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2022 Tax Year-End Planning for Businesses

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Agenda

- Changes to business interest deduction & bonus depreciation
- R&E expensing changes
- Employee Retention Credit
- Year-end planning reminders
- Partnerships & S-corporations reminders
- Looking forward to 2023 – legislative changes

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Polling Question #1

Which of the following year-end planning considerations is at the top of your list this year?

A. Changes to Sec. 163(j) interest rules

B. Changes to bonus depreciation rules

C. R&D expensing changes

D. Compliance with tax law and regulatory changes

E. Tax planning for 2023

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Business Interest Expense §163(j) Deduction

- For tax years beginning after December 31, 2021, the addback for depreciation, depletion, & amortization will no longer be included in the computation of adjusted taxable income
- May result in businesses having more interest expense disallowed for tax purposes

	Taxable income
+/-	Items of income, gain, deduction or loss not properly allocable to trade/business
+	Business interest expense
-	Business interest income
+	Net operating loss
+	Pass-through business deduction
+	Depletion, depreciation & amortization (taxable years beginning **before** January 1, 2022, only)

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Business Interest Expense §163(j) Deduction

- Calculation of “adjusted taxable income” could have a major impact for taxpayers that are capital intensive & leveraged
  - Depreciation & amortization is only added back when calculating “adjusted taxable income” for taxable years beginning before January 1, 2022
  - Calendar year taxpayers will no longer add back depreciation starting with their 2022 tax years
- The test or limit does not apply to
  - Businesses with average annual gross receipts of $27 million or less for the three prior tax years (affiliated group basis)
    - Threshold is $26 million for 2019, 2020, & 2021 tax returns
    - $27 million for 2022 & indexed for inflation
- Excess deduction that was disallowed carried forward indefinitely

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Bonus Depreciation

- Taxpayers may deduct 100% of the cost of bonus eligible property in the first year for property acquired & placed in service after September 27, 2017, & before January 1, 2023
- Bonus rate will decrease by 20% each year until it fully phases out to 0% for assets placed in service in 2027
  - 100% will be allowed for property placed in service through 2022
  - 80% for 2023
  - 60% for 2024
  - 40% for 2025
  - 20% for 2026
- Definition of qualified property expanded in 2018 by removing requirement that original use begin with taxpayer

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Accounting for R&E Expenses

- For tax years beginning in 2022, businesses are no longer able to immediately deduct the full cost of R&E expenditures
- Instead, the TCJA requires companies to amortize their costs over five years for research conducted inside the United States
  - For research conducted abroad, amortization of 15 years is required
  - Software development costs are now specifically included in the definition of Section 174 costs

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Why Is This Change So Significant?

- Cash flow planning & cash taxes
- Financial statement impact & considerations within Accounting Standards Codification (ASC) 740
- Consideration of state tax conformity issues
- Accounting method change considerations
- International tax provisions
- Implications for increased adjusted taxable income under §163(j), potentially limiting the amount of disallowed interest in a given period
- Timing differences between the deduction for generally accepted accounting principles versus tax
- Classification of expenses as §162, ordinary & necessary business expenses, versus §174
- Software development – Buy or build, onshore or offshore?

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Impact on Taxpayers Going Forward

- Potential IRS guidance
- Evaluate location of R&E
- How to prepare
- Timing of implementation

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Polling Question #2

Has your business applied for the Employee Retention Credit?

A. Yes
B. No, we are not eligible
C. No, because we are not sure if we're eligible
D. Not applicable

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Employee Retention Credit Year-End Considerations

- For 2021
  - Credit is equal to 70% (vs. 50%) of qualified wages (maximum wages of $10,000 per employee per quarter)
  - Maximum number of quarters for 2021 is three quarters (Q1 through Q3)
  - Could result in a refundable credit of $175,000/quarter for a company with 25 employees, *i.e.*, $7,000 * 25. This equates to $525,000 of refundable credits if eligible for all three quarters in 2021
  - If company has fewer than 500 “full-time employees” (FTEs) & other qualifications are met, this credit can be a home run
  - Not allowed to “double count” qualified wages. For example, qualified wages for ERC purposes would not include wages that were used to obtain PPP loan forgiveness
- More restrictive rules apply to both the 2020 ERC credit & to those companies with more than 500 FTEs

