Planning during Uncertain Times Taking Advantage of Tax Laws Today While Preparing for Changes on the Horizon

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Presenters

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Agenda

1. Sunsetting Provisions of the Tax Cuts & Jobs Act
2. Highlights of Tax Proposals and Opportunities to Consider While We Await Legislative Action
3. State Tax Update

Learning objectives

- To understand some recent and soon to be expiring tax provisions enacted under previous legislation.
- To highlight tax changes found in various legislative proposals.
- To discuss planning and select tax credit opportunities available in the current environment.

Section 1

Sunsetting Provisions of the Tax Cuts & Jobs Act

Sunsetting Provisions of the Tax Cuts & Jobs Act

Recently sunset provisions and more on the horizon

1

Required capitalization of Section 174 research and experimental expenses

Effective January 1, 2022

2

Limits on the deductibility of business interest expense under Section 163j

Effective January 1, 2022

3

Incremental reduction of bonus depreciation rates under Section 168k

Effective January 1, 2023

4

Expiration of the qualified business income (QBI) deduction under Section 199A

Effective January 1, 2026

5

Other miscellaneous provisions of importance

Sunsetting Provisions of the Tax Cuts & Jobs Act

Recently sunset provisions and more on the horizon

1. Required capitalization of Section 174 research and experimental expenses: Effective January 1, 2022.
   - Cost recovery period: 5-year (Domestic) vs 15-year (Foreign).
   - Applicable costs: Direct (wages, supplies, etc.) and indirect (rent, utilities, etc.).
   - Compliance challenges to consider: Cost identification and documentation, impact with other Internal Revenue Code (IRC) sections (41, 163(j), 263A, etc.), and state conformity issues.
2. Limits on the deductibility of business interest expense under Section 163j: Effective January 1, 2022.
   - Deduction is limited to sum of: (a) business interest income, (b) 30% of adjusted taxable income (ATI), and (c) floor plan financing interest.
   - ATI calculation: EBITDA vs EBIT.
   - Exceptions for small businesses, certain electing businesses, and the ADS trade-off.

Sunsetting Provisions of the Tax Cuts & Jobs Act

Recently sunset provisions and more on the horizon

3 Incremental reduction of bonus depreciation rates under Section 168k: Effective January 1, 2023.

- 2022 was the last year of 100% bonus. Beginning 2023, the rate drops 20% per year until completely phased out in 2027.

4 Expiration of the qualified business income (QBI) deduction under Section 199A: Effective January 1, 2026.

- Remains 20% of QBI from certain pass-through entities.
- Potential impacts if not renewed.

5 Other miscellaneous provisions of importance.

- Most business (corporate) provisions were made permanent, e.g., corporate tax rate reduction (21%), repeal of AMT. Not so for pass-through entities.
- Individual: Marginal tax rate changes, SALT limitation, standard deduction, and personal exemptions, child tax credit, estate tax exemptions.

Polling Question #1

In what year are most of the tax provisions enacted under the Tax Cuts and Jobs Act currently set to expire?

(a) 2024
(b) 2025
(c) 2026
(d) 2027

Section 2

Highlights of Tax Proposals and Opportunities to Consider While We Await Legislative Action

Highlights of Various Tax Proposals

Hoping for legislative action yet to materialize and may not until after the next election cycle

- Three separate bills proposed in the House: (a) The Build in America Act, (b) The Small Business Jobs Act, and (c) The Tax Cuts and Working Families Act.
  - Retroactively restore Sec. 174 expensing, Sec. 163j relief, and extend 100% bonus depreciation (through 2025), while repealing many of the energy tax credits enacted under the Inflation Reduction Act (IRA).
- Major tax provisions from Biden’s 2024 budget proposal:
  - Increase corporate tax rate to 28%, increase various rates/taxes on high-income individuals, while providing tax relief for middle to lower income taxpayers.
- Dueling agendas and the current political environment would suggest that it could be difficult for legislation to get passed by either party.

