Team at BerryDunn has the specialized experience to advise owners and developers of renewable energy systems.

We can help you with:

- Financial modeling
- Deal structuring
- Investment Tax Credit (ITC)
- Production tax credit (PTC)
- Ongoing tax advisory services
- Strategic financial and tax planning
- Permanent and temporary financial/accounting staffing
- Financial/accounting software selection and services

Polling question

Which changes in the proposed legislation concerns you the most?

- Capital gains tax rate increase
- Corporate tax rate increase
- Taxes on gifting my assets/inheritance
- Increased taxes on income from my S-Corporation or partnership

Questions?

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