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Employee Retention Credit Year-End Considerations

- Eligibility
  - Test 1 – Significant decline in gross receipts
    - 2021 – >20% decline in gross receipts, quarter over quarter 2021 compared to 2019
      - Election to use previous quarter for revenue reduction test – provides a business the ability to claim the ERC for two 2021 quarters even though only suffered the 20% decline for one quarter in 2021, *i.e.*, a “twofer”
    - 2020 – >50% decline in gross receipts, quarter over quarter 2020 compared to 2019
  - Test 2 – Full or partial suspension of operations due to government order

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Employee Retention Credit Year-End Considerations

- Impact to taxable income – must reduce wage expense by the amount of the credit when the wages were incurred
- If credits were not claimed on originally filed return, will get claimed by amending the applicable payroll tax return Form 941
- If income tax returns have already been filed, will need to amend them to reduce the wage expense by the amount of the credit
- Some consulting firms around the nation taking aggressive positions on these credits
  - Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties & interest

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Corporate Net Operating Loss (NOL)

- **NOL deduction limitations on utilization**
  - 80% of taxable income
  - Applies to losses generated in tax years beginning after December 31, 2017, & not utilized prior to 2021
- **No carryback**
  - Applies to losses arising in tax years beginning after December 31, 2020
  - Property/casualty insurance companies & certain farm losses have special carryback rules
- **Carried forward indefinitely**
  - Applies to losses arising in tax years beginning after December 31, 2017
- **NOL limitations for pre-2018 losses**
  - Rules remained the same, losses can be carried back two years & forward 20 years
  - No taxable income limit, can offset 100% of taxable income if NOL is large enough

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Payroll Tax Deferral

- Failure to deposit payroll employment taxes deferred under the CARES Act by the applicable due dates will result in a penalty under Section 6656 that runs from the original due date & applies to the entire deferred amount, *i.e.*, employers are potentially liable for penalties on the full amount of tax deferred if they fail to pay any portion when due
  - Timely if 50% of the deferred amount was paid by December 31, 2021, & remainder by December 31, 2022
  - Since the dates fall on a weekend, IRS confirmed actual due dates are January 3, 2022 & January 3, 2023

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Other Year-End Planning Reminders

- Business Meals
  - The CARES Act allows taxpayers to temporarily deduct 100% of business-related meals (food or beverages) provided by a restaurant
  - Applies to expenses incurred in 2021 & 2022 but will revert to the 50% allowable deduction after December 31, 2022
- Last-In First-Out (LIFO) Inventory Opportunities
  - Allows a manufacturer, distributor, or retailer to assume that its goods sold during the year are first sold from its most recently produced or purchased inventory cost of the most recently purchased or manufactured inventory
  - Helps alleviate some of the negative impact of increasing costs & inflation

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Polling Question #3

What is the top concern your partnership or S-corporation has going into the 2022 tax filing season?

A. Complying with changing laws and regulations

B. Schedule K-2 / K-3 reporting

C. Pass-Through Entity (PTE) Tax Election

D. Other

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Schedules K-2 & K-3 Reminders for Pass-through Entities

- Reports items of international tax relevance
  - New requirement beginning with 2021 Form 1065 & Form 1120S
  - IRS granted relief from reporting for 2021
- 2022 Schedule K-2 & Schedule K-3 Domestic Filing Exception
  - The domestic partnership must have no or limited foreign activity
  - All direct partners in the domestic partnership for the 2022 tax year are:
    - Individuals who are U.S. citizens and/or resident aliens
    - Domestic decedent's estates that are not foreign estates, with solely U.S. citizen and/or resident alien individual beneficiaries,
    - Domestic grantor trusts that are not foreign trusts, with solely U.S. citizen and/or resident alien individual grantors and beneficiaries, or
    - Domestic non-grantor trusts that are not foreign trusts, with solely U.S. citizen and/or resident alien individual beneficiaries
  - The partnership must notify all partners that it meets criteria 1 and 2 and will not be providing Schedule K-3 to the partners unless the partner requests the schedule. **For tax year 2022 calendar-year partnerships, notifications must be sent to partners by January 15, 2023.**
  - No 2022 Schedule K-3 is requested by a partner on or before the "1-month date," which is one month before the due date (without extension) for the filing of the partnership's 2022 Form 1065. For tax year 2022 calendar-year partnerships, the 1-month date is February 15, 2023.
  - Similar exception available for S-Corporations