Opportunities to Consider While We Await Legislative Action

Actions to take in the meantime

- Assume this is the new norm and take action to reduce the compliance burden.
- Scrutinize historical R&E costs classification for potential deductibility as ordinary business expenses (Sec. 162).
- Consider differences between Sec. 179 vs. bonus depreciation, alternate deprecation methods, or cost segregation studies, to control timing of deductions.
- Electing out of Sec. 163j could make sense where the impact of switching to the ADS deprecation method is insignificant.
- Consider separately identifying financing components in sales contracts to increase “business interest income” and the ATI base used to calculate interest expense limitation under Sec. 163j.
- With tax rates at historic lows, consider accelerating income recognition before rates change…and they will!

Opportunities to Consider While We Await Legislative Action

Don’t forget there are some new tax credits available under the Inflation Reduction Act

- An investment tax credit (ITC) is available for certain solar energy projects placed in service under Section 48 of the Code
  - The ITC is calculated as a percentage of the basis of eligible equipment used to generate electricity and placed in service
  - Base and bonus structure: (a) Base of 6% and (b) Increase to 5X (up to 30%) if prevailing wage and apprenticeship requirements are satisfied or an exception applies
  - Bonus Depreciation
- The Act creates a multitude of new (or extends existing) clean energy initiatives and tax credits.
  - A new credit for the purchase of commercial clean vehicles (Sec. 45W) provides a tax credit for up to $7,500, subject to gross vehicle weight (GVW) and vehicle price limitations.
  - The clean vehicle credit (Sec. 30D) has been modified in various ways. It imposes certain requirements for sourcing critical materials used in the manufacture/assembly of the battery components, and final vehicle assembly in the US, among other things. The credit is capped at $7,500 per vehicle. The limitation on which vehicle manufacturers qualify for the credit has been removed.

Polling Question #2

Under the current law, domestic R&E cost must be capitalized and amortized over how many years?