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Rev. Proc. 2022-19

- Taxpayer assistance procedures to resolve certain issues involving S corporations & their shareholders without requiring a PLR
  1. Agreements & Arrangements with No Principal Purpose to Circumvent One Class of Stock Requirement
  2. Governing Provisions That Provide for Identical Distribution & Liquidation Rights
  3. Procedures for Addressing Missing Shareholder Consents, Errors with Regard to a Permitted Year, Missing Officer's Signature, & Other Inadvertent Errors & Omissions
  4. Procedures for Verifying S Elections or QSub Elections
  5. Procedures for Addressing a Federal Income Tax Return Filing Inconsistent with an S Election or a QSub Election
  6. Procedures for Retroactively Correcting One or More Non-Identical Governing Provisions

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Rev. Proc. 2022-19

- Eligibility for the retroactive relief is conditioned upon all of the following requirements being met
  1. The corporation has (or had) one or more non-identical governing provisions
  2. The corporation has not made, and for federal income tax purposes is not deemed to have made, a disproportionate distribution to its shareholders
  3. The corporation timely filed a return on Form 1120-S for each taxable year beginning with the taxable year in which the first non-identical governing provision was adopted & ending with the taxable year immediately preceding the year in which the corporation made a request for corrective relief under this Revenue Procedure
  4. Before any non-identical governing provision is discovered by the IRS, all of the requirements described in the revenue procedure are satisfied

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Pass-Through Entity (PTE) Tax Election

- The TCJA created a cap on the State & Local Tax itemized deduction of $10,000 (married filing jointly) & $5,000 (married filing separately) for tax years beginning after 12/31/17 & before 1/1/2026
- IRS Notice 2020-75 indicates that the tax paid under a PTE election will be treated as a deduction of the PTE & is applicable to Specified Income Tax Payments made on or after November 9, 2020
- There are questions & issues that should be considered before a taxpayer makes a PTE election in any state

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States with a PTE Election (effective tax year beginning on or after)

- Alabama (1/1/21)
- Arizona (12/31/21)
- Arkansas (1/1/22)
- California (1/1/21)
- Colorado (1/1/22)
- Connecticut (1/1/18)
- Georgia (1/1/22)
- Idaho (1/1/21)
- Illinois (12/31/21)
- Kansas (1/1/22)
- Louisiana (1/1/19)
- Maryland (12/31/19)
- Massachusetts (1/1/21)
- Michigan (1/1/21)
- Minnesota (12/31/20)
- Mississippi (1/1/22)
- Missouri (*ending* on or after 12/31/22)
- New Jersey (1/1/20)
- New Mexico (1/1/22)
- New York (1/1/21)
- New York City (1/1/23)
- North Carolina (1/1/22)
- Ohio (1/1/22)
- Oklahoma (1/1/19)
- Oregon (1/1/22)
- Rhode Island (1/1/19)
- South Carolina (1/1/21)
- Utah (1/1/22)
- Virginia (1/1/21)
- Wisconsin (S-Corps 1/1/18; Other PTEs 1/1/19)

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Polling Question #4

Would you like to schedule time with a FORVIS professional to discuss one of the following topics from today's session?

A. Yes, Employee Retention Credit

B. Yes, R&D Expensing Changes

C. Yes, year-end tax planning strategies

D. Yes, tax planning for 2023 under the IRA and/or CHIPS Act

E. Not at this time, thank you

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Looking Forward to 2023 – Legislative Changes

- **Inflation Reduction Act**
  - 15% corporate alternative minimum tax, effective for taxable years beginning after December 31, 2022
  - 1% stock buyback excise tax applies to repurchases after 2022
  - Tax credits for vehicles, construction, manufacturing, renewable electricity, fuel, energy property, etc.
- **CHIPS Act**
  - Advanced Manufacturing Investment Tax Credit for manufacturing semiconductors and specialized tooling equipment
  - CHIPS for America Fund – loans, loan guarantees and grants to fund development of domestic manufacturing capabilities
    - Applications open in February 2023

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Questions?

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