(a) 5 years

(b) 7 years

(c) 10 years

(d) 15 years

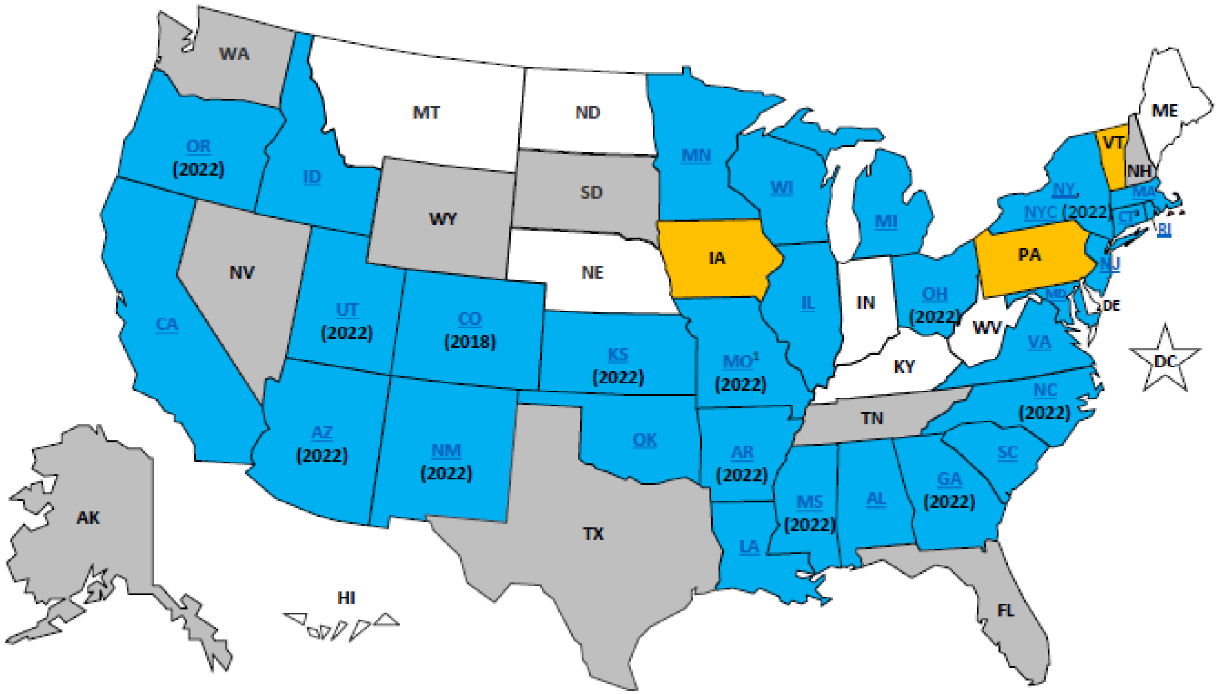
Section 3

State Tax Update

State Pass-Through Entity Level Tax Update

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

State Pass-Through Entity Level Tax Update

- Each state has various nuances to its pass-through entity (PTE) tax rules that should be considered carefully before making the election.
  - When is the election made? It can be on or before the due date of the return, or in some cases it’s due by the fifteenth day of the third month for the year it is to be effective.
  - How is it made? The election may be made with the annual return, filing an election form, or by making estimated payments.
  - For some states, the election is effective until revoked, while others require an annual election. In some cases, the election is irrevocable once made.

State Pass-Through Entity Level Tax Update

- Each state has various nuances to its PTE tax rules that should be considered carefully before making the election.
  - Who can make the election? May be made by the Board, by greater than 50% voting control, by the entity itself, or individually by each owner of the entity.
  - States may still require withholding/composite estimates for some owners. Election to file composite returns may no longer be allowed.
  - Some states require nonresident owners of electing PTEs to continue filing personal tax returns.

Highlights of Select State Tax Code Changes

Massachusetts – Business and individual tax update

- Optional PTE excise tax (Chapter 63D, Section 7) went into effect for electing entities for taxable years beginning on or before Jan. 1, 2022.
  - S-corporations, partnerships, and certain trusts can elect to pay 5% tax on the income allocable to its qualified owners.
    - Sole proprietorships, single member limited liability companies (SMLLC), and grantor trusts disregarded for federal tax purposes are ineligible. Upstream partnerships and S-corporation owner must make the election at their level.
  - No deduction for the excise tax paid by the entity is allowed.
  - The owners can claim a nontransferable, refundable credit on their personal returns equal to 90% of their share of the tax.
  - Many other nuances exist. See TIR 22-6 for a detailed summary.

Highlights of Select State Tax Code Changes

New Hampshire – Business and individual tax update

- New Business Tax Reporting Requirements:
  - The minimum gross income filing requirement for a business profit tax return (BPT) has increased to in excess of $92,000 (up from $50,000 for 2022).
  - The business enterprise tax (BET) gross receipts threshold has increased to $250,000 as has the enterprise value threshold (up from $220,000 and $111,000 respectively for 2022).
  - The BPT and BET rates are reduced to 7.5% and 0.55% respectively (down from 7.6% and unchanged from 2022).
- The rules for calculating a net operating loss (NOL) under the BPT now conform with the IRC.

Highlights of Select State Tax Code Changes

New Hampshire – Business and individual tax update (continued)

- Interest and Dividends (I&D) Tax:
  - The tax will begin phasing over the next five years and is repealed for tax years beginning Jan. 1, 2027. The rate reduction schedule is as follows:
    - TY 2023 – I&D tax rate is 4%
    - TY 2024 – I&D tax rate is 3%
    - TY 2025 – I&D tax rate is 2%
    - TY 2026 – I&D tax rate is 1%
  - The I&D tax is levied on resident individuals, partnerships, and fiduciaries with interest and dividend income exceeding $2,400 ($4,800 MFJ).

Questions?

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Break

Next session:

Navigating Recent Accounting Standards: Mastering Compliance and Optimization for Enhanced Financial Reporting.

Begins at

12:50 PM

Presenters:

Bob Leonard

Dylan Oxley

Chat Prompt #1

- Back up discussion question 1 TBD

Chat Prompt #2

- Back up discussion question 2 TBD